

EBA/GL/2015/20

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03/06/2016

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## Guidelines

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Limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395(2) of Regulation (EU) No 575/2013

# 1. Compliance and reporting obligations

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## Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010<sup>1</sup>. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.
2. Guidelines set out the EBA's view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

## Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by 03/08/2016. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website to [compliance@eba.europa.eu](mailto:compliance@eba.europa.eu) with the reference 'EBA/GL/201x/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to the EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3) of Regulation (EU) No 1093/2010.

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<sup>1</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

## 2. Subject matter, scope and definitions

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### Subject matter

5. These guidelines specify the methodology that should be used by institutions, as part of their internal processes and policies, for addressing and managing concentration risk arising from exposures to shadow banking entities. In particular, these guidelines specify criteria for setting an appropriate aggregate limit on exposures to shadow banking entities which carry out banking activities outside a regulated framework, as well as individual limits on exposures to such entities.

### Scope of application

6. These guidelines fulfil the mandate given to the EBA under Article 395(2) of Regulation (EU) No 575/2013<sup>2</sup>.
7. These guidelines build in particular on Articles 73 and 74 of Directive 2013/36/EU<sup>3</sup>, which require institutions to have sound, effective and comprehensive strategies and processes to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they are or might be exposed, as well as effective processes to identify, manage, monitor and report such risks and adequate internal control mechanisms; and Articles 97 and 103 of Directive 2013/36/EU, which establish that competent authorities must review the arrangements, strategies, processes and mechanisms implemented by institutions to comply with Regulation (EU) No 575/2013 and Directive 2013/36/EU, and evaluate the risks to which the institutions are or might be exposed, and that they may apply the supervisory review and evaluation process (SREP) to institutions which are or might be exposed to similar risks or pose similar risks to the financial system.
8. These guidelines apply to exposures to shadow banking entities as defined below.
9. These guidelines apply to institutions to which Part Four of Regulation (EU) No 575/2013 (Large Exposures) applies, in accordance with the level of application set out in Part I, Title II, of that Regulation.

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<sup>2</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) no 648/2012 (OJ L 321, 30.11.2013, p. 6).

<sup>3</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

## Addressees

10. These guidelines are addressed to competent authorities as defined in point (i) of Article 4(2) of Regulation (EU) No 1093/2010 and to financial institutions as defined in Article 4(1) of Regulation No 1093/2010.

## Definitions

11. Unless otherwise specified, terms used and defined in Regulation (EU) No 575/2013 and Directive 2013/36/EU have the same meaning in the guidelines. In addition, for the purposes of these guidelines, the following definitions apply:

<p><b><i>Credit intermediation activities</i></b></p>	<p>Bank-like activities involving maturity transformation, liquidity transformation, leverage, credit risk transfer or similar activities.</p> <p>These activities include at least those listed in the following points of Annex 1 of Directive 2013/36/EU: points 1 to 3, 6 to 8, and 10.</p>
<p><b><i>Exposures to shadow banking entities</i></b></p>	<p>Exposures to individual shadow banking entities pursuant to Part Four of Regulation (EU) No 575/2013 with an exposure value, after taking into account the effect of the credit risk mitigation in accordance with Articles 399 to 403 and exemptions in accordance with Articles 400 and 493(3) of that Regulation, equal to or in excess of 0.25% of the institution's eligible capital as defined in Article 4(1)(71) of Regulation (EU) No 575/2013.</p>
<p><b><i>Shadow banking entities</i></b></p>	<p>Undertakings that carry out one or more credit intermediation activities and that are not excluded undertakings.</p>
<p><b><i>Excluded undertakings</i></b></p>	<p>(1) undertakings included in consolidated supervision on the basis of the consolidated situation of an institution as defined in Article 4(1)(47) of Regulation (EU) No 575/2013.</p> <p>(2) undertakings which are supervised on a consolidated basis by a third country competent authority pursuant to the law of a third country</p>

which applies prudential and supervisory requirements that are at least equivalent to those applied in the Union.

(3) undertakings which are not within the scope of points (1) and (2) but which are:

(a) credit institutions;(b) investment firms;

(c) third country credit institutions if the third country applies prudential and supervisory requirements to that institution that are at least equivalent to those applied in the Union;

(d) recognised third country investment firms;

(e) entities which are financial institutions authorised and supervised by the competent authorities or third country competent authorities and subject to prudential requirements comparable to those applied to institutions in terms of robustness where the institution's exposure(s) to the entity concerned is treated as an exposure to an institution pursuant to Article 119(5) of Regulation (EU) No 575/2013;

(f) entities referred to in points (2) to (23) of Article 2(5) of Directive 2013/36/EU;

(g) entities referred to in Article 9(2) of Directive 2013/36/EU;

(h) insurance holding companies, insurance undertakings, reinsurance undertakings and third country insurance undertakings and third-country reinsurance undertakings where the supervisory regime of the third country concerned is deemed equivalent;

(i) undertakings excluded from the scope of Directive 2009/138/EC<sup>4</sup> in accordance with

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<sup>4</sup> Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) (recast) (OJ L 335, 17.12.2009, p. 1).

