Consultation response

Draft Regulatory Technical Standards

on criteria for the identification of shadow banking entities

26 October 2021

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the EBA's consultation on criteria for the identification of shadow banking entities under Article 394(4) of Regulation (EU) No 575/2013. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

Overview

The industry notes that the draft RTS is intended to address three areas:

- Criteria for identifying both shadow banking and non-shadow banking entities;
- Definition of banking activities and services; and
- Criteria for excluding entities established in third countries from being deemed as shadow banking entities

We believe the draft RTS refines the definition of shadow banking entities ("SBE") in a manner which better represents the risks that are intended to be captured. We ask that this effort be leveraged further by either consolidating the EBA Guidelines on limits on exposures to shadow banking entities[1] ("EBA Guidelines") and the final RTS into a single text, or updating the guidelines to reference the definition provided in the RTS. This will help avoid any confusion, duplication of effort or inconsistent application, including application of the pragmatic approach to excluding third country entities in regions that have not received an equivalence decision but are subject to internationally agreed standards of authorisation and supervision[2], from the definition of a shadow banking entity.

Further to the above, we ask that certain provisions that appear to have been omitted in the RTS that are included in the guidelines are incorporated; the treatment of third-country

[1] Available at: https://www.eba.europa.eu/regulation-and-policy/large-exposures/guidelines-on-limits-on-exposures-to-shadow-ban

[2] authorised and supervised by a supervisory authority that applies banking regulation and supervision based on at least the Basel core principles for effective banking supervision

entities also ensures certain insurance firms, investment firms and CCPs are not included within the definition of shadow banking entities; and we seek clarity on the treatment of specific exposure types e.g. public sector entities, sovereigns, supranational, agencies and conduits in our response to the individual questions in the remainder of this document.

Overall, while we support a narrow and clear definition of shadow banking, global consistency should be an overarching theme. For example, the EU (via these EBA RTS) is one of the first major jurisdictions to legislate for the criteria to identify shadow banking entities, and therefore we urge the EBA to consider internationally agreed standards, e.g. definition of non-bank financial intermediation, at the FSB level. Having different definitions across jurisdictions will increase regulatory fragmentation and decrease comparability, which ultimately could weaken the monitoring of possible financial stability risks.

As such, whilst we have provided comments in this response which focus on aspects of the RTS definition of shadow banking and support the EBA's intent of excluding entities that carry out banking activities or services from the definition of shadow banking entities, we believe that this should continue to be reviewed to ensure alignment with further global policy development in this area. This will help ensure that intended risks are being captured / reported, rather than codifying a prescriptive methodology that gives rise to unintended consequences i.e. anomalous reporting of exposures that would in any other context not be considered as shadow banking activity.

Consultation Questions

We provide responses to individual questions from the consultation below, with the exception of questions 10, 13 and 14 where we have no additional comments.

Question 1: Do you agree with the conditions of Article 1 paragraph 2 for identifying an entity as a non-shadow banking entity? Please provide reasons if you do not agree with any of the conditions or have comments with regard to any of them.

We agree that any entity that is authorised and supervised in accordance with any of the legal acts referred to in Annex I shall not be identified as a shadow banking entity for the purposes of Article 394 paragraph 2 of Regulation (EU) No. 575/2013.

Question 2: Have you got any comments regarding the list of entities that, being exempted or optionally excluded from those four legal acts in Annex I, should not be considered as shadow banking entities?

We support the approach taken to align the approach with the EBA Guidelines, such that entities exempted or optionally excluded from the CRR, CRD and Solvency II are excluded from SBE definition.

In order to implement this in the way intended, we propose the following amendment to paragraph 3 of Article 1:

Article 1 *Criteria for identifying entities* ***Per consultation***	*Article 1* *Criteria for identifying entities* ***Proposed amendment***
3. Any entity that is exempted or optionally excluded from Regulation (EU) No 575/2013, Directive 2013/36/EU, Regulation (EU) No 648/2012 and Directive 2009/138/EC shall not be identified as a shadow banking entity for the purposes of Article 394 paragraph 2 of Regulation (EU) No 575/2013.	3. Any entity that is exempted or optionally excluded from **any of** Regulation (EU) No 575/2013, Directive 2013/36/EU, Regulation (EU) No 648/2012 and Directive 2009/138/EC shall not be identified as a shadow banking entity for the purposes of Article 394 paragraph 2 of Regulation (EU) No 575/2013.
Justification This amendment will ensure that those exempted from any of the legal acts will not be treated as shadow banking entities. Without the amendment, the paragraph could be misinterpreted such that if an entity that is listed as exempt in one of the legal acts but not the others, it would still be treated as a shadow banking entity.	

We remark that a number of entities e.g. Public Sector Entities (PSEs) and Multilateral Development Banks (MDBs) are exempt from EMIR 'with the exception of the reporting obligation' (EMIR article 1 paragraph 5). We understand that these entities should not be treated as shadow banking entities and ask that this be confirmed in the final RTS.

