Comments

Draft EBA Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework

Register of Interest Representatives
Identification number in the register: 52646912360-95

Contact: Michael Engelhard
Telephone: +49 30 20225- 5331
Fax: +49 30 20225- 5325
E-mail: Michael.Engelhard@dsgv.de

Berlin, 15-06-19

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

Coordinator:
German Savings Banks Association
Charlottenstrasse 47 | 10117 Berlin | Germany
Telephone: +49 30 20225-0
Fax: +49 30 20225-250
www.die-deutsche-kreditwirtschaft.de

I. General remarks

We thank you for having the opportunity to comment on the consultation paper (CP) "Draft EBA Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395 para. Regulation (EU) No. 575 / 2013 (EBA/CP/2015/06)", hereinafter referred to as "Draft Guidelines".

In principle, we support the EBA's view that unregulated parts of the financial sector may pose risks to the financial system, the so-called shadow banks. We therefore generally understand the EBA's reasons for further regulation of shadow banks.

However, we reject the Draft Guidelines in the form currently proposed, not only because they are not covered by the EBA's mandate, but also for the following reasons relating to their substance (see also in particular our answers to the questions in the CP).

No indirect regulation by tightening supervisory requirements for institutions

Although we welcome in principle the intention of the Draft Guidelines to create greater transparency and risk sensitivity at the institutions with regard to exposures from unregulated parts of the financial system, this may not be allowed to lead to any overloading of and detrimental impact on the already heavily regulated banking sector. Unfortunately, in the final analysis the result of the Draft Guidelines will be to further tighten the process-related regulatory requirements imposed on already highly regulated institutions, with the "polluter pays" principle ultimately being disregarded. In contrast to the requirements of Article 395(2) of the CRR, the effects on the real economy resulting from the definition of shadow banks and the limits set for them do not yet appear to have been taken into account. In our opinion, this is urgently required in order to appropriately reflect the clear intention of the lawmakers to avoid a negative impact on the real economy.

We believe that the priority objective must be to drive forward the internationally coordinated supervision of those parts of the financial sector that have been unregulated up to now. Regulatory attention should be focused more clearly on entities currently slipping through the regulatory net and on unregulated activities that raise potential stability concerns.

The EBA has no mandate to mitigate risks from shadow banks by imposing additional Pillar II requirements

In the context of the large exposure regime in Part 4 of the CRR, the EBA is required to issue guidelines in accordance with Article 395(2) of the CRR that will allow appropriate aggregate large exposure limits or tighter individual large exposure limits to be set on exposures to shadow banks. We have doubts whether the proposed Guidelines, which are largely aimed at internal controls and internal risk management, are covered by the mandate under Article 395(2) of the CRR. It is a matter of considerable surprise that the Draft Guidelines are designed to address specific requirements for Pillar II internal controls and risk management that relate solely to exposures to shadow banks. We believe that these requirements developed solely for shadow banks are unnecessary because the general limits set for risks are already anchored in regulation through the transposition into national law of the CRD IV requirements relating to Pillar II (in Germany, for example, by section 25a of the German Banking Act (KWG) in conjunction with the "Minimum Requirements for Risk Management" – MaRisk). They are also covered by the new EBA requirements (SREP guidelines). We would also like to refer in this context to our remarks on question 2.

Our understanding is that the EBA was mandated to develop guidelines as the basis for the assessment to be conducted by the European Commission by 31 December 2015, the outcome of which could result in a legislative proposal on large exposure limits for exposures to shadow banks that carry out activities outside a regulated framework.

Problematic definition of shadow banks

We are very concerned about the definition of shadow banks proposed in the Draft Guidelines. We would also like to refer in this context to our remarks on questions 1 and 2. The main reasons for the fault lines in the shadow banking system given by the EBA in paragraph 2 of 3.1 of the CP are "a heavy reliance on short-term wholesale funding and a general lack of transparency which masked the increasing amounts of leverage, maturity and liquidity transformation in the run-up to the crisis". We agree with this analysis. However, we believe that the requirements governing the setting of limits for shadow banks according to the definition in the Draft Guidelines go beyond entities with a corresponding risk profile. In our opinion, the Draft Guidelines on limits on exposures to shadow banking entities represent the multiple regulation of AIFs, MMFs and special purpose vehicles engaged in securitisation transactions[1] (SSPEs). They also affect structures that do not give rise to the sort of greater risks that prompt the concerns cited in 3.1.1 on the CP.

In light of the objectives of the regulatory initiative and its impact on competition in the financial markets, we believe that the Draft Guidelines must be harmonised with existing rules and requirements. At the EU level, the objectives associated with this new regulatory initiative on shadow banks are:

a) to avoid excessive exposures
b) to create transparency
c) to avoid bank regulation being circumvented

Where funds and SSPEs are concerned, we believe that these objectives have already been achieved through tougher conditions (including the Single Rulebook, requirements governing capital deductions and capital charges, the large exposures regime with requirements governing look-through and definition of groups of connected clients, various disclosure requirements, etc.). We are of the opinion that including the above-mentioned entities does not add any value in the sense of increasing transparency and (legal) certainty in the financial markets. If this were to result in the uncoordinated co-existence of regulatory requirements with increasingly similar objectives, it would further increase cost and effort and affect competition. This would not help to promote transparency, clarity and investor protection.

In addition, the EBA's proposals risk counteracting the European Commission's initiative to encourage and develop the securitisation market. So as not to hinder the initiative to promote the securitisation market announced by the Commission for the end of 2015, special purpose vehicles for simple, transparent, standard ABSs should be removed from the scope of shadow banks and classified as excluded undertakings.

