INVEST EUROPE

European Banking Authority (EBA)
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18 October 2021

Subject: EBA Consultation on the criteria for the identification of shadow banking entities

Dear Ms Vaillant,

With this letter we would like to provide our views, on the draft regulatory technical standards the European Banking Authority has prepared to define criteria for the identification of shadow banking entities (RTS) under Article 394(4) of Regulation (EU) No 575/2013.

While our members, European managers of private equity funds, will not be captured as shadow banking entities under the proposed approach, we did want to share our thoughts on the potential implications of the EBA's method.

First, we provide our full support to the EBA's decision, in Article, paragraph 5, section ii) of the RTS that only funds that are substantially leveraged should be considered as shadow bank entities. The AIFMD cross-reference represents a substantial improvement compared to previous EBA guidance. We however note that a more complete, "self-standing" reference to "AIFs with an exposure (calculated according to the commitment method under Article 8 of Regulation Commission Delegated Regulation (EU) 231/2013) which exceeds three times its net asset value" would likely provide more clarity than a simple cross-reference.

We also appreciate the statement made in the Consultation paper Background & Rationale (Section 3, paragraph 76) that "*only exposures to AIFs that do not employ leverage on a basis according to Article 111(1) of Delegated Regulation 231/2013* ***and*** *that do not grant loans or purchase third parties' lending exposures onto their balance sheet should be excluded from being identified as shadow banking entities*".

An RTS based on this statement would have ensured that only AIFs that generate their own exposures while being substantially leveraged would be deemed as shadow banks. This would in our view have put under the right amount of scrutiny non-bank entities effectively performing banking services that are prone to create a systemic risk. Finally, it would also have been closest to the limits of Article 394(4)'s mandate as it would have best " *take[n] into account international developments and internationally agreed standards on shadow banking*".

It is therefore disappointing that, in the actual draft of the RTS, the EBA appears to have taken a stricter approach, and introduced a simple positive step (as opposed to a double negative one) where any AIFMD manager is, irrespective of its other activities, considered as a shadow bank as soon as the fund it is managing is substantially leveraged.

We do not question that the use of substantial leverage in a fund context can give rise to systemic concerns and that this should be addressed as part of the relevant EU law.

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Nonetheless, the approach chosen will lead to a situation where entities will be deemed “shadow banks” irrespective of whether:

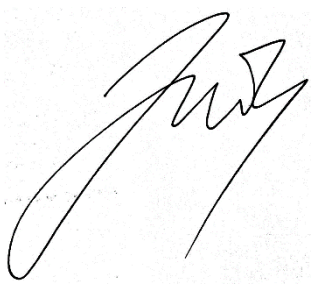
- they are regulated under EU law
- they are or not involved in lending activities
- they are effectively interconnected with the rest of the financial system

While the proposed EBA definition of a shadow banking entity may be relevant for the purpose of Article 394, it is in our view not sufficiently sophisticated and could as such constitute an unhelpful precedent for the future, leading to regulatory confusion as to the actual risk these funds pose. This is certainly true from the perspective of the private equity industry, where funds are rarely using debt at fund level other than when such debt is backed by uncalled commitments, and which, could in exceptional situations be deemed “shadow banks”.

Perhaps one of the major concerns we have as alternative investment fund representatives is the description the EBA makes of the AIFMD as a framework where "some risks arising directly from the funds themselves are not mitigated satisfactorily". As we show in the regulatory table attached, AIFMD and UCITS introduced similar rules when it comes to the use of leverage – and we see no reason to distinguish the two from a prudential perspective.

We stand at the disposal of the European Banking Authority should it need any additional information on the views shared in this letter.

