TSI's comments
on the EBA's Consultation Paper
Draft EBA Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395 para. 2 Regulation (EU) No. 575/2013 of 19 March 2015

General remarks

We essentially welcome all measures to increase financial market stability. We also consider that the following objectives to secure financial market stability – generally referred to in connection with the regulation of shadow banking – make good sense:

a) Prevention of excessive engagements with shadow banks

b) Creating transparency with regard to unregulated shadow banking

c) No circumvention of banking regulation

At the same time, in view of the regulatory objectives and their impact, we consider it vital to harmonise the current regulatory proposal with existing rules and regulations. Measures to achieve the stated objectives should have no negative impact on the real economy.

Measures to limit exposure to "shadow banks" could well be an appropriate way of increasing financial market stability if the term "shadow banking" is unambiguously defined and the measures are accordingly pursued to the letter and if, in so doing, sight is not lost of any impact for the real economy. The European legislator appears to see things that way as Article 395 (2) of the CRR, on which the Consultation Paper is based, includes the following stipulation: "In developing those guidelines, EBA shall consider whether the introduction of additional limits would have a material detrimental impact on the risk profile of institutions established in the Union, **<u>on the provision of credit to the real economy</u>** or on the stability and orderly functioning of financial markets."

The present Consultation Paper does not seem to consider the effects on the real economy deriving from the definition of the sphere of application of shadow banks and their limitation, contrary to what is stipulated in Article 395(2) of the CRR. However, we deem it essential to consider such effects if adequate account is to be taken of the legislator's clearly perceivable intention of avoiding negative impact on the real economy.

The definition of the term "shadow bank" is too broad and therefore imprecise, as discussed below.

The definition of shadow banks proposed in the draft is, in our opinion, too broad and thus goes wide of the intended mark. As the main causes for disruptions in the shadow banking system, the EBA refers in 3.1 No 2 to "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 that analysis. However, the rules on limitations for shadow banks should then also apply to enterprises with a similar risk profile. The proposed guidelines also affect structures that have no increased risks giving rise to the "concerns" referred to under 3.1.1. Run risks and/or liquidity risks generated by high leverage and liquidity and maturity mismatches, contagion risks generated by interconnectivity and spill overs generated notably by drawing credit commitments and opaqueness and complexity in times of stress are cited as specific risks that require supervisory attention. **<u>The guidelines should therefore be structured so as to include institutions with the risk profiles cited under 3.1.1 in the shadow bank regulation while other enterprises that are covered by the proposed definition of "shadow banks" but that present no risks of the same kind are removed from the sphere of application of the rules for shadow banks.</u>**

If this is not done, a blanket limitation of "shadow banks" in the sense of the proposed definition will lead to clearly negative repercussions on the real economy, as the very broad definition of "shadow banks" will include enterprises that would not normally be associated with the term "shadow bank". These include, for example, companies financing industrial enterprises which raise funds in the money and capital markets as well as through banks. However, they would also include non-actively managed special purpose vehicles (SPVs) used for the purpose of refinancing securitised receivables belonging to the Originator, which are backed by the financing of real economic goods. The purpose of such companies is completely different from that of an unregulated, actively managed hedge fund, for example. Therefore, such companies, which have a completely different risk profile and for which there is no evidence of their having been the source of systemic risk in the past, should also not be lumped together with unregulated shadow banks, which actually present increased risk. SPVs from such securitisations should therefore be excluded from the sphere of application of the Guideline and included in the circle of "excluded undertakings". Otherwise the banks' exposures to securitisation SPVs would be *de facto* subject to a double regulatory restriction: large loans and shadow banks. What is more, at banks these exposures are already subject to extensive and detailed regulation with regard to the analytical, monitoring and decision-making processes, with the result that additional regulation is not required in this connection.

What would the potential impact of Option 1, preferred by the EBA, otherwise be for the securitisation market?

Our assumption is that by implementing Option 1, the European securitisation market would be brought to a standstill as exposures to "shadow banks" within the meaning of the proposed definition, which do not fulfil the requirements of the "Principal Approach", would become the rule. In that case, the bank with all exposures to "shadow banks" , i.e. investments in securitisations, funds and receivables vis-à-vis leasing companies, factoring companies, finance companies, etc. would be limited to 25% of the eligible capital. It would then cease *de facto* to be possible for banks to invest in or to structure and retain risk positions from securitisation positions because of the negative spill over effect.