[1] SSPEs hereafter includes also all special purpose vehicles engaged in financial transactions, which for the purpose of issuing securities purchase receivables or other securities, regardless of whether the purchased or subsequently issued securities are securitisations in the meaning of Article 4 (1) point 61 of the CRR, because for example they lack any tranching.

Impact study is vital – Alternatives must be considered

The second subparagraph of Article 395(2) of the CRR in particular clarifies that the EBA's mandate should be understood as preparing the way for the European Commission. This states that, in developing the Guidelines, the EBA must consider whether the introduction of additional large exposure 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. The Draft Guidelines currently do not comply to a significant extent with the mandate established by Article 395(2) of the CRR. First, we do not think that the CP makes the results of this review sufficiently transparent, and second, the effects of the proposed internal limits, especially an aggregate / sectoral limit, do not appear to have been adequately assessed, although this is of critical importance. We therefore welcome the EBA's statement in the context of its cost-benefit analysis that: "There is need for additional data collection to estimate the current level of exposures to shadow banking entities (according to the specifications provided [in the Draft Guidelines]) and what would be the economic impact after applying the GL." In other words, no Guidelines can be finally adopted and applied before the analyses have been fully completed, alternatives have been examined and the banking industry has been consulted.

Additionally, we by no means share the view that "There would be costs for some banks". In our view the banking sector as a whole will be affected, not just in terms of having to adapt their internal processes, but also in terms of potential changes to their business policies (in particular as regards the structuring of institutions' own investments, e.g. in (institutional) funds.

It is therefore a matter of considerable surprise that the EBA already appears to envisage including the very conservative Option 1 for the fallback approach (paragraph 34) in the final Guidelines. In light of this, we would like to argue firmly in favour of ensuring that the effects of any and all restrictions on lending opportunities due to stricter limits are thoroughly assessed in an impact study, in particular in order to be able to estimate the business implications of the proposed definition of shadow banks and a defined aggregate limit for institutions and the financial system as a whole. This is also the only way of allowing the European Commission to examine the appropriateness and effects of stricter limits for exposures to shadow banks.

The proposed Option 1 for the fallback approach would de facto implement a strict aggregate large exposure limit for shadow banks and thus pre-empt the forthcoming assessment by the European Commission and any legislative proposal. In particular, it can be assumed that limiting the exposures for this very conservative fallback approach to 25% of the eligible capital would impose unreasonably strong restrictions on the lending policies of institutions, especially small and medium ones and those having a regional or client specific business focus, and force them to make unreasonable changes to their portfolio and investment policy.

We are concerned that the EBA has not exposed any other alternatives for discussion or explained why conceivable alternatives that might prove to be more suitable from cost-benefit perspectives were not considered. For example, simple approaches would considerably reduce the administrative effort that would necessarily result from the Guidelines. In light of the large exposure regime already established at the institutions, possible solutions could be lower individual large exposure limits and/or the introduction of a sectoral large exposure aggregate limit (e.g. 800%, oriented on the former aggregate large exposure limit). In any case, an appropriate calibration depends significantly on the underlying definition of a shadow bank, so an impact study is also vital for this reason alone.

It should also be considered that Option 1 would paralyse the European securitisation market because there would most likely always be exposures to shadow banks that do not meet the requirements of the principal approach. In such a case, the bank's entire exposures to shadow banks, i.e. investments in securitisations, funds and exposures to leasing companies, factoring companies, financing companies, etc., would be limited to 25% of its eligible capital. This would effectively prevent banks from investing in securitisations.

In addition, Article 395(2) of the CRR does not require both individual and aggregate large exposure limits to be set. In other words: it would also be perfectly possible to set only one of these limits.

In light of these numerous issues, the least we expect from the EBA before the Guidelines are finalised is to examine the alternatives on the basis of a QIS and to conduct a further consultation with the banking industry, because only a QIS will achieve transparency about the implications of the proposals.

With regard to the current EBA-QIS on shadow banks, we believe that the results will not be a suitable basis for defining shadow bank, the calibration of limits and the estimation of possible economic impacts. Overall the breakdown into the different types of shadow banks is insufficiently granular. In addition the query does not appropriately differ between different kinds of funds, in particular within the group of AIF-funds. Furthermore with the inclusion of Not-UCITS-Money Market Funds the query goes beyond the definition of shadow banks as being proposed in the Draft Guidelines. Moreover, like with the Draft Guidelines, important questions about the relevance of look-through rules or groups of connected clients (GCC) relevance are not addressed. This allows far-reaching interpretation during the filling of the templates.

Questions not answered by the Draft Guidelines

In general, we have the impression that the Draft Guidelines do not sufficiently reflect the fact that the lawmakers' purpose in establishing Article 395 of the CRR is to limit large exposures, with the result that the focus is on individual borrowers or GCCs (see our comments on question 1 for more details).
As a result, the Draft Guidelines leave many questions unanswered, for example with regard to the requirements governing the determination of GCCs or the interaction with the look-through requirements in Article 390(7) of the CRR in conjunction with Implementing Regulation (EU) Nr 1187/2014.

Initial application, Grandfathering arrangements and and application only at consolidated level

The CP does not yet contain a timetable for national implementation of the requirements. We would ask for a sufficiently long implementation period because the impact of the CP will require established processes and methodologies for monitoring and managing concentration risk arising from exposures to shadow banks to be modified (including identifying relevant exposures, ICAAP, managing limits, capital planning, reporting) and IT systems will have to be adapted. In addition, we believe that it important to introduce a grandfathering arrangement specifying that the Guidelines must be applied solely to transactions entered into after 1 April 2015.

From our perspective, the initial application date should under no circumstances be before 31 December 2016.

