

**MEMO# 27563**

September 16, 2013

## **European Commission Publishes Communication on Shadow Banking**

[27563]

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TO: ICI GLOBAL SHADOW BANKING TASK FORCE  
INTERNATIONAL MEMBERS No. 44-13  
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 23-13 RE: EUROPEAN COMMISSION  
PUBLISHES COMMUNICATION ON SHADOW BANKING

On September 4, 2013, the European Commission (“EC”) published a communication on shadow banking – addressing new sources of risk in the financial sector (“EC Communication”). [\[1\]](#) The purpose was to set out the EC’s “roadmap” for the coming months to limit the emergence of systemic risks in the unregulated system. The EC Communication also describes measures that the European Union (“EU”) has completed or is in the process of implementing to provide a better framework for financial sector risks, including new rules for banks, OTC derivatives, credit rating agencies and securitizations. The EC Communication outlines the EC’s priorities related to: (1) increasing transparency; (2) enhancing fund rules, including for money market funds and UCITS; (3) reforms to limit the risks of securities financing transactions; (4) strengthening the banking framework to limit contagion and arbitrage risks; and (5) greater supervision of shadow banking. The EC also acknowledges the important role of shadow banking in the financial sector as an alternative financing channel for the real economy.

### **Increasing Transparency**

To effectively monitor shadow banking risks for the EU, data must be collected and authorities must supplement and enhance their tools. The EC recommends that a periodic quantitative assessment take place at least annually. The EC also expects to work with the European Systemic Risk Board, the Financial Stability Board and the International Monetary Fund which also are collecting and analyzing data.

The EC also considers the central repositories for derivatives data a major step in helping identify transfers of risks, interconnectedness and the identity of entities buying and selling in certain markets. The EC believes the data will provide a way to determine if shadow banking entities are dominant or bearing significant risks. MiFID revisions also will increase transparency and allow better monitoring of risks posed by activities such as high frequency trading. The EC also cites the importance of the global legal entity identifier (LEI)

and states that it will consider a legislative proposal to transpose the obligation to use the global LEI in the EU.

On securities financing, the EC discusses the need to increase transparency and an initiative by the European Central Bank to establish a central repository on repurchase transactions. The EC states that it will monitor transparency at the EU level and reserves the right to propose remedies to improve transparency.

### **Enhanced Frameworks for Funds**

The EC cites and briefly describes its recent proposal for the regulation of money market funds to strengthen these funds. The EC also intends to consider issues related to UCITS including the way in which investment techniques and strategies are carried out. Part of this work will relate to securities financing (e.g., securities lending and repurchase agreements) and the EC will consider issues such as fund liquidity, collateral and counterparty risk and connectedness to banking.

### **Securities Financing Transactions**

Beyond funds engaging in securities financing transactions, the EC is considering securities financing more broadly and how to reduce risks associated with these transactions. The EC is considering issues related to collateral, re-use or re-investment of collateral, market transparency and interconnectedness. The EC asserts in-depth work has been done to better understand securities financing transactions and states that it is considering a legislative proposal to address perceived problems.

### **Strengthening the Banking Framework**

The EC states that shadow banking risks to banks can be addressed by tighter rules on banks for their dealings with unregulated entities and by possibly extending prudential rules. For example, solvency rules and capital rules for holdings in certain entities have been tightened. There also are new liquidity rules for banks. New reporting to banking regulators on bank exposures to unregulated entities as well as exposures from repurchase agreements and securities lending also begins in 2014. On the extension of prudential rules, the EC is considering how to approach the issues posed by Member States having different interpretations of whether similar activities by an entity should require qualification as a credit institution. The EC believes it must assess how the definition of credit institution is being applied and, if there are problems, then the EC may need to clarify the definition.

The EC also intends to monitor further FSB recommendations regarding shadow banking entities and propose legislation as appropriate.

### **Greater Supervision of Shadow Banking**

The EC believes that national and European authorities must ensure the establishment of suitable and comprehensive monitoring. The EC intends to pay close attention to national level efforts, including the quality of efforts and the level of cooperation between national authorities. The EC also expects the European level authorities to “step up” their work and their coordination. The EC also expects that the review of the European System of Financial Supervisors will be helpful in clarifying the roles of authorities, as needed.

## **endnotes**

[1] The EC Communication is available at  
[http://ec.europa.eu/internal\\_market/finances/shadow-banking/index\\_en.htm](http://ec.europa.eu/internal_market/finances/shadow-banking/index_en.htm).

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