



FEDERAL RESERVE BANK *of* NEW YORK

Banks and the Rise of Nonbanks in Credit Markets

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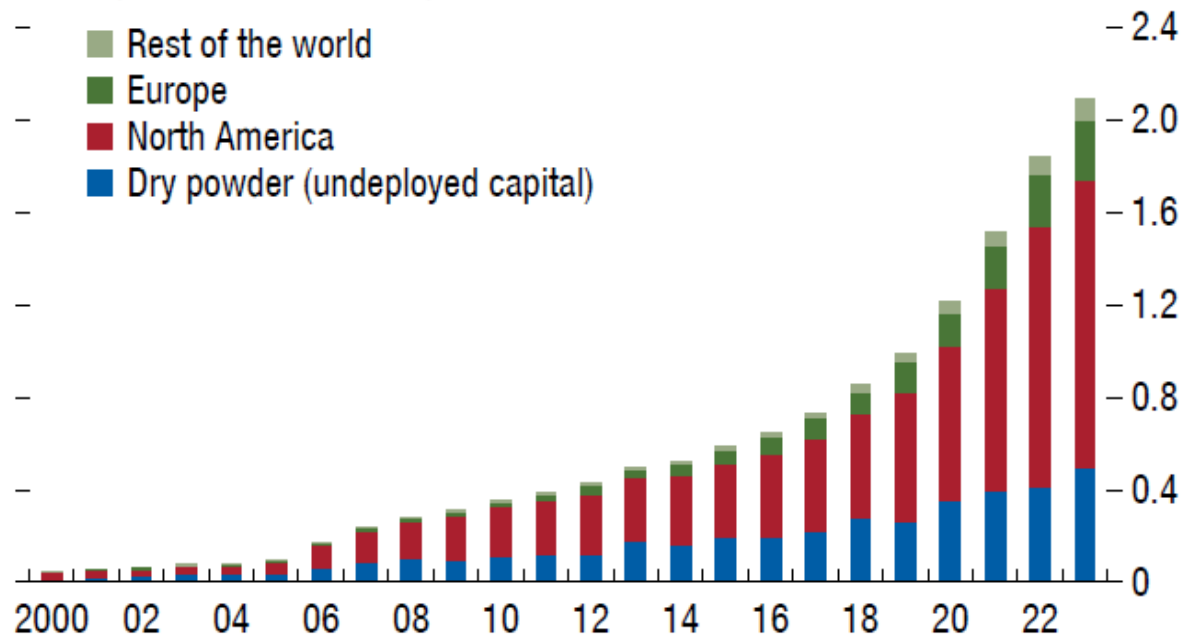
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The Rise of Nonbanks in Credit Markets

Private Credit Has Skyrocketed

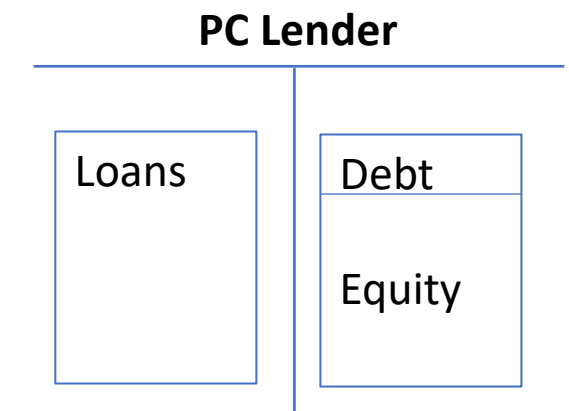
2. The Growth of Private Credit Markets
(Trillions of US dollars)



Source: IMF GFSR 2024

Benefits

- Growth of private credit should imply a more efficient risk allocation
- It reduces exposure of banks to high-risk obligors
- Credit provision without liquidity transformation!



Hidden costs?

Still intermediation activity

- Loans are subject to possible renegotiation, extension of maturity, size increases, contingent liquidity
- Natural need to manage liquidity risk
- Holding liquid buffers is costly
- Can't deploy "dry powder" on demand
- "Buy" liquidity services from banks as solution

From Apollo's 2023 10Ks

As a financial services company, we are exposed to liquidity risk, which is the risk that we are unable to meet near-term obligations as they come due.