Additionally, we believe that the Guidelines should only apply at the consolidated level. The rationale for this is three-fold:

- The usual large exposure limits set out in the CRR already apply to exposures to counterparties that would be considered "shadow banks" under the EBA's proposed definition. Those CRR rules already apply at both solo and consolidated levels, so a sufficient backstop already exists within the current framework. Therefore, the enhanced protection against single name concentration risk that would be provided by the Draft Guidelines can still be achieved by applying it at the consolidated level.
- The burden of the significant infrastructure, systems and processes that institutions would need to put in place to comply with the Guidelines would be less onerous if applied at the consolidated level only.
- Applying the Guidelines at the consolidated level only would make it easier for institutions to manage them within the ICAAP process.

<u>Specific remarks</u>

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.**

Under the EBA's proposals, the definition of a shadow bank covers entities that carry out credit intermediation activities and are not any of the excluded undertakings defined in the Draft Guidelines, for example undertakings that are included directly or indirectly in (consolidated) supervision.

Article 394(2) of the CRR introduced a new reporting requirement for the ten largest exposures to "unregulated financial entities". The instructions concerning the templates for the large exposures regime (see Annex III to Implementing Regulation (EU) 2015 / 227) refer to Article 142(1) point 5 of the CRR for a definition of this term. It is therefore a matter of considerable surprise in this context that, in its proposals, the EBA does not make any comment on the term "unregulated financial sector entities" used in the CRR. In our view, this reporting requirement is already aimed at exposures to shadow banks. To this extent, it is our perception that the CRR already contains a definition of shadow banks. A separate definition of shadow banks that differs from the definition already implemented – along with the resulting far-reaching consequences – is therefore superfluous in the context of the Draft Guidelines. Furthermore, it is our view that a definition like this is the sole responsibility of the EU lawmakers.

But at least "unregulated financial sector entities" in the meaning of Article 142(1) point 5 of the CRR could therefore be used as a basis. If the EBA wishes to stick to a separate definition, it will be vitally important for practitioners to ensure that the final version of the Guidelines includes a detailed, transparent comparison of the differences between the definition used in the final Guidelines and the definition contained in Article 142(1) point 5 of the CRR.

In line with the actual objective, i.e. to set limits on exposures to shadow banks, which by their nature are associated with a greater risk, the scope of the definition of shadow banks should be further restricted by expanding the list of excluded undertakings.

In our opinion, shadow banks are currently unregulated entities that actively conduct financial market activities – in contrast to e.g. securitisations or CIUs (UCITS and AIFs). In light of this, the general definition of "credit intermediation activities" is insufficiently exact and results in delimitation problems. In principle, all undertakings perform maturity transformation, for example. In addition, the bulk of capital market financing in the real economy is handled using subsidiaries that are classified as "financial sector entities". We therefore believe it is critically important to expand the list of excluded undertakings (see our remarks below). Specifying the criteria or providing a central allocation list would enhance transparency and eliminate ambiguity.

We ask you to clarify that entities that are either subject to mandatory prudential consolidation under the CRR, but are excluded from the scope of prudential consolidation on the basis of Article 19 of the CRR, or that are consolidated on a voluntary basis are excluded from the definition of a shadow bank.

It is our understanding that insurance undertakings as defined in Article 4(1) point 27 d) to k) of the CRR are entirely excluded from the scope of the Guidelines. On the one hand, we believe that it is only possible to a limited extent to assess whether insurance undertakings carry out credit intermediation activities (it is in the nature of insurance undertakings to do this because it is inherent in the insurance business), while on the other, Article 395(2) of the CRR makes it clear that the EBA's specific mandate is to develop guidelines for shadow banks that carry out "banking activities" outside a regulated framework. These do not include insurance activities, which are performed primarily by insurance undertakings.

For this reason – if the definition by reference to credit intermediation is retained – it should be clarified that an entity will only be regarded as a shadow bank if its primary activity consists of credit intermediation. In addition, the term of the "similar activities" referred to in the CP in the description of the credit intermediation activities of shadow banks should be deleted. As a minimum EBA should provide examples, since the term "similar activities" is very imprecise from the applicant's perspective.

We also believe that leasing and factoring companies in Germany are already well regulated. The German lawmakers subjected German leasing companies to supervision by the supervisory authority for financial services institutions in 2008. The regulatory framework imposed on them was adapted to the business model and risk profile of the leasing sector, thus pre-empting any regulatory arbitrage. Supervision of leasing companies includes comprehensive authorisation, reporting and control requirements that were taken over from the banking sector. In addition, no shadow bank-specific risks within the meaning of the criteria used by the EBA are assumed to exist in relation to the business model used by the German leasing and factoring sector. It should therefore be clarified that leasing and factoring companies do not fall within the scope of the Guidelines.

We believe that the proposed limit of 0.25% of eligible capital above which exposures to shadow banks would fall within the scope of the Draft Guidelines is far too low. Especially in the case of small exposures, there is no greater (concentration) risk for the bank, because shadow banks are not normally strongly correlated. Consequently, the focus should be on large exposures to shadow banks. For this reason, there should be at most a requirement to set individual limits only for borrowers that are equal to or in excess of the definition of a large exposure in Article 392 of the CRR. If the EBA wishes to depart from the mandate of Article 395 of the CRR, only exposures that are equal to or exceed the large exposure definition, or alternatively exceed the absolute amount of EUR 300 million, should fall within the scope of the final Guidelines.

