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Article

EU and UK Stress Tests on Non-bank Financial Institutions (NBFIs) and its Implications

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Context: A New Era of Oversight for NBFIs

In May 2025, the European Union announced initiatives to launch stress tests targeting non-bank financial institutions (NBFIs). This will be the EU's first system-wide stress test for non-banks, with implementation expected in 2026-27. The test will assess how a market shock could cascade through hedge funds, private equity firms, and other alternative asset managers.

This follows exploratory scenario work by the Bank of England's in 2024, which modelled the default of a hedge fund and its ripple effects across over 50 institutions. The BoE concluded that while resilience was "comparatively high" in liability-driven investment funds, concerns remained around the liquidity and mass-sales of assets during a market crisis.

The EU initiatives highlight several critical areas of regulatory focus such as:

1. **Greater transparency on leverage and liquidity risk of NBFIs:** The ECB informs that non-banks now account for roughly €5 trillion in loans in the Eurozone, with lending by banks to these entities tripling since 1999. The stress tests are expected to fuel future regulatory reforms, potentially including new disclosure requirements, leverage caps, or capital buffers for NBFIs.

2. **Cross-border regulatory coordination:** The EU's initiative involves coordination between multiple supervisory bodies, including the ECB (European Central Bank), ESMA (European

Securities and Markets Authority) and EIOPA (European Insurance and Occupational Pensions Authority), and national regulators. This cross-border interrelationship introduces challenges for compliance and risk management, particularly for multinational firms. It also increases the likelihood of regulatory divergence, which could lead to inconsistent enforcement or overlapping obligations.

3. **Risk disclosure and governance:** As regulators move to close perceived gaps in oversight, we expect a heightened focus on governance, risk disclosure, and operational resilience within the non-bank sector.

Although the upcoming stress tests are exploratory in nature, they signal a notable shift in regulatory focus, placing non-bank financial institutions (NBFIs) under increased scrutiny as potential sources of systemic risk. As these reforms evolve, we expect several implications not only for NBFI's, but to brokers and insurers alike.

Key implications include:

1. **For NBFI's** will likely face new reporting requirements , including stress test participation, leverage disclosures, and liquidity risk assessments. Failure to comply could lead to enforcement actions or shareholder litigation. The regulatory exercises, might also point to fragilities around governance, especially in organizations with aggressive leveraged structures. Therefore, it's important that NBFIs reassess their risk frameworks to ensure compliance with the regulatory expectations.

2. **For brokers** we expect the advisory role will be ever more important to guide NBFI's through a more complex regulatory and risk environment. This includes understanding the reach of insurance coverage under this new regulatory framework and for this to be translated it to actionable insights around risk presentation and pre-contractual disclosures.

3. **For insurers** with the heightened scrutiny and risk environment, we expect a more complex underwriting process. Stress test outcomes could expose governance failures or risk mismanagement, triggering claims. Additionally, With NBFIs operating across multiple jurisdictions, insurers must understand the regulatory frameworks in each region.

In this increasingly complex risk environment, proactive client engagement and close monitoring of regulatory developments will be essential. At Beazley, we remain committed to supporting our clients as they navigate this shifting landscape and the unique challenges posed by regulatory changes.

1. Financial Times, May 27 2025: Article: EU plans sweeping stress test of non-banks

2. Hedge Week, May 27 2025: Article: EU plans first system-wide stress test for hedge funds and PE firms - Hedgeweek

3. Standard UK Article: Bank of England to run stress tests on non-bank financial institutions

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