Finally, we seek confirmation that entities excluded or optionally excluded from the Large Exposures framework per CRR Article 400 are not considered as shadow banking entities.

Question 3: Conversely, what are your views concerning other entities exempted or optionally excluded from the other legal acts in Annex I and that would be identified as shadow banking entities? Please provide reasons in case you view that any of those entities should fall under the exemption in Article 1 paragraph 3 and therefore not be treated as shadow banking entities.

Whilst it is clear that the intention is to exclude sovereigns, supranational and agencies (SSAs) form the definition of shadow banking, the scope of the exclusion would benefit from additional clarity. For instance, we would like clarity that entities, such as Fannie Mae and Freddie Mac, shall be considered as public sector entities and not as shadow banking entities. This definition should be made clearer more broadly and governmental agencies or associations in countries that apply the Basel core principles should be excluded from the definition of a shadow banking entity.

Furthermore, we ask that further direction is provided regarded the treatment of SPVs. The EBA appear to have designated all SPVs as Shadow Banking Entities. However, the criteria should also be dependent on the activity of the SPV and whether or not it is performing banking services and activities as included in Article 2 of the draft RTS. As such, it would be helpful to

consider different forms of SPVs, for example those established for the purposes of asset ownership e.g. for ringfencing a ship or office building, which are not engaging in activity that would constitute shadow banking activity.

In respect of securitisation SPEs, we request guidance on the treatment of those entities which fall outside the scope of consolidation. The EBA appears to have designated all SPVs that achieve SRT as shadow banking entities[3]. Consideration should also be given to the treatment of specific structures, for instance, conduits that are funded by Asset Backed Commercial Paper (ABCP) programmes. These are typically self-funded, but benefit from committed standby facilities. Clarity as to the treatment of ABCP conduits and other structures would be welcome.

Question 4: Have you got any other comments with regard to the content of Article 1 of the draft RTS? In your view, is it clear and easy to implement for the purposes of the reporting obligation of Article 394(2) of Regulation (EU) No 575/2013?

The industry notes that in developing the draft RTS, the EBA has built as much as possible on the existing EBA guidelines on Shadow Banking developed in accordance with CRR Article 395(2). We support this effort, but note that the definitions are slightly different and would result in certain entities considered as Shadow Banks for the purpose of art 395(2) but not for the purposes of art 394(4) e.g. UK Banks. To avoid any duplication of effort, unnecessary confusion and complexity, we ask that both standards are integrated into a single text. In addition to bringing clarity, we believe this will ease implementation and help ensure consistency of application of the definition within the prudential framework and across the industry. Alternatively, the EBA guidelines could simply cross reference the RTS for the definition of a shadow banking entity.

Furthermore, the industry would like to raise the proportionality concern with regard to the proposed method. The proposal is principle-based and requires firms to assess available exemptions under various legal acts to their own client portfolios. This may lead to excessive operational burden and implementation difficulties, especially for smaller banks or firms that do not have dedicated resources. If the EBA is able to publish an accompanying document that lists the article number of relevant legal acts where exemptions are made, this would help ensure a consistent first implementation of the rules across the industry, with firms responsible for tracking changes in articles thereafter.

In addition, we have noted other areas of consideration below, in particular with respect to maintaining consistency with the Guidelines:

- **Consolidation:** all subsidiaries included in a regulated consolidation were permitted to be excluded in the guidelines - that does not seem to be in the draft RTS. We ask that this provision be included in the RTS.
- **Materiality threshold:** a materiality threshold of 0.25% of the institution's eligible capital below which immaterial exposures can be disregarded, to reduce the burden of application is included in the guidelines. It is not clear that this has been integrated into the draft RTS. The omission of a materiality threshold would constitute a major change in the framework and would require significant time for banks to adapt internal

[3] https://www.eba.europa.eu/eba-published-final-draft-technical-standards-specifying-methods-prudential-consolidation

monitoring frameworks. As such, we ask that the threshold be maintained, as the removal will increase the perimeter which is subject to limits, requiring a resetting of internal risk appetite settings and result in a large increase in the associated operational burden, whilst the EBA concluded in the guidelines that "these are not likely to pose risks that would deserve special attention".

- **Definition of capital:** the guidelines make reference to Eligible Capital, whilst the 25% large exposure limit is now in reference to Tier 1 capital (as amended by CRR2). As such, the Guidelines should be updated to reflect this to avoid confusion.

Alternative Investment Funds

Question 5: In general, what are your views on the treatment of funds in these draft RTS? Do you agree with the approach adopted in these draft RTS, that follows the approach in the EBA Guidelines on limits on exposures to shadow banking entities, or alternatively should it be extended to capture those funds as shadow banking entities?

Question 6: What would be the advantages and disadvantages of taking a broader approach with respect to the scope of funds included as shadow banking entities?

Question 7: What are your views with regard to the consideration of money market funds as shadow banking entities?