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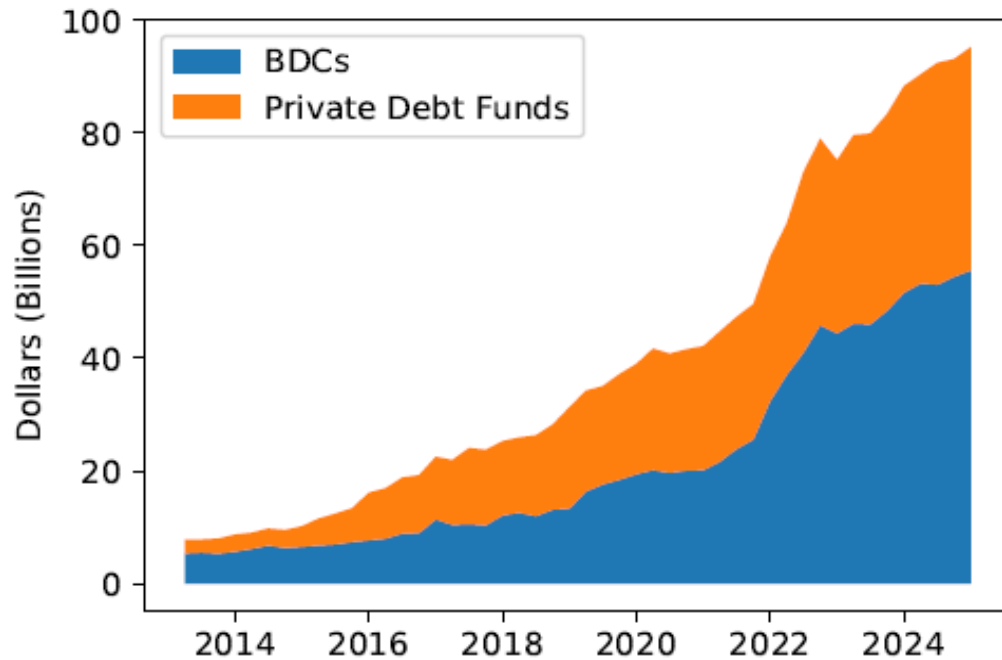
A liquidity shortfall may arise in the event of insufficient funding sources or an immediate and significant need for cash or collateral. In addition, it is possible that expected liquidity sources, such as the AHL Credit Facility and AHL Liquidity Facility [Apollo's banks' credit facilities], may be unavailable or inadequate to satisfy the liquidity demands described below.

...

If a material liquidity demand is triggered and we are unable to satisfy the demand with the sources of liquidity readily available to us, it may have a material adverse impact on our business, financial condition, results of operations, liquidity and cash flows.

Private Credit Growth is Backed by Banks

U.S. Bank Loan Commitments to Private Credit Vehicles



Source: FR Y-14Q, Schedule H.1.

“Bank Lending to Private Credit: Size, Characteristics, and Financial Stability Implications”, J. Berrospide, F. Cai, S. Lewis-Hayre and F. Zikes, FEDS Notes, Forthcoming

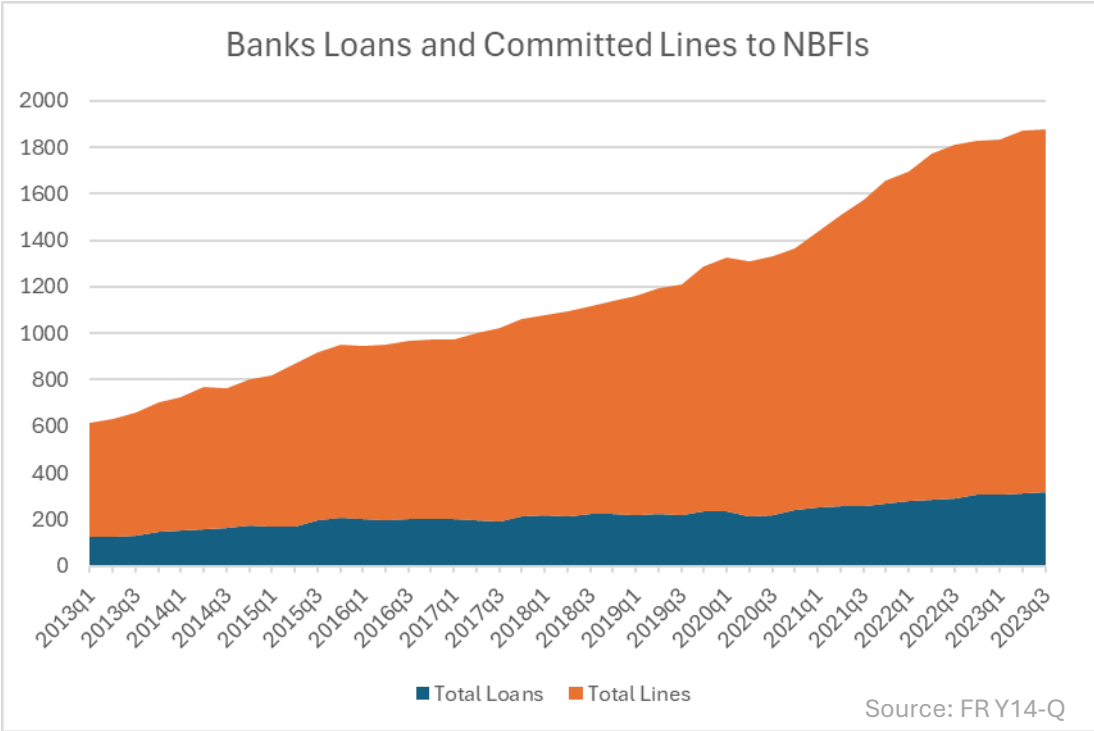
- Loan commitments ~ 10% of total PC AUM
- 145% growth last 5 years
- Significant growth in utilized amounts as well