In addition, the Draft Guidelines specify a definition of a shadow bank without making any corresponding reference to the group of connected clients (GCC). The EBA should therefore clarify whether the Guidelines refer to GCCs and/or individual borrowers. The definition of "exposures to shadow banking entities" refers to the part of the CRR addressing rules for large exposures. This implies that GCCs must be included as a matter of principle. However, if this means that GCCs must be taken as the basis, it is still unclear whether all exposures within the GCC are to be interpreted as shadow bank exposures, or only exposures to those counterparties that actually meet the definition of a shadow bank. We believe that including all exposures to the GCC would definitely be too far-reaching and objectively not justified if a subordinate subsidiary in a GCC were to be classified as a shadow bank.

In its Q&A process, the EBA has already clarified in the past that, when considering a GCC, classification of the parent company as an unregulated financial entity is decisive (e.g. Q&A 2013_492). Hence, for the purposes of Article 394(2) of the CRR, a GCC whose parent company is an unregulated financial entity (which we interpret to mean a shadow bank) is reported as a shadow bank GCC. The question arises as to whether a similar procedure should be applied to GCCs for the purposes of these Guidelines.

By contrast, GCCs whose parent company is neither an institution nor an unregulated financial entity (for example an automotive group that includes a financing company) are not included in the reporting required by Article 394(2) of the CRR. It is correctly assumed in such cases that the subsidiary that is classified as a financial sector entity (regulated or unregulated) does not pose any risk of contamination for the GCC as a whole. To this extent, we believe that it is necessary to clarify that this interpretation remains in force and – if treatment on a GCC basis were to be required for the Guidelines – it would also be applied to the Guidelines for shadow bank exposures.

In addition, it should be clarified that the provision of information called for by the Draft Guidelines can only be required from those shadow banks to which the institution has exposures. If this is not the case, treatment on a GCC basis would pose the question of what the legal basis is for requiring the information called for by the Draft Guidelines from members of a GCC who are not themselves borrowers of the institution.

- **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).**

Funds and fund managers as shadow banks

According to the EBA's proposals, funds covered by Directive 2009 / 65 / EC (UCITS Directive) are excluded from the scope of definition of shadow banks except if they are money market funds. By contrast, all alternative investment funds (AIFs) and unregulated funds are to be automatically classified as shadow banks.

We believe that this is neither appropriate nor expedient. Especially in the case of AIFs established as institutional funds, for example, the lock-in period for the capital provided is subject to the lock-in periods for invested capital applicable to medium- to long-term investment strategies and is thus not comparable with the continuous inflow and outflow of investments found in traditional banking business. Maturity

transformation as defined in Title I, paragraph 6 of the Draft Guidelines therefore happens only to a limited extent.

AIFMs are subject to almost exactly the same regulatory requirements as UCITS management companies (implemented in Germany by sections 25ff. of the German Investment Code – KAGB). This applies in particular to the requirements governing own funds, organisation and risk management emphasised by the EBA. AIFMs are therefore not *"entities that are not subject to appropriate prudential supervision"*, to which the proposed Guidelines are supposed to apply in accordance with the statements on page 5 of the CP. Consequently, there is no justification for making a distinction between UCITS and AIFs with regard to the regulation of management companies.

The proposed definition of "credit intermediation activities" is much broader than the approach followed by the FSB in its work on shadow banking issues. Specifically, it refers to activities "similar" to bank-like activities and is thus very imprecise from the applicant's perspective. Moreover, by reference to point 11 of Annex 1 of CRD, it also treats at least portfolio management and advice as credit intermediation activities.

We strongly oppose such a classification. Portfolio management and advice are investment services that are regulated on a separate basis under the MiFID framework. These services are primarily performed by asset managers that are authorised investment firms subject to a separate set of prudential rules. In addition, portfolio management and advice may also be provided by other qualified market participants, such as fund managers authorised for the purpose of collective portfolio management under the UCITS Directive or the AIFMD, as well as by credit institutions.

Hence, it must be recognised that portfolio management and advice are on no account comparable with bank-like activities. On the contrary, these services do not require a banking licence and are thus attributable to the investment services sector.

As a precaution, and in addition to our requests above, we are asking for UCITS and AIF managers to be explicitly excluded from the definition of shadow banking entities. UCITS and AIF managers' core activity is (collective) portfolio management, which is undertaken for the account of fund investors/clients and does not entail any risks for the fund managers' balance sheets. In our understanding, such limits would also apply to shareholdings by banks in the case of fund managers who are members of banking groups, since such shareholdings also create a relevant exposure. However, it should be evident that a bank's investment in a UCITS or AIF management company that is an authorised entity not engaging in any own-account market activities should not be considered a potential source of shadow banking risk. Consequently, we propose adding UCITS and AIF managers to the list of excluded undertakings in Title I, paragraph 6 of the Draft Guidelines.

At the fund level, it should also be noted that the term "AIF" is extremely broad, ranging from retail securities funds through retail real estate funds and institutional funds with UCITS investment restrictions, down to closed-end real asset funds, hedge funds and private equity funds. Many institutional and retail securities funds are subject to investment restrictions that are similar or even identical to those for UCITS. If it really is the case that all AIFs are to be treated as shadow banks, this would also include funds whose risk profile does not differ – or only differs marginally – from the risk profile of a UCITS. There is no objective justification for this unequal treatment.

In addition, classifying AIFs in their entirety as shadow banks runs counter to the principles developed only recently by the EBA for including exposures to "transactions with underlying assets" in the large exposures regime (see Commission Delegated Regulation (EU) No 1187 / 2014). UCITS and AIFs qualify as such "transactions with underlying assets".

