



EBA/CP/2021/30

26 July 2021

Consultation Paper

Draft Regulatory Technical Standards

on criteria for the identification of shadow banking entities under
Article 394(4) of Regulation (EU) No 575/2013

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1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 26 October 2021. Please note that comments submitted after this deadline or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

Article 394(4) of the CRR requires the EBA to develop draft regulatory technical standards (RTS) to specify the criteria for the identification of shadow banking entities. In developing these draft RTS, EBA is required to take into account international developments and internationally agreed standards on shadow banking and consider whether, (a) the relation with an individual entity or a group of entities may carry risks to the institution's solvency or liquidity position; (b) entities that are subject to solvency or liquidity requirements similar to those imposed by this Regulation and Directive 2013/36/EU should be entirely or partially excluded from the obligation to be reported on shadow banking entities.

Regulation (EU) No 2019/876 amending the CRR has modified slightly the reporting obligation of Article 394(2) of the CRR. Where it said before “An institution shall report [...] its 10 largest exposures on a consolidated basis to unregulated financial entities [...]” it now states “an institution shall report [...] its 10 largest exposures to shadow banking entities which carry out banking activities outside the regulated framework on a consolidated basis [...]”. This amended obligation becomes applicable on 28 June 2021.

The CRR requires the EBA to submit the draft RTS to the Commission by 28 June 2020. However, in November 2019, the EBA adopted roadmaps with a planned timetable to deliver regulatory deliverables resulting from Regulation (EU) No 2019/876 amending the CRR. Accordingly, the EBA should submit these draft RTS to the Commission by December 2021.¹

The main basis for the development of the draft RTS has been the guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395(2) of Regulation (EU) No 575/2013.² These guidelines were published in December 2015 to give effect to the mandate of Article 395(2) of the CRR.

The draft RTS is a rather short legal text with three main legal provisions addressing the following:

- Criteria for identifying both shadow banking and non-shadow banking entities;
- Definition of banking activities and services; and
- Criteria for excluding entities established in third countries from being deemed as shadow banking entities

In a nutshell, entities that carry out banking activities or services and have been authorised and are supervised in accordance with the regulatory framework consisting of any of the legal acts referred to in Annex I of these draft RTS shall not be considered as shadow banking entities; the same treatment shall apply to the entities that are exempted or excluded from the application of some of those legal acts, notably the CRR, the CRD, EMIR and Solvency II. On the contrary, all other entities that provide banking activities and services shall be considered shadow banking entities, however specific rules apply to certain collective investment undertakings.

¹ The EBA published on 21 November 2019 a roadmap on the Risk Reduction Measures (RRM) package with a planned timetable to deliver the regulatory deliverables according to the mandates given by the CRR2 to the EBA. (<https://eba.europa.eu/eba-publishes-its-roadmap-risk-reduction-measures-package>).

² See here: <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/1310259/f7e7ce6b-7075-44b5-9547-5534c8c39a37/EBA-GL-2015-20%20Final%20report%20on%20GL%20on%20Shadow%20Banking%20Entities.pdf>



In the case of entities established in a third country, the draft RTS differentiate between banks and other entities: banks would not be identified as shadow banking entities provided that they are authorised and supervised by a supervisory authority that applies banking regulation and supervision based on at least the Basel core principles for effective banking supervision; other entities would not be identified as shadow banking entities provided that they are subject to a regulatory regime recognised as equivalent to the one applied in the Union for such entities in accordance with the equivalence provisions of the relevant Union legal act.

Next steps

The draft regulatory technical standards will be submitted to the Commission for endorsement following which they will be subject to scrutiny by the European Parliament and the Council before being published in the Official Journal of the European Union.

3. Background and rationale

1. The large exposure (LE) framework is a tool for limiting the maximum possible loss that a credit institution could face in the event of the sudden failure of a client or a group of connected clients, if available. By requiring credit institutions to measure and limit the size of their LE in relation to their Tier 1 capital, the LE framework acts as a backstop that complements the regulatory capital framework. In this sense, the LE framework also contributes to the stability of the financial system by reducing the possibility of contagion risk between credit institutions.
2. The BCBS is of the view that the LE framework is a useful tool to mitigate the risk of contagion between global systemically important banks, thus supporting global financial stability. Further, the LE framework is also seen as a useful tool to contribute to strengthening the oversight and regulation of the shadow banking system in relation to LE.³ In particular, the rules for the treatment of exposures to funds, securitisation structures and collective investment undertakings (CIU) and the requirement for banks to apply a look-through approach (LTA) when appropriate, help achieving this objective.
3. The LE framework applicable to institutions⁴ in the European Union is laid down in Regulation (EU) No 575/2013 (the CRR).⁵ Supplemented by technical standards and guidelines developed by the European Banking Authority (EBA), the Union's LE framework was inspiration for the large exposures standard (LEX) of the Basel Committee on Banking Supervision (BCBS) introduced in 2019.
4. The LE rules in the CRR were amended following the adoption of Regulation (EU) No 2019/876 (CRR2) amending the CRR.⁶ One of the consequences of these amendments has been a greater alignment of the Union's LE framework with the LEX e.g. taking Tier 1 as reference instead of eligible capital. In addition to dedicated rules related to the treatment of exposures with underlying assets (CIUs, securitisation structures) and the requirement for institutions to apply a look-through approach, the reporting obligations in relation to an institution's 10 largest exposures to non-bank exposures⁷ formerly named "unregulated financial entities" was clarified by using the

³ LEX Large exposures of the Basel Committee on Banking Supervision (BCBS), rationale and objectives of a large exposures' framework, paragraph 10.3. https://www.bis.org/basel_framework/standard/LEX.htm?type=all

⁴ According to point (3) of paragraph 1 of Article 4 of the CRR, an institution means a credit institution or an investment firm. Article 387 of the CRR states that "Institutions shall monitor and control their large exposures in accordance with this Part."

⁵ 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 176 27.6.2013, p. 1) <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02013R0575-20200627>

⁶ Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (OJ L 150, 7.6.2019, p. 1–225) <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R0876>

⁷ Article 394(2) of the CRR.

term “shadow banking entities” already introduced to the CRR (see Article 395(2) of the CRR) and specified in the EBA guidelines on limits on exposures to shadow banking entities (EBA/GL/2015/20, hereinafter, the EBA guidelines).⁸

3.1 Legal mandate

5. Further to the amendments of Regulation (EU) No 2019/876, Article 394(2) of the CRR on *reporting requirements* states that

[...] institutions shall report the following information to their competent authorities in relation to their 10 largest exposures to institutions on a consolidated basis, as well as their 10 largest exposures to shadow banking entities which carry out banking activities outside the regulated framework on a consolidated basis, including large exposures exempted from the application of Article 395(1) [...].

6. Moreover, the new paragraph 4 to Article 394 mandates the EBA to

develop draft regulatory technical standards to specify the criteria for the identification of shadow banking entities referred to in paragraph 2. In developing those draft regulatory technical standards, EBA shall take into account international developments and internationally agreed standards on shadow banking and shall consider whether:

(a) the relation with an individual entity or a group of entities may carry risks to the institution's solvency or liquidity position;

(b) entities that are subject to solvency or liquidity requirements similar to those imposed by this Regulation and Directive 2013/36/EU should be entirely or partially excluded from the obligation to be reported referred to in paragraph 2 on shadow banking entities.

EBA shall submit those draft regulatory technical standards to the Commission by 28 June 2020.

7. The reporting framework 3.0, applicable from 30 June 2021, reflects the changes introduced by CRR2, amongst other things, to the LE regime. Annex IX concerns instructions for reporting LE and concentration risk. In order to report information on the 10 largest exposures to institutions, on a consolidated basis, as well as on the 10 largest exposures to shadow banking entities which carry out banking activities outside the regulated framework on a consolidated basis, the parent institutions in a Member State shall use templates LE1, LE2 and LE3. The exposure value calculated in column 210 (“Total”) of template LE2 is the amount that shall be used for determining these 20 largest exposures.⁹

⁸ EBA/GL/2015/20 of 15 December 2015 Guidelines on 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. <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/1310259/f7e7ce6b-7075-44b5-9547-5534c8c39a37/EBA-GL-2015-20%20Final%20report%20on%20GL%20on%20Shadow%20Banking%20Entities.pdf>

⁹ For information on the reporting framework 3.0, see the EBA website <https://www.eba.europa.eu/risk-analysis-and-data/reporting-frameworks/reporting-framework-3.0>

8. In November 2019, the EBA adopted roadmaps with a planned timetable to deliver regulatory deliverables resulting from the CRR2. Given the need to prioritize the high number of newly introduced mandates and the existence of the EBA guidelines and the definition included therein, it was decided to postpone the date of delivery by 1.5 years. Accordingly, the draft RTS under Article 394(4) of the CRR should be submitted to the Commission by December 2021.
9. Under the mandate of Article 395(2) of the CRR, the EBA guidelines were published in 2015. The EBA guidelines were published with the objective of setting specific LE limits to shadow banking entities under Pillar 2 in view of the risks that such entities pose to the financial system. On the contrary, the new mandate under Article 394(4) of the CRR requires the identification of shadow banking entities specifically for the purposes of reporting and, in any case, of only the 10 largest exposures rather than of all exposures to shadow banking entities.
10. The EBA guidelines define credit intermediation activities as well as shadow banking entities by exclusion. Given the continued relevance of these guidelines in the Union's LE framework, the fact that the mandate in Article 395(2) of the CRR remains unaltered, and having due regard to the ultimate prudential objective of ensuring consistency of the implementation of the single rulebook on LE to institutions in the Union, these draft RTS rely to a great extent on the work undertaken for the EBA guidelines.

