EBA/GL/2015/20

14 December 2015

Guidelines

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

Contents

1. Executive Summary

Under Article 395(2) of Regulation (EU) No 575/2013, the EBA has a 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.

The global financial crisis has revealed previously unrecognised fault lines which can transmit risk from the shadow banking system to the regulated banking system, putting the stability of the entire financial system at risk.

From a microprudential perspective, shadow banking entities are generally not subject to the same standards of prudential regulation as core regulated entities such as institutions, do not provide protection to investors' investment from these entities' failures, and do not have access to central banks' liquidity facilities. To the extent that shadow banking entities carry out bank-like activities, exposures to such entities may therefore be inherently risky - and thus specific limits for individual and aggregate exposures could be warranted.

Macro prudentially, institutions' exposures to shadow banking entities could be of concern for different reasons. Here, institutions' exposures to such entities undertaking bank-like activity may lead to regulatory arbitrage concerns, and worries that core banking activity may migrate systematically away from the regulated sector 'into the shadows'. In order to seek profits, institutions may still actively seek ways to arbitrage the rules by funding shadow banking entities. These entities, which are potentially more vulnerable to runs and/or liquidity problems, tend to be highly correlated and interconnected with the banking sector, which leads to financial stability concerns.

To minimise the risks posed to institutions arising from their exposures to shadow banking entities, the guidelines lay down requirements for institutions to set limits, as part of their internal processes, on their individual exposures to shadow banking entities (alleviating primarily the microprudential concerns expressed above) and on their aggregate exposure to shadow banking entities (alleviating macroprudential concerns).

In the absence of a definition in Regulation (EU) No 575/2013 of the terms 'shadow banking entities', 'banking activities' and 'regulated framework', it has been necessary to develop a definition of those terms for the purposes of the guidelines. The definitions proposed are in line with the previous EBA Opinion and Report on the perimeter of credit institutions[1] and aim at capturing entities that are not subject to appropriate prudential regulation and supervision, and therefore pose the greatest risks.

1 The Opinion and Report are available here: http://www.eba.europa.eu/-/eba-publishes-an-opinion-on-the-perimeter-of-credit-institutions.

To better understand the relevance of institutions' exposures to shadow banking entities and the impact of potential limits, a data collection was conducted and the results published in a separate report. The scope of the data collection was, however, broader than the current scope of the guidelines so as to provide a sound basis for the calibration of any limits and to assist the European Commission's work in relation to its report on the appropriateness and impact of imposing limits on exposures to shadow banking entities under the last subparagraph of Article 395(2) of Regulation (EU) No 575/2013.

In prescribing the approach institutions should adopt for the purposes of setting appropriate individual and aggregate limits for exposures to shadow banking entities, these guidelines will establish a harmonised approach for mitigating the risks identified above and will also inform the European Commission's report.

Next steps

The guidelines will be translated into the official EU languages and published on the EBA website. The deadline for competent authorities to report on whether they comply with the guidelines will be two months after the publication of the translations. The guidelines will apply from 01/01/2017.

2. Background and rationale

2.1 General background

1. Shadow banking can complement traditional banking by expanding valuable access to credit in support of economic activity or by supporting market liquidity, maturity transformation and risk sharing, thereby supporting growth in the real economy. For example, various types of non-bank funds have stepped in (often as intermediaries for insurance companies and pension funds) to provide long-term credit to the private sector while banks have been repairing their balance sheets and retrenching from certain activities[2]. Moreover, in the euro area, recent data shows that lending by shadow banks as a proportion of total lending is rising[3]. Research also suggests that shadow banking often enhances the efficiency of the financial sector by enabling better risk sharing and maturity transformation and by deepening market liquidity[4].

2. However, the global financial crisis has revealed previously unrecognised fault lines in the shadow banking system which put the stability of the financial system at risk. These include 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, and in turn increased the vulnerability of shadow banking entities to runs. The subsequent fire sale of assets by such entities helped spread the stress to the traditional banking system.

3. A number of international regulatory initiatives relating to shadow banking have been undertaken and some are currently in progress. For example, in April 2011 the Financial Stability Board (FSB) published Recommendations to Strengthen Oversight and Regulation of Shadow Banking[5] and in April 2014 the Basel Committee on Banking Supervision (BCBS) published a revised supervisory framework for measuring and controlling large exposures, which includes exposures to shadow banking entities[6]. At the EU level, the Commission has adopted a proposal for a regulation aimed at increasing transparency of certain transactions outside the regulated banking sector[7]. Additionally, work has been undertaken to analyse the scope of the perimeter of credit

[2] See IMF Global Financial Stability Report, April 2014, available here: http://www.imf.org/external/pubs/FT/GFSR/2014/01/index.htm.

[3] See IMF Global Financial Stability Report, October 2014, available here: http://www.imf.org/external/pubs/ft/gfsr/2014/02/ ; and the Financial Stability Board's Global Shadow Banking Monitoring Report 2014, available here: http://www.financialstabilityboard.org/2014/11/global-shadow-banking-monitoring-report-2014/ .

[4] Claessens, Stijn, Zoltan Pozsar, Lev Ratnovski and Manmohan Singh, December 2012, 'Shadow Banking: Economics and Policy', IMF Staff Discussion Note SDN/12/12, International Monetary Fund, Washington, DC.

[5] The FSB's recommendations are available here: http://www.financialstabilityboard.org/2011/10/financial-stability-board-publishes-recommendations-to-strengthen-oversight-and-regulation-of-shadow-banking/.

[6] 'Supervisory framework for measuring and controlling large exposures - final standard', Basel Committee on Banking Supervision, Bank for International Settlements, April 2014.

[7] Proposal for a regulation of the European Parliament and of the Council on reporting and transparency of securities financing transactions, European Commission, January 2014.

institutions in the EU, the results of which are set out in the EBA's Opinion and Report on the perimeter of credit institutions[8]. At the international level, work led by the BCBS is under way on accounting and regulatory approaches to consolidation. The FSB is also conducting intensive monitoring of the shadow banking sector[9] and investigating financial stability risks from asset management activities[10].

2.1.1 Concerns regarding shadow banking entities

4. Whilst some activities carried out by shadow banking entities can have beneficial effects as regards the financing of the real economy and fostering growth, they also generate a number of specific risks from a prudential viewpoint that may warrant regulatory attention.

   - *Run risk and/or liquidity problems*: Shadow banking entities are potentially vulnerable to runs (withdrawal of deposit-like assets due to panic, early redemptions due to a confidence crisis) and/or liquidity problems (liquidation of assets at fire sale prices), stemming from credit exposures, high leverage, and liquidity and maturity mismatches between assets and liabilities. These risks are usually exacerbated because shadow banking entities do not have sectoral liquidity backstops and are generally subject to less robust and comprehensive prudential standards and supervision.

   - *Interconnectivity and spillovers:* Shadow banking entities tend to be highly correlated and interconnected with the regulated banking sector due to ownership linkages and explicit and implicit credit commitments and as direct counterparties. In times of stress this can, directly or indirectly, generate systemic risks through contagion effects both between shadow banking entities and between such entities and the regulated banking sector, leading to a flight to quality and fire sales of assets.

   - *Excessive leverage and procyclicality*: The maturity mismatch and liquidity risks are exacerbated by shadow banking entities' ability to engage in highly leveraged or otherwise risky financial activities. Highly leveraged structures are more likely to become insolvent in the case of unexpected negative events due to inadequate loss-absorbing capacity, abrupt deleveraging and inability to roll over financing needs. The crystallisation of such events can trigger a confidence crisis in the regulated banking sector, leading to severe impairment of funding sources.

   - *Opaqueness and complexity*: The opaque and complex nature of governance and ownership structures of shadow banking entities and their relationships with the regulated banking sector constitute vulnerabilities, since, during periods of stress, investors tend to retrench and flee to safe, high-quality and liquid assets. The inherent agency problem, caused by the separation of financial intermediation activities across multiple shadow banking entities, also

[8] The EBA's Opinion and Report are available here: https://www.eba.europa.eu/-/eba-publishes-an-opinion-on-the-perimeter-of-credit-institutions.

[9] See for example the FSB's Global Shadow Banking Monitoring Report 2014 as referred to in footnote 2.

[10] http://www.financialstabilityboard.org/2015/07/next-steps-on-the-nbni-g-sifi-assessment-methodologies/

contributes to vulnerabilities in the financial system. Furthermore, there is a lack of disclosure (regarding collateral, assets or value thereof), as such entities are generally unregulated or subject to less robust prudential regulation.

2.1.2 Legal mandate and definitions used

5. The EBA has the mandate under Regulation (EU) No 575/2013[11] to issue guidelines to set limits on institutions' exposures to shadow banking entities.

6. Article 395(2) of Regulation (EU) No 575/2013 reads as follows:

   '*EBA shall, in accordance with Article 16 of Regulation (EU) No 1093/2010, taking into account the effect of the credit risk mitigation in accordance with Articles 399 to 403 as well as the outcomes of developments in the area of shadow banking and large exposures at the Union and international levels, issue guidelines by 31 December 2014 to set appropriate aggregate limits to such exposures or tighter individual limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework.*

   '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, on the provision of credit to the real economy or on the stability and orderly functioning of financial markets.'

7. In the absence of a definition in Regulation (EU) No 575/2013 of the terms 'shadow banking entities', 'banking activities' and 'regulated framework', for the purposes of these guidelines, the EBA defines shadow banking entities as entities that:

   a. carry out credit intermediation activities, defined as bank-like activities involving maturity transformation, liquidity transformation, leverage, credit risk transfer or similar activities; and

   b. are neither within the scope of prudential consolidation nor subject to solo prudential requirements under specified EU legislation (or equivalent third country legal frameworks). Entities referred to in Article 2(5) and Article 9(2) of Directive 2013/36/EU[12], as well as other entities as defined in the guidelines ('excluded undertakings'), are also not to be regarded as shadow banking entities.

8. This approach is consistent with the EBA's Opinion and Report on the perimeter of credit institutions[13]. In particular, the guidelines do not prescribe an exhaustive list of activities that fall within the scope of credit intermediation activities. Instead, the description of 'credit

[11] 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).

[12] 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).

[13] See footnote 8.

intermediation' adopted in the aforementioned Opinion and Report, which follows the approach prescribed by the FSB, has been adopted, as this best describes the types of activities undertaken by shadow banking entities. The FSB has identified the four key features of credit intermediation as: (a) maturity transformation (borrowing short and lending/investing on longer timescales); (b) liquidity transformation (using cash-like liabilities to buy less liquid assets); (c) leverage; and (d) credit risk transfer (transferring the risk of credit default to another person for a fee). Examples of entities carrying out credit intermediation include money market funds (MMFs), special-purpose vehicles (SPVs) engaged in securitisation transactions, securities and derivatives dealers, and companies engaged in factoring, leasing or hire purchase.

9. In order to assist institutions in identifying entities that are carrying out credit intermediation activities, the guidelines make it clear that entities carrying out one or more of the activities listed in the following points of Annex 1 of Directive 2013/36/EU shall be automatically regarded as carrying out credit intermediation activities: points 1 (taking deposits and other repayable funds), 2 (lending), 3 (financial leasing), 6 (guarantees and commitments), 7 (trading for own account or for account of customers in specified forms of financial instrument), 8 (participation in securities issues and the provision of services relating to such issues) and 10 (money broking). However, this should not be taken as an exhaustive list of activities within the scope of 'credit intermediation'. Rather, this approach simply confirms specific cases in which entities are to be positively identified as carrying out credit intermediation activities for the purposes of the guidelines.

10. The second limb of the definition of shadow banking entities for the purposes of the guidelines carves out certain entities from the scope of the definition (and therefore from the scope of the guidelines). These are entities that are subject to an appropriate and sufficiently robust prudential framework. For example, under this approach, 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 are out of the scope of the guidelines. Furthermore, entities subject to consolidated prudential supervision (whether as a result of EU legislation, applicable national legislation or an equivalent third country legal framework) are out of the scope of the guidelines.