Open questions

The limitation which should be considered pursuant to Article 395(2) of the CRR at the aggregated and individual levels should, in our opinion, be viewed in the context of the rules governing large loans. Taking particular account of the impact on the real economy, consideration should be given to introducing an aggregated limit and lower limits at the individual level. Our impression is that the proposed rules cannot be consistently introduced into the system of rules for large loans. This means that the draft leaves a number of questions open, for example with regard to the rules on forming a group of connected clients or interplay with the look-through requirements pursuant to Article 390(7) of the CRR read in conjunction with the implementation Regulation (EU) No 1187 / 2014.

Specific remarks

Q1: Do you agree with the approach the EBA has proposed for the purposes of defining shadow banking entities? In particular:

- **Do you consider that this approach is workable in practice? If not, please explain why and present possible alternatives?**

- **Do you agree with the proposed approach to the exclusion of certain undertakings, including the approach to the treatment of funds? In particular, do you see any risks stemming from the exclusion of non-MMF UCITS given the size of the industry? If you do not agree with the proposed approach, please explain why not and present the rationale for the alternative approach(es) (e.g. on the basis of specific prudential requirements, redemption limits, maximum liquidity mismatch and leverage etc.).**

Under the EBA's proposals, the definition of the term "shadow bank" includes enterprises that are credit intermediaries and do not fall under the exceptions defined in the guidelines as direct or consolidate supervision.

As we see it, shadow banks are previously unregulated players that are active in the financial market and that generate increased risks, as discussed in 3.1.1 of the EBA's Consultation Paper. However, the general definition of "credit intermediation" is not sufficiently precise and leads to problems of overlap. In principle, every enterprise carries out liquidity transformation, for example. Furthermore, most capital market financing is processed in the real economy sector via subsidiaries. We therefore consider it necessary to widen the circle of "excluded undertakings".

According to the EBA's proposals, securitisation special purpose vehicles (SPVs) should all be considered shadow banks unless the SPV is part of a group in consolidated supervision. The assumption here is that securitisation SPVs are at present insufficiently regulated unless they are part of a supervisory consolidation. This view is in contradiction with the extensive regulatory initiatives for securitisation structures in recent years. On the basis of the current rules on capital determination, the liquidity coverage ratio, look through in the large loan regime, minimum excess and disclosure rules, which are, for banks, explicit with regard to securitisations, securitisation SPVs are already sufficiently regulated indirectly.

Account should also be taken of the fact that the purpose that is linked in many ways with securitisations for banks of obtaining equity relief through significant and effective risk transfer pursuant to Articles 243, 244 of the CRR read in conjunction with the EBA Guidelines on significant risk transfer (SRT) for securitisation transactions of 7 July 2014 requires, however, that SPVs are not subject to the capital requirements of the institutional or financial holding group at the consolidated level. If this were not the case, supervisory consolidation would render capital requirements impossible. Furthermore, account should be taken of the fact that the European regulator is already extensively involved in scrutinising this kind of capital/risk management transactions through the aforementioned EBA Guidelines.[1] There is no doubt that the exposure from securitisation transactions or vis-à-vis securitisation companies that banks retain under consolidated supervision is taken into account and backed with equity or limited by the large exposure rules.

The same applies to ABCP structures sponsored by banks. In that case customer receivables are purchased via securitisation companies and refinanced via the capital market as asset backed commercial paper. The sponsoring bank provides a fully supporting liquidity facility. Extensive regulatory stipulations also already apply to this kind of ABCP programme. For instance, the CRR contains detailed rules for sponsors with regard to risk assessment and capital backing. Particular reference should be made at this juncture to the internal assessment approach (IAA) under Article

[1] EBA Guidelines on Significant Credit Risk Transfer relating to Articles 243 and Article 244 of Regulation 575/2013, p. 5 ff.

259(3) of the CRR. As long as ABCP programmes are "fully supported", i.e. the liquidity bank also vouches for losses that would accrue to an issued ABCP, from risk perspectives an investor purchasing ABCP enters into a secured exposure vis-à-vis a regulated bank. Moreover, individual rules already apply to this special type of transaction in the CRR for the purpose of taking account of liquidity risk and large loan risk.

To sum up, it can be seen that when drafting additional regulations and limitations for shadow banks, account should be taken of the fact that the institutions' engagements in the securitisation vehicle are already subject to extensive regulatory stipulations (e.g. EU securitisation regulations in accordance with Part 3, Chapter 5, in the context of the large loan rules pursuant to Article 390(7) read in conjunction with Delegated Regulation (EU) No 1187/2014 as regards regulatory technical standards for determining overall exposure to a client or a group of connected clients in respect of transactions with underlying assets and Part 5 of the CRR). In our opinion, securitisation transactions and hence receivables vis-à-vis SPVs are therefore appropriately taken into account and limited under banking supervision. We therefore consider that an additional limitation for securitisations would be inappropriate. If the EBA were to conclude that this is necessary despite the concerns raised, at least special purpose vehicles without active management that are used to refinance securitised receivables belonging to the Originator (bank), which are backed by the financing of real economic goods, should be excluded from the term "shadow bank" and included in the circle of "excluded undertakings". As we see it, the purpose and risk profile of such SPVs are completely different from exposures to an unregulated actively managed hedge fund, for example. This is also a valid consideration, particularly since such securitisation transactions referred to here have led to no systemic risks in the past.