3.2 The shadow banking system

3.2.1 Shadow banking entities identified in the EBA Guidelines

11. In the EBA guidelines, the EBA assessed the shadow banking system, noting its complementary role of the traditional banking sector by expanding access to credit in support of economic activity or by supporting market liquidity, maturity transformation and risk sharing, thereby promoting growth in the real economy. It noted however that the financial crisis had revealed fault lines in the shadow banking system which put the stability of the financial system at risk, e.g. a heavy reliance on short-term wholesale funding and a general lack of transparency. In this respect, the EBA identified some concerns regarding shadow banking entities, namely a) run risk and/or liquidity problems; b) interconnectedness and spillovers; c) excessive leverage and procyclicality; and d) opaqueness and complexity.
12. The EBA guidelines developed a definition of the terms 'shadow banking entities', 'banking activities' and 'regulated framework' given that the CRR does not define these terms. The definitions were in line with the previous EBA Opinion and Report on the perimeter of credit institutions and captured entities not subject to appropriate prudential regulation and supervision, therefore posing the greatest risks.¹⁰

¹⁰ The Opinion and Report are available here: <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/657547/a7bf5c46-2b80-4286-8771-d14a22c87354/EBA-Op-2014-12%20%28Opinion%20on%20perimeter%20of%20credit%20institution%29.pdf>

13. The approach in the EBA guidelines to identify shadow banking entities carves out certain entities from the scope of the definition. Such excluded entities are those that are subject to an appropriate and sufficiently robust prudential framework. For example, under this approach, also credit institutions, investment firms, insurance corporations and such entities established in third countries which are subject to prudential requirements which are considered to be equivalent to those applied in the Union are taken out of the scope of the EBA guidelines. Furthermore, entities subject to consolidated prudential supervision (whether as a result of EU legislation, applicable national legislation or an equivalent third country's legal framework) are out of the scope of the guidelines. Thus, the EBA guidelines focus on institutions' exposures to entities that pose the greatest risks in terms of both the direct risk institutions face by being exposed to such entities and also the risk of credit intermediation being carried out outside the regulated framework.
14. The EBA guidelines were developed having in mind, amongst others, the European Commission's assessment of the current scope of application of the EU banking prudential rules, as part of the Commission's broader workstream on shadow banking; the work by the BCBS on the scope of consolidation for prudential regulatory purposes to ensure all banks' activities are appropriately captured in prudential regimes; and the peer review launched by the FSB in 2015 regarding its member jurisdictions' implementation of the FSB's policy framework for shadow banking entities, as well as the results of the FSB's 5th shadow banking monitoring exercise in late 2015.

3.2.2 Shadow banking risks identified by the ESRB and FSB

15. Since 2015, the European Systemic Risk Board (ESRB) has annually been monitoring what it now calls *EU non-bank financial intermediation* (NBFI) risks (previously referred to as *shadow banking risk*). According to the ESRB, NBFI accounted for around 40% of the EU financial system in 2020, and grew faster than banks over the past decade, including in 2019.¹¹ On the other side, the Financial Stability Board (FSB) asserts that the financial assets of the NBFI sector - comprising mainly pension funds, insurance corporations and other financial intermediaries (OFIs) - accounted for 49.5 % of the global financial system in 2019, compared to 42% in 2008. *Non-bank financial entities play an increasing role in providing financing to the real economy, as well as in managing the savings of households and corporates. Moreover, the relative size of NBFI in emerging market economies (EMEs) has increased at a faster pace than in advanced economies (AEs). More specifically, loan provision by non-bank entities dependent on short-term funding has increased significantly faster in EMEs than in AEs.*¹²
16. The ESRB identified structural risks and vulnerabilities as well as cyclical risks.¹³ Amongst the structural risks, it highlighted the following ones:

¹¹ ESRB EU Non-bank Financial Intermediation Risk Monitor 2020 of 21 October 2020 <https://www.esrb.europa.eu/news/pr/date/2020/html/esrb.pr201021~a3c1929670.en.html>

¹² Global Monitoring Report on Non-Bank Financial Intermediation of 16 December 2020 <https://www.fsb.org/wp-content/uploads/P161220.pdf>

¹³ ESRB EU Non-bank Financial Intermediation Risk Monitor 2020 of 21 October 2020, pages 12 et ff.

- risk-taking, liquidity risk, pricing uncertainty and risks associated with leverage among some types of investment funds and other non-bank financial institutions;
- interconnectedness and the risk of contagion across sectors and within the non-bank financial sector, including domestic and cross-border linkages;
- activity-related risks – procyclicality, leverage, and liquidity risk – created through the use of derivatives and securities financing transactions (SFTs).

17. Among the cyclical risks the report includes:

- a global recession and sharp contraction of economic activity in the EU;
- rising indebtedness, increased credit risk and the risk of rating downgrades;
- high uncertainty and risks associated with a low-for-longer interest rate environment;
- low liquidity and high volatility in some markets.

3.2.3 The range of entities covered by the ESRB and FSB monitoring¹⁴

18. The ESRB conducts its monitoring of the NBFIs part of the financial system by splitting it in two areas, namely an entity-based and an activity-based monitoring. It provides a mapping of activities to entity types, under which the following entities are considered:

- Investment funds, namely money market funds (MMFs), bond funds, mixed funds, equity funds, hedge funds, real estate funds, ETFs, private equity funds and private debt funds.
- Other financial institutions (OFIs), namely financial vehicle corporations (FVCs), special-purpose entities (SPEs), security and derivative dealers (SDDs) and financial corporations engaged in lending (FCL).

19. This list gives a useful indication of the entities that the ESRB considers in its NBFIs universe. The ESRB EU NBFIs Risk Monitor 2020 notes the following risks and interlinkages with the financial system for each of those entities:

- The investment fund sector has linkages to the financial system via wholesale funding of banks provided through non-bank financial entities, funding by banks to investment funds, or connections through the repo and securities lending markets; also has linkages to the non-financial system, including the real economy by channelling investors' funds to households and non-financial corporations. Contagion channels

¹⁴ The entities considered, both within the FSB's and ESRB's scope of monitoring are largely derived from the classification according to the National Systems of Accounts, i.e. for the EU, the ESA 2010. This entity classification might not always be fully in line with (prudential) supervisory definitions (e.g. according to CRD/CRD, UCITS, AIFMD).

can also arise due to ownership linkages between asset managers and other financial firms.¹⁵

- Bond funds have strong interconnections with the banking sector given their exposures to firms across different sectors through holdings of debt securities. Bond funds engage in credit intermediation and can also perform maturity and liquidity transformation.¹⁶
- Money market funds (MMFs) have very strong interconnections with the banking sector as they provide short-term funding to financial institutions and corporates, and engage in some maturity and liquidity transformation since a large portion of MMFs' assets consists of bank debt securities and deposits. MMFs play an important role for the liquidity management of non-banks. Therefore, stress in the MMF sector could trigger severe liquidity issues for banks and institutional investors.¹⁷
- Real estate is a highly illiquid asset class. Open-ended real estate funds may offer redemptions at higher frequencies which can expose them to liquidity transformation risks.¹⁸
- EU hedge funds are regulated entities, mostly subject to the Alternative Investment Funds Managers Directive (AIFMD) rules. They usually make greater use of leverage compared with other fund types and are typically restricted to professional investors.¹⁹
- Private equity funds are collective investment schemes that tend to invest in equity and debt issued by non-listed firms. They tend to incur little liquidity or maturity transformation risk as their redemption risk is limited by their long-term funding and closed-ended structures.²⁰
- Financial vehicle corporations (FVCs) are special-purpose vehicles engaged in securitisation activity, through which they facilitate the transfer of credit risk from financial institutions that originate the credit to the buyers of the securities issued by the FVC. FVCs can also hold deposits and loan claims, debt securities and equity and investment fund shares.²¹
- Special-purpose entities (SPEs) fulfil narrow, specific, and temporary objectives and are usually part of complex ownership networks within multinational groups. SPEs can

¹⁵ ESRB EU Non-bank Financial Intermediation Risk Monitor 2020 of 21 October 2020, page 25

¹⁶ Ibid, page 28

¹⁷ Ibid, page 30

¹⁸ Ibid, pages 33-34

¹⁹ Ibid, page 39

²⁰ Ibid, page 41

²¹ Ibid, pages 43-44

issue debt securities and may engage in liquidity transformation.²² SPEs have complex cross-border linkages which make them susceptible to vulnerabilities, and the lack of data at an EU level inhibits systemic risk monitoring of their activities and linkages.²³

- Security and derivative dealers (SDDs) are investment firms specialising in securities trading, which are authorised to provide investment services to third parties [...] They may undertake liquidity and maturity transformation and are therefore an important part of the non-bank sector from a systemic risk perspective.²⁴
- Financial corporations engaged in lending (FCL), which include financial leasing, factoring, mortgage lending and consumer lending companies, specialise in asset financing for households and non-financial corporations. They engage in credit intermediation outside the banking regulatory perimeter when carrying out lending activities [...] There are divergent prudential rules among countries to address the liquidity and leverage risk that FCLs pose. In some countries, the assets of FCLs are partly consolidated into banking groups, thus falling within the banking regulatory perimeter, whereas other countries do not impose any prudential requirements.²⁵

20. The range of activities of those entities show some common patterns as all of them engage, to a lesser or greater extent, in maturity transformation, liquidity transformation, leverage or transfer of credit risk. These activities have been characterised as typical credit intermediation activities of a credit institution under a regulated framework.

21. However, while the range of entities considered by the ESRB in its NBFIs monitoring remains large, some entities are excluded from its scope due to their low level of involvement in credit intermediation that could cause systemic risk. The NBFIs universe includes a wide range of actors, including shadow banking entities, but not limited to them. The existence of sectorial regulations and their potential risk mitigating effect seems not considered in the ESRB approach to scope out entities.

22. Furthermore, the ESRB terminology reflects its monitoring universe adequately and recognises the strengthened microprudential regulation of NBFIs. Parts of this universe, such as equity funds or large parts of the OFI residual, do not engage in shadow banking activities. Moreover, regulatory requirements, data reporting and supervision at EU and global level have been strengthened in a number of non-bank areas, for example OTC derivatives (European market infrastructure Regulation (EMIR)), alternative funds (Alternative Investment Fund Managers Directive), securitisation (Credit Rating Agencies Regulation and simple, transparent and standardised" (STS) securitisation requirements), money market funds (Money Market Funds Regulation) and

²² Ibid, page 45

²³ Ibid, page 45

²⁴ Ibid, page 46

²⁵ Ibid, pages 47-48

securities financing transactions (Regulation on transparency of securities financing transactions), also with a view to reducing shadow banking risk.

