Association des Banques et Banquiers, Luxembourg
The Luxembourg Bankers' Association
Luxemburger Bankenvereinigung

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ABBL[1] response to the EBA consultation on guidelines on limits to on exposures to shadow banking entities which carry out banking activities outside a regulated framework under article 395 para 2 of Regulation EU/575/2013

Information about the ABBL (Luxembourg Bankers' Association):	
Identity	Professional Organisation
Capacity	Industry trade body
MS of establishment	Luxembourg
Field of activity/ industry sector	Banking & other financial services
Contact Persons	Benoit Sauvage (sauvage@abbl.lu) Aurélie Cassou (aurelie.cassou@abbl-alfi.lu)

Introductory comments

The ABBL welcomes EBA for the consultation process on this issue but has several reservations, among the key concerns are:

- The discussion on shadow banking progresses at different pace at a global level. This fact shall be taken into account notably because a large part of the shadow banking entities are global by nature;
- We do not agree with the idea of considering shadow banking as a "sector". The proposal of relying on the large exposure regime is convenient and sound,

1 The Luxembourg Bankers' Association (ABBL) is the professional organisation representing the majority of banks and other financial intermediaries established in Luxembourg. Its purpose lies in defending and fostering the professional interests of its members. As such, it acts as the voice of the whole sector on various matters in both national and international organisations.
The ABBL counts amongst its members' universal banks, covered bonds issuing banks, public banks, other professionals of the financial sector (PSF), financial service providers and ancillary service providers to the financial industry.

but it shall be done at specific sub-segment of the shadow banking entities, just as it is used for avoiding excessive concentration in one specific industrial segment, peer-to-peer lending is not in a similar category as a leveraged AIF for example;

- We do have some concerns regarding the scope of entities covered. We would like to underline that from an EU perspective many of the entities are regulated under strict EU rules encompassing prudential or risk management criteria chiefly among them UCITS and AIFs;
- We disagree with the concept of adding extra constraints on the bank side only. If at EU level there is a will to propose additional regulation for shadow banking entities, this may be done via sector specific regulations (i.e. peer-to-peer lending/financing, crowd funding…) or via specific treatment/rules in these sector/product when transactions are performed outside of the banking universe.

Specific responses to questions

1.Do you agree with the approach the EBA has proposed for the purposes of defining shadow banking entities? In particular:

- **Do you consider that this approach is workable in practice? If not, please explain why and present possible alternatives.**
- **Do you agree with the proposed approach to the exclusion of certain undertakings, including the approach to the treatment of funds? In particular, do you see any risks stemming from the exclusion of non-MMF UCITS given the size of the industry? If you do not agree with the proposed approach, please explain why not and present the rationale for the alternative approach(es) (e.g. on the basis of specific prudential requirements, redemption limits, maximum liquidity mismatch and leverage etc).**

The ABBL does not agree with the approach proposed by EBA and this for several reasons. Among our concerns is the fact that the term shadow banking has been defined solely by banking regulators at a global level as a group of market stakeholders that are not banks or banks regulated entities. This does not mean no regulations at all or that these entities are not regulated in any form or shape even from a prudential point of view, simply because they are not under Basel I, II, III or in the EU CRD/CRR. From our point of view the two key concerns are the risk to the economy, or systemic risk and the risk to “investors” or a specific subset of counterparties. We would then focus on the concept of what is a shadow banking entity on the ones that do take deposits from clients but not mere intermediaries in a credit or maturity/liquidity transformation process.

Regarding the exclusions we welcome the EBA recognition that by their design UCITS are excluded and note the references to their strict - risk management - regime and would add that by rules they can only invest in listed securities. This said, we believe that most AIF funds shall as well be out of scope because the risk they present is not of systemic nature nor really on the maturity transformation nor liquidity transformation (notably they have redemption policies that may act as buffers). One shall not forget that AIFs cover a very wide scope of investment strategies, from intensive trading in some hedge fund types of products to real estate or private equity funds or simple long-short equities (bonds…) funds. In the EU, AIFs are also under a relatively strict framework where there are analysis and due diligence or responsibility schemes at various levels introduced in the AIFMD to protect investors and avoid systemic risks (as concrete example some funds have failed in recent and distant past without disrupting the economy nor any individual organization). The ABBL also notes that once these entities (AIFs) interact with a bank, transactions will in any case fall under some form of CRD/CRR provisions and risk weighting. So in fact they are already indirectly as well at least in the remit of the banking regulation, thus for AIF to be qualified as shadow banking entities we would recommend to rely on their investment strategy and focus the rules on the most leveraged only if or when that leverage is not covered.

We would also recommend changing the perspectives on the Money Market Funds (MMF), noting that ESMA has in the past issued some guidelines splitting the market into two components: short term MMF and longer term (or regular MMF), the first category being under a stricter regime. We note that the EU draft MMF regulation will set limits to the management and strategies available to MMF (maturity, liquidity, diversification…) which would then ensure they are under a high standard of confidence from an underlying assets definition and selection process point of view. In our opinion, that would place them in a situation of safe heaven assets in case of crisis rather than riskier ones. Given the much increased security and stricter rules this may be even truer for the remaining categories of CNAV MMF. As a conclusion on MMF, the ABBL is of the view that they shall be excluded from the shadow banking definition if they are EU regulated UCITS or AIFs entities. We would also encourage EBA to use the terminology of the official text once finalized and at the very least to exclude from the scope of the shadow banking rules the short-term funds for which neither liquidity nor maturity transformation occur.

