Position Paper

On EBA Consultation Paper – Draft EBA Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395 para. 2 Regulation (EU) No. 575/2013

A. General remarks

Captives are automotive manufacturer owned banks that exist to finance parent vehicle sales. The VDA Working Group of Automotive Captives is an informal alliance of EU based automotive captive banks working together and with their respective manufacturer parents to lobby against financial regulations that threaten the automotive sector. The Constructeurs Français d'Automobiles (the "CCFA") is the trade association representing the automotive industry in France, the Verband der Automobilindustrie (the "VDA") is the trade association representing the automotive industry in Germany, and the Arbeitskreis der Banken und Leasinggesellschaften der Automobilwirtschaft (the "AKA") is the trade association representing the automotive captive banks in Germany.

In general, we welcome all measures to enhance the stability of the financial markets. The following aims usually stated to secure financial market stability are understandable from our perspective:

a) Prevention of excessive exposures involving shadow banks,
b) Creation of transparency in terms of the unregulated shadow banks,
c) No circumvention of banking regulations.

Measures to limit exposures from "shadow banks" can be appropriate to maintain the stability of the financial markets. However, the possible detrimental impact on the real economy should be taken into account. This is in accordance with the view of the European legislators, when they prescribe in Art. 395 (2) of the CRR, the legal basis for the guidelines:

"*In developing those guidelines, EBA shall consider whether the introduction of additional limits would have a material detrimental impact on the risk profile of institutions established in the Union,* ***on the provision of credit to the real economy*** *or on the stability and orderly functioning of financial markets*."

In this regard we are of the view that the impact resulting from the definition of shadow banking entities and their limitation to the real economy has not been sufficiently considered yet. However, in our view, this is absolutely necessary in order to take appropriate account of the clear intention of the European legislators to avoid any detrimental impact on the real economy.

We are deeply concerned that the proposed regulations could have a significantly negative effect on the securitisation market and consequently on

- the refinancing via Auto-ABS and
- the funding of industrial enterprises such as car manufacturers via finance companies.

An over-extensive definition of shadow banking entities could have a significantly adverse impact on the real economy. This would notably apply if EBA decided to implement option 1 (further remarks, see our answer to Q 5).

Open questions

The limitation of exposures from shadow banking entities to be considered by tighter individual or aggregated limits according to Article 395 (2) of the CRR is to be seen in the context of the large exposure regime. In doing so, the impact on the real economy of such additional limits should be considered. We have the impression that the proposed rules and limits are not consistent to those of the large exposure regime. Therefore, there are many open questions, for instance with the interplay to the rules as to the “group of connected clients” according to article 4 (1) no. 39 of the CRR and the required look-through to the underlying assets according to Article 390 (7) of the CRR in conjunction with the delegated regulation No 1187/2014 for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets. Without further clarification, it will not possible to implement the proposed new rules.

B. Definition of “shadow banking entity” is too extensive

The proposed definition of shadow banking entities is too extensive and exceeds the actual goal to limit increased systemic risks from shadow banking activities.

According to the background explanation in paragraph 2 of section 3.1 (General background) of the consultation paper, the main causes for systemic risks resulting from shadow bank activities have been heavy reliance on short-term wholesale funding and a general lack of transparency which masked the increasing amounts of leverage and maturity and liquidity transformation. EBA refers to the following specific risk of shadow banks that warrant regulatory attention: run risks and/or liquidity risks by high leverage und liquidity and maturity mismatches, contagion risks by interconnectivity and spillovers notably by drawing credit commitments and opaqueness and complexity in times of stress.
We agree in principle with EBA’s analysis. However, the rules to limit the exposures of shadow banking entities should actually relate to those enterprises that exhibit these increased systemic risks as set out under 3.1.1 of the consultation paper. Indeed, the proposed guidelines on shadow banks will also affect structures that are not exposed to such increased risks.

The extremely broad definition of shadow banking entities would also capture enterprises that one wouldn’t usually associate with “shadow banks”. The definition might include, for instance, subsidiaries of industrial enterprises, such as car manufacturers, the main activity of which is to fund themselves via the capital and money market or via banks by means of loans to finance the group companies of the car manufacturer and to hedge the interest and currency risks of such group and its entities. Furthermore, the definition also captures special purpose vehicles from securitisations without any active management to fund securitised receivables of the originator that have been originated before to finance real goods such as motorcars, for instance. The purpose of such special purpose vehicles is totally different from that of non-regulated actively managed hedge funds, for example, that are at least typically highly leveraged and thus exposed to increased risk to leverage the return on equity partly combined with maturity mismatches to benefit from lower costs of short term funding means. Entities having a different risk profile compared to typical “shadow banks” and evidentially having not caused systemic risks should not be lumped together with real “shadow banks” and be measured and limited by the same yardstick.