23. The ESRB monitoring of entities is complemented by the monitoring of activities to have a wider overview of the NBFIs sector. The activities considered are *risk transformation* (e.g. credit intermediation, maturity transformation, liquidity transformation and leverage) and *market activities* (notably SFTs, derivatives and reuse of collateral).
24. As for the FSB, it considers the NBFIs sector as a *broad measure* of all non-bank financial entities, which comprises all financial institutions that are not central banks, banks, or public financial institutions. This universe of entities differs from the group of entities under the ESRB activity-based monitoring as well as from the definition of shadow banking entities in the EBA guidelines. The FSB however includes in its monitoring a *narrow measure*²⁶ comprising a subset of entities of the NBFIs sector that authorities have identified as being involved in credit intermediation activities that may pose bank-like financial stability risks (i.e. credit intermediation that involves maturity/liquidity transformation, leverage or imperfect credit risk transfer) and/or regulatory arbitrage.²⁷ This narrow measure comprises five economic functions or activities: collective investment vehicles with features that make them susceptible to runs; lending dependent on short-term funding; market intermediation dependent on short-term funding; facilitation of credit intermediation; and securitisation-based credit intermediation.²⁸
25. In general, the FSB uses a conservative approach i.e. the inclusion of non-bank financial entities or activities in the narrow measure is based on a conservative (inclusive) assessment of the risks such entities or activities may pose, especially during stressed events.²⁹ Existing policies or regulations that could mitigate shadow banking risks are not recognized. Classification is done on a pre-mitigant basis, i.e. classifying authorities are asked to assume a scenario in which policy measures have not been adopted and/or risk management tools have not been exercised.³⁰
26. The NBFIs definition used in both FSB and ESRB monitoring exercises has been adopted with a view to monitoring the size and interconnectedness of these entities from a macroprudential perspective. No limitations and/or constraints are directly imposed to these entities because of the monitoring exercise. The NBFIs definition is designed to be as broad as possible to have a global overview of these different types of actors and their impact on the stability of the financial system.
27. However, the guidelines mandate of the CRR (as well as the new reporting mandate) is to be read in the context of microprudential supervision, i.e. with the objective of overseeing and limiting the possible distress of individual financial institutions. Under this microprudential perspective, a

²⁶ NBFIs entities that are prudentially consolidated into banking groups are excluded from the narrow measures.

²⁷ Global Monitoring Report on Non-Bank Financial Intermediation of 16 December 2020, page 3

²⁸ Global Monitoring Report on Non-Bank Financial Intermediation of 19 January 2020, page 3

²⁹ Ibid, page 6

³⁰ Global Monitoring Report on Non-Bank Financial Intermediation of 19 January 2020, page 7

constraining risk management approach is used with the EBA guidelines applying stricter exposure limits to entities defined as a shadow banking entities under Pillar 2.

28. As stated above, both the FSB and ESRB incorporate a broad range of entities in their monitoring exercises, but they do not consider existing policies that mitigate shadow banking risks. Article 394(4)(b) of the CRR notes however that, in defining criteria for the identification of shadow banking entities, “entities that are subject to solvency or liquidity requirements similar to those imposed by this Regulation and Directive 2013/36/EU should be entirely or partially excluded from the obligation to be reported referred to in paragraph 2 on shadow banking entities”. Consequently, even though the FSB and ESRB NBFIs definitions have been taken into account in the development of these RTS, their approach is not fully compatible to the CRR’s mandate, and sectorial regulations in the Union that address solvency and liquidity issues have thus been considered in order to identify shadow banking entities.

3.3 Identification of shadow banking entities for regulatory reporting

3.3.1 Approach followed

29. In developing this mandate, the EBA considered several aspects, in particular:

- Under the EBA guidelines, institutions are expected to specify their risk management approach thereby setting specific individual and aggregate limits to shadow banking entities and thus limiting the risks that shadow banking entities pose to institutions when the latter enter into a relation with a shadow banking entity. Given the continued relevance of those guidelines in the Union’s LE framework, the fact that the mandate in Article 395(2) of the CRR remains unaltered, and having due regard to the ultimate prudential objective of ensuring consistency of the implementation of the single rulebook on LE to institutions in the Union, these draft RTS rely to a great extent on the work undertaken for the EBA guidelines, also noting that institutions have already developed systems to meet the obligations under the current EBA guidelines.
- By its very nature, the LE regime acts as a backstop that, by limiting the amount of exposures that an institution can have towards a single client or a group of connected clients, addresses the possible damage that the failure of the client or a group of connected clients could cause to the institution’s solvency position. Such risks are therefore considered in the LE framework itself by means of the limits of Article 395 of the CRR. Complementing this regime, the EBA guidelines require institutions to specify individual and aggregate limits to exposures to shadow banking entities under their individual risk management framework (Pillar 2). Hence the continued relevance of the EBA guidelines in developing these draft RTS.

- CRR2 does not substantially amend the reporting obligation under Article 394(2) of the CRR, but rather specifies it further by replacing the term “unregulated financial sector entities” with “shadow banking entities”, a term used already in the EBA guidelines of 2015.
- In this regard, the EBA’s intention has been to build as much as possible on the existing EBA guidelines. One remaining aspect considered was if there has been, after the publication of the EBA guidelines, changes in existing regulations (inter alia on investment firms, funds etc.) that would make an update of the EBA guidelines necessary and would have an impact in the development of the RTS mandate.

30. The requirement to report the ten largest exposures to shadow banking entities explicitly notes that these are entities that *carry out banking activities outside the regulated framework*. The shaping of these draft RTS does therefore rely to a great extent on both terms. The following two sections provide a rationale on how they were interpreted for the purpose of these draft RTS, thus setting out the criteria for the identification of shadow banking entities.

31. These draft RTS consider international developments and other work in the area of shadow banking. In particular, the work by the FSB and the ESRB, as set out in the section above, remains of utmost importance. In addition, these draft RTS consider regulatory developments in the EU. This was the case already at the time of publishing the EBA guidelines in 2015 and remains relevant for these draft RTS, too.

32. For the adoption of criteria to identify shadow banking entities, these draft RTS also look at other rules or regulatory frameworks that provide for solvency or liquidity requirements similar to those imposed by the CRR and the CRD (i.e. the term regulatory framework is used in a broad sense and not restricted to CRR and CRD). Only those entities that carry out banking activities outside an adequate prudential framework should be treated as shadow banking entities. Thus, an institution should not have to consider exposures to counterparties that operate within the regulated framework for the respective reporting requirement under Article 394(2) Regulation (EU) No 2019/876 amending the CRR, since they are not considered as shadow banking entities.

3.3.2 What are “banking activities”?

33. While the CRR does not provide a definition of the term ‘banking activities’, several publications do provide an approximation to it. The *Commission Communication on shadow banking* states that shadow banking is a system of credit intermediation that involves entities and activities outside the regular banking system.³¹

34. Although shadow banking entities are not EU-wide regulated like institutions, their operations encompass various forms of banking business, as they take in funds from the public; lend over long

³¹ Communication from the Commission to the Council and the European Parliament Shadow Banking – Addressing New Sources of Risk in the Financial Sector. COM/2013/0614 final of 4 September 2013 <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0614:FIN:EN:PDF>

periods and take in deposits that are available immediately (i.e. maturity and/or liquidity transformation), take on the risk of the borrower not being able to repay; or use borrowed money, directly or indirectly, to buy other assets.

35. The definition of credit intermediation activities provided for in the EBA guidelines is deemed clear and still remains relevant so that it was also taken up in these draft RTS. Most importantly, the same understanding of what banking activities are will prevent diverging application across the LE framework that could undermine its consistent implementation in the Union. Therefore, banking activities are to be interpreted as any activity or service involving maturity transformation, liquidity transformation, leverage or credit risk transfer. Amongst other things, the activities and services referred to in points 1 to 3, 6 to 8 and 10 of Annex I of the CRD deemed as banking activities.

3.3.3 The regulated framework

36. The CRR does not contain any reference to what the regulated framework comprises. As already stated, these draft RTS rely to a great extent on the EBA guidelines to ensure a consistent implementation, from a prudential point of view, of the LE framework in the Union. Therefore, the regulations that were considered at the time of developing the EBA guidelines in order to identify rules that provide for a robust set of prudential requirements or supervision in the Union and that decides whether an entity is an excluded undertaking or a shadow banking entity, are still relevant for the development of these draft RTS.
37. The section below considers the regulations that were assessed at the time of developing the EBA guidelines, and provides a rationale, from the point of view of the criteria in Article 394(4) of the CRR, while considering whether any important developments have occurred ever since.
38. Equally, the draft RTS consider the situation of entities established in third countries and differentiates between banks and other entities. Since the application of the amendments to the CRR from 28 June 2021, Article 391 of the CRR requires a Commission decision determining the equivalence of the prudential supervisory and regulatory requirements so that a third-country bank can be treated as an institution for the purposes of calculating the value of exposures in accordance with Part Four of the CRR. There was the risk that, in the absence of any equivalence decision, a bank in a given third country would as a result be identified as a shadow banking entity since it would not be subject to an equivalent regime in the Union.
39. Noting that this might result in an uneven treatment of banks subject to prudential regulatory and supervisory requirements, the draft RTS provides for a formula under which such banks that are authorised and supervised by an supervisory authority in a third country that applies banking regulation and supervision which is at least based on the Basel core principles for effective banking supervision should not be identified as shadow banking entities. Consequently, the institution in the Union that has exposures to a third-country bank needs to simply check that its client (bank) meets those criteria (it is authorised and is supervised by an authority that applies at least the Basel core principles) to decide whether its exposures need to be reported as exposures to a

shadow banking entity or simply reporting them under the general requirement of paragraph 1 of Article 394 of the CRR.