Reflection of a broader transformation of role of banks

From direct support to non-financial corporations ...

Activities Historically Within the Banking System	Transformation	Activities Spread Across Banks and NBFIs
<ul style="list-style-type: none">· Corporate loans· Mortgage loans	<p><u>Loans and Mortgages</u></p> <p>Loans shift from being made and held by banks to being made by NBFIs with collateralized or senior financing provided by banks.</p>	<ul style="list-style-type: none">· Banks make senior loans to private credit companies.· Banks make collateralized loans to mortgage REITs.· Banks hold senior tranches of MBS and CLOs.
<ul style="list-style-type: none">· Mortgage, CLO, and other ABS origination· Acquisition/LBO financing· Mortgage servicing	<p><u>Activities Using Short-Term Funding</u></p> <p>Activities that require short-term funding transform from being conducted and funded by banks to being conducted by nonbanks and funded by banks.</p>	<ul style="list-style-type: none">· Banks offer warehouse financing to nonbank mortgage, CLO, and other ABS originators.· Banks make short-term loans to private equity companies, including subscription finance lines and loans.· Banks sponsor CP or directly lend to nonbank mortgage servicers.
<ul style="list-style-type: none">· Credit lines to nonfinancial businesses· OTC bilateral derivatives	<p><u>Contingent Funding</u></p> <p>While the footprint of NBFIs has grown relative to that of banks, banks retain responsibility for providing contingent funding in the form of credit lines to the NBFI sector.</p>	<ul style="list-style-type: none">· Banks provide credit lines to NBFIs to be drawn down during periods of stress.· Banks bear mutualized counterparty risk as derivative clearinghouse members and provide credit lines to NBFIs to meet margin requirements.

