

We, The Association of Real Estate Funds (www.aref.org.uk/overview), do not agree with the approach to the treatment of funds in defining shadow banking entities. The effect of the proposals will be to define all European Real Estate Funds as shadow banks. This is not appropriate for funds that invest in real assets such as land and buildings, often with no borrowing or other leverage.

The EBA's proposal to define shadow banks by reference to the performance of bank-like activities and to exclude entities subject to EU prudential requirements is a suitable approach. We agree that the UCITS Directive provides a sufficiently robust prudential framework to justify excluding UCITS from the definition of a shadow bank. However, we do not agree that prudential requirements of the AIFM Directive are any less robust and we recommend that AIFs should be excluded from the scope on the same basis as UCITS. It may be appropriate to include certain AIFs that do perform bank-like activities as shadow banks, as is the approach for UCITS that are MMFs, but the blanket inclusion of all AIFs is not appropriate. In effect, by not including AIFs in the list of exclusions, this list overrides the principle that shadow banks are defined by the performance of bank-like activities – AIFs that do nothing that is bank-like will be classified as shadow banks.

It appears to us that the proposal includes funds in the definition of shadow banks because they have less robust and comprehensive prudential standards, they are exposed to risks arising due to mismatched liquidity and high leverage, and they are opaque and complex. We would argue that the AIFM Directive addresses all of these concerns for the reasons that follow.

The EBA identifies the relevant robust features of the UCITS Directive as including requirements on the asset manager (initial capital, own funds and internal control requirements) and the managed funds (eg. limits to leverage and concentration). However, the EBA concludes that UCITS that are MMFs are a special case and leave them within the scope of the definition. We have no specific view on MMFs but we agree with the approach of a general exclusion for UCITS coupled with specific exceptions for specific types of UCITS.

We do not understand why the EBA has not taken a similar approach with AIFs. The prudential requirements of the AIFM Directive are based on, and are at least as robust as, the UCITS Directive; indeed since the AIFM Directive was introduced the UCITS Directive has been amended (Directive 2014/91/EC) in order to ensure it remains as robust as the AIFM Directive.

The AIFM Directive applies to many types of fund including both closed-ended and open-ended funds. Many AIFs are closed-ended and the absence of redemption rights means there is no maturity or liquidity transformation involved. Open-ended funds potentially give rise to liquidity risk when the assets in which they invest take longer to trade than the funds' obligations to investors. However the AIFM Directive provides safeguards in this respect by requiring appropriate liquidity management procedures to be in place, stress tests under normal and exceptional circumstances to be conducted regularly and that the investment strategy, the liquidity profile and redemption policy are consistent.

The UCITS Directive limits leverage calculated on a commitment basis to two times the net asset value. However, a UCITS can access much higher levels of leverage by using market risk approaches such as value-at-risk. The AIFM Directive does not limit leverage but it does require AIFs to specify a maximum level of leverage and to report actual leverage to investors and competent authorities, grants competent authorities powers to impose leverage limits and requires more rigorous reporting where leverage is used on a substantial basis (defined as three times the net asset value when calculated on a commitment basis).

The AIFM Directive imposes rigorous reporting obligations on AIFs and Commission Delegated Regulation (EU) No 231/2013 provides a detailed reporting template that must be completed and submitted to the relevant competent authority by each AIF.

The AIFM Directive applies very widely to a broad range of sectors including hedge funds, private equity funds and, our area of representation, real estate funds. Our members pool investors' capital in order to invest on their behalf in real assets, being land and buildings. They may use modest levels of debt financing secured by the buildings they own and they may use derivatives in order to fix their interest rate exposure on such debt. However, it is difficult to see how any of these activities is bank-like in nature. It is also difficult to see how traditional banks would regard real estate funds, with the expertise and costs involved in buying, maintaining, servicing and letting buildings, as a realistic vehicle with which to arbitrage their capital requirements.

We recommend that EBA revises the proposed list of exclusions to include both UCITS and AIFs and then to identify more precisely and exclude the types of UCITS and AIFs that should be regarded as shadow banks. Identification criteria might involve the level of leverage and the nature of investments.