Current Non-bank Financial Intermediation in Korea and Potential Risks

Since the global financial crisis, there have been concerns that non-bank financial intermediation, or "shadow banking," could act to destabilize the financial system, as the interconnectedness of non-banks with other financial institutions and the financial market has been strengthened amid the possibility of accumulated systemic risk. In this regard, this paper examines the existing sectors of non-bank financial intermediation and their risks, analyzes potential risks that may undermine financial system stability, and presents implications.

Calculation of the volume of non-bank financial intermediation, following the criteria employed by the FSB in its measure of shadow banking, shows that the broad measure of all non-bank financial intermediation has continued to increase, while the narrow measure of shadow banking, focusing on activities that are more likely to pose systemic risk, has exhibited slower growth. There is little possibility of expanded risks thanks to prudential regulations on non-bank financial intermediation, but some sectors such as collective investment and securitization vehicles have experienced higher leverage and increased liquidity mismatches.

As a form of market-based finance, non-bank financial intermediation is closely linked to repo, bond, and other financial markets, and in line with the increased issuance of bank debentures, risks may spread further, for example through money and bond markets. Furthermore, according to the results of a structural VAR analysis, money-market and bond-type funds can be temporarily affected by interest rate fluctuations due to increased bond holdings and heightened volatility.

Systemic risk can accumulate in each sector of non-bank financial intermediation in terms of the cross-sectional transmission of risks and shocks to other financial sectors via the interconnected structure of the financial system. In this regard, this paper maps an interconnected structure in which sectors of non-bank financial intermediation are connected through financial markets and instruments, and conducts an input-output network analysis of the channels through which shocks are transmitted within the financial system and their effects. Securities firms, trust companies and collective investment vehicles exhibit strong interconnectedness within the financial system. Securities firms transmit shocks rapidly to a great extent in both raising and managing funds, whereas trust companies and collective investment vehicles affect other financial sectors greatly when supplying funds. Notably, non-bank financial intermediation sectors are found to be heavily shocked not only due to direct exposures to each other but also indirectly through two or more layers of the interconnected structure.

As policy is normalized following the long period of post-crisis monetary accommodation, it is necessary to pay attention to the possibility of financial system instability driven by the accumulation of systemic risks that could be triggered by non-bank financial intermediation. In addition, close monitoring is required of systemically important sectors of non-bank financial intermediation.

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