Hence, special purpose vehicles from real economy securitisations should be excluded from the scope of shadow banking entities and added to the list of “excluded undertakings”.

In addition, the subsidiaries of industrial enterprises, such as car manufactures, the main activity of which is to render financial services to group companies (group finance company) should be exempted from the scope of shadow banking entities and added to the list of “excluded undertakings” as well.

As a general principle, the guidelines should be tailored to capture real shadow banks that exhibit the risks as set out under 3.1.1, but should exclude all other enterprise linked to the real economy that do not exhibit such risks.

C. Specific remarks

Q1: 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 EBA proposal with regard to the definition of shadow banking entities comprises all companies with credit intermediation activities that are not yet prudentially supervised. We are of the view that this definition needs to be substantiated more closely.

In our view shadow banks are non-regulated entities that are active in the financial market and exposed to increased risks by high leverage and often liquidity and maturity mismatches as mentioned under 3.1.1 of the EBA consultation paper.

However, the general definition of credit intermediation activities is not sufficiently distinctive and creates demarcation problems which become apparent when applying the definition on funding structures including special purpose vehicle companies (1.) and finance companies of industrial groups (2.). Basically, each enterprise performs maturity transformation. Thus, it should be clarified, that only those credit intermediation activities are relevant that are the main activity and purpose of the company. Furthermore, large parts of capital market funding are operated in the real economy sector via subsidiaries, the main activity of which is to fund the group companies and to hedge interest and currency risks of such group and its entity by means of derivative instruments.

1. Special purpose vehicle companies

Special purpose vehicle companies being not included in the consolidated supervision

According to the EBA proposal, special purpose vehicles from securitisations shall be generally subsumed under shadow banking entities if the special purpose vehicle is not included in the consolidated supervision. The purpose of securitisation – which is often capital relief through a significant and effective risk transfer pursuant to Article 243 in conjunction with the Guidelines on significant risk transfer (SRT) for securitisation transactions dated 7 July 2014 – implies that the special purpose vehicle from the securitisation must not be included in the consolidated supervision of the credit institution or financial holding group in terms of capital requirements. Otherwise, capital relief by a significant and effective risk transfer would not be possible due to the fact that the transferred exposures to the special purpose vehicle would have to be included in the consolidated capital requirements as well. As to whether the securitised receivables are included on the consolidated level is subject to significant and effective risk transfer to the respective special purpose vehicle pursuant to Article 243 of the CRR.

Sufficient regulatory framework

In general, when creating addition rules and limitations for shadow banking entities it should be born in mind that the exposures from securitisation are already subject to extensive regulatory requirements (e.g. the rules of capital 5 of part 3 of the CRR, the large exposure regulation of article 390 (7) of the CRR in conjunction with the delegated regulation no 1187/2014 as regards regulatory technical standards for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying asset and finally part 5 of the CRR). In our opinion, securitisations and receivables from special purpose vehicles are sufficiently considered and limited. Therefore, it seems questionable whether an additional limitation for securitisation is really necessary at all.

If the EBA concludes that, despite the expressed doubt, special purpose vehicles from securitisations should be additionally limited as shadow banking entities, then at least the special purpose vehicles being not actively managed to securitise receivables from financing of real goods should be exempted from the definition of shadow banking activities and added to the list of “excluded undertakings”. Purpose and risk profile of such special purpose vehicles are totally different from actively managed hedge funds typically exposed to increased specific risk by high leverage to leverage profits partly combined with liquidity and maturity mismatch to benefit from lower costs of short term funding. Thus, we advocate excluding such special purpose vehicles from securitisations from the scope of shadow banking entities that have not caused systemic risks.

EU-Commissions approach to SST

Currently, the EU commission is pushing an initiative to promote simple, standard and transparent securitisations by the preparation of a securitisation framework according to its action plan from December last year to revitalise an advanced broad and deep securitisation market due to its merits for the real economy, thus contributing to growth and employment. A further regulation by the introduction of additional individual and aggregated limits does not create added value. In fact, the current activities of the EU commission to create the capital market union including an advanced broad and deep securitisation market for simple, standard and transparent securitisations would be undermined. Hence, all special purpose vehicles from securitisations that qualify as simple, standard and transparent securitisations should be exempted from the definition of shadow banking entities and added to the list of “excluded undertakings”. The exemption should relate both for simple, standard and transparent asset backed securities and simple, standard and transparent asset backed commercial papers, the criteria of which are being currently discussed.