11. Given this, the guidelines focus on institutions' exposures to entities that pose the greatest risks in terms of both the direct exposures institutions face and also the risk of credit intermediation being carried out outside the regulated framework (see further below). These entities include unregulated financial sector entities such as special-purpose entities (SPEs) and SPVs not covered by consolidated prudential supervision.

12. As regards funds, these tend to engage in maturity and liquidity transformation and are generally regarded as outside the traditional banking sector[14]. Therefore, *prima facie*, they should be within the scope of the definition of shadow banking entity.

[14] For example, see the FSB's Global Shadow Banking Monitoring Report 2014.

13. However, some funds are regulated pursuant to prudential frameworks similar to those applied to credit institutions and investment firms. In particular, in the EU the UCITS (Undertakings for Collective Investments in Transferable Securities) Directive (Directive 2009/65/EC) prescribes a robust set of requirements under which undertakings for collective investment in transferable securities, and their managers, operate. These include requirements on the asset manager (initial capital, own funds and internal control requirements) and the managed funds (e.g. limits to leverage and concentration). Therefore, such funds do not pose the same level of risk to institutions in terms of credit and step-in/bail-out risk (e.g. due to reputational, franchise and other risks) as unregulated funds.

14. Notwithstanding these requirements, it is proposed that all MMFs, regardless of whether they operate under the rules of Directive 2009/65/EC or others, should be within the scope of the definition of shadow banking entity for the purposes of these guidelines. This is because, as acknowledged by the European Commission in its proposal for a regulation on MMFs[15] (under negotiation), the average size of an MMF far exceeds the average size of a UCITS fund and, as acknowledged by the FSB and other institutions such as the International Organisation of Securities Commissions and the European Systemic Risk Board[16], the systemic risks posed by such funds (in particular having regard to their interconnectedness with the banking sector) have not been addressed to an adequate degree through existing regulatory measures. Therefore, at this stage (in particular, pending agreement on the Commission's legislative proposal) the EBA includes all MMFs within the scope of the definition of shadow banking entity.

15. Regarding the treatment of alternative investment funds (AIFs), the EBA has considered the feedback received during the consultation period as well as input from the European Securities Market Authority (ESMA) and the European Commission. The EBA acknowledges that AIFs are regulated indirectly, as a result of requirements imposed on their asset managers under Directive 2011/61/EU (the AIFMD), e.g. initial capital, own funds and internal controls requirements. However, the risks arising directly from the funds themselves are not mitigated in a satisfactory way from a prudential point of view. For example, leverage is strictly limited for UCITS funds: they can borrow only up to 10% of their assets provided that such borrowing takes place on a temporary basis[17]. However, similar leverage limitation does not apply to AIFs, although they

[15] The Commission's proposal is available here: http://ec.europa.eu/finance/investment/money-market-funds/index_en.htm.

[16] IOSCO's recommendations are available here: http://www.iosco.org/news/pdf/IOSCONEWS255.pdf.

The ESRB's recommendations are available here: https://www.esrb.europa.eu/pub/pdf/recommendations/2012/ESRB_2012_1.en.pdf?c9daf560cb3d72433ca237604eda38af.

[17] In most cases leverage is measured as a ratio between the fund exposure and its Net asset Value (NaV). Most UCITS are required to use the commitment approach, under which derivatives exposures are converted into equivalent cash positions. When UCITS engage in complex investment strategies or when the commitment approach does not adequately capture the market risk of their portfolio, they should use either the absolute or the relative Value at Risk (VaR). All AIFs are required to measure their exposure through the commitment method, similarly to UCITS. Under the commitment approach, UCITS exposure relating to derivative instruments cannot exceed the total net value of the portfolio. Eventually a UCITS using both external borrowing and derivatives can thus leverage up to 1.1 times its NaV (i.e. overall leverage of 2.1). For more sophisticated UCITS, the relative VaR approach does not measure the leverage of the strategies; rather it allows UCITS to double the risk of loss compared with a similar but unleveraged portfolio. Finally the VaR of a UCITS using the

must put in place risk management policies and are subject to stress testing and reporting obligations[18]. Given this, the EBA is of the view that only AIFs with limited leverage could be considered to fall outside the definition of 'shadow banking entities'. Article 111(1) of Delegated Regulation 231/2013 considers leverage to be employed on a substantial basis when the AIF exposure exceeds 300% of its net asset value. Furthermore, only AIFs which are not entitled to grant loans or purchase third parties' lending exposures onto their balance sheet should be excluded from the definition of 'shadow banking entities' for the purposes of these guidelines. On the contrary, AIFs which are entitled to grant loans carry out a typical banking activity outside the regulated banking system (i.e. Regulation (EU) No 575/2013 and Directive 2013/36/EU or comparable prudential regulation). These funds should therefore fall within the scope of the guidelines, as they act as substitutes for bank lending and could generate credit intermediation risks (i.e. runs and/or liquidity risk) without having a banking (or comparable) licence and they are not subject to harmonised rules on concentration risks, credit assessment, provisioning, etc.

16. Given this, all funds would be considered to fall within the scope of the definition of shadow banking entities except if they are non-MMF UCITS, AIFs meeting the criteria mentioned in the paragraph above or third country funds subject to requirements equivalent to the UCITS Directive.

17. Regarding the particular case of European Venture Capital Funds (EuVECAs), European Social Entrepreneurship Funds (EuSEFs) and European Long-Term Investment Funds (ELTIFs), the EBA is of the view that these funds should fall outside the definition of 'shadow banking entity' due to their type of activity, and should therefore be excluded from the scope of the guidelines.

18. This approach is consistent with the approach described in the EBA's Opinion and Report on the perimeter of credit institutions[19] and the general focus of the policy debate on shadow banking within the European Union and in international contexts[20].

2.1.3 Relation to other parts of the European rulebook

19. The guidelines should be applied independently from and in addition to the general large exposures framework as defined in Part Four of Regulation (EU) No 575/2013.

20. On 27 November 2014, Commission Delegated Regulation (EU) No 1187/2014 of 2 October 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for determining the overall exposure to a client or a group

absolute VaR approach cannot be greater than 20% of its NaV. The VaR approaches potentially allow higher leverage than the commitment approach, depending on the volatility of the underlying assets.

[18] For an overview of leverage measures and restrictions, see ECB (2015), 'Financial Stability Review, Box 7: Synthetic leverage in the investment fund sector', May 2015, pp. 92-94.

[19] See footnote 8.

[20] For example, see the Commission's (2013) Communication on shadow banking: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013DC0614&from=EN; the IMF's 2014 Global Financial Stability Report: http://www.imf.org/external/pubs/ft/gfsr/2014/02/, which includes in Chapter 2 an assessment of the size and riskiness of shadow banking around the globe; and the Financial Stability Board's 2014 Global Shadow Banking Monitoring Report, available here: http://www.financialstabilityboard.org/2014/11/global-shadow-banking-monitoring-report-2014/.

of connected clients in respect of transactions with underlying assets entered into force. This regulation applies to all exposures through transactions with underlying assets, thus also including exposures that are within the scope of the guidelines.

21. In addition, the EBA is updating the guidelines on the identification of groups of connected clients under Article 4(1)(39) of Regulation (EU) No 575/2013, including providing greater clarity on how institutions and shadow banking entities can be economically interdependent.

22. The guidelines should be read in conjunction with supervisory powers under the Supervisory Review and Evaluation Process (SREP) of Pillar 2. The articulation between these guidelines and Pillar 2 is further developed in the following section.

23. Finally, the guidelines are developed having regard to the Commission's mandate under Article 395 of Regulation (EU) No 575/2013 to 'assess the appropriateness and the impact of imposing limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework' by 31 December 2015.

24. In developing the guidelines, the EBA is also mindful of other European and international workstreams in the area of shadow banking and large exposures. These include:

- An assessment by the European Commission of the current scope of application of the EU banking prudential rules, as part of the Commission's broader workstream on shadow banking[21]. The EBA provided an opinion on this matter, at the request of the Commission, in November 2014[22].

- Work by the BCBS, on the scope of consolidation for prudential regulatory purposes to ensure all banks' activities are appropriately captured in prudential regimes. A public consultation on the proposals is expected by the end of 2015.

- A peer review, to be launched by the FSB in 2015, regarding its member jurisdictions' implementation of the FSB's policy framework for shadow banks, as well as the results of the FSB's fifth shadow banking monitoring exercise in late 2015[23].

2.1.4 Rationale for limiting institutions' exposures to shadow banking entities

25. Potential risks could arise from institutions' exposures to shadow banking entities from both a microprudential and a macroprudential perspective.

26. A general concern is that institutions' exposures to shadow banking entities undertaking bank-like activity may also lead to regulatory arbitrage concerns, and worries that core banking activity may migrate systematically away from the regulated sector 'into the shadows'. A range of regulations are now in place to address some of the arbitrage risks relating to shadow banking entities that

[21] Shadow Banking – Addressing New Sources of Risk in the Financial Sector, European Commission, 4 November 2013.

[22] Opinion of the European Banking Authority on Matters Relating to the Perimeter of Credit Institutions, EBA/Op/2014/12, 27 November 2014.

[23] Updated G20 Roadmap towards Strengthened Oversight and Regulation of Shadow Banking in 2015, G20.

were observed during the financial crisis. For example, the risk weights on various forms of shadow banking exposures have increased. Nonetheless, as the regulatory regime for institutions tightens, the pressure for bank-like activity to be carried out elsewhere in the financial system increases.

27. From a microprudential perspective, banking activities such as maturity and liquidity transformation are inherently risky. For this reason, institutions are subject to robust prudential regulation, must participate in Deposit Guarantee Schemes and generally have access to central bank liquidity facilities. Shadow banking entities are generally unregulated or not subject to the same standards of prudential regulation as core regulated entities such as institutions, do not provide protection to investors' investment from these entities' failures and do not have access to central banks' liquidity facilities. To the extent that shadow banking entities carry out banking activities, exposures to such entities may therefore be inherently risky - and thus specific limits for individual and aggregate exposures are warranted.

28. Macro prudentially, institutions' exposures to shadow banking entities could be of concern for different reasons. Here the focus is on the role that institutions' funding of bank-like activity amongst shadow banking entities may play in increasing systemic risk across the financial system. One concern is that institutions' funding of large amounts of bank-like activity amongst shadow banking entities may result in an amplification of the credit cycle. Such a concern may arise from the observation that the flow of funds into such entities tends to be volatile. Moreover, the sharp accelerations of credit flows (and implicit exposures) into these entities can result in volatile (and potentially unsustainable) credit flows into the real economy. A limit on institutions' aggregate exposures to shadow banking entities could play a role in reducing the volatility of such flows.

29. Notwithstanding these microprudential and macroprudential risks, the EBA recognises that banking activities by some shadow banking entities can play a valuable role in providing alternative sources of funding to the real economy. Excessively reducing the availability of institutions' funding to these entities could therefore interfere with the flow of funds into the real economy. Moreover, the regulatory bodies, in the EU and at the global level, are still in the process of assessing the balance of risks and benefits that institutions' funding to different types of shadow banking entities represents. It is therefore considered premature to use the guidelines to introduce a quantitative limit to institutions' exposures to these entities at the individual or aggregate exposure level. Instead, the proposed intervention is designed to place the responsibility on the banking sector to demonstrate that the risks highlighted above are being managed effectively, in particular by improving, where necessary, the due diligence carried out before taking lending decisions, for instance to identify if the counterparty is carrying out credit intermediation and its regulatory status (see also sub-section 2.1.1, *Concerns regarding shadow banking entities*).

30. Under the guidelines, institutions should implement effective processes, as well as set internal aggregate and individual limits to exposures to individual shadow banking entities with an exposure value, after credit risk mitigation and exemptions, 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. The

materiality threshold of 0.25% of the institution's eligible capital reduces the burden of application of the guidelines, as it allows institutions to disregard immaterial exposures which are not likely to pose risks that would deserve special attention. The data collection accompanying these guidelines has shown that the number of exposures below this materiality threshold is very significant for most institutions: these exposures represent around 97% of the total number of exposures for the overall sample of institutions in the data collection.