Article 4 of that Directive;

(j) institutions for occupational retirement provision within the meaning of point (a) of Article 6 of Directive 2003/41/EC<sup>5</sup> or subject to prudential and supervisory requirements comparable to those applied to institutions within the meaning of point (a) of Article 6 of Directive 2003/41/EC in terms of robustness;

(k) undertakings for collective investment:

(i) within the meaning of Article 1 of Directive 2009/65/EC<sup>6</sup>;

(ii) established in third countries where they are authorised under laws which provide that they are subject to supervision considered to be equivalent to that laid down in Directive 2009/65/EC;

(iii) within the meaning of Article 4(1)(a) of Directive 2011/61/EU<sup>7</sup> with the exception of:

- undertakings employing leverage on a substantial basis according to Article 111(1) of Commission Delegated Regulation (EU) 231/2013<sup>8</sup> and/or
- undertakings which are allowed

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<sup>5</sup> Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision (OJ L 235, 23.9.2003, p. 10).

<sup>6</sup> Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) (OJ L 302, 17.11.2009, p. 32).

<sup>7</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (OJ L 174, 1.7.2011, p. 1).

<sup>8</sup> Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (OJ L 83, 22.3.2013, p. 1).

to originate loans or purchase third party lending exposures onto their balance-sheet pursuant to the relevant fund rules or instruments of incorporation;

(iv) which are authorised as ‘European long-term investment funds’ in accordance with Regulation (EU) 2015/760<sup>9</sup>;

(v) within the meaning of Article 3(1)(b) of Regulation (EU) 346/2013<sup>10</sup> (‘qualifying social entrepreneurship funds’);

(vi) within the meaning of Article 3(b) of Regulation (EU) 345/2013<sup>11</sup> (‘qualifying venture capital funds’).

except undertakings that invest in financial assets with a residual maturity not exceeding two years (short-term assets) and have as distinct or cumulative objectives offering returns in line with money market rates or preserving the value of the investment (money market funds);

(l) central counterparties (CCPs) as defined in point (1) of Article 2 of Regulation (EU) No 648/2012<sup>12</sup> established in the EU and third country CCPs recognised by ESMA pursuant to

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<sup>9</sup> Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds (OJ L 123, 19.5.2015, p. 98).

<sup>10</sup> Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds (OJ L 115, 25.4.2013, p. 18).

<sup>11</sup> Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds (OJ L 115, 25.4.2013, p. 1).

<sup>12</sup> Regulation (EU) 648/2012 of European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1).

Article 25 of that Regulation;

(m) electronic money issuers as defined in point (3) of Article 2 of Directive 2009/110/EC<sup>13</sup>;

(n) payment institutions as defined in point (4) of Article 4 of Directive 2007/64/EC<sup>14</sup>;

(o) entities the principal activity of which is to carry out credit intermediation activities for their parent undertakings, for their subsidiaries or for other subsidiaries of their parent undertakings;

(p) resolution authorities, asset management vehicles and bridge institutions as defined in points (18), (56) and (59) of Article 2(1) of Directive 2014/59/EU<sup>15</sup> and entities wholly or partially owned by one or more public authorities established prior to the 1 January 2016 for the purpose of receiving and holding some or all of the assets, rights and liabilities of one or more institutions in order to preserve or restore the viability, liquidity or solvency of an institution or to stabilise the financial market.

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<sup>13</sup> Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (OJ L 267, 10.10.2009, p. 7).

<sup>14</sup> Directive 2007/64/EC of the European Parliament and of the Council of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC (OJ L 319, 5.12.2007, p. 1).

<sup>15</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU and Regulations (EU) No 1093/2010 and (EU) No 648/2012 of the European Parliament and of the Council (OJ L 173, 12.6.2014, p.190).



## 3. Implementation

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### Date of application

12. These guidelines apply from 01.01.2017.

## 4. Requirements regarding limits to exposures to shadow banking entities

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13. Institutions should comply with the general principles referred to in this section, as well as set limits as referred to under Section 5, as applicable.