In accordance with Article 7 of Commission Delegated Regulation (EU) No 1187 / 2014, banks can base their exposure for the purposes of the large exposures regime solely on the assets in the funds and do not have to include the funds themselves or their managers, provided firstly that the legal and operational structure prevents any cash flows from being redirected from the funds to third parties, and secondly that investors only receive payments from the assets in the funds. In accordance with Article 7(2) of Commission Delegated Regulation (EU) No 1187 / 2014, these conditions are considered to be met by UCITS at least in terms of the condition that cash flows must be prevented from being redirected. However, the second condition will normally also be met by UCITS because claims by investors are typically limited to the assets of the UCITS.

Almost all AIFs also meet the conditions set out in Article 7 of Commission Delegated Regulation (EU) No 1187 / 2014. The obligatory use of AIF depositaries means that legal and operational structures must be provided to prevent cash flows from being redirected, just as with UCITS. In addition, the claims of AIF investors are also typically limited to the assets of the AIFs. Consequently, banks generally also base their exposures to AIFs solely on the assets in the funds, in compliance with Article 7 of Commission Delegated Regulation (EU) No 1187 / 2014. This is also appropriate in light of the fact that the counterparty credit risk is the same.

As a result, the exclusion of UCITS should also be extended in principle to AIFs, unless the latter employ leverage on a substantial basis as defined in Article 111 of Commission Delegated Regulation (EU) No 231 / 2013. The definitions in Title I, paragraph 6, point 3(k)(i) of the fifth subparagraph of the Draft Guidelines must be amended accordingly.

The problem with the proposed inclusion of all AIFs and MMFs arises in particular in light of the EBA's preference for Option 1 for the fallback approach. Our understanding of the Draft Guidelines is that an information deficit in respect of just a single shadow bank would result in the exposures to all shadow banks being limited to 25% of eligible capital. This means that – even though it is an internal limit – the 25% aggregate limit ultimately acts like a sectoral large exposure limit. Among other things, this would be a clearly unreasonable restriction on institutions' ability to put their own investments into (institutional) funds.

Furthermore, we believe that the explicit inclusion of all MMFs – regardless of whether or not they are already regulated – is as inappropriate. In light of the fact that work is also currently underway on developing a separate regulatory regime for money market funds at the European level (Proposal for a Regulation on Money Market Funds 2013 / 0306), we cannot understand this broad interpretation and the associated additional requirements and effort.

Application of the look-through rules for funds and securitisations

We would like to draw attention to the following ambiguity in the Draft Guidelines in particular as it affects funds and securitisations:

To date, the Draft Guidelines have not addressed the issue of interaction with a range of existing requirements of the large exposure regime that in principle also cover unregulated capital market entities. 3.1.3 paragraph 17 of the CP merely refers to Commission Delegated Regulation (EU) No 1187 / 2014, but does not explain the interaction in any further detail. It is not clear from the Draft Guidelines at what level the limits should be applied, which makes it considerably more difficult to evaluate the proposals. We propose excluding all transactions that fall under the European look-through rules from the scope of these Guidelines. At a minimum, the final version of the Guidelines should spell out in greater detail the interaction with the look-through requirements in the large exposures regime.

The EBA's considerations appear to suggest that an exposure to a shadow bank that is also a transaction within the meaning of Article 390(7) of the CRR in conjunction with Commission Delegated Regulation (EU) No 1187 / 2014 must always be limited. In the standard case, the exposure to the transaction is replaced by the underlying assets as a result of the look-through in the large exposures regime. There is only an exposure to the transaction as a "separate client" in exceptional cases. However, if there were to be a requirement in all cases to internally limit a transaction as defined in Article 390(7) of the CRR in full as a shadow bank – given the definition is fulfilled –, we believe that there would be no requirement from an aggregate risk perspective to examine the individual underlying assets that might be contained in such a transaction to determine whether they meet the definition of a shadow bank. As a result, the requirements of the Guidelines addressing the setting of internal limits should therefore refer at most to transactions as defined in Article 390(7) of the CRR and not additionally to the underlying assets, as this would otherwise lead to the same risk being included twice in the aggregate limit. If this does not happen, AIFs, MMFs and securitisations would otherwise be included twice in the large exposures regime – they would be included firstly at the issuers of the underlying assets, and secondly the fund and the securitisation structure itself would be included.

It thus appears that the EBA does not interpret the new requirements governing look-through in accordance with Article 390(7) of the CRR in conjunction with Commission Delegated Regulation (EU) No 1187 / 2014 as offering any relief, although all funds and SSPEs are already among the entities that are regularly looked through for potential risks (including additional risk), and in this respect only the underlying assets that have been looked through need to be used for setting any limits as a shadow bank. There is no evident objective justification for the different treatment of AIFs or transactions generally relevant for look-through in Commission Delegated Regulation (EU) No 1187 / 2014 and in the Draft Guidelines. In addition, Commission Delegated Regulation (EU) No 1187 / 2014 implements a fallback solution under which transactions for which no look-through is possible and neither the materiality thresholds nor the mandate-based approach can be applied are assigned to the "unknown client". We therefore cannot understand why transactions that are subject to look-through should be (additionally) limited again by further requirements under these Draft Guidelines.

SSPEs as shadow banks

Under the EBA's proposals, all SSPEs will be classified as shadow banks because they are unregulated, unless the SSPE is covered by consolidated prudential supervision. In our opinion, however, SSPEs should be excluded from this. The institutions' exposures to SSPEs are already subject to comprehensive regulatory requirements both at the European level (e.g. EU securitisation framework in Part 3, Chapter 5 and Part 5 of the CRR) and in the global context (e.g. the BCBS-IOSCO Task Force on Securitisation Markets). We believe that securitisation transactions, and hence exposures to SSPEs, are already adequately covered by the banking supervision regime (e.g. by the minimum retention for securitised

exposures, the regulatory limits imposed by requirements on the treatment of liquidity lines and credit exposures, etc.).