31. The internal limits should be set using criteria which are laid down in the guidelines. The rationale for this approach ('the principal approach') is to make sure institutions have sufficient information about their counterparties in the shadow banking sector to make an informed assessment of their risk exposures to shadow banking entities as a whole, as well as of any individual exposure to shadow banking entities. It shall be noted that there is no necessary sequence for the setting of limits: i.e. institutions have to set both aggregate and individual limits, in any order.

32. Institutions that cannot use the principal approach for setting the internal limits as a result of their inability to take into account all the criteria, due to either an insufficient level of information about their exposures to shadow banking entities or the lack of effective processes to use that information, shall use an alternative approach ('the fallback approach') involving a set aggregate limit to all or some of their exposures to shadow banking entities. Where institutions can meet the requirements regarding effective processes and control mechanisms or oversight by their management board as set out in Section 4 of the guidelines, but cannot gather sufficient information to enable them to set out appropriate limits as set out in Section 5 of the guidelines, the fallback approach should only be applied to the exposures to shadow banking entities for which the institutions are not able to gather sufficient information. The principal approach should be applied to the remaining exposures to shadow banking entities.

33. Although the results of the data collection provided relevant input to the calibration of the aggregate limit under the fallback approach, the EBA notes some important differences between the data collection and the guidelines: the scope of the data collection was broader than the current scope of the guidelines[24]; the data collection was conducted at the highest level of consolidation in a Member State or individual level if the consolidated level did not apply; and

[24] The data collection used the same definition of 'shadow banking entities' as included in the guidelines, with the following exceptions, where more granular data was collected:

a. The list of 'excluded undertakings' considered for the definition of 'shadow banking entity' in the guidelines extends beyond the one considered for the data collection (i.e. points (k), (m), (n), (o), and (p) of the list in the guidelines have not been considered 'excluded undertakings' for the purposes of the data collection). For example, institutions have been asked to report exposures to all investment funds, regardless of whether they are subject to the UCITS Directive or the AIFMD. Note that UCITS funds (other than money market funds) and alternative investment funds that meet certain requirements have been excluded from the scope of the guidelines.
b. Institutions have been asked to report exposures to all third party undertakings. Note that undertakings which are not supervised on a solo level, but supervised on a consolidated level in the Union or in a third country which has a regime at least equivalent to the one applied in the Union, have been excluded from the scope of the guidelines.

data simulations were done under the conservative assumption that the institution would apply the fallback approach to all of its exposures.

34. The main purpose of the fallback approach is to create certainty about the possibility of setting a limit for any institution; in particular, some institutions may not be able to apply all of the relevant criteria to use the principal approach. In that sense, the limit in the fallback approach can be seen as a way to ensure that these institutions apply a sufficiently tight limit to their exposures to shadow banking entities, for which institutions are not able to collect sufficient information that would enable them to understand and manage the risks of these exposures. The fallback approach can also work as an incentive for these institutions to improve their processes and control mechanisms concerning their exposures to shadow banking entities in order to be able to apply the criteria under the ‘principal approach’ to all their exposures to shadow banking entities.

35. All in all, the approach proposed in these guidelines requires institutions to set risk tolerance levels for exposures to shadow banking entities within their overall business model and risk management framework, under the supervision of the competent authority. In this regard, it is recognised that some institutions may have a higher risk appetite for these types of exposures and this can be accommodated within the guidelines once risks arising from these exposures are identified and appropriately mitigated. Given this, these guidelines are a first step to address the potential risks stemming from exposures to shadow banking entities. As already mentioned, the EBA has collected data about exposures to shadow banking entities in order to inform further work to be done on the topic by the Commission in accordance with its mandate under the last subparagraph of Article 395(2) of Regulation (EU) No 575/2013. The results of this data collection are presented in a separate report. As part of this mandate, the Commission may choose to propose imposing mandatory limits to exposures to shadow banking entities that are tighter than the limits currently laid down for large exposures in general. In any case, the EBA expects these guidelines to be a useful input to the Commission’s report.

36. Under this approach, competent authorities will retain the ability to take supervisory measures to address any risks arising from exposures to shadow banking entities, as appropriate, and in particular to assess and challenge the internal limits and risk mitigation plans set by institutions.

37. The competent authorities’ assessment will be guided by the SREP under Article 97 of Directive 2013/36/EU and in particular the technical criteria for the supervisory review and evaluation of exposure to and management of concentration risk by institutions under Article 98 of the same directive. Where it is deemed appropriate, consideration shall be given to the assignment of potential Pillar 2 requirements on specific institutions and, where necessary, competent authorities may also impose additional requirements under Article 104 of Directive 2013/36/EU where the risks arising from excessive exposures to shadow banking entities are not appropriately mitigated. The guidelines aim to provide a more structured basis for supervisors to make such Pillar 2 judgements within the supervisory review process in relation to exposures to shadow banking entities.

38. The combination of the chosen approach within the guidelines with the parallel option for supervisors to apply existing Pillar 2 measures in certain cases will allow the right balance to be found between allowing institutions to set their risk appetite for exposures to shadow banking entities and ensuring that their exposure does not result in excessive risk to the financial system.

3. Guidelines

EBA/GL/20XX/XX

DD Month YYYY

Guidelines

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

Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010[25]. 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 ([dd.mm.yyyy]). 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 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.

[25] 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

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[26].

7. These guidelines build in particular on Articles 73 and 74 of Directive 2013/36/EU[27], 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.

[26] 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).

[27] 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:

Credit intermediation activities	Bank-like activities involving maturity transformation, liquidity transformation, leverage, credit risk transfer or similar activities. 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.
Exposures to shadow banking entities	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.
Shadow banking entities	Undertakings that carry out one or more credit intermediation activities and that are not excluded undertakings.
Excluded undertakings	(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. (2) undertakings which are supervised on a consolidated basis by a third country competent authority pursuant to the law of a third country

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[28] in accordance with

[28] 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[29] 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[30];

(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[31] with the exception of:

- undertakings employing leverage on a substantial basis according to Article 111(1) of Commission Delegated Regulation (EU) 231/2013 [32] and/or
- undertakings which are allowed

[29] 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).

[30] 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).

[31] 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).

[32] 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[33];

(v) within the meaning of Article 3 (1)(b) of Regulation (EU) 346/2013[34] ('qualifying social entrepreneurship funds');

(vi) within the meaning of Article 3(b) of Regulation (EU) 345/2013[35] ('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[36] established in the EU and third country CCPs recognised by ESMA pursuant to

[33] 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).

[34] 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).

[35] 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).

[36] 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[37];

(n) payment institutions as defined in point (4) of Article 4 of Directive 2007/64/EC[38];

(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[39] 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.

[37] 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).

[38] 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).

[39] 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

Date of application

12. These guidelines apply from 01.01.2017.

4. Requirements regarding limits to exposures to shadow banking entities

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

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

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.

4. Accompanying documents

4.1 Cost-Benefit Analysis/Impact Assessment[40]

4.1.1 Problem identification

The interconnectedness between the (regulated) banking sector and shadow banking entities and the specific risks posed by shadow banking entities to the stability of the financial system provide the motivation for action to be taken with regard to institutions' exposures to shadow banking entities.

Under the current regulatory regime, institutions' exposures to shadow banking entities are already subject to limits under the general framework for large exposures. However, the general framework for large exposures could be supplemented by provisions that would be specific to the monitoring and limiting of exposures to shadow banking entities, given the risks they might entail. To set such a framework, a set of decisions must be made regarding the scope of the application of the guidelines (in particular the definition of shadow banking entities) and the limits to be set.

4.1.2 Policy objectives

The present guidelines are intended to fulfil the regulatory objectives of (a) mitigating microprudential risk (i.e. risks posed to institutions as a result of their exposures to shadow banking entities), (b) mitigating macroprudential risks (e.g. financial stability) and (c) mitigating regulatory arbitrage risks (i.e. between the regulated and unregulated parts of the financial system). To achieve the regulatory objectives, the guidelines target specific and operational objectives. In particular, the guidelines aim to specify the scope of their application (specific objective), the definition of shadow banking entities (operational objective to meet the specific objective of the scope of application) and the types of limits which might be set (specific objective).

The legal mandate in Article 395(2) of Regulation (EU) No 575/2013 requires the EBA to issue guidelines to set appropriate aggregate limits to shadow banking exposures or tighter individual limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework, taking into account any material detrimental impact on the provision of credit to the real economy or on the stability of financial markets.

[40] The analysis in this section is partly based on information collected in a dedicated exercise and presented in more detail in the EBA Report on institutions' exposures to shadow banking entities (2015).

4.1.3 Options considered

First set of options (specific): scope of application/definition of shadow banking entities

The legal mandate requires the EBA to set limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework.

As a starting point, the EBA considers that 'banking activities' should be interpreted as activities involving maturity transformation, liquidity transformation, leverage, credit risk transfer or similar credit intermediation activities. To provide guidance to institutions the EBA suggests that these activities include at least those listed in points 1 to 3, 6 to 8 and 10 of Annex 1 of Directive 2013/36/EU. This is consistent with the approach adopted in international (in particular FSB) and other European contexts.

As for the interpretation of 'regulated framework', two key elements were considered: (i) the inclusion in prudential consolidation and supervision and (ii) specific solo prudential and conduct regulatory frameworks.

First, as regards the treatment of ***entities within the scope of prudential consolidation*** the following options were considered:

a. **Option 1.1:** Entities which are subject to prudential supervision on the basis of the consolidated situation of an institution as defined in Article 4(1)(47) of Regulation (EU) No 575/2013 should be outside the definition of shadow banking entities only if they are also subject to solo prudential requirements which are at least equivalent to Regulation (EU) No 575/2013 and Directive 2013/36/EU.

b. **Option 1.2:** Entities which are subject to prudential supervision on the basis of the consolidated situation of an institution as defined in Article 4(1)(47) of Regulation (EU) No 575/2013 should be outside the definition of shadow banking entities regardless of whether they are subject to solo prudential requirements which are at least equivalent to Regulation (EU) No 575/2013 and Directive 2013/36/EU.

Preferred option: Option 1.2 is preferable, as any such entities carrying out credit intermediation activities would be subject to prudential requirements at the consolidated level as a result of prudential consolidation, thereby mitigating any risks posed by the bank-like activities carried out by those entities. Given this, these entities should not be regarded as being 'outside a regulated framework' and therefore should be carved out from the definition of shadow banking entities.

Second, for those ***entities that are not subject to prudential consolidation***, the EBA considered different types of regulatory frameworks. In particular, two options were considered:

a. **Option 2.1:** Institutions subject to third country prudential and supervisory requirements or other Union or national prudential frameworks, which are at least equivalent to Regulation (EU) No 575/2013 and Directive 2013/36/EU should be carved out from the definition of shadow banking entities.

b. **Option 2.2:** Entities subject to any regulatory framework (of a prudential or conduct nature) under Union law or equivalent third country or national law for institutions and other regulated entities should be carved out from the definition of shadow banking entities.

Preferred option: Having regard to the objectives identified in the section above, the focus of the policy debate on shadow banking in Union and international contexts, the need for EBA to act in a manner that is consistent and coherent with Union initiatives in the field of financial regulation, and the need for EBA to adopt a risk-based proportionate approach to regulation, the EBA considers that Option 2.1 is the only reasonable approach to interpretation for the purposes of the guidelines. Under that approach, such a 'regulated framework' is understood as a robust prudential regulation framework where credit, liquidity, leverage and other risks are adequately addressed.

The approach under Option 2.2, on the other hand, would exclude entities that are, for example, subject to a light touch or non-prudential regime which may fail to mitigate effectively risks posed by the carrying out of credit intermediation by the entity concerned.

The proposed approach, in contrast, would focus on entities that are not subject to an appropriate prudential framework, thereby concentrating on those entities that pose the greatest risks in terms of both the direct exposures institutions face and, more widely, the incentives for credit intermediation to be carried out outside the regulated framework.