40. The application of the Basel core principles for effective banking supervision have been deemed a sufficiently prudential standard to support the identification of banks in third countries as they represent a sound foundation for the regulation, supervision, governance and risk management of a country's banking sector. Furthermore, it is also recognised that the application of such principles by a supervisory authority appear adequately proportional for LE purposes. In general, the Basel core principles provide in this regard a sufficient basis for effective supervision, capturing effective risk-based supervision, and the need for early intervention and timely supervisory actions; as well as supervisory expectations of banks, emphasising the importance of good corporate governance and risk management, and compliance with supervisory standards.
41. Notwithstanding the treatment of third-country banks, there is the case of other entities subject to other regulatory regimes. The draft RTS recognise that the requirements in different legal acts under Annex I vary. Exposures to entities in third countries subject to regulatory regimes which have been deemed equivalent in accordance with the equivalence provisions of the Union legal act that would apply to those entities, would not be treated as exposures to shadow banking entities and should therefore be reported under the general requirement of paragraph 1 of Article 394 of the CRR. Conversely, the absence of an equivalence decision in accordance with the equivalence provisions of the Union legal act would result in those exposures being reported as exposures to shadow banking entities.

(i) The CRR and the CRD

42. Both the CRR and the CRD are the core legal instruments for credit institutions in the Union. As stated in the CRR, "together, this Regulation and Directive 2013/36/EU should form the legal framework governing the access to the activity, the supervisory framework and the prudential rules for credit institutions. This Regulation should therefore be read together with that Directive".³² While the CRR contains the prudential requirements for institutions that relate to the functioning of banking and financial services markets, the CRD contains provisions on, inter alia, the access to the activity of institutions, governance and the supervisory framework. The CRR and CRD are indeed the legal framework for institutions³³ in the Union and thus the core of "the regulated framework".
43. Entities in a consolidated situation as defined in point (47) of Article 4(1) of the CRR should be interpreted as falling within the CRR, thus part of the regulated framework. On the other side, Article 2(5) of the CRD excludes from its scope entities such as central banks and post office giro institutions and, in 20 Member States, various types of specified entities (see points (4) to (23) of

³² Recital 5 of the CRR.

³³ From 28 June 2021, "institution" means a credit institution authorised under Article 8 of Directive 2013/36/EU or an undertaking as referred to in Article 8a(3) thereof (see Article 62(3)(c) of Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014. OJ L 314, 5.12.2019, p. 1–63).

Article 2(5)) where, due to the nature of their activities (e.g. national savings banks), it is not considered necessary to subject them to EU legislation intended to promote a level-playing field for the provision of banking services. Since such entities are explicitly exempted or optionally excluded from the application of an act of the regulated framework, it should be interpreted that they are not shadow banking entities. In a similar way, entities referred to in Article 9(2) of Directive 2013/36/EU are excluded entities and therefore not treated as shadow banking entities.

44. Article 119(5) of the CRR states that “exposures to financial institutions authorised and supervised by the competent authorities and subject to prudential requirements comparable to those applied to institutions in terms of robustness shall be treated as exposures to institutions.” The CRR defines “financial institution” as an *undertaking other than an institution and other than a pure industrial holding company, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in points 2 to 12 and point 15 of Annex I to Directive 2013/36/EU, including a financial holding company, a mixed financial holding company, a payment institution as defined in point (4) of Article 4 of Directive (EU) 2015/2366 of the European Parliament and of the Council, and an asset management company, but excluding insurance holding companies and mixed-activity insurance holding companies as defined, respectively, in points (f) and (g) of Article 212(1) of Directive 2009/138/EC*³⁴. Exposures to financial institutions should not be treated as exposures to shadow banking entities as long as such financial institutions, pursuant to Article 119(5) of the CRR, are supervised and authorised and subject to comparable requirements of those applicable to institutions. It must be noted that Article 21a of the CRD governs the authorisation of (mixed) financial holding companies.³⁵

(ii) The regulation of investment firms

45. The European legislator has adopted specific prudential rules for investment firms, namely Regulation (EU) 2019/2033 on the prudential requirements of investment firms (IFR)³⁶ and Directive (EU) 2019/2034 (IFD) on the prudential requirements and prudential supervision of investment firms³⁷ which are authorised under, and subject to the requirements of, Directive 2014/65/EU (MiFID)³⁸ and Regulation Regulation (EU) No 600/2014 (MiFIR)³⁹.

³⁴ Article 4(26) of Regulation (EU) No 575/2013

³⁵ See also the ECB note “The ECB’s role in approving (mixed) financial holding companies” (https://www.bankingsupervision.europa.eu/ecb/pub/pdf/The_ECBS_role_in_approving_mixed_financial_holding_companies.pdf)

³⁶ Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014. OJ L 314, 5.12.2019, p. 1–63 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019R2033>

³⁷ Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU. OJ L 314, 5.12.2019, p. 64–114 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019L2034>

³⁸ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU. OJ L 173, 12.6.2014, p. 349–496

³⁹ Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012. OJ L 173, 12.6.2014, p. 84–148

46. This new prudential regime addresses investment firms which are not systemic by virtue of their size and interconnectedness with other financial and economic actors; whereas systemic investment firms remain subject to the prudential framework of the CRR and CRD and are required to apply for an authorisation as credit institutions. Furthermore, investment firms which carry out any of the activities referred to in points (3) and (6) of Section A of Annex I of MiFID shall apply, or can be allowed to apply by a decision of a competent authority and if they meet the conditions of Article 5 of the IFD, the requirements of the CRR and CRD in order to avoid disrupting certain group organisational structure which are currently covered in the CRR/CRD prudential rules.
47. The IFR lays down rules on own funds whose definition and composition is aligned with the CRR. This is so to allow investment firms to continue relying on their existing own funds to meet their own funds requirements under the prudential framework specific to investment firms. All investment firms should, at all times, hold own funds to cover either the permanent minimum capital requirement, which equals the initial capital set in accordance with the IFD required for obtaining a MiFID authorisation, or the fixed overheads requirements, which equals to a quarter of the past year fixed costs. Furthermore, the investment firms which are not small and non-interconnected have to meet the capital requirement based on the activities they perform or the services they provide (so called K-factor requirements⁴⁰).
48. All investment firms are under the obligation to monitor and control their concentration risk, including in respect of their clients. Furthermore, they must have in place internal procedures to monitor and manage their liquidity requirements such that they can function in an orderly manner over time. To that end, investment firms should hold a minimum of one third of their fixed overheads requirement in high quality and liquid assets listed in the Commission Delegated Regulation (EU) 2015/61. However, the IFR allows for investment firms which are small and non-interconnected, or which do not perform MiFID activities (3) and (6) to consider receivables from trade debtors as well as fees or commissions receivable within 30 days as liquid assets. Furthermore, competent authorities may exempt small and non-interconnected investment firms from liquidity requirements.
49. In view of the prudential treatment of investment firms in the Union, some subject to the CRR, whereas others are subject to a specific prudential framework with dedicated capital and liquidity rules, it is prudent to consider the rules applicable to investment firms as defined in Article 4(1) of Directive 2014/65/EU⁴¹, as part of the regulated framework.

(iii) Payment institutions and electronic money institutions

50. Point 4 of Article 4 of Directive (EU) 2015/2366 defines ‘payment institution’ as a legal person that has been granted authorisation in accordance with Article 11 to provide and execute payment

⁴⁰ K-factors are a series of risk parameters/indicators representing the specific risks investment firms face and the risks they pose to customers/markets.

⁴¹ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU. OJ L 173, 12.6.2014, p. 349–496 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0065>

services throughout the Union.⁴² Directive (EU) 2015/2366 governs the conditions for the authorisation of payment institutions in the Union. Amongst other things, payment institutions are required to maintain a level of initial capital as referred to in Article 26(1)(a) to (e) of the CRR and a level of own funds that should not be lower than its initial capital or a level of own funds as calculated according to the rules of Article 9 of the Directive. Member States or their respective competent authorities may decide not to apply the rules of Article 9 where the payment institution is included in consolidated supervisions of the parent credit institution.

51. Payment institutions are subject to several controls and to robust supervision by competent authorities, as detailed in Directive (EU) 2015/2366, which imposes stringent requirements for their authorisation. For these reasons and because Directive (EU) 2015/2366 concerns different categories of payment service providers (e.g. also credit institutions under the CRR) it appears prudent to consider this framework as part of the regulated framework.

52. The same rationale applies to electronic money institutions. Point (1) of Article 2 of Directive 2009/110/EC states that an electronic money institution is a legal person that has been granted authorisation under Title II to issue electronic money.⁴³ Title II governs the requirements for the taking up, pursuit and prudential supervision of the business of electronic money institutions. Like payment institutions, electronic money institutions are subject to both initial capital and to own funds requirements. Electronic money institutions can also be included in the consolidated supervision of the parent credit institution.

(iv) Insurance and reinsurance undertakings

53. Equally, these draft RTS consider as part of the regulated framework the rules applicable in the Union to insurance undertakings as defined in point (5) of Article 4(1) of the CRR and to reinsurance undertakings as defined in point (6) Article 4(1) of the CRR,⁴⁴ as well as the rules applicable in the Union to institutions for occupational retirement provision (IORPs) as defined in point (1) of Article 6 of Directive (EU) 2016/2341.⁴⁵

54. Directive 2009/138/EC (also known as ‘Solvency II’) governs the taking-up and pursuit of the business of insurance and reinsurance. It provides for a robust and stringent system of supervision of undertakings providing insurance and reinsurance services in the EU. Among the conditions for

⁴² Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC. OJ L 337, 23.12.2015, p. 35–127 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32015L2366>

⁴³ 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. 7–17 <https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32009L0110>

⁴⁴ 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). OJ L 335, 17.12.2009, p. 1–155 <https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32009L0138>

⁴⁵ Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs). OJ L 354, 23.12.2016, p. 37–85 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32016L2341>

their authorisation, set out in Article 18 of that Directive, insurance and reinsurance undertakings are required to hold the eligible basic own funds to cover the absolute floor of the Minimum Capital Requirement provided for in Article 129(1)(d) of that Directive; to show evidence that it will be in a position to hold eligible own funds to cover the Solvency Capital Requirement, as provided for in Article 100 of that Directive, going forward; and to show evidence that it will be in a position to hold eligible basic own funds to cover the Minimum Capital Requirement, as provided for in Article 128 of that Directive, going forward.