### Effective processes and control mechanisms

14. Institutions should:

- a. Identify their individual exposures to shadow banking entities, all potential risks to the institution arising from those exposures, and the potential impact of those risks.
- b. Set out an internal framework for the identification, management, control and mitigation of the risks outlined in point a). This framework should include clearly defined analyses to be performed by risk officers regarding the business of a shadow banking entity to which an exposure arises, the potential risks to the institution and the likelihood of contagion stemming from these risks to the entity. Those analyses should be performed under the supervision of the credit risk committee, which should be duly informed of the results.
- c. Ensure that risks outlined in letter a) are adequately taken into account within the institution's Internal Capital Adequacy Assessment (ICAAP) and capital planning.
- d. Based on the assessment conducted under letter a), set the institution's risk tolerance/risk appetite for exposures to shadow banking entities.
- e. Implement a robust process for determining interconnectedness between shadow banking entities, and between shadow banking entities and the institution. This process should in particular address situations where interconnectedness cannot be determined, and set out appropriate mitigation techniques to address potential risks stemming from this uncertainty.
- f. Have effective procedures and reporting processes to the management body regarding exposures to shadow banking entities within the institution's overall risk management framework.
- g. Implement appropriate action plans in the event of a breach of the limits set by the institution in accordance with Section 5.

## Oversight by the management body of the institutions

15. When overseeing the application of the principles referred to above as well as the application of limits set out in accordance with the principal approach in Section 5, the institution's management body should, on a regular predetermined basis:
  - a. review and approve the institution's risk appetite to exposures to shadow banking entities and the aggregate and individual limits set in line with Section 5;
  - b. review and approve the risk management process to manage exposures to shadow banking entities, including analysis of risks arising from those exposures, risk mitigation techniques and potential impact on the institution under stressed scenarios;
  - c. review the institution's exposures to shadow banking entities (on an aggregate and individual basis) as a percentage of total exposures and expected and incurred losses;
  - d. ensure the setting of the limits referred to in these guidelines is documented, including any changes to them.
  
16. The institution's management body may delegate the reviews set out in paragraph 15 a) to d) to senior management.

## 5. Principal approach for setting limits to exposures to shadow banking entities

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### Setting an aggregate limit on exposures to shadow banking entities

17. Institutions should set an aggregate limit to their exposures to shadow banking entities relative to their eligible capital.
18. When setting an aggregate limit to exposures to shadow banking entities, each institution should take into account:
  - a. its business model, risk management framework as outlined in paragraph 14b), and risk appetite as outlined in paragraph 14d);
  - b. the size of its current exposures to shadow banking entities relative to its total exposures and relative to its total exposure to regulated financial sector entities;
  - c. interconnectedness as outlined in paragraph 14e).

### Setting individual limits on exposures to shadow banking entities

19. Independently of the aggregate limit, and in addition to it, institutions should set tighter limits on their individual exposures to shadow banking entities. When setting those limits, as part of their internal assessment process, the institutions should take into account:
  - a. the regulatory status of the shadow banking entity, in particular whether it is subject to any type of prudential or supervisory requirements;
  - b. the financial situation of the shadow banking entity including, but not limited to, its capital position, leverage and liquidity position;
  - c. information available about the portfolio of the shadow banking entity, in particular non-performing loans;
  - d. available evidence about the adequacy of the credit analysis performed by the shadow banking entity on its portfolio, if applicable;
  - e. whether the shadow banking entity will be vulnerable to asset price or credit quality volatility;
  - f. concentration of credit intermediation activities relative to other business activities of the shadow banking entity;
  - g. interconnectedness as outlined in paragraph 14 e);
  - h. any other relevant factors identified by the institution under paragraph 14 a).

## 6. Fallback approach

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20. If institutions are not able to apply the principal approach as set out in Section 5, their aggregate exposures to shadow banking entities should be subject to the limits on large exposures in accordance with Article 395 of Regulation (EU) No 575/2013 (including the use of Article 395(5) of the same Regulation) ('the fallback approach').
21. The fallback approach should be applied in the following way:
- a) If institutions cannot meet the requirements regarding effective processes and control mechanisms or oversight by their management body as set out in Section 4, they should apply the fallback approach to all their exposures to shadow banking entities (i.e. the sum of all their exposures to shadow banking entities).
  - b) If institutions can meet the requirements regarding effective processes and control mechanisms or oversight by their management body as set out in Section 4, but cannot gather sufficient information to enable them to set out appropriate limits as set out in Section 5, they should only apply the fallback approach to the exposures to shadow banking entities for which the institutions are not able to gather sufficient information. The principal approach as set out in Section 5 should be applied to the remaining exposures to shadow banking entities.