



Public hearing on draft GL on limits on exposures to shadow banking entities

London, 18 May 2015

EBA's work so far

- Mandate to develop guidelines to set appropriate aggregate limits or tighter individual limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework (Article 395(2) of CRR)
- These guidelines will inform the Commission's report on the appropriateness and impact of imposing limits on exposures to shadow banking entities
- EBA draft guidelines published for consultation until 19 June. In particular, feedback is sought regarding the approach to:
 - Define 'shadow banking entities'
 - Establish effective processes and control mechanisms
 - Establish appropriate oversight arrangements
 - Establish aggregate and individual limits
 - Design the fallback approach

Content of the draft guidelines

- Guidance to institutions regarding the methodology that should be used, as part of their internal processes and policies, for addressing and managing concentration risk arising from exposures to shadow banking entities
- Guidance to institutions to set an aggregate limit on exposures to shadow banking entities, as well as tighter individual limits to exposures to such entities
- A simple fallback approach for setting-up of limits is offered in case it is impossible for the institution to apply the principal approach
- The guidelines apply to exposures to shadow banking entities with an exposure value $\geq 0.25\%$ of institution's eligible capital

Approach to the definition of ‘shadow banking entities’

- In the absence of a definition in the CRR of the terms ‘shadow banking entities’, ‘banking activities’ and ‘regulated framework’ it has been necessary to develop a definition of ‘shadow banking entity’ to establish the scope of the guidelines.
- A ‘hybrid’ approach has been proposed consistent with the approach set out in the EBA’s Opinion and Report on the perimeter of credit institutions.
- This involves two limbs:
 - the entity carries out one or more ‘credit intermediation activities’, and
 - the entity is not an ‘excluded undertaking’.
- The intention is to focus on institutions’ exposures to entities that pose the greatest risks both in terms of the direct exposures institutions face and also the risk of credit intermediation being carried out outside the regulated framework.

Approach to the definition of ‘shadow banking entities’ (cont.)

- ‘Credit intermediation activities’ are defined as bank-like activities involving:
 - maturity transformation;
 - liquidity transformation;
 - leverage;
 - credit risk transfer; or
 - similar activities.

- To assist institutions in identifying entities that are carrying out credit intermediation activities, the draft guidelines make clear that entities carrying out one or more activities listed in points 1-3, 6-8, 10 and 11 of Annex 1 of the CRD (e.g. lending and financial leasing) shall be regarded *automatically* as carrying out credit intermediation activities. This is not intended to be an exhaustive list of activities within the scope of ‘credit intermediation’.

- ‘Excluded undertakings’ are defined as:
 - undertakings included in consolidated supervision;
 - undertakings not included in consolidated supervision but which are supervised on a consolidated basis by third country competent authorities pursuant to a regime at least equivalent to that applied in the Union;
 - undertakings which are not within the scope of the above, but which are subject to appropriate and sufficiently robust prudential frameworks (e.g. credit institutions, investment firms, insurers and entities established in third countries which are subject to prudential requirements which are considered to be equivalent to those applied in the Union);
 - entities within the scope of Article 2(5) and 9(2) of CRD (e.g. post office giro institutions).

Approach to the definition of ‘shadow banking entities’ (cont.)

- A focus on funds:
 - Funds are generally considered to be part of the shadow banking sector due to their activities (in particular, maturity and liquidity transformation).
 - The crisis demonstrated the risks institutions face as a result of their exposures to funds (e.g. in terms of reputational, franchise and other risks).
 - Therefore it is proposed that all funds, except for non-MMF UCITS (and non-MMF funds subject to supervision equivalent to that prescribed in the UCITS Directive), should fall within the scope of the definition of ‘shadow banking entity’.
 - Non-MMF UCTIS (and non-MMF funds subject to equivalent third country prudential frameworks) have been carved out of the definition of ‘shadow banking entity’ as they are regulated pursuant to prudential frameworks similar to those applied to credit institutions and investment firms. Therefore such funds do not pose the same level of risk as unregulated funds. Nor do they pose the same level of risk as MMF UCITS which tend to be considerably larger than non-MMF UCITS.

Requirements on effective processes, control mechanisms and oversight

- Institutions should:
 - Identify exposures to shadow banking entities and potential risks arising from these exposures
 - Have in place a framework to identify, manage, control and mitigate identified risks
 - Take into account these risks in their ICAAP and capital planning
 - Have a robust process to determine interconnectedness
 - Have effective reporting procedures to the management body
 - Implement appropriate action plans to deal with breach of limits
- The institutions' management body should review and approve the institution's risk appetite towards exposures to shadow banking entities, the risk management process, the relative importance of these exposures and ensure that limits are set and documented.

Principal approach to setting-up limits

Setting-up an aggregate limit to exposures to shadow banking entities (% of eligible capital)

- Institutions should take into account:
 - Their business model, risk management framework, and risk appetite
 - Relative importance of their exposures to shadow banking entities
 - Interconnectedness

Setting-up additional individual limits to exposures to shadow banking entities (% of eligible capital)

- Institutions should take into account relevant info about the shadow banking entity (whether it is subject to prudential requirements or supervision, its financial situation, its portfolio, vulnerabilities, interconnectedness, etc)

Fallback approach

- Apply a limit of 25% of the institution's eligible capital to the aggregate exposures to shadow banking entities
- This approach can be used only if institutions are not able – due to insufficient information about the activities of shadow banking entities or to the lack of effective processes to use that information – to apply the principal approach
- Two options under consultation:
 - Option 1: apply the 25% limit to the sum of all exposures to shadow banking entities
 - Option 2: apply the 25% limit only to the sum of the exposures to shadow banking entities to which the institution is not able to apply the criteria defined in the guidelines (and apply the principal approach to set out individual limits for the remaining exposures and to set out an aggregate limit for all exposures)

Next steps

- Process the feedback from the public consultation and finalise the guidelines by year-end
- Guidelines to apply a number of months after their translation to all EU languages
- Institutions to comply with the guidelines
- Competent authorities to implement the guidelines in their supervisory processes and legal frameworks
- In parallel, the EBA is coordinating a data collection on institutions' exposures to shadow banking entities with the objective of assisting the Commission's work in relation to its report on the appropriateness and impact of imposing limits on exposures to shadow banking entities (last subparagraph of Article 395(2) of the CRR)

Hearing - 25 minutes for each of the following topics:
(please provide your name and organisation before your intervention)

- Approach to the definition of ‘shadow banking entities’
- Principles to establish effective processes and control mechanisms and appropriate oversight arrangements
- Criteria to determine aggregate and individual limits
- Fallback approach



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