55. Solvency II contains a chapter on valuation of assets and liabilities, technical provisions, own funds, Solvency Capital Requirement, Minimum Capital Requirement and investment rules, under which a whole system of robust and detailed solvency requirements is established, supplemented by Commission delegated acts and other technical standards by the European Supervisory Authority (EIOPA). It must be highlighted that there are entities which are exempted from the application of the Directive due to their size, provided that they meet all the conditions of Article 4 of that Directive; notwithstanding that, those undertakings are not prevented from applying for authorisation or continuing to be authorised under the Directive.
56. Moreover, Solvency II provides that insurance and reinsurance undertakings which are part of a group, the head of which is outside the Union, should be subject to equivalent and appropriate group supervisory arrangements. The European Commission should adopt in this case a binding decision regarding the equivalence of third-country solvency regimes. In the case of third countries for which no decision has been made by the Commission, the assessment of equivalence should be made by the group supervisor after consulting the other relevant supervisory authorities.
57. Article 4 of Solvency II excludes from its scope of application insurance undertaking on the basis of their size. In that case, said undertakings should not be considered as shadow banking entities. Equally, insurance undertakings to which Solvency II ceases to apply pursuant to Article 4 of Solvency II should not be considered as shadow banking entities.
58. Furthermore, Directive (EU) 2016/2341 governs the activities and supervision of IORPs. Among many requirements, the Directive requires Member States to require of every IORPs referred to in Article 15(1) which is registered or authorised in their territories an adequate available solvency margin in respect of its entire business at all times which is at least equal to the requirements in this Directive in order to ensure long-term sustainability of occupational retirement provision. It also provides for Member States to require those IORPs to invest in accordance with the 'prudent person' rule⁴⁶.
59. IORPs are required to adopt strategies, processes and reporting procedures to identify, measure, monitor, manage and report to its administrative, management or supervisory body regularly the

⁴⁶ The prudent-person rule is a legal principle that is used to restrict the choices of the financial manager of an account to the types of investments that a person seeking reasonable income and preservation of capital might buy for his or her own portfolio.

risks, at an individual and at an aggregated level, to which the IORPs and the pension schemes operated by them are or could be exposed, and their interdependencies.

(v) Central counterparties

60. Central counterparties (CCPs) play a fundamental role in the clearing of over the counter (OTC) derivatives. To ensure their adequate capitalisation to deal with possible credit, counterparty, market, operational, legal and business risks and to facilitate their orderly winding-up or restructuring of its operations if necessary, Regulation (EU) No 648/2012 (also known as EMIR) requires the authorisation and supervision of CCPs in accordance with the requirements therein laid down.⁴⁷ Such authorisation should be conditional on a minimum amount of initial capital as well as other requirements (organisational, business conduct, and prudential requirements) which apply to the clearing of all financial instruments in which the CCPs deal.
61. CCPs are required to have a risk-management framework to manage credit risks, liquidity risks, operational and other risks, e.g. the risks that it poses to other entities as a result of interdependencies. A CCP should have adequate procedures and mechanisms in place to deal with the default of a clearing member. To minimise the contagion risk of such a default, the CCP should have in place stringent participation requirements, collect appropriate initial margins, maintain a default fund and other financial resources to cover potential losses. To ensure that it benefits from sufficient resources on an ongoing basis, the CCP should establish a minimum amount below which the size of the default fund is not generally to fall.⁴⁸
62. In view of the stringent requirements applicable to CCPs in the Union, which would aim to limit the risks to other entities in case of their failure, the EU framework that govern CCPs should be considered as part of the regulated framework.
63. Article 1, paragraph 4 of EMIR states that the Regulation will not apply to a number of entities, namely (a) the members of the ESCB and other Member States' bodies performing similar functions and other Union public bodies charged with or intervening in the management of the public debt and the BIS. Further, paragraph 5 notes that, with the exception of the reporting obligation under Article 9, EMIR shall not apply to (a) multilateral development banks, as listed under Section 4.2 of Part 1 of Annex VI to Directive 2006/48/EC; (b) public sector entities within the meaning of point (18) of Article 4 of Directive 2006/48/EC where they are owned by central governments and have explicit guarantee arrangements provided by central governments; and (c) the European Financial Stability Facility and the European Stability Mechanism.
64. In view of the nature of those entities and the limited scope for risks that they could cause an institution to incur in, those entities should not be regarded as shadow banking entities.

⁴⁷ Regulation (EU) No 648/2012 of the 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. 1–59. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32012R0648>

⁴⁸ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories. OJ L 201, 27.7.2012, recital 65.

(vi) The rules for the resolution of institutions in the Union

65. Directive 2014/59/EU of 15 May 2014 (also known as the Bank Recovery and Resolution Directive or BRRD) lays down rules and procedures relating to the recovery and resolution of institutions established in the Union, financial institutions established in the Union, financial holding companies, mixed financial holding companies and mixed-activity holding companies that are established in the Union; parent financial holding companies in a Member State, Union parent financial holding companies, parent mixed financial holding companies in a Member State, Union parent mixed financial holding companies; and branches of institutions that are established outside the Union in accordance with the specific conditions laid down in this Directive.⁴⁹
66. The regime established in the BRRD provides authorities with a set of tools to intervene sufficiently early and quickly in an unsound or failing institution so as to ensure the continuity of its critical financial and economic function's, while minimising the impact of its failure on the economy and the financial system. Authorities should be able, amongst others, to maintain uninterrupted access to deposits and payment transactions, sell viable portions of the institution where appropriate, and apportion losses in a manner that is fair and predictable. These are objectives of a public interest nature should help avoid destabilising financial markets while minimising the costs for taxpayers.
67. The BRRD includes a set of resolution tools available to resolution authorities to resolve a bank. Those tools are a) the sale of the business or shares of the institution under resolution, b) the setting up of a bridge institution, c) the separation of the performing assets from the impaired or under-performing assets of the failing institution, and d) the bail-in of the shareholders and creditors of the failing institution.⁵⁰ The relevant entities for carrying out such resolution tools are resolution authorities, bridge institutions and asset management vehicles.
68. A bridge institution is a legal person wholly or partially owned by one or more public authorities which may include the resolution authority or the resolution financing arrangement and is controlled by the resolution authority. A bridge institution must be created for the purpose of receiving and holding some or all of the shares or other instruments of ownership issued by an institution under resolution or some or all of the assets, rights and liabilities of one or more institutions under resolution with a view to maintaining access to critical functions and selling the

⁴⁹ 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. 190–348 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0059>

⁵⁰ 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, Article 37.

institution or entity referred to in point (b), (c) or (d) of Article 1(1).⁵¹ Normally, a bridge institution will operate under a new banking license.

69. Asset management vehicle is defined in the BRRD as a legal person that is wholly or partially owned by one or more public authorities which may include the resolution authority or the resolution financing arrangement and is controlled by the resolution authority, and that is created for the purpose of receiving some or all of the assets, rights and liabilities of one or more institutions under resolution or from a bridge institution.⁵² Asset management vehicles manage the assets transferred to it with a view to maximising their value through eventual sale or orderly wind down.⁵³ An asset management vehicle is not established to carry out business, but to support the resolution of an institution and remain under public control, e.g. resolution authorities should define their risk profile and investment strategy.
70. In view of all the above, and considering that such entities are established for the purposes of the resolution of institutions pursuant to the BRRD, i.e. with the objective of public policy relating to financial stability, it appears necessary to consider the rules that define and govern the setting up and business of entities that pursue objectives linked to the resolution of institutions pursuant to Directive 2014/59/EU as falling under the regulated framework for the purposes of these RTS.
71. Equally, the rules that govern the setting up and business of entities that pursue the same objectives of, and carry out functions similar to those of asset management vehicles under Directive 2014/59/EU that were established prior to 1 January 2016 should also be regarded as being comprised under the regulated framework.

(vii) The regulation of funds in the Union

72. The ESRB NBFMI Monitor has identified various linkages of the fund investment sector to the financial system through different routes.⁵⁴ There are some prudential frameworks in the EU similar to that of credit institutions and investment firms that apply to some types of funds. Two main sets of regulation for funds co-exist in the EU: the Undertakings for Collective Investments in

⁵¹ 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, Article 40(2).

⁵² 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, Article 42(2).

⁵³ 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, Article 42(3).

⁵⁴ See paragraph 15 of this background section.

Transferable Securities (UCITS) Directive⁵⁵ and the Alternative Investment Fund Managers (AIFM) Directive⁵⁶.

73. The UCITS Directive prescribes rules under which UCITS 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 and should not be regarded as shadow banking entities. Equally, entities established in non-EU countries and authorised under laws and regulations that subject them to supervision considered to be equivalent to that of the UCITS Directive should be subject to the same treatment.
74. Alternative Investment Funds (AIFs) are regulated via the requirements imposed on their asset managers under the AIFMD, e.g. initial capital, own funds, and internal controls requirements. However, some risks arising directly from the funds themselves are not mitigated satisfactorily from a prudential point of view. Leverage limitation like that applicable to UCITS does not apply to AIFs, although they shall put in place risk management policies and are subject to stress testing and reporting obligations. Given this, only AIFs with limited leverage should not be identified as shadow banking entities. Article 111(1) of Delegated Regulation 231/2013⁵⁷ considers leverage to be employed on a substantial basis when the AIF exposure exceeds 300% of its net asset value.
75. Some AIFs are entitled to grant loans thus carrying out a core banking activity outside the regulated banking system, i.e. CRR/CRD or comparable prudential regulation. These funds 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) authorisation and they are not subject to harmonised rules on concentration risks, credit assessment, provisioning, etc. Given this, only AIFs which are not entitled to grant loans or purchase third parties' lending exposures onto their balance sheet should not be identified as shadow banking entities.
76. As a consequence, only exposures to AIFs that do not employ leverage on a substantial basis according to Article 111(1) of Delegated Regulation 231/2013 and that do not grant loans or purchase third parties' lending exposures onto their balance sheet should be excluded from being identified as shadow banking entities.