According to the results of the dedicated data collection, only slightly more than 10% of the exposure amounts are to entities which are known to be supervised on a consolidated level in the Union or in a third country with an at least equivalent prudential regime. For almost 90% of the exposure amounts, the type of supervision of the counterparty is not known or not further specified. From a prudential perspective, this result justifies the option chosen above, as only a minor proportion of the exposure amounts is known to be supervised on a consolidated level and can consequently be reasonably carved out from the scope of application of these guidelines.

Turning specifically to the treatment of funds, these tend to engage in maturity and liquidity transformation and are generally regarded as outside the traditional banking sector. Therefore, *prima facie*, they should be within the scope of the definition of shadow banking entity. However, some funds are regulated pursuant to prudential frameworks similar to those applied to credit institutions and investment firms and should therefore be excluded from the scope of the guidelines. Based on the results of the data collection, the proportion of amounts of exposures (after taking into account credit risk mitigation and exemptions) to MMFs (UCITS and others) is rather small (< 5% of total exposure amounts). Around one quarter of the exposure amounts is to (non-MMF) investment funds, out of which one fifth is to hedge funds.

Second set of options (specific): establishment of limits

After assessing the objectives of the limits to be developed and the concerns to be addressed, EBA has identified three possible policy options (see 3.1 to 3.3 below).

a) **Option 3.1**: Explicit appropriate aggregate limits or tighter individual limits on exposures to shadow banking entities under Pillar 1

Setting tighter individual limits (i.e. an exposure limit lower than the large exposure limit of 25% of an institution's eligible capital after taking into account the effect of credit risk mitigation measures) or appropriate aggregated limits on exposures to individual shadow banking entities would be a very direct way to limit the regulated banking sector's exposures to shadow banking entities. When setting individual limits, different types of shadow banking entities, activities or instruments could be considered.

Given that any regulatory proposal about quantitative limits on exposures to shadow banking entities needs to be based on a thorough impact analysis, the EBA finds it premature to set out limits to individual or aggregate exposures to shadow banking entities. Simultaneously with issuing these guidelines, EBA is publishing an in-depth report to inform the Commission on European credit institutions' and investment firms' exposures to shadow banking entities. Based on that analysis, the co-legislators may decide on any harder limits in accordance with Article 395(2) of the CRR, after having assessed the appropriateness and impact of regulatory measures.

b) **Option 3.2**: Individual limits on exposures to shadow banking entities to be set by institutions

To the extent that shadow banking entities carry out banking activities, such as maturity and liquidity transformation, which are inherently risky, exposures to such entities may therefore also be inherently risky - and thus specific limits for individual and aggregate exposures are warranted (see further reasoning in section 2.*1.4, Rationale for limiting institutions' exposures to shadow banking entities*).

This approach could be understood as forming part of the Pillar 2 framework. It should be noted that concentration risk is clearly identified as a core part of the Supervisory Review Process within the Capital Requirement Directive.[41] Where a concentration risk to shadow banking entities was identified, then a capital add-on, or additional obligation on a bank's funding/liquidity structure, may be warranted.[42]

[41] See Directive 2013/36/EU – Section III, Article 98(1)(b).

[42] It should be noted that, in the Basel Capital Framework (and the CRD), concentration risk is not fully addressed in the context of Pillar 1. For credit risk it is assumed that IRB portfolios are perfectly diversified. Any resultant underestimation of risk should be corrected by addressing the concentration risk and allocating capital, where necessary. For details see the EBA guidelines on concentration risk: https://www.eba.europa.eu/documents/10180/16094/Concentration.pdf.

c) **Option 3.3**: Aggregate limits on exposures to shadow banking entities to be set by the institutions

The interconnectedness between the shadow banking and the regulated banking sector, plus the tendency of shadow banking entities to engage in excessively leveraged or otherwise risky activities, calls for management of exposures not only to individual shadow banking entities, but also to the shadow banking sector in its entirety.

Institutions may have an incentive to shift activities to the shadow banking sector in response to more stringent capital requirement. Also, periods of low real interest rates may fuel such a tendency as demand from institutional cash pools for alternative investment opportunities grows and the 'search for yield' phenomenon accelerates funds into the shadow banking sector. An overall backstop limit, together with improved identification of large exposures connected to the shadow banking sector, would help safeguard the regulated banking sector, preventing it from overly fuelling the growth of the unregulated shadow banking sector (thus getting overly interlinked and exposed).

The EBA sees that an aggregate limit to the shadow banking sector will result in a net benefit to the economy. From a macroprudential perspective, this approach should ensure that the shadow banking sector remains able to provide credit to the real economy without creating excessive risks to financial stability (including spillover risk). The institutions would set their aggregate limit to the aggregate of shadow banking entities, in the same way as described in Option 3.2.

If the approach under Options 3.2 and 3.3 ('the principal approach') cannot be applied, a 'fallback approach' would be applied, whereby a specific limit would be applied for the aggregate exposures to shadow banking entities. The report on institutions' exposures to shadow banking entities shows the distribution of institutions into different clusters by their exposure to the shadow banking sector. The following technical specifications are considered fallback solutions:

Option 3.3.a: If institutions cannot meet the requirements regarding effective processes and control mechanisms or oversight by their management board, regardless of whether they can gather sufficient information about their individual exposures 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).

Option 3.3.b: If institutions can meet the requirements regarding effective processes and control mechanisms or oversight by their management board, but cannot gather sufficient information regarding one or more individual exposures, 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), regardless of whether the institutions are able to gather sufficient information on some exposures.

Option 3.3.c: If institutions can meet the requirements regarding effective processes and control mechanisms or oversight by their management board, but cannot gather sufficient information regarding one or more individual exposures, 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 should be applied to the remaining exposures to shadow banking entities.

Preferred options: After deliberating all pros and cons from a prudential perspective and having regard to the feedback received during the public consultation, the EBA proposes to combine Options 3.2 and 3.3. Institutions should both set an aggregate limit to their exposure to the shadow banking entities and also set tighter limits to individual exposures to shadow banking entities. In addition, institutions unable to implement effective processes and control mechanisms or to ensure oversight by their management board should apply the fallback approach to all their exposures (Option 3.3a). However, if institutions can meet these requirements and can gather relevant information about one or more individual counterparties from the shadow banking sector, this would be recognised and the fallback approach would apply only to the exposures for which the institution has not been able to collect sufficient information (Option 3.3c).

In addition, for the purposes of the application of the guideline, institutions could either:

a) **Option 4.1**: consider only exposures, after taking into account credit risk mitigation techniques and exemptions, with a value equal to or in excess of 0.25% of the institution's eligible capital; or

b) **Option 4.2**: consider all exposures to shadow banking entities.

Option 4.1 is consistent with other EBA products in the area of large exposures[43] and would significantly alleviate the burden for institutions and is therefore proposed as the preferred option. Although some caution needs to be exerted when interpreting the reported data, the EBA's dedicated analysis estimates that around 97% of the number of exposures reported by institutions in the sample are below this materiality threshold, which alleviates considerably the burden of compliance with the guidelines.

4.1.4 Cost-benefit analysis

The EBA conducted a comprehensive data collection to better understand the relevance and characteristics of institutions' exposures to shadow banking entities and also to support the development and policy choices of these guidelines. Based on that data collection, the costs for credit institutions, the credit provided to financial counterparties and the real economy and the benefits for the solvency of individual institutions and the stability of the financial system are estimated in a separate report. For the purpose of the Commission's assessment of the appropriateness of imposing regulatory limits, that report also contains a comprehensive analysis of institutions' exposures to shadow banking entities.

[43] EBA Final Draft Regulatory Technical Standards on the determination of the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets under Art. 390(8) of Regulation (EU) No 575/2013.

Concerning the impact on the risk profile of credit institutions and investment firms, the results of the dedicated data analysis confirm that the number of exposures above common large exposure thresholds (e.g. 10% for reporting requirements, 25% for quantitative restrictions) is rather small. Relative to their eligible capital, average individual exposures are significantly higher (a multiple) for small and/or domestic institutions (Group 2 banks) and investment firms than for large and internationally active banks (Group 1). These guidelines should contribute to improved risk management and more comprehensive counterparty information collection. Requirements for individual and aggregate limits can be reasonably expected to contribute to less concentration risk towards shadow banking entities/the shadow banking sector for both Group 1 and Group 2 banks as well as investment firms. The majority of institutions' qualitative responses to the data collection associate exposures to shadow banking entities with above-average risk weights. Around a quarter of institutions associate higher revenues with shadow banking exposures and estimate the overall impact of their replacement by other exposures to be rather costly in profitability terms.

The potential detrimental impact on the provision of credit to the real economy in the EU is expected to be small (to medium) and carefully managed by the design of these guidelines. The results of the dedicated data collection show that around half of the amount of funds provided by European institutions is to counterparties resident outside the EU. It is rather unlikely that those funds would be finally destined for financing the real economy in the EU. Further, a certain proportion of those funds is provided to types of counterparty which are far less likely to focus on the direct provision of credit to the real economy. Thus the potential detrimental impact of limiting exposures to hedge funds, MMFs or broker-dealers is expected to be rather small. Lastly, the restriction of the application of these guidelines to exposure values after taking into account credit risk mitigation and exemptions, exposures to counterparties not (known to be) equivalently supervised at consolidated level, the qualitative principle-oriented approach of these guidelines and the application of a materiality threshold have all been designed to mitigate any potential detriment to the provision of credit to the real economy.

The direct and indirect beneficial impact on the stability and orderly functioning of financial markets in the EU is expected to be medium to high. Firstly, the largest part of European institutions' exposures to shadow banking entities is in the portfolio of Group 1 banks. Those, on average, exhibit higher exposures to the shadow banking sector in its entirety. Limiting concentrated exposures of institutions which are closer to being systemically important (because of their size and interconnectedness) to a potentially risky sector has benefits for financial stability. Similarly, certain types of counterparty entities are commonly perceived as carrying out risky activities (e.g. reliance on leverage, use of complex financial instruments) and being subject to relatively light prudential regulation (e.g. hedge funds). Limiting institutions' exposures to those counterparties which are also commonly perceived to behave in a correlated manner (e.g. invested in similar markets) can contribute to dampening procyclicality and systemic risk. Finally, the indirect approach of shadow banking regulation via tighter regulation of institutions' interaction with shadow banking entities can constitute a backstop to regulatory arbitrage. In summary, these guidelines are assumed to efficiently contribute to achieving the objectives stated above, while allowing for further regulatory intervention if considered appropriate.

4.2 Views of the Banking Stakeholder Group (BSG)

General comments

The consultation paper is an addition to other existing measures (such as SFT rules, haircut and reporting rules, etc.) that are designed to reduce systemic risk migration from the (largely unregulated) shadow banking sector to the highly regulated banking sector.

It is widely accepted that shadow banks of various sorts played an important role in the recent global banking crisis and that there were flaws in the way that such institutions operated and the links between the banking and shadow banking sectors. However, many of these flaws have since vanished as markets and institutions have reacted.

As a point of perspective, we also note that regulated banks are already subject to 'large exposure' rules irrespective of whether this relates to positions vis-à-vis banks or shadow banks. Furthermore, general capital requirements have been tightened up. Overall, these measures are likely to reduce the activity of banks vis-à-vis non-banks in general and shadow banks in particular.

The shadow banking landscape includes a heterogeneous set of institutions which cover a wide range of business activities and different business structures, and its size and functions can vary significantly between countries and markets. The shadow banking sector has a function in parallel with, and as a complement to, the banking system but on the other hand can create complexity and systemic risks. In addition, there is a risk of an undesirable risk transfer from the directly regulated sector to the shadow banking sector. The risk related to the shadow banking sector can to some extent be mitigated through indirect regulation, for example limitations for institutions to securitized assets, or as direct regulation towards shadow banking entities as example through AIFMD. Even if the indirect approach might have an impact in mitigating the risk in some areas, the view of BSG is that a more robust long term solution includes a regulation covering the shadow banking entities and its intermediation activities.