Specifically, this also applies in particular to ABCP programmes. For sponsors, the CRR already contains comprehensive regulatory requirements that also contain detailed rules for assessing risks (whereby the Internal Assessment Approach – IAA – in accordance with Article 259(3) of the CRR is particularly relevant in practice). If the ABCP programmes are fully supported, meaning that the liquidity-providing bank is also liable for losses that would accrue to an issued ABCP, an investor buying an ABCP enters into a collateralised investment in a regulated bank from a risk perspective.

The European Commission in particular is currently driving forward an initiative to support the European economy by extending regulatory privileges to simple, standardised and transparent securitisations that offer considerable benefits for the real economy. Any more far-reaching regulation of and setting limits for such transactions, including by specifying additional separate internal limits or large exposure limits, will not generate any prudential added value. On the contrary: this would run counter to the ongoing activities of the EU (Capital Markets Union) and the European banking supervisors to create a high-quality securitisation segment. For this reason, all SSPEs for securitisations that qualify as simple, transparent, standard ABSs should be removed from the scope of shadow banks and the corresponding limits and classified as excluded undertakings.

Because the large number of conditions can make it very difficult to meet the criteria for simple, transparent, standard ABSs, we assume that a majority of the securitisations that are important for the real economy will be unable to meet the criteria for simple, transparent, standard ABSs. For this reason, SSPEs that are not actively managed, that are not exposed to any rollover risk, and whose purpose is to issue asset-backed securities in order to refinance the originator, should additionally to simple, standard, transparent securitisations be excluded from the scope of shadow banks, or at a minimum from the additional limits for shadow banks, because these SSPEs do not exhibit any of the increased risks that are typical for shadow banks. Such exclusion is justified in particular if the SSPE is consolidated by the industrial enterprise according to applicable accounting rules. In such a case, the SSPE has been established to enable the insolvency-proof transfer of securitised exposures so that the asset-backed securities can be collateralised and the trustee can be assured exclusive access to the collateral on behalf of the investors. This aims to avoid a situation in which the securitised exposures are included in the originator's assets and the credit quality of the SSPE is thus dependent on the credit quality of the originator. The purpose of this type of refinancing is to enable the originator to be funded largely independently of its credit rating, as the funding depends primarily on the quality of the securitised exposures and the credit enhancements granted. Repayment of the asset-backed securities depends on the amortisation profile of the securitised exposures. This form of refinancing increases the diversification of the originator's sources of funding and helps mitigate its liquidity risk. Equally, no contagion risks are expected if the cash flows of the securitised exposures are used to service the asset-backed securities and no liquidity facility is needed to protect against rollover risk. Additionally, in many cases these asset-backed securities are also eligible for central bank borrowings and can be used to obtain liquidity from the central bank.

Financing companies belonging to industrial enterprises

Financing companies like this whose main purpose is to finance companies belonging to industrial groups should be explicitly excluded from the scope of shadow banks and classified as excluded undertakings because of the very far-reaching definition of credit intermediation activities. This could be done, for

example, by excluding from the scope of shadow banks those financing companies that provide the funds they have raised on the money and capital markets exclusively to other group companies (group exemption). Derivative transactions in the course of asset-liability management by these financing companies that are used to hedge interest rate and currency risk should also be covered by the group exemption. Because industrial enterprises' financing companies often have to finance joint ventures on a pro rata basis as well, funding for these joint ventures should not override the group exemption. Thus, financial services companies of industrial groups the main purpose of which is to render financial services to the companies of this group (in-house financial services) should be exempted explicitly.

As a matter of principle, SSPEs and financing companies belonging to industrial enterprises have a different and significantly lower risk profile than typical shadow banks such as hedge funds. The credit quality of SSPEs depends mainly on the securitised exposures and the credit enhancements. The credit quality of industrial enterprises' financing companies generally depends on the controlling industrial parent company. We do not believe that it would be useful or expedient to impose special controls and limits on exposures to these SSPEs and financing companies belonging to industrial enterprises by including them with real shadow banks such as hedge funds, which exhibit a greater risk, because there are no common, sector-specific risks.

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.

We wish to stress again at this point our view that the requirements contained in the Draft Guidelines relating to internal risk management processes are not covered by the mandate in Article 395(2) of the CRR. The objective of Article 395(2) of the CRR is clearly to mitigate overarching/systemic risks from interconnectedness between banks and shadow banks by means of suitable additional large exposure limits, not to expand the Pillar II requirements.

Quite apart from the lack of a mandate, we do not see any issues of substance or risk aspects that would support the need for separate Pillar II requirements relating to the setting of specific internal limits for shadow bank exposures. We are therefore highly critical of and reject the additional qualitative requirements explicitly for shadow banks. The qualitative requirements for Pillar II arising from CRD IV have already been comprehensively transposed into national law (in Germany, for example, through section 25a of the KWG in conjunction with the "MaRisk"). In addition to individual limits, these also include overarching, e.g. sectoral limits. Mitigating risks by using limits and other safeguards is thus already an established element of internal risk management at institutions and also covers risks arising from shadow bank exposures. We cannot understand why separate requirements and processes should now be stipulated explicitly for shadow banks in these Draft Guidelines when they must in any case be imposed for all kinds of borrowers. In addition to CRD IV, requirements for risk management by institutions are already anchored in a range of EBA guidelines (e.g. Internal Governance, SREP). The requirements set out in Title II, paragraphs 1 and 2 of the Draft Guidelines would cause unnecessary additional administrative effort, because separate frameworks, policies and reports would have to be developed explicitly for shadow banks, and these would then be subject to separate examination by supervisors and auditors. We cannot identify any corresponding benefits from this.