At present, an initiative is being furthered – in particular by the European Commission – to support the European economy by affording regulatory privileges to simple, standard and transparent securitisations with real economic advantages. A more far-reaching regulation and limitation of such transactions, for example by issuing additional separate internal individual and aggregate limits, generates no value added in supervisory terms. Rather, this would run counter to the ongoing activities of the EU (capital markets union) and European banking supervision to create a high quality securitisation segment and would nullify the efforts of the European Commission to promote the development and expansion of the securitisation market.

In particular, we wonder how the new rule for simple, standard and transparent securitisations proposed by the EU in the context of the capital markets union could be harmonised with the proposed shadow bank regulation for securitisations.

However there will be a number of securitisations that are important for the real economy but not qualifying as STS transactions although they are not actively managed, are not open to any follow-up financing risk and whose sole purpose is to issue asset backed securities to refinance/protect the Originator. Here again there is little point in including these in a shadow banking regulation. That applies, in particular if, as a CRR institution or part of a supervised institution or financial holding group, the Originator of the receivables is itself an "excluded undertaking". In the context of traditional securitisations, an SPV is established for the purpose of enabling insolvency-remote transfer of the securitised receivables, so as to collateralise the asset backed securities and to give the trustee exclusive access to the collateral for the benefit of the investors. This is intended to avoid securitised receivables being included in the Originator's insolvency estate, and to avoid that the creditworthiness of the SPV therefore depends on the creditworthiness of the Originator. The purpose of this kind of refinancing is to make it possible for the Originator to raise funds largely without reference to its creditworthiness. The refinancing terms should being dependent mainly on the quality of the securitised receivables and the guaranteed credit enhancements. Repayment of the asset backed securities depends on the amortisation profile of the securitised receivables. This kind of refinancing increases the diversification of the Originator's sources of funds and helps to reduce its liquidity risk. Contagion risks can likewise not be expected if the cash flows of the securitisation receivables are used to service the asset backed securities and no liquidity line is needed to hedge against follow-up refinancing risk. In addition, these asset backed securities are in many ways central bank eligible and can be used to obtain liquidity from the central bank.

Beyond true sale transactions synthetic securitisation structures are broadly used by banks for purposes associated with their risk and capital management. In particular, such capital-releasing transactions are an important instrument for capital management at banks and thus for the credit supply of the real economy. Most of the above arguments apply for such structures as well.

TSI – What we do

Securitisation in Germany and TSI – the two belong together. True Sale International GmbH (TSI) was set up in 2004 as an initiative of the German securitisation industry with the aim of promoting the German securitisation market.
Nowadays TSI Partners come from all areas of the German securitisation market – banks, consulting firms and service providers, law firms, rating agencies and business associations. They all have substantial expertise and experience in connection with the securitisation market and share a common interest in developing this market further. TSI Partners derive particular benefit from TSI's lobbying work and its PR activities.
Furthermore TSI's concern has always been to establish a brand for German securitization which is founded on clearly defined rules for transparency, disclosure, lending and loan processing. Detailed guidelines and samples for investor reporting ensure high transparency for investors and the Originator guarantees, by means of a declaration of undertaking, the application of clear rules for lending and loan processing as well as for sales and back office incentive systems. The offering circular, the declaration of undertaking and all investor reports are publicly available on the TSI website, thus ensuring free access to relevant information.

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Another objective has always been to give banks an opportunity to securitise loans under German law on the basis of a standardised procedure agreed with all market participants.
And finally the goal is to create a platform for the German securitization industry and its concerns and to bridge the gap to politics and industry.

Events and Congress of TSI

Events of TSI provide opportunities for specialists in the fields of economics and politics to discuss current topics relating to the credit and securitisation markets. The TSI Congress in Berlin is the annual meeting place for securitisation experts and specialists from the credit and loan portfolio management, risk management, law, trade and treasury departments at banks, experts from law firms, auditing companies, rating agencies, service providers, consulting companies and investors from Germany and other countries. Many representatives of German business and politics and academics working in this field take advantage of the TSI Congress to exchange professional views and experience. As a venue, Berlin is at the pulse of German politics and encourages an exchange between the financial market and the world of politics.