Before considering the specific questions raised in the consultation paper, we emphasise three general concerns. Firstly, there is a potential danger that the overall regulatory regime that is applied to regulated banks may not be as sufficiently competitively neutral as between institutions conducting essentially similar business and that this may unnecessarily distort competition between the regulated banking sector and the less-regulated institutions in the shadow banking sector.

A second concern is that regulatory agencies and national authorities should have a common definition of what is meant by 'shadow banks', and that regulation and supervision of the relationship between banks and shadow banks should be applied consistently between countries. This also raises issues of competitive neutrality between different national regulatory regimes.

Thirdly, the proposed rules outlined in the consultation paper may have the unintended consequence of undermining the fluidity of securitisation schemes that are currently proposed under the Capital Market Union: this may again produce regulatory inconsistencies.

Replies to questions

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.

In the FSB's 2014 Global Shadow Banking Monitoring Report, the shadow banking sector is defined as credit intermediation involving entities and activities outside the regular banking system or, as other market participants prefer, as 'market based activity'. This is a very broad definition and, in addition, the term carries a negative image. However, often this activity with non-bank financial institutions is carried out with institutions which are highly regulated, such as UCITS or insurance companies. As the consultation paper proposes increased control mechanisms towards shadow banking entities, a clear and operational definition is of great importance.

In this context we again emphasise the need for a common global definition of shadow banking.

The approach of defining entities that is out of scope for the definition of shadow banking is relevant and easy to adopt. In addition, the exposures towards UCITS are to a large extent already restricted by limits contained in the CRR. The most relevant approach for defining shadow banking entities seems to be by reference to the activities performed. Some of these are listed in the proposal with reference to CRD, annex 1. There is, nevertheless, considerable room for different translation of entities and activities in scope and the definitions still involve a high degree of subjectivity. Exposures to funds that are not considered as excluded undertakings should be possible to be treated by a look through principle where possible. It is also unclear how the exposure towards entities with mixed business lines should be treated in this context. As an example, should the total exposure towards an entity with some kind of shadow banking activity be considered as shadow banking in total when defining limits and interconnectedness?

The definition is broad and may generate a high number of 'positives', which could lead to an additional operational risk and disproportionate burden in terms of policies and control mechanisms, given that there would likely be only a relatively small overall risk reduction in the banking sector.

The view of the BSG is that the threshold of 0.25% is too low and the process of maintaining, monitoring and reporting these can be excessively administratively burdensome and disproportionate, considering turnover in portfolios and interconnectedness but also considering the fallback approach option 1 or option 2.

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.

The process will require specific instructions and monitoring and reporting requirements that are directly related to entities defined as shadow banking. Risk related to concentration and interconnectedness and specific risk towards specific entities is already an integrated part of the credit risk monitoring entity within most institutions and the need to set specific restrictions, at an institutional level towards a broad category of companies sorted into the category shadow banking, could be questioned. The definition of shadow banking entities includes intermediate activities, but in many cases this may be the only common denominator.

The proposed specific requirement for shadow banking entities related to Pillar 2 can be questioned, since the Pillar 2 requirements are already defined and in use already.

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.

It could be questioned if there is a need to have a specific process for exposures defined as being within the shadow banking definition. Risks, limits and risk appetite are an integral part of the credit risk monitoring and reporting process. However, we agree in principle with the arrangements.

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.

An aggregated limit only has relevance if there is a defined interconnectedness between two or more entities in scope for the definition of shadow banking. There are potentially less combined risk and interconnectedness in exposures towards totally different shadow banking activities in different countries compared to some other interconnections which already should be considered following the large exposures regulation. Besides, indirect interconnectedness is difficult to assess in practice, for example if there are holdings by other institutions. With reference to no 18 of the consultation it is stated that the EBA is considering updating the 'Guidelines on the identification of groups of connected clients under Article 4, Para. 1, No 39 Regulation (EU) No 575/2013, including providing greater clarity on how institutions and special-purpose vehicles can be economically interdependent.'

The view of the BSG is that the review and updating of that guideline should be undertaken in parallel with the guideline on shadow banking. Furthermore, indirect interconnectedness is to some extent already addressed in the BCBS paper 'Supervisory framework for measuring and controlling large exposures', April 2014. Even though the Basel paper considers the identification of additional risk imposed by third parties by the structure the bank invests in (e.g. in the case of an originator, fund manager, liquidity provider or credit protection provider), there are remaining difficulties in identifying all those connections. Furthermore, the Basel paper remains vague in the case of structured finance products.

Q5. Do you agree with the fall back approach the EBA has proposed, including the cases in which it should apply? If not, please explain why and present possible alternatives. Do you think that Option 2 is preferable to Option 1 for the fall back 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?

The view of the BSG is that Option 2 is the preferred option, since the requirements for the main part of exposures are fulfilled and should not be affected by a small number of exposures where the criteria are not met. It would be to presume a very close linkage between normally rather heterogeneous entities that are treated as directly connected. The most conservative outcome of the different options should not be the main reason for preference and could basically be affected by just one minor exposure. However, a technical fallback is not necessarily the only approach to address shortcomings, as in the SPREP and by capital add-on.

4.3 Feedback on the public consultation and on the opinion of the BSG

The EBA publicly consulted on the guidelines contained in this paper.

The consultation period lasted for 3 months and ended on 19 June 2015. 57 responses were received, of which 48 were published on the EBA website, including the opinion of the BSG.

This paper presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them if deemed necessary.

In many cases, several industry bodies made similar comments or the same body repeated its comments in response to different questions. In such cases, the comments, and the EBA's analysis, are included in the section of this paper where the EBA considers them most appropriate.

Changes to the guidelines have been incorporated as a result of the responses received during the public consultation.

Summary of key issues and the EBA's response

Most respondents focused their feedback on the proposed scope of the guidelines and the proposed definition for 'shadow banking entities' and argued for further exemptions. The EBA has carefully considered this feedback and amended the definition of 'excluded entities' to consider additional exceptions, which were intended but not clearly set out in the consultation paper, and has also revised its policy decisions regarding the treatment of certain funds.

Some respondents were critical about the fallback approach, in particular Option 1 in the consultation paper. The EBA has considered this feedback and redesigned the fallback approach along the lines of Option 2 in the consultation paper. The data collection has provided useful input to confirm the calibration of the fallback approach.

Summary of responses to the consultation and the EBA's analysis

Summary of responses received	EBA analysis	Amendments to the proposals
General comments		
The EBA's mandate expressly requires that 'international level' developments on shadow banking should be taken into account in the development of these guidelines. Proper coordination has to be ensured with existing international work on shadow banking before setting a definition (e.g. work undertaken by the Basel Committee on Banking supervision, the Financial Stability Board, ESMA or the G20). There is a need for development of a fundamental and robust level 1 regulation designed for shadow banking entities.	The EBA has given due consideration to on-going work in the area of shadow banking in the Union and other international fora. The EBA has also consulted the ESMA, the FSB, the European Commission services and the European Central Bank regarding the proposed definition of 'shadow banking entities' and has considered their feedback when finalising the guidelines. The EBA notes that the suggestion for regulating the shadow banking sector goes beyond the scope of the guidelines.	No amendment.
Responses to questions in Consultation Paper EBA/CP/2015/06		
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**		

Summary of responses received	EBA analysis	Amendments to the proposals
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.).		
Most respondents focused their feedback on the scope of the guidelines and the proposed definition of ‘shadow banking entities’. **Definition of ‘credit intermediation activities’:** • **Portfolio management and advice** – regarding the definition of ‘credit intermediation activities’, feedback noted that ‘credit intermediation activities’ are not present while carrying out portfolio management and advice according to point 11 of Annex I of the CRD. Moreover, this activity is also regulated by the Markets in Financial Instruments Directive 2004/39/EC, by the UCITS Directive and, if undertaken by AIF managers, the AIFMD. • **Relation of bank-like activities and CRD/Annex I references -** some respondents also sought clarification of whether the four proposed bank-like activities for the identification of an activity as ’credit intermediation activities’ are independent of the eight activities proposed by reference to Annex I of CRD IV. **Definition of ‘excluded undertaking’:** Broadly, respondents’ view was that the proposed catalogue of excluded undertakings is too narrow, and does not take into account the wide diversity in underlying business models and activities that exists in practice. Various additional segments of the non-bank sector should be excluded from the definition of ‘shadow banking entities’. Respondents	**Definition of ‘credit intermediation activities’** *Portfolio management and advice:* On reflection, the EBA regards it as inappropriate to include this activity in the list of activities which institutions can consider automatically as ‘credit intermediation activities’, as it is not always the case that this activity will involve credit intermediation. Instead, the institution would need to carry out a case-by-case assessment of an entity’s business (assuming that the entity concerned does not carry out one of the other activities listed in the definition of ‘credit intermediation activities’) in order to identify whether the entity is to be considered a ‘shadow banking entity’ for the purposes of the guidelines. *Relation of bank-like activities and CRD/Annex I references:* The referenced activities mentioned in Annex I of the CRD should be understood as examples	**Definition of ‘credit intermediation activities’** *Portfolio management and advice:* The definition of ‘credit intermediation activities’ has been amended to omit the reference to point 11 of Annex I to the CRD (portfolio management and advice). *Relation of bank-like activities and CRD/Annex I*

Summary of responses received	EBA analysis	Amendments to the proposals
cited the existence of various regulatory frameworks that applied already to certain entities in the non-bank sector. Concerns on the impact of the proposed broad scope were expressed – including about the cost of financing to the real economy in some cases. A list of the entities that were put forward for exclusion by respondents (in addition to those identified in the EBA's proposed list of excluded undertakings) is provided below. Some respondents proposed that the EBA use the definition of 'unregulated financial entity' as set out in Article 142(1) point 5 of Regulation (EU) No 575/2013 (the CRR). • **Money market funds (MMFs)** – respondents noted that most MMFs in the EU (80% of the assets and 60% of the funds) operate under the rules of the UCITS Directive[44], with the remainder operating (since July 2013) under the rules of the AIFMD[45]. Respondents cited the following requirements as providing specific prudential controls: i) Run risk and/or liquidity problems are addressed by risk management, liquidity management requirements, gates and liquidity fees requirements as set out in Article 16 of the AIFMD and Section 4 of Regulation 231/2013[46], and/or	of credit intermediation activities. **Definition of 'excluded undertaking'** *MMFs:* The EBA notes the consultation feedback regarding MMFs. For the reasons given in the consultation paper the EBA considers that, at this stage, in particular pending the agreement of the European Commission's proposal for a regulation on MMFs[61], and noting the size of the funds (for instance, relative to other types of UCITS), it remains appropriate for MMFs to fall within the scope of the definition of 'shadow banking entity'. The EBA will keep the scope of the guidelines under review, in particular having regard to relevant regulatory	*references:* No amendment. **Definition of 'excluded undertaking'** *MMFs:* No amendment. *AIFs:* The definition of 'excluded undertaking', point K) has been amended.

[44] 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).

[45] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

[46] 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.

Summary of responses received	EBA analysis	Amendments to the proposals
Directive 2010/43/EU[47], as well as more MMF-specific requirements by CESR guidelines 10-49[48] and ESMA guidelines, which since 2010 have imposed strict limits in term of liquidity, risk and leverage on all MMFs in Europe and limit the use of derivatives. ii) Interconnectivity and spillovers are addressed by counterparty limits and risk management requirements as set out in Article 15 of AIFMD and Section 3 of Regulation 231/2013, the UCITS Directive and Directive 2010/43/EU. iii) Excessive leverage and procyclicality are addressed by limits on leverage and disclosure on leverage as set out in Articles 11, 22 and 112 of the AIFMD, the UCITS Directive, Directive 2010/43/EU and CESR guidelines 10-788[49], as well as more MMF-specific requirements by CESR guidelines 10-49 and ESMA guidelines 2014/110. iv) Opaqueness and complexity are addressed by the obligation	developments. *AIFs:* The EBA has considered the feedback received during the consultation period as well as input from ESMA and the European Commission. The EBA acknowledges that AIFs are regulated indirectly, as a result of requirements imposed on their asset managers under the AIFMD. However, the risks arising directly from the funds themselves are not mitigated in a satisfactory way from a prudential point of view. For example, while leverage is strictly limited for UCITS funds, a similar limitation does not apply to AIFs. Given this, the EBA is of the view that only AIFs with limited leverage could be considered to fall outside the definition of 'shadow banking entities'. Under the AIFMD, a	*Particular case of EuVECAs, EuSEFs and ELTIFs:* The definition of 'excluded undertaking', point K) has been amended to include these specific cases. *Transactions with underlying assets:* No amendment. *Securitisation*

[61] The Commission's proposal is available here: http://ec.europa.eu/finance/investment/money-market-funds/index_en.htm.