The limiting rules in existing limit systems under Pillar II are not based on the eligible capital referred to in the CP, but are based on the specific requirements for each institution derived from the borrower-related, sectoral and geographic risk diversification that is necessary or defined in the business policy,

based on the credit portfolio model used. In addition, limits are not normally set at the level of the GCCs in Pillar II, but at the level of the individual borrower or counterparty. Overall, it can be said that there is no synchronisation with existing limit systems, which would ultimately lead to a further increase in cost and effort for implementation and the subsequent ongoing processes.

Moreover, the Draft Guidelines give the impression that shadow banks represent their own risk type. This is something we do not understand. As a matter of principle, each shadow bank inherently represents a borrower that can give rise to a range of risks for an institution (credit risk, market risk, operational risk, etc.) that are different for each shadow banking entity. We believe that it is overstepping the mark to generally assume a correlation of 1 and thus a high concentration risk for shadow banks. This would put shadow banks in a worse position per se than other borrowers, which would not be appropriate. It therefore also does not make any sense to require separate risk management mechanisms for shadow banks. In fact, this would not be possible, because the shadow banking sector is far too heterogeneous for it to be managed using a standardised approach.

Of course Pillar II requires institutions to identify, measure and manage credit risk concentrations. Applied to shadow banks, this means that – as set out in Article 81 of CRD IV – the concentration risk that arises from connections between a shadow bank and other borrowers (keyword: groups of connected clients) or from sectoral or geographic concentration must be managed appropriately. In any case, the CEBS Guidelines on the revised large exposures regime from December 2011 already stated that only idiosyncratic risk is analysed in the large exposures regime, whereas geographic and sectoral risk would be addressed under Pillar II. Our understanding is that the requirement to consider interconnectedness is therefore already satisfactorily met in the large exposures regime through the fundamental obligation to test for control or interconnectedness in accordance with Article 4(1) point 39(a) and (b) of the CRR.

The requirements governing the provision of information for setting limits for shadow banks set out in the Draft Guidelines are already very far-reaching, much too detailed and almost impossible to implement fully in practice. We believe that the proposals run the risk that the fallback approach would become the default because of the very detailed information requirements.

We have the following specific remarks on paragraph 1 of Title II of the Draft Guidelines:
Point a) does not make clear which exposure is meant with regard to individual borrowers or the GCCs, and whether the look-through requirements should be considered or not. The definition of the exposure in the Draft Guidelines is not sufficiently precise (see also our specific remarks on Q1 relating to groups of connected clients and look-through requirements). In addition, it should be sufficient to identify all material potential risks. The word "material" should therefore be inserted in front of "potential risks".

In point b), we are concerned about the requirement to involve the credit risk committee in each decision, as this would undermine existing credit approval arrangements. We believe that it is not necessary to involve the CRC in the case of minor exposures.

In point e), it is doubtful that the requirement is practicable, as we believe that it will not be possible to obtain complete transparency about the interconnectedness between shadow banks, which will also change over time. In consequence, the process of assessing/reflecting risks will also remain unclear. In this case, too, the principle of materiality should play a role and a corresponding materiality threshold should be specified (e.g. similar to the increase proposed by the Basel Committee in its April 2014 large exposures framework in the limit for an in-depth test of interconnectedness to 5% of the aggregate risk

exposures to a shadow bank); on the topic of interconnectedness, please also refer to our previous remarks.

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.

We refer here to our fundamental comments on Q2, in which we argue that separate requirements for exposures to shadow banks are not needed from a risk perspective for either internal risk management or the governance of the institutions. In addition, imposing such requirements is not covered by the mandate under Article 395(2) of the CRR.

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.

As we already explained in our specific remarks on Q2, we believe that setting separate limits for shadow banks under Pillar II does not make any sense, because the shadow banking sector is very heterogeneous and setting separate limits would not generate adequate management triggers.

In any case, individual limits are set as part of the regular credit processes or can be derived from the criteria defined in the credit risk strategy.

We reject a prudential requirement for an aggregate limit for shadow banks – regardless of whether this is 25% or another defined limit – by the EBA as part of the Pillar II process, as provided for under the fallback approach. In line with the principle of proportionality, and in exercise of their responsibility as managers, aggregate / sectoral limits should be set – where this is sensible and necessary – by the institutions individually to reflect their business model, their risk appetite and the materiality of the exposures. The necessary limits thus depend significantly on the business model and cannot therefore be specified globally. It is then a matter for the competent authorities to examine the appropriateness of the limits set by the institutions in the course of their supervisory activities.

For example, groups of institutions that themselves establish funds have larger volumes of AIFs – because of start-up finance, etc. – than institutions with another business model. On the other hand, small and medium sized institutions with a business model focussed on regional lending use investments in funds or securitisations for risk diversification purposes.

As an alternative, we are proposing to at least examine the possibility of setting lower individual and/or aggregate limits for shadow banks in the large exposures regime. This would mean that individual limits under Pillar II due purely to the classification of the borrower as a shadow bank would be unnecessary. In our view, calibrating an aggregate large exposure limit for shadow banks depends crucially on the definition of what is a shadow bank, and should under no circumstances be set at less than 800% (calibration subject to the QIS and depending on the definition of a shadow bank) of eligible capital so as to reflect the reservations expressed in these comments, in particular as regards the inclusion of all AIFs and MMFs without exception.

Alternatively, a lower individual large exposure limit for shadow banks could be set on condition that the definition of a shadow bank is modified to reflect our reservations above.