Kind regards,



Martin Bresson
Public Affairs Director – Invest Europe

Appendix: UCITS / AIFMD Overview Table

Directive 2009/65	Requirements applicable at fund level	Directive 2011/61
Articles 5 and 27	Prior authorisation of the UCITS is required. / Prior authorisation of the AIF internally managed required.	Article 5
Article 14 b para. 3	Remuneration policy principles apply at fund level.	Article 13
Article 15	Investment companies must have appropriate procedures in place to deal properly with investor complaints.	(professional investors - not retail, Article 43)
Article 22	Appointment of a single depositary by the fund is mandatory.	Article 21
Article 25 para 2	In carrying out their functions, the fund and the depositary must act fairly and solely in the interest of the UCITS.	Article 21
Article 29 para 1	A UCITS without management company must hold higher initial capital, and respect additional rules (disclosure of information, rules on conflict of interest). / An internally managed AIF must hold higher initial capital.	Article 9
Article 30	Requirements applicable to the managing companies will apply to the UCITS if it has not designated a managing company. UCITS may only manage assets of their own portfolio.	-
-	In cases of failure of an AIFM to ensure compliance with the applicable requirements of an AIF, the competent authorities can require the AIFM to resign as manager of that AIF.	Recital 11 and Article 5(3)
Article 51 para 1	Risk management processes must be in place, including risk limits for AIFs.	Article 15
Articles 52 et s.	Requirements on diversification of assets, concentration of exposure, and limits on acquisition of voting rights apply.	-
-	Liquidity management systems must be in place.	Article 16
-	Securitisation requirements apply.	Article 17
Articles 68 et s.	Disclosure requirements apply.	Articles 22 and 23
Article 76	Regular reports must be published regarding the issue, sale, repurchase or redemption price of the UCITS' units. / Valuation requirements apply for each AIF managed by an AIFM.	Article 19
Article 83	Prohibition of borrowing. There may be temporary exceptions to that principle. / Limits on leverage used by the AIFM are supervised by the competent authority.	Article 25
Article 84	UCITS are open-ended: they must repurchase or redeem its units at the request of any unit-holder. / AIFs may be open-ended or closed-ended.	Article 2 (2) (a)
Article 88	UCITS shall not grant loans or act as a guarantor on behalf of third parties.	-

Directive 2009/65	Requirements applicable at manager level	Directive 2011/61
Article 6 para 1	MCs/AIFMs must obtain prior authorisation from national authorities to acquire their "passport".	Articles 6(1) and 7
Article 6 para 2	MCs/AIFMs may engage in investment management, administration and marketing activities. Exceptionally, they may undertake discretionary portfolio management service.	Article 6(2) to (4)

Directive 2009/65	Requirements applicable at manager level	Directive 2011/61
Article 7 para 1	MCs/AIFMs must have initial capital, and additional own funds depending on portfolio value.	Article 9
Articles 7 and 12, para 1	MCs/AIFMs must respect rules regarding conflict of interests.	Articles 12 (1) (d) and 14
Article 8 (1) and 12 para 1	MCs/AIFMs must insure the sound and prudent management of the management company.	Articles 8 (1) and 12
Article 13	Delegation of functions by the MCs/AIFMs is possible, provided it does not become a letter-box entity.	Article 20
Article 14	MCs/AIFMs must act in the best interests of the fund it manages, avoid conflicts of interests.	Article 12
Articles 14a and 14b	MCs/AIFMs must implement remuneration policies that are consistent with sound and effective risk management.	Article 13
Article 15	MCs must establish appropriate procedures and arrangements to deal properly with investor complaints.	(professional investors - not retail, Article 43)
Article 18 para 1 and 4	Any MC undertaking activities under the freedom to provide services must inform its (home) authority.	Article 33
Article 19 para 4	The MC must comply with the fund rules, the instruments of incorporation, and the prospectus.	Article 18
Article 20 para 1 and 4	A MC which applies to manage a UCITS established in another Member State must provide the competent authorities of the UCITS home Member State with documentation regarding the depositary and delegation arrangements.	Article 33
Article 22	A MC must ensure that a single depositary is appointed.	Article 21 para 1
Article 25 para 2	In carrying out their [respective] functions, the MC/AIFM [and the depositary] must act fairly and in the interest of the fund and its investors.	Article 21 para 10
Article 51 para 1	Risk management processes/systems must be in place.	Article 15
Article 56 para 1	A MC must not acquire any shares carrying voting rights which would enable it to exercise significant influence over the management of an issuing body. / Additional obligations apply in case of acquisition of control by an AIF managed by an AIFM.	Articles 26 to 30
Article 68 para 1 and 2, 69 para 1,2,3,4; 70 para 1 and 2,3,71,72	A MC/AIFM must disclose information to investors.	Articles 22 and 23
Article 83 para 1	The MC is prohibited from borrowing or granting loans. / Limits on leverage used by the AIFM are supervised by the competent authority.	Article 15(4) and Article 25

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Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance and transparency from our members.

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