[47] Commission Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company.

[48] CESR's Guidelines on a common definition of European money market funds (review).

[49] CESR's Guidelines on a common definition of European money market funds.

Summary of responses received	EBA analysis	Amendments to the proposals
to report to investors and regulators (i.e. national competent authorities, ESMA and the ESRB) and supervise managers, as set out by Articles 22, 23, 24, 26, and Annex IV of the AIFMD, and by Commission Regulation (EU) No 583/2010[50]. Specific existing arrangements under the CRR (e.g. increases in risk weights for institutions' exposures to the unregulated financial sector, higher capital requirements for banks' investments in the equity of funds), as well as the introduction of liquidity and funding requirements under Basel III (e.g. liquidity coverage ratio, net stable funding ratio) were also invoked to prove that institutions will be less susceptible to liquidity and funding risks arising. The proposed MMFs Regulation[51] was noted, which will soon add to the weight of regulation on this sector. Further, the importance of MMFs as a source of funding for governments, corporates and financial institutions was highlighted – with concerns raised on how the guidelines may affect MMFs' role in providing this finance. • **Alternative investment funds (AIFs)** – respondents noted that all non-UCITS investment funds are regulated under AIFMD – which applies similar or even identical requirements to UCITS in many areas, e.g. liquidity management requirements, counterparty limits, leverage restrictions and disclosure. Respondents cited the following	fund manager who manages an AIF which employs leverage must, on a regular basis, disclose to its investors any change to the maximum level of leverage permitted as well as any re-hypothecation rights or any guarantee granted under the leveraging arrangement and the total amount of leverage employed by the AIF. For an institution, it would thus be easy to identify which AIF counterparty is leveraged or not. In addition to this condition, only AIFs which are not allowed to originate loans or purchase third parties' lending exposures and add them to their balance sheets would be excluded from the definition of 'shadow banking entity'. *Particular case of EuVECAs, EuSEFs and ELTIFs:* Regarding the particular case of EuVECAs (European Venture Capital Funds), EuSEFs (European Social Entrepreneurship Funds) and ELTIFs (European Long Term Investment Funds), the EBA is of the view that since these funds are	*activity:* No amendment. *Factoring and leasing companies:* The definition of 'financial institution' has been amended to clarify that it is to be interpreted in line with Article 119(5) of the CRR. *Payment institutions and electronic money issuers:* The definition of

[50] Commission Regulation (EU) No 583/2010 of 1 July 2010 on key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website.

[51] The Commission's proposal for the regulation is available here: http://ec.europa.eu/finance/investment/money-market-funds/index_en.htm.

Summary of responses received	EBA analysis	Amendments to the proposals
requirements as providing specific prudential controls: i) Run risk and/or liquidity problems are addressed by risk management, liquidity management requirements, gates and liquidity fees requirements as set out by Article 16 of the AIFMD, Section 4 of Regulation 231/2013 and the EVCA risk measurement guidelines[52]. ii) Interconnectivity and spillovers are addressed by counterparty limits and risk management requirements as set out by Article 15 of the AIFMD and Section 3 of Regulation 231/2013. iii) Excessive leverage and procyclicality are addressed by limits on leverage and disclosure on leverage as set out in Articles 11, 22 and 112 of the AIFMD. iv) Opaqueness and complexity are addressed by the obligation to report to investors, report frequently and in a granular way to regulators (i.e. national competent authorities, ESMA and the ESRB) and supervise managers, as set out by Articles 22, 23, 24, 26, and Annex IV of the AIFMD. It was stressed that supervisory reporting on a quarterly basis is mandatory for most AIFs and includes detailed information on portfolio composition, principal exposures and most	closed-ended vehicles that do not usually perform credit intermediation they should fall outside the definition of 'shadow banking entity' and be out of the scope of the guidelines. *Transactions with underlying assets:* The EBA notes that the guidelines apply in parallel with Commission Delegated Regulation (EU) No 1187/2014 of 2 October 2014. This delegated regulation addresses concerns related to the failure of a single counterparty or a group of connected counterparties and sets out conditions under which the transaction itself does not constitute an additional exposure and is not subject to a limit. The guidelines address a different set of concerns, as laid out in the background section, and require that any transaction is subject to a limit. *Securitisation activity:* The mere fact that a securitisation is compliant	'excluded undertaking' has been amended to include two new points dealing expressly with 'electronic money institutions' and 'payment institutions'. *Resolution authorities, bridge institutions and asset management vehicles and similar entities established for the purposes relating to the resolution of institutions:* The definition of 'excluded

[52] https://www.evca.eu/media/10083/EVCA-Risk-Measurement-Guidelines-January-2013.pdf

Summary of responses received	EBA analysis	Amendments to the proposals
significant counterparty concentrations, risk profile and liquidity management, which proves helpful for assessing the interconnectedness between institutions and other financial entities. Furthermore the AIFMD reporting has been developed with the specific aim of enabling supervisory authorities to effectively monitor systemic risks associated with AIF management. Specific reporting is due by AIFs that use significant leverage (commitment in excess of 3 for 1 of capital). v) An exchange of information on the potential systemic consequences of AIFM activity is ensured by Article 116 of the AIFMD.	with the 'Simple, transparent and standardised' (STS) requirements would not be sufficient to justify securitisation vehicles being 'excluded undertakings'. In fact, the STS requirements do not mitigate prudential risk as such. Nevertheless the institution could take into account the fact that a securitisation is compliant with STS requirements when setting up a limit to its individual exposure to such securitisation. *Factoring and leasing companies:*	undertaking' has been amended to include a new point for such entities. *Financial companies carrying out credit intermediation activities for group companies:*
vi) 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. The proposed Securities and Financing Transactions Regulation[53], Solvency II, and the Banking Structural Reform Regulation[54] were cited as a further set of requirements that will soon add to the weight of regulation on AIFs and the interactions between credit institutions and AIFs.	The feedback touches two different aspects. Firstly, the industry claims that there is low reliance on short-term funding amongst leasing companies. This point relates to the question whether the criteria of 'credit intermediation activity' are fulfilled or not (see above). The EBA notes in this regard that this statement needs to be taken into account while applying the guidelines. It does not request a modification of	The definition of 'excluded undertaking' has been amended to include a new point (o) to cover entities which have as their principal activity

[53] The Commission's original proposal for the regulation is available here: http://ec.europa.eu/finance/general-policy/shadow-banking/index_en.htm#maincontentSec1.

[54] The Commission's original proposal for the regulation is available here: http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0CC0QFjAB&url=http%3A%2F%2Feur-lex.europa.eu%2Flegal-content%2FEN%2FALL%2F%3Furi%3DCELEX%3A52014PC0043&ei=V6CSVYD_JcOX7Qan8JH4Cw&usg=AFQjCNHS6W7SrEYm95rX6F12fm86uF38RA&bvm=bv.96783405,d.ZGU.

Summary of responses received	EBA analysis	Amendments to the proposals
A number of bodies also stressed that the population of AIFs is very diverse – and that the draft guidelines risked applying an inappropriate 'one size fits all' approach that would ignore the divergent riskiness that different AIFs represent. In this same regard, some respondents suggested that only AIFs that employ substantial leverage (as defined in Article 111 of Regulation 213/2013) should be captured in the guidelines. The distinction that has been proposed between AIFs and UCITS was also questioned – as some respondents stated that AIFs are often not substantially different from UCITS in risk terms, or in terms of the prudential regime applied. Furthermore the treatment of non-UCITS (and MMFs) should be consistent throughout the large exposure framework, in particular considering Commission Delegated Act 1187/2014[55], which distinguishes funds solely based upon their added risk. Most respondents see no specific justification for not excluding from the scope of the term 'shadow banking entity' certain closed-ended and unleveraged AIFs, EuVECAs, EuSEFs and ELTIFs, as these provide useful and much-needed financing to EU businesses and economies. • **Transactions with underlying assets** – some respondents highlighted a risk of duplication in cases where institutions 'look through'[56] their	'credit intermediation activity'. Secondly, assuming that a specific leasing or factoring company exercises 'credit intermediation activity', these companies will fall within the definition of 'financial institution' according to point (e) of excluded undertakings. The EBA clarifies that the definition of 'financial institution' should be interpreted in line with Article 119(5) of the CRR (exposures to institutions). That is, where an institution's exposure to an entity (for instance a factoring or leasing company) is treated as an exposure to an institution pursuant to Article 119(5) of the CRR, because the entity is subject to a comparable prudential framework to that applicable to institutions in terms of robustness, the entity should be regarded as a 'financial institution' for the purposes of the guidelines. In such cases the entity shall not be treated as a 'shadow banking entity' for the purposes of the guidelines.	carrying out credit intermediation activities for their parent undertakings, for their subsidiaries or for other subsidiaries of their parent undertakings. **Consolidation** No amendment. **Equivalence of third country regimes** No amendment.

55 Commission Delegated Regulation (EU) No 1187/2014 of 2 October 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets.

56 See 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.

Summary of responses received	EBA analysis	Amendments to the proposals
exposures to investment funds in measuring their exposures for large exposures purposes. Where the look-through approach is used for measuring exposures to a fund (e.g. UCITs and AIFs), it was argued that additional exposure limits under the proposed guidelines are not necessary – and thus that the exposure to the fund should be excluded from the scope of the guidelines. • **Securitisation activity** – Related to the *Look-Through Approach*, some respondents noted that exposures to securitisations are also generally handled under this system – and thus that exposures arising in connection with securitisations should also be explicitly excluded from the scope of the guidelines. Additionally, some concerns were expressed that capturing securitisation exposures would run counter to the overall direction of policy at present, which is seeking ways to 'revitalise' securitisation markets. Such concerns applied also to special-purpose vehicles (SPVs) and conduits, which respondents argued should also be excluded from the guidelines. Traditional 'self-liquidating' securitisation activity, it was argued, does not involve material maturity transformation, as investors' rights to repayment arise from the cash generated by the underlying securitised assets. Given this, securitisation activity may not involve 'bank-like activity' and thus it should be made explicit that this situation is excluded from the definition of shadow banking for the purpose of these guidelines. Where securitisations meet the new requirements (to be finalised) for *simple, transparent, and standardised* securitisation, the above	*Payment institutions and e-money issuers:* The EBA agrees that, due to the Union frameworks applicable to such entities, the definition of 'excluded undertaking' should be clarified to make it clear that such entities are not to be treated as a 'shadow banking entity' for the purposes of the guidelines. The EBA also points out that this clarifies a pre-existing policy position. *Resolution authorities, bridge institutions and asset management vehicles and similar entities established for the purposes relating to the resolution of institutions:* The EBA agrees with the consultation feedback regarding the treatment of exposures to entities established for purposes relating to the resolution of institutions pursuant to Directive 2014/59/EU or for similar purposes as, broadly speaking, these entities are established in pursuance of public policy objectives relating to financial stability. Accordingly the EBA agrees that such entities should not fall within the scope of the definition of 'shadow banking	**Groups of connected clients** The definition of 'exposure to shadow banking entity' has been amended to clarify that these are exposures to individual entities.