As an EU Association, we would ensure that no non-EU funds receive a better treatment than EU ones, noting that UCITS by definition cannot be “non-European”.

We would as well invite EBA to consider that global forums have focused their work on entities in the shadow banking universe that are non-banks acting with other non-bank entities, an approach that has some merits as that may all things else being equal as there might under very specific circumstances exist riskier scenarios. We would thus strongly question the rational for imposing additional burden on the bank side. Finally as said several times in the paper these non-bank entities serve in many circumstances as facilitators to the economic operators to access financing, thus too strict regulation will definitely play against the CMU objectives, banks may be safer but activity will develop elsewhere.

2.Do you agree with the approach the EBA has proposed for the purposes of establishing effective processes and control mechanisms? If not, please explain why and present possible alternatives.

The approach proposed appear sensible, however we would propose at least:

- to set a materiality threshold at sub-sector level (the entities under the shadow banking umbrella are too diverse to be grouped under one single brand),
- these additional requirements shall not place banks in a situation where they are either co-supervisors of the shadow banking entities or rule them out of business because of capital surcharge considering prudential regulation already imposes risk weightings.

We think that wording in points e) or f) for example is a bit too rigid, because it may place banks in a situation where it is impossible to fully assess all the impacts and links mentioned which would translate into forbidding to do business with entities in the shadow banking perimeter, which may by nature not be easy to evidence or circumscribe.

Concretely we fear that this approach will put the burden of supervising the shadow banking entities onto bank shoulders, what would in turn have the perverse effect of reinforcing dealings between shadow banking entities purely outside of the banking sphere, an objective contradictory with the aim of displaying more light on these activities. That is why we would advise to create in the first place regulations at EU level to deal with the likes of peer-to-peer financing or crowdfunding or alternative credit channels/operators.

3.Do you agree with the approach the EBA has proposed for the purposes of establishing appropriate oversight arrangements? If not, please explain why and present possible alternatives.

Conceptually the approach may be sound, but it places all the burden of supervision and control on the banking entities that are not equipped nor assigned to “market supervision”. In addition we remind EBA that there already exist risk weighting criteria for many of the transactions performed with clients/debtors or generally counterparties and do not see the need to add a specific layer for these broad base of entities. What counts in the end is ensuring systemic risk management and we are not convinced that entities as defined in the present scope are actually creating additional systemic risk in a way that would spread to banks and the financial system as a whole.

4.Do you agree with the approaches the EBA has proposed for the purposes of establishing aggregate and individual limits? If not, please explain why and present possible alternatives.

We do not agree. First the concept of shadow banking will remain complex to define, then the list of entities covered is in our view not appropriate and most of these entities will in the context of interactions with banks be under regulatory requirements and subject to risk weightings. Hence we do not share the view that an additional layer needs to be applied without discrimination. It may be that some of the entities present an extra level of potential risks but that will have to be addressed under CRD/CRR provision for specific transactions. It is a case-by-case analysis, depending on the real business model and then subject to each bank risk appetite. It should be noted that in many cases the entities covered are facilitators of liquidity or credit transmission/access to finance to the economy and thus imposing additional constraints only on the bank side, which will also play against the CMU objectives.

Finally, we note that if an authority is not satisfied with the prudential approach of one of its supervised institutions it may still rely on the SREP process to force additional capital buffer.

5.Do you agree with the fallback approach the EBA has proposed, including the cases in which it should apply? If not, please explain why and present possible alternatives. Do you think that Option 2 is preferable to Option 1 for the fallback approach? If so, why? In particular:

- **Do you believe that Option 2 provides more incentives to gather information about exposures than Option 1?**
- **Do you believe that Option 2 can be more conservative than Option 1? If so, when?**
- **Do you see some practical issues in implementing one option rather than the other?**

No, we do not agree. Conceptually we do not support the principle of using banks as co-supervisory authorities for shadow banking supervision. The types of entities under the umbrella “shadow banking” are to diverse to be considered as a single group. Furthermore, it is not clear if this proposal would come on top of other risk-weighting criteria, what would then be extremely limitative. Generally speaking, we consider that banks shall handle their transactions with these entities on risk basis and do not agree with the one size fits all approach to add by default a fixed percentage limit.

This said it is difficult to judge if option 2 will be detrimental compared to option 1. We note that under the scenario presented, it is only because the bank was able to assess exposures to C and D that option 2 is superior, which may not always be the case, thus depending on scenarios both options may end up in similar or very close situations. However, option 2 should be easier to manage, as it is less granular, but it shall be declined in sub-sectors of shadow banking entities.

6.Taking into account, in particular, the fact that the 25% limit is consistent with the current limit in the large exposures framework, do you agree it is an adequate limit for the fallback approach? If not, why? What would the impact of such a limit be in the case of Option 1? And in the case of Option 2?

The ABBL does not support the 25% limit of the eligible capital to aggregate exposures to shadow banking entities proposed in the fall-back approach. This approach is not consistent with the large exposure framework and there is no rationale for such an approach. The large exposure framework does not provide a limit on ***aggregate exposures*** and we believe the guidelines on limits to exposure to shadow banking entities should not provide such a limit. Again, this approach has no rationale, nor justification in the large exposure framework proposed in the CRR. Furthermore as underlined earlier, we consider erroneous the approach of shadow banking as a "single" category item as underlying business models due to the fact that market structures and risk factors are different.