... to support of NBFIs

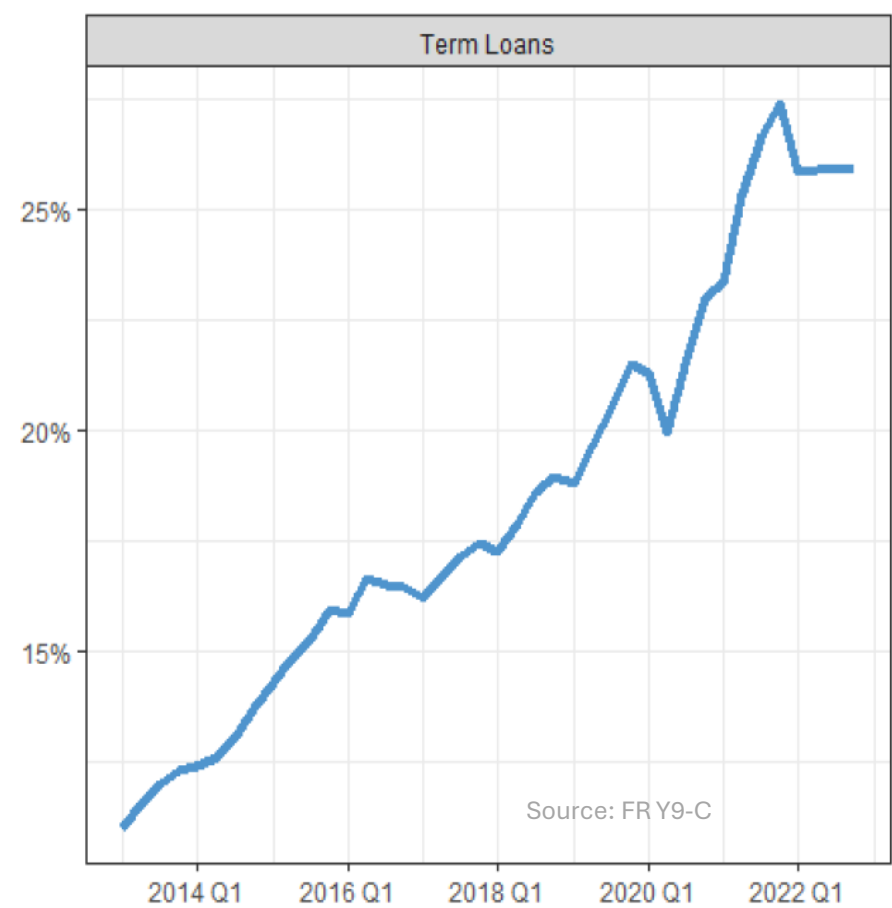


“Where Do Banks End and NBFIs Begin?” (2024), Viral Acharya, Nicola Cetorelli and Bruce Tuckman

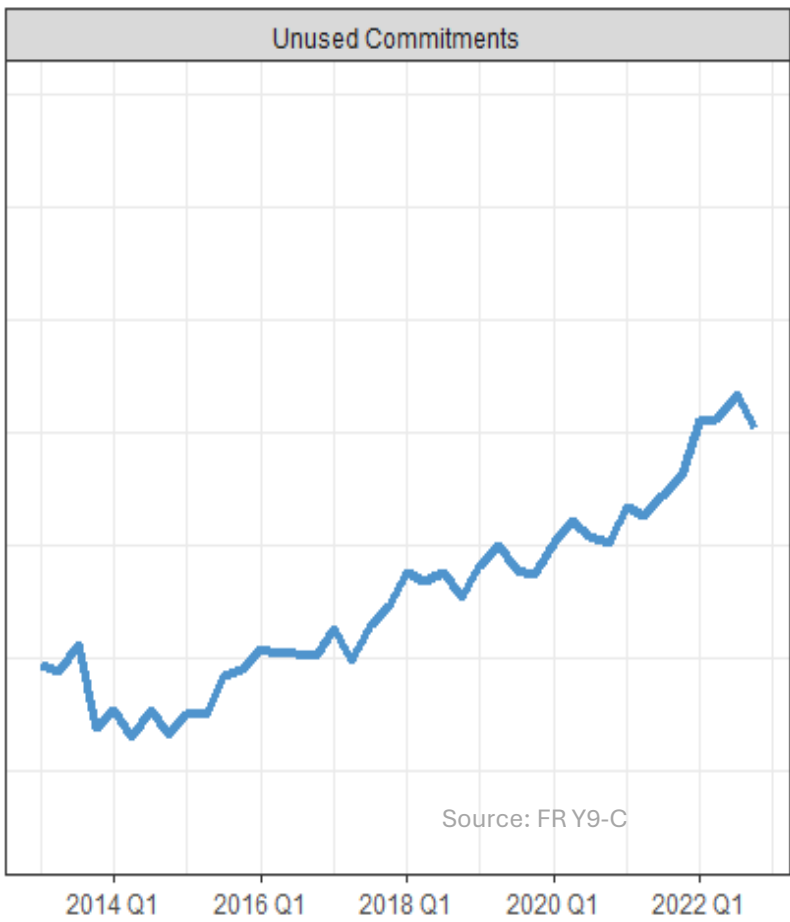
“Transformation of Risks across Banks and NBFIs” (2025), Viral Acharya, Nicola Cetorelli and Bruce Tuckman

Banks shift focus away from direct funding to firms to funding on nonbanks

NBFI loans as share of total bank loans



NBFI credit lines as share of total bank credit lines



“Where Do Banks End and NBFIs Begin?” (2024), Viral Acharya, Nicola Cetorelli and Bruce Tuckman

Optimizing on regulatory constraints a likely driver

- Cost of equity for bank to add a unit of risky loan high, because of regulatory and supervisory costs
- Same unit of activity done by nonbanks has higher return on equity because of the absence of regulatory costs
- Nonbanks buy liquidity insurance from banks
- Banks price this service at a level different than what social planner would require to even out, avoid systemic externalities. Banks do not internalize such externalities.
- On surface it appears nonbank intermediaries “solid” with equity financing. But their liquidity risk is managed by banks. Cannot look at balance sheet of nonbanks and banks separately

Déjà Vu All Over Again?

- Regulation shifts activity to nonbanks but banks retain a significant role
- Banks are the funding/liquidity providers to nonbank
- Contractually or otherwise, risks ultimately return to banks
- Akin to the pre-GFC Asset-backed Commercial Paper (ABCP) conduits and SIVs (Acharya, Schnabl and Suarez, 2013)
- History repeating itself an indication of underlying fundamental forces