Real economy securitisations

Since it could in part be very difficult to fulfil all qualifying criteria for simple, standard and transparent securitisations due to the high number of criteria and different market practices, we assume that a major part of securitisations that are important for the real economy will not qualify for simple, standard and transparent securitisations. In addition to simple, standard and transparent securitisations, such special purpose vehicles should also be exempted from the definition of shadow banking activities and added to the list of “excluded enterprises” that are not actively managed, that are not exposed to material funding risks by maturity mismatches and the main purpose of which is to fund the securitised underlying assets financing real goods such as, for instance, motor vehicles. If such special purpose vehicles were not exempted from the definition of shadow banking entities, they should at least be exempted from any limitation for shadow banking entities. This should apply in particular, if the special purpose vehicle is included in the consolidated accounts and the financial statements of the group according to the respective accounting rules and if the originator is a CRR-credit institution or part of a supervised credit institution or financial holding group that itself belongs to the “excluded undertakings”.

The special purpose vehicle has been established as a bankruptcy remote company with the purpose to legally transfer the receivables and to exclude such receivables from the insolvency of the originator backing the issued securities. Such a structure ensures the exclusive access of the fiduciary to the transferred underlying assets including the underlying collaterals such as the vehicles backing the underlying assets in favour of the bond holders with the result that the rating of the asset backed securities is independent of that of the originator. Instead, the rating of the asset backed securities mainly depends on the quality of the securitised underlying assets and the provided credit enhancements. The amortisation of such asset backed securities is subject to the amortisation profile of the underlying assets. This kind of funding via securitisation increases the diversification of funding sources and expands the investor base and thus contributes to the reduction of the liquidity risk of the originator. Contagion risks are not to be expected as well through the self-liquidating nature of such securitisations that do not require any liquidity facility in order to protect against funding risks. In addition, such asset backed securities are often eligible collateral for standard liquidity operations of a central bank in a Member State.

Furthermore, it should be noted that the performance of Auto-ABS has been outstanding in the past. No bond holder of Auto-ABS has ever been faced with losses from a default in Europe. In the case that an asset backed security should get into default, we would not expect a spill-over to other ABS transactions due to the due diligence requirements according to Article 406 of the CRR that requires and enables investors to assess the quality of the asset backed security. Therefore, herding behaviour is significantly less likely than during the last financial crisis because, in contrast to the zenith of the last financial crisis, investors are now aware of the very good performance of all Auto-ABS transactions and most European real economy securitisations in the past, even under conditions of extreme market stress. Investors are now able to distinguish the different qualities of asset backed securities by their own due diligence and the surveillance of running asset backed securities on the basis of on investor reports.

ABCP-Programs

For ABCP programs as well, there are extensive regulatory requirements. The CRR contains detailed rules for sponsoring credit institutions with regard to the risk assessment such as the IAA of Article 259 (3) of the CRR. As far as the ABCP-programmes are "fully supported" by a liquidity bank, it is from an economic point of view an exposure to the liquidity bank. Against this backdrop, special purpose vehicles of asset backed commercial papers should be exempted as well from the definition of shadow banking activities if such securitisations qualify as simple, standard and transparent securitisations according to qualifying criteria that are still in discussion for ABCPs.

We propose to extend the scope of excluded enterprises as follows:

I. Special purpose vehicles from simple, standard and transparent securitisations (asset backed securities and asset backed commercial papers)
II. Special purpose vehicles from securitisations with asset backed securities that are not exposed to material funding risk by maturity mismatch between the securitised underlying assets financing real goods and the issued asset backed securities (real economy securitisation without material funding risks).

2. Financial services companies of industrial groups

Financial services companies of industrial groups with the main purpose of rendering financial services to the companies of the industrial group should explicitly be exempted from the scope of shadow banking activities and added to the list of "excluded undertakings" – due to the broad definition of credit intermediation activities. Such an exemption is very important to ensure that these companies will remain able to raise money on the capital and money market e.g. by debentures, commercial papers etc. and to forward it to group companies belonging to the controlling industrial enterprise such as the car manufacturers. In this context, derivative instruments to hedge risk such as interest rate and currency risks of the group and its entities should be captured from the group exemption as well. Due to the fact that such financial services companies belonging to industrial enterprises often have to fund joint venture companies proportionately to its share, the group exemption should also comprise the funding of such joint venture companies.

