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AFG response to the consulation on the draft EBA Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework

Introductory remarks

- The Association Française de la Gestion financière (AFG) is grateful for the opportunity to respond to the consultation of the EBA on the raft EBA Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework.

- As an introductory comment, we would like to stress the **specificities of asset management actors and entities.** They do not collect any deposits but invest liquidities received from investors seeking an exposure and aware of the corresponding potential profits and losses. There is no credit risk transfer, as the credit risk is entirely passed on to the end investor. Maturity and liquidity transformation is far less important with asset management activities comparing to banking activities and is easier to manage.

- **We believe that shadow banking should be linked to non-regulated entities or structures embedding systemic risk (notably by using significant leverage) or to express regulatory arbitrage.** "Shadow banking" should imply opaque activities bearing systemic risk, with no definition or specific rules attached.

- **In this vein,** AFG supports the EBA for focusing on prudentially unregulated entities and for making the point that "some funds are regulated pursuant to prudential frameworks similar to those applied to credit institutions and investment firms." However, **we would like to precise that from a EU perspective, "the scope of prudential consolidation" is applicable both to entities, which are within the scope of the CRD as well as to entities, which are within the scope of Solvency 2. Therefore this double exemption should be recognized by the EBA.**

- **AFG welcomes the fact that investment firms and UCITS are left ouf the scope and that the EBA acknowledges the robustness of UCITS' framework.**

- **Nonetheless, we regret to see other AM activities considered "banking-like activities": MMF (including UCITS MMFs) & AIF.**

- AFG would like to remind that the **collective European asset management industry is tightly regulated** both at the activity and actor levels with materially reduced non-financial risks.

- **AIFs and MMFs, which are listed by the EBA as SB entities, are no exception to this, and therefore we would not consider them as operating " in the shadow" of the regulation** (AIFM Directive, UCITS Directive, Eligible Assets directive, ESMA Guidelines on a common definition on European Money Market Funds, forthcoming MMF Regulation).

- **AFG woud suggest keeping MMFs and AIFs, which don't use leverage on a significant basis, out of the scope.** MMFs and AIFs carry no credit risk transfer, as the credit risk is entirely passed on to the end investor. As for liquidity transformation, the risk is very limited for both types of funds as managers use management liquidity tools. MMFs are not leveraged, while most AIFs in Europe do not use leverage on a significant basis and are 'UCITS-like' funds.

- Regarding "UCITS-like', we have taken note that the EBA is allowing for an 'equivalence' with third country regimes when considering prudential regulation, and we don't see why this 'equivalence' approach couldn't be followed, in a similar way, within the EU between the UCITS regime and national regimes for UCITS -like AIFs.

- **AFG regrets that other reforms under negotiations or already set to "shield" banks from non-bank entities are not taken in account by the EBA in the consultation (e.g. EMIR, BSR, MMFR).**

The general approach proposed by the EBA is to exclude from the scope of the definition of'shadow banking entities' entities that are subject to an appropriate prudential framework either as a result of prudential consolidation or, where entities are not within the scope of consolidation, certain sector- specific prudential frameworks which are deemed to cover for the risks posed by the bank-like activities of the entity. With regard to funds nevertheless, non-MMFs UCITS established in the EU (and those established in third countries where equivalent supervisory requirements apply) would be excluded. Said differently, all funds would be considered as falling in the scope of the definition of shadow banking entities except if they are non-MMF UCITS (and third country firms subject to equivalent requirements). All MMFs (being UCITS or AIFs), all AIFs and all unregulated funds would fall in the scope.

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

In particular:

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

-Do you agree with the proposed approach to the exclusion of certain undertakings, including the approach to the treatment of funds? In particular, do you see any risks stemming from the exclusion of non-MMF UCITS given the size of the industry?

-If you do not agree with the proposed approach, please explain why not and present the rationale for the alternative approach(es) (e.g. on the basis of specific prudential requirements, redemption limits, maximum liquidity mismatch and leverage etc)

We disagree with the general approach and would suggest to **focus strictly on to non-regulated entities or structures embedding systemic risk (notably by using significant leverage) or to express regulatory arbitrage.** "Shadow banking" should imply opaque activities bearing systemic risk, with no definition or specific rules attached.

Also if AFG welcomes the fact that investment firms and UCITS are left out of the scope and that the EBA acknowledges the robustness of UCITS' framework, we regret to see other AM activities considered "banking-like activities": MMF & AIF.

a. MMFs

No justification is brought by the EBA as to why it wants to include MMFs in the scope of the Guidelines.

We believe MMFs are tightly regulated and subject to prudential rules and that as such they don't fulfill the first criterion establised by the EBA to be considered as shadow banking entities. AFG would like to highlight that currently almost all of MMFs in Europe are complying with UCITS directives, the Eligible Assets directive, ESMA Guidelines on a common definition on European Money Market Funds, **and that a specific Money Market Funds Regulation (MMFR), currently close to final adoption, was explicitly proposed by the European Commission to tackle the supposed risk of shadow banking in the area of MMFs and will, once adopted, tackle the potential risks identified by EBA**. For instance, the liquidity rules voted by the European Parliament in the MMFR will reduce considerably the risk of liquidity mismatch, as it requires MMFs to comply with daily and weekly liquidity thresholds for 10% and 20%. **Thus we see no reason to include all MMFs as relevant shadow banking entities, at least as soon as the MMF Regulation will be definitively adopted.**

If anything, the definition of the type of fund subject to scrutiny under shadow banking should be focused on the risks which stem from the discrepancy between marked to market and published NAV in the specific case of constant NAV MMFs.

b. AIFs

No justification is brought by the EBA as to why it wants to include all AIFs in the scope of the Guidelines.

We believe AIFs are tightly regulated and subject to prudential rules and that as such they don't fulfill the first criterion establised by the EBA to be considered as shadow banking entities.

As for the second criteria (credit intermediation), we believe that risks identified with AIFs such as leverage effect, maturity and liquidity transformation as well as credit risk exposure are tightly limited at the level of low leveraged AIFs: the vast majority of AIFs are not hedge funds, and are regulated at national level as UCITS-like funds.

AIFs, especially AIFs without significant leverage as defined by AIFMD (3:1), should not be considered SB entities given their rules in terms of leverage, investment diversification, liquidity credit and counterparty risk management as well as the strict and continuous control they are subject to.

Under AIFMD, supervisory reporting is mandatory for most AIFs on a quarterly basis and includes detailed information on portfolio composition, principal exposures and most important concentrations, risk profile and liquidity management.

The AIFMD reporting also provides helpful data for assessing the interconnectedness between banks and other financial entities. These requirements have been developed with the specific

aim of enabling supervisory authorities to effectively monitor systemic risks associated with AIF management**.**

We understand that banks exposure to highly leveraged funds is a source of concern for the EBA, but this matter is to be dealt with the current negotiation on the Banking Structural Reform at level 1, and should not be adressed via level 3 regulation.

4. 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.

If relevant entities were to be considered as SB entities (cf. answer to question 1) and in order to avoid burdensome procedures, AFG would suggest having a limit at aggregate level. Monitoring of individual exposures should exist, but we do not think that individual limits should be required.

5. 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:

· 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?

It's hard to agree or disagree with the fall back approach, as there is no justification as to why the 25% limit woud be relevant. For the same reasons, it is hard to assess whether option 1 or 2 would be more relevant.

If and only if the relevant entities were to be identified as SB entities (cf. answer to question 1), AFG would support the principal approach.

6. 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? What would the impact of such a limit be in the case of Option 1? And in the case of Option 2?

See answer to question 5.

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