We wish to make the following additional remarks on paragraph 4 of Title II of the Draft Guidelines:

The scope of the information to be collected appears to be very substantial – especially if the EBA wishes to stick to its proposed materiality limit of 0.25% of eligible capital. It will therefore be difficult to gather all the information required to set individual limits for exposures to shadow banking activities, and some of an institution's counterparties might not be comprehensively assessed in accordance with all of the requirements illustrated in the CP.

We believe that points c), d), e) and f) are not practicable because a complete look-through does not appear to be possible, at least to the extent necessary, and the bank would have to rely solely on the assessment by the shadow bank itself. It should be clarified at least in respect of paragraph 4 of Title II of the Draft Guidelines that the requirements should be interpreted such that the information to be provided by a shadow bank is sufficient, and that the institution is not required to obtain information over and above this, or to verify the information that has been provided to it.

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?**

It is understandable that the EBA wishes to create incentives to collect as much and as comprehensive information as possible about shadow banks. However, this masks the aspect of materiality, which is a part of every lending decision. In our view, there is no need for any "technical" fallback approach because any deficiencies in setting internal limits – even if they relate to shadow banks – would be addressed as part of the SREP and could be sanctioned by additional capital requirements.

If an institution is unable to meet the requirements, the EBA is proposing an aggregate limit of 25% of eligible capital for all exposures to shadow banks (Option 1 preferred by the EBA). We cannot understand what motivates the EBA to already favour Option 1 at this stage. Of course, this approach is the most conservative of all the options.

If the EBA wishes to stick to its plan to impose an aggregate prudential limit for the fallback approach – despite the serious concerns expressed above – the proposed 25% of eligible capital is far too conservative and would have an impact on the business and investment policies of the institutions that is extremely difficult to estimate. The reason for this is that, at present, up to 25% of the institution's eligible capital can be lent in principle to each shadow bank. Option 1 would considerably exaggerate the risks arising from lending to shadow banks. It therefore has the effect of sharply limiting investments by banks and, in view of the broad definition of shadow banks that underlies the Draft Guidelines, it would effectively restrict transactions in funds, certifications, etc., to an extent that goes far beyond the current large exposures regime. We also believe it would negatively impact portfolio diversification. In our opinion, this would represent an economically unjustified restriction on the institutions' business lines that would be affected, it would contradict the economic policy objective of encouraging the securitisation market, and would significantly exceed the EBA's mandate under Article 395(2) of the CRR.

A QIS would have to be performed before such an aggregate limit is set, and the alternative options listed in the CRR (a lower large exposure limit for individual exposures or an aggregate limit for large exposures to shadow banks) would have to be examined.

If, additionally, this requirement were to come into force without a suitable grandfathering arrangement, the institutions would be forced to terminate some of their current exposures before the agreed terms, with unforeseeable consequences for the markets.

Because institutions have already implemented comprehensive analysis and control processes for their significant investments in funds and securitisations, Option 2 of the fallback approach would have considerably less restrictive consequences for the markets.

As a result, Option 2 not only rewards institutions with a potentially higher exposure limit for knowing their counterparties, but in fact more adequately reflects the reality of their risk profile. Hence, Option 2 could potentially provide more incentives to gather information about exposures than Option 1. However, Option 2 will only be attractive for those institutions (1) whose exposures to shadow banking entities currently amount to more than 25% of their eligible capital, and (2) if an exposure assessment according to the requirements of the principal approach results in higher individual and aggregate limits than the proposed 25% in Option 1 of the fallback approach. At first sight, these potentially higher limits if Option 2 is applied are apparently less conservative than the defined 25% limit in Option 1. However, as pointed out above, they reflect the real risk profile of exposures to shadow banking entities better than a fixed percentage, and therefore represent a more prudent approach that should be in the EBA's interest.

In light of the high level of requirements associated with the principal approach, institutions (particularly smaller and medium-sized institutions) should be free to choose the fallback approach. We do not share the concern that giving institutions such a choice would lead to regulatory arbitrage (see paragraph 29). In this context, we again call for an EU-wide QIS in particular for the assessment of questions 5 and 6.

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?

We wish to refer to our remarks above on question 5. In our opinion, a purely static aggregate internal imit of 25% for exposures to shadow banking entities in relation to an institution's eligible capital does not make allowance for any institution-specific characteristics regarding its risk management of exposures to shadow banking entities. Additionally, we wish to comment that the assumption of interconnectedness (correlation of 1) for all shadow banks implied by the application of a 25% limit to all shadow banks (Option 1) is unrealistic in our opinion and is evidently not shared by the EBA, which also expects interconnectedness between shadow banks to be examined when individual limits are set.

In our view, the proposed 25% aggregate internal limit is therefore not consistent with the large exposures regime, because the limit of 25% of eligible capital in the large exposure regime always only refers to a limit on the risk concentration in respect of an individual borrower or a group of connected clients. However, shadow banks as a whole do not represent a group of connected clients because of control or interconnectedness. Consequently, 25% is far too low for an aggregate limit. We wish to recall at this point that CRD II specified a limit of 800% of own funds for all of an institution's large exposures. In this case too, the limit referred only to those exposures that exceeded the 10% large exposure limit.

Moreover, the fallback approach would probably have to be used in particular by small and medium-sized regional institutions because it is more likely than not that the substantial process requirements of the principal approach cannot be met by banks of this size. From the viewpoint of these regional institutions, investments in funds, including for example in real estate funds with a national scope, help diversifying their portfolio, which is a positive factor from a risk perspective. Limiting these investments, together with the investments in other shadow banks, to an aggregate of 25% of eligible capital, would unreasonably disadvantage small and medium-sized institutions, including in terms of risk diversification.