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AFG response to EBA's consultation on Draft Regulatory Technical Standards

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AFG welcomes EBA's consultation on Draft Regulatory Technical Standards on criteria for the identification of shadow banking entities under Article 394(4) of Regulation (EU) No 575/2013.

AFG believes that European regulated funds should not be included in the shadow banking entities list that serves for the LE regime. Currently, regulated funds are either framed under the UCITS or the AIFM Directives. In addition to the AIFMD framework, national competent authorities have issued national regulatory regimes for non UCITS funds. The vast majority of AIFs in France are UCITS like funds (66% of AIFs by AUM are open to retail and employee savings schemes that benefit from UCITS like provisions).

Regarding the vocable "shadow banking", AFG would like to remind that a new, more appropriate vocable is used internationally and benefits from increasing and extended research and statistics: Non-bank Financial Intermediation (NBFI). For instance, the ESRB does a report called: NBFI Monitor[1].

This vocable has replaced shadow banking. We would thus like to use this consultation's occasion to urge EBA to drop this stigmatising vocable.

Regarding the specific categories mentioned by the consultation, AFG strongly believes that there is no reason to include them in the shadow banking entities list under Article 394(4) of Regulation (EU), No 575/2013. Namely, AFG opposes that money market funds (MMFs), 3 times leveraged AIFs and AIFs that grant loans are considered under this shadow banking scope. These funds are not non-regulated funds and they don't bear a risk that would justify this inclusion.

[1] NBFI Monitor No 6 / August 2021 EU Non-bank Financial Intermediation Risk Monitor 2021 https://www.esrb.europa.eu/pub/pdf/reports/nbfi_monitor/esrb.202108_eunon-bankfinancialintermediationriskmonitor2021_~88093a4a94.en.pdf

AFG's rationale regarding MMFs

AFG disagrees heavily with the inclusion of MMFs in the shadow banking scope. We would like to recall that the vast majority of MMFs are UCITS and in addition they bear the MMFR (Money Market Fund Regulation) specific layer of regulation.

This latest dedicated reform to MMFs in Europe is quite recent in its application (since January 2019 on the existing funds and delivering a quarterly reporting since the 1st quarter 2020), has been a heavy one and resulted in MMFs being resilient during the unforeseeable exogenous global COVID-19 sanitary crisis.

MMFR has already imposed very stringent rules on MMFs: rules on diversification, eligible assets restrictions, immediate liquidity cushions, WAM/WAL/maturity limits, valuation rules, market and liquidity stress tests, Know Your Customer rules, reportings, etc. We think MMFR has done a lot and it is not clear to us why the COVID-19 crisis episode should have as a consequence the integration of MMFs as shadow banking entities.

During the crisis, the stringent need for cash expressed by MMF investors, especially corporates, amounted to high levels of redemptions from MMFs. MMFs are liquid funds that were used in priority compared with other types of assets, even if the redemption was high almost in all asset classes. We would like to recall that the current regulation has permitted during the unprecedented COVID-19 crisis to ensure that the vast majority of redemptions orders be fulfilled before the PEPP become effective. They are already resilient and permit to respond to clients demands even in periods of stress.

AFG does not think that the COVID-19 crisis revealed MMFs' vulnerabilities. Seeking further improvement of an already very resilient vehicle (that has undergone a heavy reform not so much time ago) is a sound goal. However, over-emphasizing the MMFs potential vulnerabilities through the lens of a global unprecedented sanitary pandemic seems to us somewhat disproportionate. In addition, it might possibly convey the wrong message that it is the fund that should be fixed, not the orderly functioning of the underlying markets.

AFG's members would like to recall that:

1. Unlike the 2008 episode, no issue is to be reported linked to the composition of the portfolio, especially in terms of the quality of assets; funds are sane and resilient in their construction and composition. MMFR increased funds resilience and proved to be efficient.

2. European MMFs have not been bailed out by the ECB: we recall that the bulk of redemptions in French VNAV MMFs were already dealt with before the ECB's intervention became effective on 27th of March.

3. Exogenous shock to money markets: As the sanitary Covid-19 crisis took in March a global dimension and impacted both real economy and financial markets, money markets underwent a sudden series of brutal imbalances where:

   – many corporates withdrew their money (from credit lines, deposits and MMFs) to face a brutal drop in their revenues due to the economic quasi shutdown trigged by the pandemic

   – in consequence, MMFs stopped purchasing money market instruments and requested bids from the banking system to buy some of their holdings in order to rebuild their cash buffers

   – eventually, banks – already impacted by their corporate clients' funding requests - could not anymore absorb these flows, thus concentrating the liquidity stress, in a context that got worse with the looming quarter end.