Summary of responses received	EBA analysis	Amendments to the proposals
arguments for exclusion were felt to be stronger still. Additional relevant prudential requirements in relation to securitisation were also noted – including within the CRR, where specifics are laid out on minimum retention, the treatment of liquidity lines to SPVs and the risk weighting of credit exposures[57]. • **Factoring and leasing companies** – feedback from the industry noted that this sector is regulated under national law[58], and thus is subject to some prudential requirements that ensure risks are appropriately managed. Given this, some respondents advocated for the exclusion of this sector from the scope of the guidelines. Further, it was claimed that the activity in this sector is not generally 'banking-like' – and therefore it would not be appropriate for the sector to be labelled as 'shadow banking'. In particular, it is claimed that there is low reliance on short-term funding amongst these companies, that leverage is not a major feature of the markets they operate in and that they are generally transparent – e.g. via published accounts of parent companies. The statement by the Haut Conseil de Stabilité Financière	entity'. *Financial companies carrying out credit intermediation activities exclusively for group companies:* The EBA notes the consultation feedback regarding the treatment of entities which carry out credit intermediation activities exclusively (or as their main business) for non-financial sector group companies. The EBA agrees that such entities should not fall within the scope of the definition of 'shadow banking entity' as long as their principal activity is to carry out credit intermediation activities for other entities of their non-financial group and not for third parties. **Consolidation**	

57 See Part 3, Chapter 5, and Part 5 of the CRR.

58 For example, the feedback noted national regimes in (i) supervision by the German supervisory authority for financial services institutions and the Deutsche Bundesbank that are legally enabled by the German Banking Act to obtain a comprehensive assessment of the risk situation of any leasing company at any time, (ii) UK Financial Conduct Authority's regime regulating the consumer credit markets and (iii) authorisation and regulation by the French national competent authority.

Summary of responses received	EBA analysis	Amendments to the proposals
(HCSF) in its 2015 annual report that French financing companies do not constitute shadow banks was noted[59]. It was also suggested that it should be clarified that rental companies are not considered leasing companies. • **Payment institutions and electronic money institutions** – their exclusion should be clarified, as such institutions are regulated and authorised under the EU Payment Services Directive 2007/64 (PSD-1) and EU E-money Directive 2009/110, and also, if credit related to payment services is granted, under Article 16, paragraph 3, of the PSD-1. • **Public resolution agencies** ('Finanzmarktstabilisierungsfonds') – these institutions wind down risk exposures and non-strategic business lines from banking institutions in trouble. They are subject to German national legislation[60] and supervision by the German Federal Agency for Financial Market Stabilisation and the German Federal Financial Supervisory Authority. • **Finance companies relating to industrial groups** – concerns were expressed that the proposed approach would capture exposures to entities that carry out 'bank-like activities' only as a small part of their business, e.g. the treasury/liquidity management function of	The EBA's intention is to exclude entities which are subject to prudential consolidation (i.e. which form a group with an institution) and to which CRR/CRD requirements apply at the consolidated level. **Equivalence of third country regimes** The EBA notes the consultation feedback regarding the process for assessing the equivalence of third country regimes. The EBA notes that this is a cross-cutting issue relevant to the application of various provisions of the CRD/CRR which refer to entities subject to third country regimes comparable to those in the Union. Consistent with normal practices, it is for institutions to assess whether a third country regime is comparable. In so doing, institutions may have regard to relevant decisions, including the Commission's Decision of 12 December 2014 on the equivalence of the supervisory and regulatory requirements of certain third countries and territories for the purposes of the treatment of exposures	

[59] http://www.economie.gouv.fr/files/hcsf_rapport_annuel_062015.pdf

[60] Act on the Establishment of a Financial Market Stabilisation Fund (Finanzmarktstabilisierungsfonds Gesetz, FMStFG).

Summary of responses received	EBA analysis	Amendments to the proposals
corporates. It was considered disproportionate to capture the exposure within the guidelines, as such intragroup operations are industry standard practices and neither create additional risks for the group as a whole nor increase the interconnectedness with institutions and the financial system (and thus do not pose a systemic risk). EMIR exempts intragroup OTC derivative transactions from the clearing obligation and margining requirements for non-centrally cleared transactions as long as the clearing thresholds are not crossed. In the same way, Article 2(1)(b) of Directive 2014/65/EU (MiFID II) deliberately waives the application of its provisions in full with regard to investment services exclusively provided for parent undertakings, for subsidiaries or for other subsidiaries of the parent undertaking. The EU legislature also recognises that (i) transactions in derivatives which are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity and (ii) intragroup transactions that serve group-wide liquidity or risk management purposes shall not be considered when determining the extent to which ancillary activities constitute a minority of activities at a group level for MiFID II purposes (see Article 2(4), fifth subparagraph, of MiFID II). To address this point, some respondents proposed that only entities that carry out banking activity as their *main* business should be	according to Regulation (EU) No 575/2013 of the European Parliament and of the Council[62], and any relevant assessments of relevant authorities in the Member State in which the institution concerned is established and other relevant materials. In line with normal supervisory practices, competent authorities will be able to challenge the assessment of institutions as to the comparability of third country regimes. **Groups of connected clients** The EBA clarifies that these guidelines only apply to exposures to individual counterparties, i.e. individual shadow banking entities, and do not require the creation of groups of connected clients. The large exposures regime, as set out in Regulation (EU) No 575/2013, applies independently of these guidelines.	

[62] The Commission's decision is available here: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.359.01.0155.01.ENG.

Summary of responses received	EBA analysis	Amendments to the proposals
captured by the guidelines. As an alternative, other respondents proposed that the *de minimis* exposure amount should be increased from 0.25% of a bank's capital to either 1% or €300m. **Consolidation:** Respondents supported the approach of excluding entities that are consolidated on an institution's balance sheet. It should be clarified that this applies also for entities consolidated on a voluntary basis, or entities that are 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. **Equivalence of third country regimes:** In addition to scope issues, further clarity was sought on how the guidelines would work in practice in some areas. Most prominently, respondents noted a lack of clarity on how to judge whether a third country's prudential/regulatory requirements are 'equivalent' or 'comparable' to those applied under Union law. Respondents supported an approach that would allow institutions to make their own equivalence/comparability assessments – subject to ex post review of those assessments by the authorities. This is seen as advantageous, as it would avoid delays associated with centralised equivalence decisions. At a minimum, further details were requested on how equivalence decisions would be taken forward by authorities. The importance of this issue was seen as particularly high in the area of the requirements for credit institutions and insurers. In such cases, few equivalence decisions have yet been taken by the Commission– and thus exposures to banks or insurers in many third countries may unnecessarily fall into the scope of the		

Summary of responses received	EBA analysis	Amendments to the proposals
guidelines unless a practical solution is identified. One respondent queried whether an insurance company in a third country not considered to have an equivalent regime would be considered within the scope of the guidelines. **Groups of connected clients:** Finally, it remained unclear to some respondents how the guidelines would apply to groups of connected clients (GCCs). Further details were requested to explain (i) whether the guidelines would apply only to an entity within a GCC that met the relevant shadow banking definition, or whether the guidelines would instead capture the entire GCC as a single exposure, and (ii) the procedure to adopt in case of a classification of the parent company as an unregulated financial entity pursuant to Q&A 2013_492.		
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.		
{30 out of 57 respondents were silent on this question} According to a minority (4) of the respondents, this question should not be addressed at this stage, as establishing processes and control mechanisms is only possible once the scope of exposures under review has been clearly defined, or a full impact assessment has been conducted. Several of the respondents (8) broadly agree with the approach taken in allowing institutions to rely on their own internal framework and risk	The EBA notes the broad support for the guidelines' approach regarding the setting up of internal limits by the institutions. The EBA also notes the comments on the need to apply the guidelines in a proportional way. However, the EBA is of the view that risks posed by exposures to shadow banking entities need	No amendment.

Summary of responses received	EBA analysis	Amendments to the proposals
appetite to set internal limits. There is, however, also a substantial call (9) to introduce a principle of proportionality. This is justified because (i) the scope is so broad as to encompass entities which are very different in nature and not exposed to the same increased risks and (ii) the requirement to 'identify all potential risks [...] and the potential impact of those risks' is relatively broad and will result in operational challenges. According to their views, some exposures warrant very high levels of due diligence, whereas other exposures could easily be demonstrated to be less risky and less complex. The intensity and frequency of monitoring carried out should vary accordingly. Some respondents (4) stressed that it is important that the requirement for establishing effective process and effective mechanisms should be applied on a consolidated basis only, as: • Large exposure limits under CRR rules already apply at both solo and consolidated levels and so a sufficient backstop already exists within the current framework. • Applying the guidelines at consolidated level only would make it easier for institutions to manage the requirements within the ICAAP process, as individual legal entities may have only a partial view of the phenomenon. • The burden of infrastructure, systems and processes that institutions would need to put in place to comply with the guidelines would be kept proportionate.	to be monitored and managed regardless of the size, complexity or business model of the institution. The fact that institutions are allowed to set up internal limits as part of their risk assessment processes should ensure an application of the guidelines which is adequate to the institutions' risk profile. The EBA clarifies that these guidelines do not intend to introduce additional Pillar 2 requirements, but that the assessments should be done in the context of the regular Pillar 2 assessments, but with a focus on the shadow banking sector as a specific exposure class.	

Summary of responses received	EBA analysis	Amendments to the proposals
Some respondents (3) oppose aggregating limits, as they do not consider the targeted risk to be sectoral. It would be excessive to assume that shadow banking entities by their very nature have a default correlation close to one and thus pose a high concentration risk. Shadow banking entities are subject to (i) individual large exposure limits, (ii) a look-through approach to the ultimate underlying assets of a transaction and (iii) the limitation of exposures to individual counterparties or groups of connected clients under the current large exposure framework of the CRR. Some respondents therefore argued that an aggregate limit would give few additional benefits over the current framework. The targeted risk could be better addressed via ICAAP/Pillar 2, which specifically covers concentration risk, rather than the large exposure regime, which is intended to address default of single entities or groups of connected counterparties. It was requested that EBA clarify whether it wishes to introduce additional Pillar 2 requirements or whether compliance with the existing framework is sufficient, and whether the look-through requirements should be considered or not for the definition of the exposure. The assessment of the performed analyses could also be made consistent with the internal authorisation levels in the credit process. Some respondents (4) saw no issues of substance that would justify introducing additional specific Pillar II requirements relating to shadow bank exposures. In their opinion, requirements for institutions' risk management (credit risk, market risk, operational risk, etc.) are already sufficient to address shadow banking issues. Moreover, the use of Pillar 2 measures in such a		

Summary of responses received	EBA analysis	Amendments to the proposals
complex context might result in very heterogeneous implementation, thus endangering the level playing field among banks operating across borders. Furthermore the requirements regarding effective processes and control mechanisms, and oversight by the management body of the institutions as set out in the draft guidelines, would cause unnecessary additional administrative effort with few corresponding benefits.		
Q3. Do you agree with the approach the EBA has proposed for the purposes of establishing appropriate oversight arrangements?		
{37 out of 57 respondents were silent on this question} A significant number (8) of the respondents to this question share the EBA's view on the approach to oversight arrangements. This supports the view that institutions' management bodies must review and approve their shadow banking risk appetite and related risk management processes. Some respondents emphasised that attention should be paid to avoid duplication of work which would create additional burdens and overlaps. A minority of the respondents (3) explicitly opposed the idea of introducing separate qualitative requirements for exposures to shadow banks that are already part of Pillar II processes (e.g. internal risk management, governance of the institutions). These respondents do not see the need to add a specific layer for these broad bases of entities, as risk weighting criteria already exist for many of the transactions performed with clients/debtors or counterparties. One respondent even added that imposing such requirements is not covered by the mandate under Article 395(2) of the CRR.	The EBA notes the broad support for its proposals. The EBA agrees with the suggestion that the institution's management body could delegate certain reviews to senior management.	Amendment to the section on oversight by the management body of the institution.