⁵⁵ 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). OJ L 302, 17.11.2009, p. 32–96 <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32009L0065>

⁵⁶ 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. OJ L 174, 1.7.2011, p. 1–73 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32011L0061&qid=1615386509767>

⁵⁷ 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 Text with EEA relevance. OJ L 83, 22.3.2013, p. 1–95 <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0231&from=EN>

77. However, there are special rules in the Union for some types of AIFs, namely European long-term investment funds (ELTIFs)⁵⁸, qualifying social entrepreneurship funds⁵⁹, and qualifying venture capital funds.⁶⁰
78. European long-term investment funds (ELTIFs) are AIFs or compartments of EU AIFs marketed in the EU as ELTIFs whose objective is to facilitate the raising and channeling of capital towards European long-term investments in the real economy, in line with the Union objective of smart, sustainable and inclusive growth.
79. Qualifying social entrepreneurship funds (EuSEF) are a type of AIF that provide funding to social undertakings that act as drivers of social change by offering innovative solutions to social problems, for example by helping to tackle the social consequences of the financial crisis, and by making a valuable contribution to meeting the objectives of the Europe 2020 Strategy.⁶¹
80. Qualifying venture capital funds (EuVECA) are a type of AIF with very specific objectives e.g. to finance undertakings that are generally very small, that are in the initial stages of their corporate existence and that display a strong potential for growth and expansion. They also provide them with valuable expertise and knowledge, business contacts, brand equity and strategic advice, thus stimulating economic growth, contributing to the creation of jobs and capital mobilisation, fostering the establishment and expansion of innovative undertakings, increasing their investment in research and development and fostering entrepreneurship, innovation and competitiveness in line with the objectives of the Europe 2020 Strategy.⁶²
81. In view of the objectives and the requirements applicable to these funds as well as to the managers of EuSEFs and EuVECAs, and in derogation of the treatment of some AIFs as shadow banking entities, ELTIFs, EuSEFs as defined under point (b) of Article 3(1) of Regulation (EU) No 346/2013, and EuVECAs as defined under point (b) of Article 3 of Regulation (EU) No 345/2013, should not be identified as shadow banking entities.
82. In the case of money market funds (MMFs), the EU legislator adopted in 2017 the Money Market Funds Regulation (MMFR).⁶³ It applies to MMFs that are required to be authorized as UCITS under

⁵⁸ 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. 98–121 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32015R0760>

⁵⁹ 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. 18–38 <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32013R0346>

⁶⁰ 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. 1–17 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R0345>

⁶¹ Recital 1 of Regulation (EU) No 346/2013.

⁶² Recital 1 of Regulation (EU) No 345/2013.

⁶³ Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds. OJ L 169, 30.6.2017, p. 8–45

the UCITS Directive or as AIFs under the AIFMD.⁶⁴ Accordingly, MMFs under MMFR are, in principle, either UCITS or AIFs and are subject, in addition to the MMFR, to the relevant rules under the UCITS Directive and the AIFM Directive. However, the MMFR requirements could override the obligations laid down in the UCITS Directive. It is the case of Article 8(2) of the MMFR, where MMFs authorised as UCITS shall not be subject to the obligations concerning investment policies of UCITS Directive, unless explicitly specified otherwise in the MMFR.

83. The scope of the MMFR is CIUs authorised as UCITS or AIFs, which invest in short-term assets; and have distinct or cumulative objectives offering returns in line with money market rates or preserving the value of the investment.⁶⁵ Under the MMFR, MMFs are subject to specific authorisation procedures by competent authorities, and can invest only in certain activities (money market instruments, bank deposits, eligible securitizations and ABCPs, as well as (reverse) repurchase agreements, derivatives, and units or shares of other MMFs under specific conditions, aimed at ensuring the low riskiness and high liquidity of such assets. The MMFR lays down specific regulatory requirements for MMFs, including in terms of liquidity, concentration and diversification, as well as risk management requirements, and introduces a set of rules of maximum harmonisation that, in certain cases, are more stringent than those applied to UCITS or AIFs.
84. These requirements make the framework under which MMFs operate more robust and safer. However, on 26 March 2021 the European Securities and Markets Authority, ESMA, published a consultation document in response to the mandate of Article 46 of the MMFR which requires that, *by 21 July 2022, the Commission shall review the adequacy of this Regulation from a prudential and economic point of view, following consultations with ESMA.*
85. The consultation document notes that “the COVID-19 crisis has been challenging for MMFs. A number of EU MMFs faced significant liquidity issues during the period of acute stress in March 2020 with large redemptions from investors on the liability side, and a severe deterioration of liquidity of money market instruments on the asset side.”
86. At international and EU level, various workstreams have started to assess the situation faced by MMFs during the March 2020 crisis, and which policy options should be considered in order to address the issues which have been identified. This is the case in particular at FSB and IOSCO level. The objectives of that work include in particular: i) enhance MMF resilience and ensure that regardless of the market conditions, they can operate without impacting financial stability; and ii) avoid interventions of central banks.

⁶⁴ 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. OJ L 174, 1.7.2011, p. 1–73 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32011L0061&qid=1615386509767>

⁶⁵ The main objectives of the MMFR are to harmonise the rules applicable to MMFs established, managed or marketed in the EU; to enhance the protection of investors, and to improve the resilience of MMFs in situations where redemption requests reach such a level that they threaten both the ability of MMFs to honour them and the supply of cash on the money market.

87. The changes that the consultation document proposes are three-fold: a) reforms targeting the liability side of MMFs (e.g. related to swing pricing, redemptions in kind, holdbacks, minimum balance at risk, or removal of stable NAV); b) reforms targeting the asset side of MMFs (e.g. related to restrictions on asset holdings, increase liquidity buffers and/or make them usable/countercyclical, decouple regulatory thresholds from suspensions/gates); and c) reforms that are external to MMFs themselves (e.g. related sponsor support, enhance liquidity of underlying instruments in which MMFs invest, liquidity exchange bank, enhanced MMF reporting to and stress testing by authorities).
88. ESMA notes that it is of the view that “the main objective of the review of the MMFR should be to make MMFs more resilient to stressed market conditions without the need of (implicit) central bank support and to reduce their contribution to the building up of risk in the financial system. This objective is not conflicting with the preservation of the key intermediation role that MMFs perform in the short-term segment of money markets. On the contrary, tackling the vulnerabilities emerged in the Covid-19 turmoil would make more clear and transparent to investors and issuers of the financial instruments purchased by the MMFs the allocation of costs and risks that is implied by the intermediation function offered by MMFs. In addition, this will allow to preserve the current economic functions played by MMFs, in particular cash management, and short-term funding to issuers.”
89. In view of the ongoing review of the MMFR to tackle the vulnerabilities identified with MMFs, it is considered appropriate to follow the EBA guidelines and consider MMFs as shadow banking entities until such reforms are in place before re-assessing the current policy stance.



4. Draft regulatory technical standards



COMMISSION DELEGATED REGULATION (EU) No .../..

of **XXX**

[...]

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for specifying the criteria for the identification of shadow banking entities referred to in paragraph 2 of Article 394 of Regulation (EU) No 575/2013

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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 648/2012⁶⁶, and in particular Article 394(4) thereof,

Whereas:

- (1) According to Article 394(4) of Regulation (EU) No 575/2013, when specifying the criteria for the identification of shadow banking entities, entities that are subject to solvency or liquidity requirements similar to those imposed by that Regulation and Directive 2013/36/EU should be excluded from the obligation to be reported referred to in Article 394(2) of that Regulation. Against this background, financial institutions treated as institutions for the purposes of the calculation of risk weighted assets under the standardised approach in accordance with Article 119(5) of Regulation (EU) No 575/2013 should not be considered as shadow banking entities. This Regulation determines that entities authorised and supervised in accordance with Union legal acts (“regulated framework”) should not be identified as shadow banking entities, to the extent that these entities provide services or perform activities included in their authorisation.
- (2) There is a need to ensure that, in addition to the entities authorised and supervised in accordance with the regulated framework consisting of the Union legal acts referred to in this Regulation, entities explicitly exempted or excluded from the legal acts listed in points 1, 2, 7 and 10 of Annex I, including entities that are part of a non-financial group, whose principal activity is to carry out credit intermediation activities for entities within the group, central banks, post office giro institutions, should not be identified as shadow banking entities for the provision of services or performance of activities, for which they have been exempted or optionally excluded.
- (3) When an entity is not authorised and supervised or exempted or optionally excluded from the regulated framework or when the relevant services offered or activities performed are not within its authorisation, this entity should be identified as shadow

⁶⁶

OJ L 176 27.6.2013, p. 1



banking entity, except where it does not offer banking services and does not perform banking activities.

- (4) According to Article 394(4) of Regulation (EU) No 575/2013, when specifying the criteria for the identification of shadow banking entities, international developments and internationally agreed standards on shadow banking should be taken into account. Against this background, it should be ensured that collective investment undertakings (AIF) authorised in accordance with Directive 2011/61/EU (Alternative Investment Funds Directive), should be regarded as shadow banking entities except where they do not employ substantial leverage or where they do not originate exposures in the ordinary course of their business or where they do not purchase third-party exposures for their own account.
- (5) Exposures to money market funds (MMFs) should be seen as exposures to shadow banking entities, on the basis that the risks associated with MMFs have not been fully addressed by prudential requirements in the Union, and in particular MMFs have faced severe liquidity issues during the COVID-19 crisis.
- (6) There is a need to ensure that, in addition to the services and activities referred to in points 1 to 3, 6 to 8 and 10 of Annex I of Directive (EU) No 2013/36/EU, other services and activities, whether referred to in the regulated framework or not, should be regarded as banking services and activities to the extent they involve maturity transformation, liquidity transformation, leverage or credit risk transfer.
- (7) Since the Basel core principles for effective banking supervision represent internationally agreed principles and a sound foundation for the regulation, supervision, governance and risk management of a country's banking sector, this Regulation recognises that the exposures to institutions in third countries subject to prudential supervisory and regulatory requirements that have not been deemed equivalent pursuant to Article 391 of Regulation (EU) No 575/2013 should not be reported as exposures to shadow banking entities provided that the institution verifies that the third-country institution is authorised and supervised by a supervisory authority that applies at least those core principles.
- (8) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (9) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010⁶⁷.