We propose to extend the scope of excluded enterprises as follows:

– Financial services companies of industrial groups with the main purpose of rendering financial services to the companies of this group (in-house financial services).

3. Rental companies

Classification of car rental companies as leasing company and thus as shadow banking entity would limit financing available to those companies. As a result, car rental companies could be limited in their car purchases and their rental business. This would result in a reduction in people's mobility and negatively impact automotive sales through this channel. We would welcome clarification that rental companies are out of the scope of shadow banking.

Q2: 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.

In principle, we agree with the approach of establishing effective processes and control mechanism to create transparency with regard to exposures from shadow banks and to control the increased risks that are linked to shadow banks. However, as outlined above, the definition of "shadow banking entity" is too broad and comprises also entities that are not exposed to increased risks. If the scope of "excluded undertakings" is not extended as requested, the portfolio of such entities will be extremely heterogeneous with regard to its risk profile as a consequence.

In addition, it should be kept in mind that many entities that only perform certain activities of Annex 1 of the CRD listed in the consultation paper under paragraph 6 of title I on page 18 have not been of supervisory interest in the past or only on a limited basis due to their limited relevance. Such companies cannot be shadow banks by definition because they are not exposed to increased specific risks that are typical for real shadow banks. Thus, we question whether it is the appropriate approach to determine that all entities performing at least one of the activities of Annex 1 of the CRD listed in the consultation paper under paragraph 6 of title I on page 18 shall qualify as shadow banking entity without having analysed if there are specific increased risks that are typical for real shadow banks.

From a risk management perspective, it would hardly be possible to generate reasonable additional management impulse for the controlling of the risk of these entities beyond the limitation within the credit process. Thus, if individual and aggregate limits shall generate additional management impulse to control the increased risk of shadow banks, then it is of utmost importance to narrow down the scope of shadow banking entities to real shadow banks such as hedge funds, private equity funds, structured investment vehicles, AIFs and money market funds financial difficulties of which can imply systemic impact.

In addition, to reduce the operational burden for the aggregation of exposures from shadow banking entities to all companies of a credit institution or financial holding group that can be operationally challenging certain materiality thresholds should apply for the aggregation on the level of the credit institution or financial holding group.

The general threshold of 0.25% of the eligible capital for exposures to shadow banking entities is significantly too low. Contagion risks are not to be expected if the level of potential worst case losses expressed in its exposure is so low. A threshold of 5% of the eligible capital on an individual level might be appropriate given the risks and the extent of analysis to be performed. This is the half of the large exposure threshold.

Furthermore, it does not seem practical that the analyses shall be performed under the supervision of the credit risk committee. Typically, there are certain internal authorisation levels in the credit process. The assessment of the performed analyses shall be made consistent to the internal authorisation levels.

The identification of potential risks should only relate to potentially material risks and not to all potential risks.

It should be possible to abstain from considering risks from shadow banking entities in the ICAAP if the analyses show that the risks from shadow banking entities are not material.

Q3: 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.

In principle, we agree with the approach if the definition of shadow banks will be narrowed down to real shadow banking entities and if the proposals were considered to reduce unnecessary operational burden (as to more details see our answer to question 2).

Q4: 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.

In principle, we agree with the approach if the definition of shadow banks will be narrowed down to real shadow banking entities and if the proposals were considered to reduce unnecessary operational burden (as to more details see our answer to question 2).

Q5: 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?**

Yes, we think that option 2 is the preferable option. If option 1 was implemented then we expect a breakdown of the European securitisation market because there might be always exposures in many major credit institutions and credit institution groups that do not meet the requirements of the “Principle Approach”. In such a case, the investing credit institutions would be limited with all exposures from shadow banking activities comprising at least investments in all kinds of securitisations, funds, receivables from leasing companies and factoring companies being not part of a credit institution or financial holding group, finance companies of industrial groups etc. to 25 % of its eligible capital. An investment in asset backed securities such as Auto-ABS would no longer be possible for such credit institutions. In addition, the financing of industrial enterprises and its subsidiaries via group finance companies would be possible neither. Therefore, we expressively advocate for the implementation of option 2.

We believe that option 2 creates sufficient incentives to gather all information that are necessary to assess the special risks linked with shadow banking entities.

Q6: 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?

It is not possible to answer to this question at this point in time, because the right calibration of the limit depends on the scope of definition of shadow banking entities. The results of the impact analysis should be taken into consideration for the right calibration as well.

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