Summary of responses received	EBA analysis	Amendments to the proposals
Another theme was that shadow banking entities should not be considered a single risk category. This could lead to underestimating risk for the risky exposures and over-allocation of risk management resources to the less risky exposures. Proportionality should be introduced taking into account the size, riskiness and nature of the exposures concerned. On a more practical side, it was also highlighted that the management body should be allowed to delegate necessary reviews to specialised and more relevant employees, such as the Chief Risk Officer and Risk Control function. Furthermore, sufficient time should be granted for the operationalisation of these requirements, e.g. via a phased implementation approach to avoid potential macrosystemic risks if banks are not in a position to use the principal approach on 1 January 2016. According to two respondents (2), it seems inappropriate to establish oversight arrangements before finalising a clear narrow definition of a shadow banking entity. Taking together a wide variety of vehicles may result in a very heterogeneous portfolio, the constituents of which are highly unlikely to impact an institution at the same time or in the same way. It seems unclear to these respondents how a bank would set a strategy and define a risk appetite for such a diverse group of exposures. Further, as the oversight arrangements cover such a wide array of exposures, it might distract the risk management's resources from the most risky ones. A full impact analysis is also requested, to show whether the sectoral definition applied for the aggregation under the shadow bank definition will result in a population which behaves in a correlated fashion.		
Q4. Do you agree with the approaches the EBA has proposed for the purposes of establishing aggregate and individual limits?		

Summary of responses received	EBA analysis	Amendments to the proposals
{31 out of 57 respondents were silent on this question} Some respondents (5) agreed in principle with the proposed approach and welcomed the principle of proportionality reflected within it. Opponents (7) claimed that no risk management benefits would be generated by the guidelines, as banks' routine lending processes and strategies for managing credit risk are already sufficiently robust. The approach was also criticised for potentially working against the objectives of Capital Market Union. Whereas a few (2) suggest having a limit at the aggregate level, most of the respondents (8) have significant reservations regarding the requirement for institutions to set an aggregate limit to the entire shadow banking sector. These concerns were particularly based on the heterogeneity of the targeted population, which would make calibration of an objectively 'appropriate' aggregate limit difficult. Individual limits were preferred by these respondents, as they could be calibrated more simply, and would better fit with the philosophy of the large exposure regime[63]. Those concerned with the calibration of aggregate limits requested that an impact study be undertaken. Further, they advocated the introduction of the following amendments: • Reduction of the scope of the guideline so as exclude all UCITS,	The EBA recognises the role the shadow banking sector plays in providing alternative sources of funding to the real economy. Given this, the EBA considers it premature to use the guidelines to introduce a quantitative limit to institutions' individual or aggregated exposures to these shadow banking entities. The approach described in the guidelines allows institutions to set risk tolerance levels for exposures to shadow banking entities, corresponding to their risk appetite, within their overall business model and risk management framework, with competent authorities retaining the ability to take supervisory measures where appropriate. This approach places the responsibility on institutions to demonstrate that the risks related to exposures to shadow banking entities are being managed effectively, in particular by improving, where necessary, the due diligence carried out concerning these exposures.	No amendment.

[63] The large exposure regime is traditionally designed to act as a backstop to individual client limits rather than to address sectoral credit concentration risk.

Summary of responses received	EBA analysis	Amendments to the proposals
and AIFs without substantial leverage, including VNAV MMFs. • Preferential treatment of exposures related to central clearing activities. • Exemption for certain custody-related services. • Increase of the materiality threshold. Should the EBA decide to introduce new limits, some respondents advocated either a blanket aggregate limit[64] or a general individual limit to shadow banking entities of 20% of eligible capital subject to the condition that the definition of shadow banking entities is narrowed. If these alternatives are not considered acceptable and the idea of establishing both individual and aggregate limits is retained, it was considered essential to drop the fallback approach. The issue was also raised whether the draft guidelines go significantly beyond the CRR mandate in setting out a combination of aggregate and individual limits.		

Q5. Do you agree with the fallback approach the EBA has proposed, including the cases in which it should apply? If not, please explain why and present possible alternatives.

Do you think that Option 2 is preferable to Option 1 for the fallback approach? If so, why? In particular:

[64] For example, at a level of between 500% and 800% of eligible capital.

Summary of responses received	EBA analysis	Amendments to the proposals
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?**		
{34 out of 57 respondents were silent on this question} A few respondents found it hard to agree or disagree with the fallback approach, as there is no justification as to why the 25% limit would be relevant. Some respondents expressed concern that the proposed fallback approach is unlikely to serve as an effective risk management tool, as it is quite blunt and might ignore the materiality aspect, which is part of every loan decision. Further, the need for a fallback was questioned, given that shortcomings in setting internal credit exposure limits can be addressed under the SREP. In addition, concerns were raised that this approach may run the risk of setting a de facto limit of 25% should banks be unable to meet the data requirements that would enable them to use the principal approach by 1 January 2016. If a fallback approach will be applied, the majority tended to favour Option 2. The following reasons were cited: • Shadow banking entities will be a very heterogeneous group with different business models, levels of disclosure and risk levels within their portfolios. Based on this heterogeneity, it does not seem appropriate that, if a credit institution gathers all required information for the majority of those entities but, for a small group of entities, cannot obtain the information required to set a	The EBA has given great consideration to the feedback received in the context of the consultation and has changed the design of the fallback option. The rationale was threefold. First of all, one the objectives of the guidelines is to create appropriate incentives for institutions to have in place the right processes and procedures to gather information on shadow banking entities. In this sense, the incapacity of an institution to get information on a minor part (or even on one only) of its exposures to shadow banking entities would de facto hinder the incentives for the 'search for information' also with reference to the other exposures to shadow banking entities. The EBA has also considered the importance of the coherence between the fallback approach and the concept of the 'unknown client' defined in the delegated regulation regarding the treatment of	The fallback approach has been redefined along the lines of Option 2 in the consultation paper.

Summary of responses received	EBA analysis	Amendments to the proposals
meaningful limits framework, all the bank's exposures to all shadow banking entities - regardless of the information obtained - should be perceived as an exposure to the 'same client' and, as such, will be subject to a 25% aggregate limit. • Option 2 makes better use of available information and provides stronger incentives to gather information about shadow banking exposures by rewarding the collection and use of pertinent data with appropriate and realistic exposure limits. • Option 2 is better aligned with the rationale of the large exposure framework to prevent institutions from incurring disproportionately large losses as a result of the failure of an individual client or group of connected clients due to the occurrence of unforeseen events. • Option 2 is better aligned with the approach of the RTS regarding the treatment of transactions with underlying assets. Here, the 'unknown client' bucket is only required for those exposures for which an institution fails to meet the specific principal requirements of the RTS. • The Option 2 approach is not unknown outside the area of large exposures, as it applies, for example, to investments in financial sector entities for purposes of capital deductions. • Option 2 leads to less overestimation of the total population in	exposures to transactions with underlying assets. Finally, the EBA is aware that a fallback approach based on Option 1 of the consultation paper might not fully respect the proportionality principle, which is one of the crucial elements of EU prudential regulation. Given the above, therefore, the EBA decided that the fallback approach should be implemented in a way that is coherent with Option 2 of the consultation paper. In particular, the fallback approach will be applied: i) to all exposures to shadow banking entities if institutions cannot meet the requirements regarding effective processes and control mechanisms or oversight by their management board; and ii) if institutions meet the above requirements of processes, control and oversight, only to those exposures to shadow banking entities for which sufficient information is unavailable. Regarding the calibration, results of the data collection show that a limit of 25% of the institution's eligible capital on aggregate exposures to shadow banking entities would have an impact on around half of the credit institutions and investment firms which reported individual exposures equal or above 0.25% of its eligible capital (i.e. 65 institutions	

Summary of responses received	EBA analysis	Amendments to the proposals
case of difficulty eliminating exempt institutions from their datasets. Option 1 is perceived by some as unnecessarily punitive and not in line with the development of enhanced risk-sensitive regulatory frameworks and internal modelling. In addition it does not provide incentives to develop a robust assessment process, as non-compliance with the principal approach for just one shadow banking exposure will lead to an overall limit to all shadow banking exposures. Furthermore, Option 1 could lead, in the short term, to swift systemic events resulting from the insolvency/fire sale of assets from the shadow banking entities that cannot provide the necessary information to the banking sector. The limit may need to be considerably higher than 25%, as banks may lend up to 25% of their eligible capital to each shadow banking entity with which they do business. A Quantitative Impact Study is requested before such an aggregate limit is set. Additionally, if the guidelines 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.	of the total of 184 institutions that participated in the data collection). However, it should be noted that the results of the data collection are very conservative given that a much wider definition of 'shadow banking entity' was used for purposes of the data collection than the definition used in these guidelines and that the simulations assume that all exposures would be captured by the fallback approach (Option 1 in the consultation paper). It is also noted that the number of individual exposures which are above 25% of the institution's eligible capital is extremely negligible (around 0.01% of all exposures reported). Everything considered and taking into account the risky nature of these exposures, the EBA believes it would be prudentially sound to align the fallback approach with the large exposures limits of 25% of eligible capital (with possible exceptions for positions in the trading book which meet the conditions in Article 395(5) of the CRR and could therefore exceed the 25% limit) to provide a backstop to exposures to counterparties for which the institution is not able to collect sufficient information to set out an internal limit.	

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?

Summary of responses received	EBA analysis	Amendments to the proposals
What would the impact of such a limit be in the case of Option 1? And in the case of Option 2?		
{34 out of the 57 respondents were silent on this question} Only a few respondents explicitly agree that the 25% limit is an appropriate limit for the fallback approach. The inclusion of a 'fallback' approach could run the risk of setting a de facto aggregate limit of 25%, as it is unlikely banks will be able to meet the data requirements to allow use of the principal approach from 1 January 2016. This in itself could pose a macrosystemic risk if most or all banks are forced to use the fallback approach from day one. For example, this may spark fire sales, thereby destabilising markets, leading to withdrawal of finance and affecting credit mediation. The majority of the respondents state that the 25% aggregate limit proposed under the fallback approach is overly conservative and onerous and lacks a robust justification. The assumption of interconnectedness is deemed erroneous and unrealistic. The mere fact that banks gather insufficient information to allow compliance with the specific rules of the principal approach does not imply that all the shadow banking exposures are highly correlated or should be connected. The variety of entities grouped together does not pose a single risk to an institution and should not be understood as the same client. The EBA should refrain from introducing elements related to geographic and sectoral risks that conflict with the existing policy framework for large exposures and the forthcoming framework of the BCBS. A limit of 25% applied sectorally is likely to lead to a need for exposure reductions by institutions, thereby	These guidelines will apply from 01.01.2017, therefore allowing sufficient time for institutions to prepare to meet the data requirements that are required to use the principal approach. The EBA notes the concerns regarding the 25% aggregate limit (fallback approach) and draws attention to its response to Q5. The EBA agrees with the consultation feedback pertaining to geographic and sectoral risks and therefore considers it unnecessary to assess exposures via this categorisation. The EBA has considered the proposed alternative to segment shadow banking exposures and has rejected it, as it is deemed too onerous to implement in practice and would not ultimately ensure a harmonised application of the guidelines and a level playing field and would not allow meaningful comparisons, as each institution may define different segments.	No amendment.

Summary of responses received	EBA analysis	Amendments to the proposals
having a potential impact on the supply of credit to SMEs and hampering growth as well as restraining recent efforts to revive the securitisation market. As an alternative, some respondents suggest that banks might have the possibility to segment shadow banking exposures between specific sub-groups. Where it is possible to prove that no correlation is observed within a sub-group, individual limits for shadow banking entities should be sufficient - even if the remaining data requirements are not totally fulfilled. In addition to the main distinction based on the prudential framework, some consider that the criteria of the nature of the activity, the level of risk and the possibility of 'run' effects could be used to introduce granularity in the treatment of shadow banking entities. If a fallback approach is nevertheless retained, then an appropriate limit, much higher than 25%, would need to be considered. Using the same percentage for an aggregate limit to the whole shadow banking sector as the one currently used for the large exposure limit of Article 395 of the CRR indicates that the proposed percentage is much too low. Reference was made to the aggregate limit for all large exposures (exposures exceeding the 10% threshold) of 800% of own funds in Directive 2006/48/EC (CRD II), a limit in the three-digit range or a whole-number multiplier of an institution's capital base.		