HAS ADOPTED THIS REGULATION:

⁶⁷ 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).



Article 1

Criteria for identifying entities

1. Any entity established in the Union or in a third country that offers banking services or performs banking activities as set out in Article 2 and that is not excluded according to paragraphs 2 and 3 shall be identified as a shadow banking entity for the purposes of Article 394 paragraph 2 of Regulation (EU) No 575/2013.
2. Any entity that is authorised and supervised in accordance with any of the legal acts referred to in Annex I shall not be identified as a shadow banking entity for the purposes of Article 394 paragraph 2 of Regulation (EU) No. 575/2013.
3. Any entity that is exempted or optionally excluded from Regulation (EU) No 575/2013, Directive 2013/36/EU, Regulation (EU) No 648/2012 and Directive 2009/138/EC shall not be identified as a shadow banking entity for the purposes of Article 394 paragraph 2 of Regulation (EU) No 575/2013.
4. Undertakings for the Collective Investment in Transferable Securities as defined in Directive 2009/65/EC shall be regarded as shadow banking entities where they are money market funds falling under Regulation (EU) No 2017/1131.
5. Alternative investment funds as defined in Directive 2011/61/EU shall be regarded as shadow banking entities, where either of the following applies:
 - (a) the alternative investment fund is a money market fund falling under Regulation (EU) 2017/1131; or
 - (b) the alternative investment fund employs leverage on a substantial basis as set out in Article 111(1) of Commission Delegated Regulation (EU) 231/2013; or
 - (c) the alternative investment fund is not, from its rules or instruments of incorporation, effectively prevented from originating exposures in the ordinary course of its business or from purchasing third-party exposures for its own account.

Explanatory box and questions

Question 1: Do you agree with the conditions of Article 1 paragraph 2 for identifying an entity as a non-shadow banking entity? Please provide reasons if you do not agree with any of the conditions or have comments with regard to any of them.

Like the approach taken in the EBA Guidelines on limits on exposures to shadow banking entities, Article 1 paragraph 3 excludes from the SBE definition entities that are exempted or optionally



excluded from the CRR, CRD and Solvency II. Equally, entities exempted from EMIR are also not identified as shadow banking entities due to their nature (supranational, public sector entities). That means that other entities exempted or optionally excluded from the other legal acts included in Annex I would be considered as shadow banking entities.

Question 2: Have you got any comments regarding the list of entities that, being exempted or optionally excluded from those four legal acts in Annex I, should not be considered as shadow banking entities?

Question 3: Conversely, what are your views concerning other entities exempted or optionally excluded from the other legal acts in Annex I and that would be identified as shadow banking entities? Please provide reasons in case you view that any of those entities should fall under the exemption in Article 1 paragraph 3 and therefore not be treated as shadow banking entities.

Question 4: Have you got any other comments with regard to the content of Article 1 of the draft RTS? In your view, is it clear and easy to implement for the purposes of the reporting obligation of Article 394(2) of Regulation (EU) No 575/2013?

Recent market events have shown weaknesses with certain investment funds. The draft RTS, following the assessment of UCITS and AIFs as carried out for the EBA Guidelines on limits on exposures to shadow banking entities (EBA/GL/2015/20), consider that indeed the rules applicable to these funds as reflected in Article 1 paragraphs 4 and 5 limit the risks that an institution would run into when it is exposed to them. But those recent cases show that funds could still carry significant risks to the financial system. The fact that they are subject to certain requirements that aim to limit their leverage (in general, these funds are subject to market or investment regulations and not to solvency or liquidity requirements comparable to those of credit institutions) may not be sufficient in all cases to prevent risks to an institution's solvency or liquidity.

Question 5: In general, what are your views on the treatment of funds in these draft RTS? Do you agree with the approach adopted in these draft RTS, that follows the approach in the EBA Guidelines on limits on exposures to shadow banking entities, or alternatively should it be extended to capture those funds as shadow banking entities?

Question 6: What would be the advantages and disadvantages of taking a broader approach with respect to the scope of funds included as shadow banking entities?

These draft RTS consider funds authorised as money market funds (MMFs) under the Money Market Fund Regulation (Regulation (EU) No 2017/1131) as shadow banking entities. For the reasons explained in recital number 5, and more in detail in paragraphs 82 to 89 of this Consultation Paper, money market funds have experienced severe liquidity issues during the COVID-19 crisis; there are also, discussions at international level to strengthen their regulation. Equally, at EU level the European Securities and Markets Authority (ESMA) has launched a consultation document detailing the shortcomings identified with MMFs and the reforms that it is proposing to address them while preserving the economic functions played by MMFs, in particular cash management, and short-term funding to issuers. Equally, the draft RTS consider other two



specific situations where AIFs should be considered as shadow banking entities (letters (b) and (c) of Article 1 paragraph 5).

Question 7: What are your views with regard to the consideration of money market funds as shadow banking entities?

In view of the draft RTS following the identification of some funds as shadow banking entities as set out in the EBA Guidelines on limits on exposures to shadow banking entities, the EBA would like to better understand whether there are any difficulties in that process of identification.

Question 8: Do you face any difficulties identifying whether an alternative investment fund (AIF) should be considered as a shadow banking entity?

Question 9: Have you got any specific comments with regard to AIFs and in particular, with points (b) and (c) of Article 1 paragraph 5?

Article 2

Banking services and activities

For the purpose of this regulation, the following shall be regarded as banking services and activities:

- (a) the services and activities referred to in points 1 to 3, 6 to 8 and 10 of Annex I of Directive (EU) No 2013/36/EU; and
- (b) any service or activity involving maturity transformation, liquidity transformation, leverage or credit risk transfer.

Explanatory box and questions

Following the same approach as adopted in the *EBA guidelines on 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*, the draft RTS do not prescribe an exhaustive list of activities of banking activities. As explained in the guidelines, the Financial Stability Board (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).

The list of activities/services of Annex 1 of Directive 2013/36/EU explicitly mentioned in this Article (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)) should automatically be regarded as banking activities/services. However, this list is not exhaustive but an indication of specific cases of banking activities/services; therefore, point (b) is open to other services or activities that, involving maturity transformation, liquidity transformation, leverage or credit risk transfer, would be interpreted as banking services or activities.

Question 10: Do you agree with the description of banking services and activities as included in Article 2 of the draft RTS? Have you got any specific comments regarding any of the points included?

Article 3

Criteria for excluding entities established in third countries from being deemed as shadow banking entities

1. A third-country institution shall not be identified as a shadow banking entity where the institution has verified that that third-country institution has been authorised and is being supervised by a third-country supervisory authority that applies banking regulation and supervision based on at least the Basel core principles for effective banking supervision.
2. Other entities established in a third-country shall not be identified as shadow banking entities where the third country's regulatory regime in accordance with which these entities have been authorised and are being supervised has been recognised as equivalent to the one applied in the Union for such entities in accordance with the equivalence provisions of the relevant Union legal act.

Explanatory box and questions

In the absence of an equivalence decision pursuant to Article 391 of the CRR declaring the equivalence of a third country's prudential supervisory and regulatory requirements with those applied in the Union, an institution could avoid the reporting of its exposures to a bank in that third country as exposures to a shadow banking entity as long as it verifies that the bank is authorised and supervised by an authority that applies at least the Basel core principles for effective banking supervision. The Basel core principles represent agreed standards for a sound regulation, supervision, governance and risk management of a country's banking sector. They aim to ensure effective risk-based supervision and set out supervisory expectations of banks, emphasising the importance of good corporate governance and risk management, and compliance with supervisory standards.

Question 11: Do you agree with the possibility granted under paragraph 1 of Article 3 to prevent the identification of a bank in a third country as a shadow banking entity in the absence of an equivalence decision under Article 391 of the CRR?



In the case of other entities, other legal acts in Annex I provide for different procedures to determine the equivalence of the requirements applicable in a third country with those applied in the Union. Those entities would not be identified as shadow banking entities, and therefore exposures to them should not be reported as exposures to shadow banking entities, as long as there is a decision on equivalence adopted in accordance with the equivalence provisions of the relevant Union legal act.

Question 12: Have you got any comments regarding the approach set out in paragraph 2 of Article 3 for other entities established in third countries to prevent their identification as shadow banking entities?

Article 4

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President

[For the Commission
On behalf of the President
[Position]



ANNEX I

List of Union Acts under the Regulated Framework

1. 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 176 27.6.2013, p. 1
2. 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. 338–436
3. Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014. OJ L 314, 5.12.2019, p. 1–63
4. Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU. OJ L 314, 5.12.2019, p. 64–114
5. Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012. OJ L 173, 12.6.2014, p. 84–148
6. Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU. OJ L 173, 12.6.2014, p. 349–496
7. Regulation (EU) No 648/2012 of the 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. 1–59
8. Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC. OJ L 337, 23.12.2015, p. 35–127
9. 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. 7–17
10. 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). OJ L 335, 17.12.2009, p. 1–155
11. Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs). OJ L 354, 23.12.2016, p. 37–85
12. 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. 190–348
13. 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). OJ L 302, 17.11.2009, p. 32–96
 14. 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. OJ L 174, 1.7.2011, p. 1–73
 15. 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. 98–121
 16. 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. 18–38
 17. 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. 1–17

Explanatory box and questions

Based on the criteria of the mandate of Article 394(4) of Regulation (EU) No 575/2013, namely international developments and internationally agreed standards, whether the relation with an individual entity or a group of entities may carry risks to the institution's solvency or liquidity position; and the similarity of the solvency or liquidity requirements applicable to an entity with those imposed by Regulation (EU) No 575/2013 and Directive 2013/36/EU, the list of legal acts of Annex I has been compiled. These acts represent *the regulated framework* as mentioned in Article 394(2) of Regulation (EU) No 575/2013 and referred to in Article 1 of these draft RTS.