4. MMFs should be seen as the "canary in coal mine" and should not be designated as the ideal culprits each time there is a crisis. Thanks to their role in the liquidity sphere, authorities are quickly informed about markets disruptions. Thanks to a well-organized cash management industry with well-identified investment vehicles and well-identified fund managers, authorities have highly valuable interlocutors to talk to.

AFG thus reiterates that MMFs are highly regulated funds in Europe and in addition their regulation will undergo an even further reform on targeted points. There is no reason to consider them as shadow banking entities. The

European regulation ensures that the risk of liquidity or maturity transformation is contained and very low. What could be risky would be the excess of transformation, but this is not permitted in any case. In reality, if you take the impact of the COVID-19 crisis on MMF investors for instance, the only impact was a performance impact of a few basis points.

AFG therefore urges the EBA to leave MMFs out of the scope.

AFG's rationale regarding significantly leveraged AIFs (3 times the commitment measure)

AFG reminds that these funds are regulated too by AIFMD and bear in addition specific requirements. They should be exempted too.

There are specific reporting requirements and authorities have already an intervention power regarding the use of leverage by AIFs. In this respect, ESMA has in addition released in December 2020 its final guidance to address leverage risks in the Alternative Investment Fund (AIF) sector[2].

ESMA's guidelines set out common criteria in order to promote convergence in the way NCAs assess the extent to which the use of leverage within the AIF sector contributes to the build-up of systemic risk in the financial system; and design, calibrate and implement leverage limits.

These guidelines operationalise the Article 25 of AIFMD intervention powers related to leverage by providing NCAs with a set of indicators to be considered when performing their risk assessment and a set of principles that NCAs should take into account when calibrating and imposing leverage limits.

The guidelines respond to the European Systemic Risk Board (ESRB)'s requirement that ESMA produces guidance on Article 25 of the AIFMD (Directive 2011/61/EU). The objective is to provide a common framework for NCAs to identify the extent to which the use of leverage in the AIF sector contributes to the build-up of systemic risk in the financial system, risks of disorderly markets or risks to the long-term growth of the economy.

[2] https://www.esma.europa.eu/press-news/esma-news/esma-publishes-final-guidance-address-leverage-risk-in-aif-sector

All these regulatory elements reinforce the treatment of any leverage risk in leveraged AIFs.

In addition, in technical terms, any possible inclusion in the shadow banking scope of a fund on an individual fund basis with regards to the leverage criteria should consider in addition risk-based measures. We recall that the commitment is an exposure metric and this 3 times the commitment measure (to qualify as a substantially leveraged AIF) is not always meaningful from a risk perspective. It overstates the risk, like for a non-risky AIF that just manages short term futures for instance. This is why, local regulators like AMF are using in addition the UCITS leverage measures (and limits) to more adequately grasp global exposure for UCITS-like AIFs on an individual basis.

AFG's rationale regarding AIFs that grant loans

The consultation paper suggests that AIFs which are « entitled to grant loans or purchase third parties' lending exposure onto their balance sheet » should be identified as shadow banking entities (point 75).

We would like to point out the fact that in France for instance, AIFs that grant or purchase loans are submitted to a stringent regulation. In France, the possibility to grant or purchase loans is specific to certain types of AIFs, and the asset management company must obtain a special agreement from the national competent authority NCA (AMF) to be able to perform in this space. These AIFs and their management company, as well as banks, are stringently regulated, regarding for instance:

- Expertise within the asset management company (managers or analysts with prior experience in a lending entity, with expertise covering the financial, legal, and structuring aspects of loans)
- Procedures (credit risk analysis procedure, loans granting procedure, etc.)
- Credit and legal risk analysis framework, including analysis of guarantees or collateral
- Know your customer KYC / anti-money laundering diligences

- Risk monitoring and control
- Reporting to authorities (AMF and Banque de France)

We therefore consider that these AIFs should definitely not be considered as shadow banking entities. We thus propose to narrow the scope of these AIFs to those that do not benefit from a stringent national regime. All French AIFs that may grant loans should be clearly and namely out of the scope.

If you need any further information, please don't hesitate to contact me at +33.1.44.94.94.31 (a.gurau.audibert@afg.asso.fr).

Sincerely Yours,

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