Question 8: Do you face any difficulties identifying whether an alternative investment fund (AIF) should be considered as a shadow banking entity?

Question 9: Have you got any specific comments with regard to AIFs and in particular, with points (b) and (c) of Article 1 paragraph 5?

The consultation sets out a broad range of AIFs that it considers should be regarded as shadow banking entities. Specifically, with respect to point (b) of Article 1 paragraph 5, which captures funds where "the alternative investment fund employs leverage on a substantial basis as set out in Article 111(1) of Commission Delegated Regulation (EU) 231/2013", the EBA has proposed that only those AIFs with limited leverage should not be identified as shadow banking entities, contemplating an exposure of 300% of its net asset value as an appropriate threshold against which to make an assessment. The consultation does not quantify the impact of this threshold and the scope of AIFs which would be designated as shadow banking entities versus non-shadow banking entities. The extent to which banks will have exposure to AIFs, and those with leverage in excess of 300% will vary across the industry. As such, banks should have the ability to apply a lower threshold to the 300% based on an internal assessment, including considering the cost-benefit of performing the assessment versus the scope of counterparties that would be considered shadow banking entities by applying the leverage threshold.

Question 11: Do you agree with the possibility granted under paragraph 1 of Article 3 to prevent the identification of a bank in a third country as a shadow banking entity in the absence of an equivalence decision under Article 391 of the CRR?

The industry supports the approach that ensures non-EU banks will not be considered as Shadow Banking entities if the local regulator has implemented the Basel core principles for effective banking supervision. We believe this will help ensure that reporting of shadow banking exposures is not dominated by exposures to banking institution subject to prudential standards derived from globally agreed standards due to a technicality of the framework, and will enable supervisors a clearer view of the shadow banking sector. We understand that we can rely on assessments conducted by the International Monetary Fund (IMF) and the World Bank, in the context of the Finance Sector Assessment Programme (FSAP) for the purposes of considering whether a local regulator has implement the core principles. In this regard, the industry would benefit from the EBA publishing of a list of countries to be considered compliant within Basel core principles on its website or cross-referencing the relevant list that should be relied upon.

Question 12: Have you got any comments regarding the approach set out in paragraph 2 of Article 3 for other entities established in third countries to prevent their identification as shadow banking entities?

The industry supports the approach that ensures non-EU banks will not be considered as Shadow Banking entities if the local regulator has implemented the Basel core principles for effective banking supervision.

Further to the treatment applied to non-EU banks, we believe a similar approach can be applied to insurance firms. The current requirement for third-countries to have equivalence under Solvency II should be replaced by an approach that ensures non-EU insurance firms will not be considered as Shadow Banking entities if supervised in a country that follows the IAIS's (International Association of Insurance Supervisors[4]) Insurance Core Principles (ICP) for effective supervision. The ICP assessment process includes third-country reviews and reviews conducted by the World Bank and the IMF in the Financial Sector Assessment Program (FSAP).

We believe the current framework does not allow a similar approach to be applied to third country investment firms. As such, these entities will feature in the reporting of shadow banking until such a time that an equivalence decision is take. We note that the European Commission has published its implementing decision[5] with respect to third country equivalence for the treatment of exposures under CRR. We support the consolidation of all third country equivalence decisions under the CRR into a single document, but believe there are a number of additional jurisdictions that should feature in Annex II of the Implementing Decision relating to third country equivalence for investment firms. As such, we ask that the

[4] The International Association of Insurance Supervisors (IAIS) (www.iaisweb.org) is the international standard setting body for the insurance sector. Is a member of the FSB, the IASB, and recognised by the G20

[5] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021D1753&form=EN

process for assessing third country equivalence for investment firms be expedited and the list updated on a regular basis.

In addition, whilst they do not currently fall within the definition of an 'institution' we do not believe CCPs are intended to be captured within the scope of shadow banking entities. In addition to EU CCPs, and consistent with the approach being applied to banking institutions, we believe consideration should be treated to the treatment of third country CCPs. The CRR provisions have equivalence provisions related to CCPs that will be relevant until 28 June 2022. However, CCPs that have applied for QCCP status cease to be treated as such on 28 June 2022, without any provision to extend the treatment within the CRR. The cessation in treatment is not related to any change in the risk profile of such entities, but is simply a result of the ESMA not having completed its assessment, despite it being specified in EMIR Article 25 (4) that "Within 180 working days of the submission of a complete application, ESMA shall inform the applicant CCP in writing, with a fully reasoned explanation, whether the recognition has been granted or refused."[6] We do not believe these CCPs should be considered as shadow banking entities. As such, we propose that any third country CCP that ceases to be treated as a QCCP as at 28 June 2022, in the absence of a formal ESMA decision rejecting the CCPs application, shall continue to be excluded from the definition of a shadow banking entity for a period of 2 years.

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[6] The delay in ESMA's assessment is in some instances linked in not simply a delay in ESMA performing the assessment, but rather a factor of the European Commission not having yet decided on third country regulation and supervision equivalence.