Question 13: Do you agree with the list of legal acts included in Annex I?

Question 14: Is there any other legal act that should be included in Annex I? If yes, please mention the act and legal reference, and provide reasons to support it based on the criteria included in Article 394(4) of Regulation (EU) No 575/2013.



5. Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

1. Regulation (EU) 2019/876 amending Regulation (EU) No 575/2013 (the CRR) has added paragraph (4) to Article 394 mandating the EBA to develop draft regulatory technical standards (RTS) to specify the criteria for the identification of shadow banking entities.
2. The present analysis provides an overview of the findings as regards problem identification, possible options to remove problems and their potential impacts. Given the nature and the scope of the draft RTS, and pursuant to the principle of 'proportionate analysis', this analysis is high-level and qualitative in nature. Only a quantitative analysis is presented with the aim to provide information about the materiality of the phenomena here discussed.
3. The quantitative analysis relies on information available through the Supervisory Reporting Templates (i.e. COREP) and, in particular, it leverages only on data provided in the EBA sample. This way, it is not necessary to collect information from National Competent Authorities (NCAs) or directly from the institutions⁶⁸.

A. Problem identification and baseline scenario

4. Notwithstanding its recognised complementary role, the shadow banking system is considered as systematically affected by some risks like heavy reliance on short-term wholesale funding and lack of transparency. For this reason, an excessive level of exposures of the traditional institutions toward this sector could jeopardise the stability of the financial system.
5. The large exposure (LE) regime already set limits to the maximum possible loss that a credit institution could face in the event of the failure of a client or group of connected clients. However, it is required to pay additional attention to the shadow banking sector. Indeed, the CRR already subjected institutions to a specific reporting obligation in relation to their 10 largest exposures to unregulated financial entities and the EBA guidelines on limits on exposures to shadow banking entities under paragraph 2 of Article 395 of Regulation (EU) No 575/2013 requires to set specific (i.e. at counterparty level) and aggregate limits to the exposures toward these entities.
6. With the adoption of the Regulation (EU) No 2019/876 the reporting requirement has been modified by referring to the 10 largest exposures to shadow banking entities which carry out banking activities outside the regulated framework on a consolidated basis.

⁶⁸ Making ad hoc data collections is a costly and time-consuming process. For this reason it is preferable, whenever it is possible to exploit data that are readily available from statistical agencies and databases.



7. The CRR does not provide a comprehensive definition of the shadow banking sector so that it is material the risk that different interpretation could be adopted across institutions when reporting under the obligation of Article 394(2) of the CRR.

B. Policy objectives

8. Providing a common framework for the identification of shadow banking entities should bring a harmonised reporting under Article 394(2) of the CRR and in turn it would enable competent authorities to exploit this data for monitoring the shadow banking sector. Moreover, this should help supervisors and institutions alike to better limit and monitor exposure toward this sector.

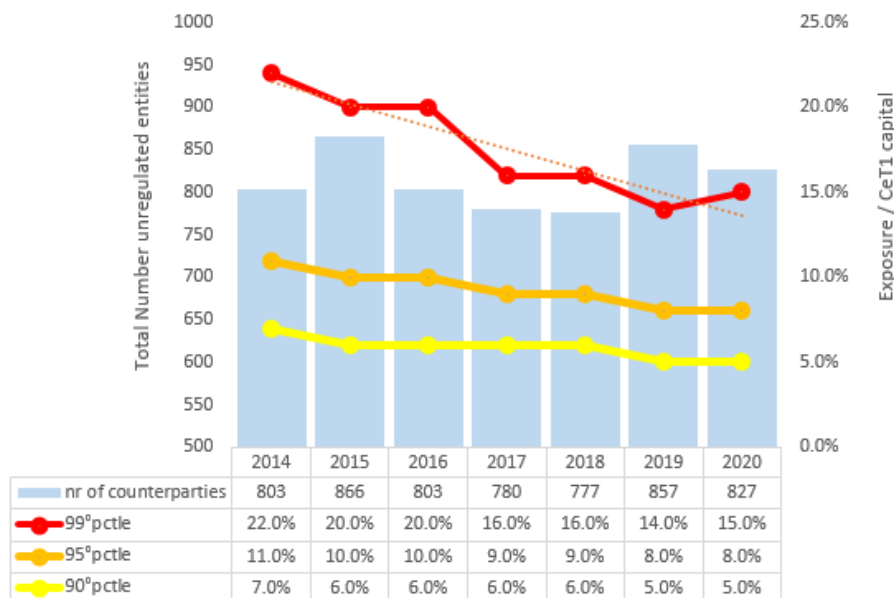
Quantitative Analysis

9. The following chart has been obtained by exploiting the information contained in the Corep templates. In particular, pursuant to Article 394(2) of the CRR, institutions are required to report their 10 largest exposures to unregulated financial entities. The sample analysed is constituted by about 130 institutions (excluding subsidiaries). The data are at the highest level of consolidation.
10. The chart shows the total number of counterparties reported (at the end of each year) as being among the 10 largest exposures to unregulated financial entities⁶⁹. The number of reported entities has been quite stable over the observed period (816 on average) with relatively low variation in the different years.
11. The chart also shows some percentiles of the distribution of the ratio between the exposure value⁷⁰ of the reporting institution toward the reported entity and the CeT1 capital of the reporting institutions. A decreasing trend can be observed: at the end of the 2014, one over twenty (5%) of reported non-regulated financial entities had an exposure value higher than 11% of the CeT1 capital of the reporting institution. At the end of the 2020, the same quantile of the distribution of the ratio between the exposure and the CeT1 capital was 8%. A similar trend can be observed also for the 90-esim and 99-esim percentiles suggesting a general shift of the distribution.

⁶⁹ Some counterparties may be reported multiple times.

⁷⁰ After the CRM substitution effect but before the application of the exemptions as per article 400 and 493 CRR

Number of reported non-regulated financial entities and percentiles of the distribution of the ratio between exposure of the reported entity and CeT1 capital of the reporting institution



Source: Corep

C. Options considered, Cost-Benefit Analysis and Preferred Options

Scope of the RTS

12. The common framework presented in these draft RTS largely relies on the EBA guidelines. Under the EBA guidelines, institutions are expected to set limits to the exposures toward shadow banking entities. This reduces the cost of compliance in as much institutions have already developed systems to meet the obligations under the current EBA guidelines and it appears also coherent with the fact that Regulation (EU) No 2019/876 did not amend substantially the reporting obligation under Article 394(2).
13. However, the draft RTS provides a rationale for considering entities subject to different regulatory frameworks (e.g. investment firms, payment institutions, funds, etc.) as being entitled to be considered as regulated.

Scope of application

14. As regard the typical “zero” option i.e. not doing nothing, it should be taken in consideration whenever the costs of the proposed regulation are deemed higher than the benefit. In this specific case, the draft RTS do not entail additional costs in that they mainly confirm the existing EBA guidelines. However, the draft RTS provide a relevant clarification about the possibility to extend the classification of regulated entities outside the perimeter represented by the CRD/CRR.
15. The draft RTS browses through the regulatory frameworks that are relevant for different entities (namely investment firms, payment institutions and electronic money institutions, insurance and



reinsurance undertakings, central counterparties, resolution institutions) and provide a rationale for considering them as similar to the rules in the CRR and CRD.

Preferred option

16. The draft RTS clarify that it is possible to avoid classifying as shadow banking entities counterparties different from credit institutions but carrying banking activities (such maturity and liquidity transformation, credit risk transfer and similar activities) to the extent that they are subject to a framework considered similar to the CRD/CRR. The draft RTS specify which regulations can be so considered.
17. Considering the possible risks stemming from exposures toward the shadow banking sector, the importance for authorities to have information about that sector and the need to ensure a harmonised level of reporting across EU institutions, it is deemed that the benefits of the draft RTS compensate the costs.



5.2 Overview of questions for consultation

Question 1: Do you agree with the conditions of Article 1 paragraph 2 for identifying an entity as a non-shadow banking entity? Please provide reasons if you do not agree with any of the conditions or have comments with regard to any of them.

Question 2: Have you got any comments regarding the list of entities that, being exempted or optionally excluded from those four legal acts in Annex I, should not be considered as shadow banking entities?

Question 3: Conversely, what are your views concerning other entities exempted or optionally excluded from the other legal acts in Annex I and that would be identified as shadow banking entities? Please provide reasons in case you view that any of those entities should fall under the exemption in Article 1 paragraph 3 and therefore not be treated as shadow banking entities.

Question 4: Have you got any other comments with regard to the content of Article 1 of the draft RTS? In your view, is it clear and easy to implement for the purposes of the reporting obligation of Article 394(2) of Regulation (EU) No 575/2013?

Question 5: In general, what are your views on the treatment of funds in these draft RTS? Do you agree with the approach adopted in these draft RTS, that follows the approach in the EBA Guidelines on limits on exposures to shadow banking entities, or alternatively should it be extended to capture those funds as shadow banking entities?

Question 6: What would be the advantages and disadvantages of taking a broader approach with respect to the scope of funds included as shadow banking entities?

Question 7: What are your views with regard to the consideration of money market funds as shadow banking entities?

Question 8: Do you face any difficulties identifying whether an alternative investment fund (AIF) should be considered as a shadow banking entity?

Question 9: Have you got any specific comments with regard to AIFs and in particular, with points (b) and (c) of Article 1 paragraph 5?

Question 10: Do you agree with the description of banking services and activities as included in Article 2 of the draft RTS? Have you got any specific comments regarding any of the points included?

Question 11: Do you agree with the possibility granted under paragraph 1 of Article 3 to prevent the identification of a bank in a third country as a shadow banking entity in the absence of an equivalence decision under Article 391 of the CRR?

Question 12: Have you got any comments regarding the approach set out in paragraph 2 of Article 3 for other entities established in third countries to prevent their identification as shadow banking entities?



Question 13: Do you agree with the list of legal acts included in Annex I?

Question 14: Is there any other legal act that should be included in Annex I? If yes, please mention the act and legal reference, and provide reasons to support it based on the criteria included in Article 394(4) of Regulation (EU) No 575/2013.