

MEMO# 26234

June 12, 2012

Institute Letter on European Commission's Green Paper on Shadow Banking

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TO: ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 18-12
ETF ADVISORY COMMITTEE No. 16-12
INTERNATIONAL MEMBERS No. 23-12
ICI GLOBAL MEMBERS
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 41-12
SEC RULES COMMITTEE No. 37-12 RE: INSTITUTE LETTER ON EUROPEAN COMMISSION'S
GREEN PAPER ON SHADOW BANKING

On June 8, 2012, the Institute submitted a comment letter regarding the European Commission's green paper on "shadow banking" ("Green Paper"). [\[1\]](#) The European Commission ("Commission") is seeking to contribute to the global debate on this topic, increase the resilience of the European Union's financial system and ensure financial activities are contributing to economic growth. [\[2\]](#) The Institute submitted a letter generally describing the insights that it has previously offered to policymakers in recent comment letters on the definition of "shadow banking," exchange traded funds ("ETFs"), money market funds and securities lending and repurchase agreements.

"Shadow Banking" - Definition and Framework

As a preliminary matter, we objected to the terms "shadow banks" and "shadow banking" as inherently inaccurate and misleading. We urged the Commission to use more precise and neutral terminology when discussing the various roles of non-bank financial intermediaries.

With respect to a definition of non-bank credit intermediation, the risks and benefits as well as the challenges for authorities regarding oversight and regulatory approaches, we referred the Commission to the Institute's comment letter to the Financial Stability Board ("FSB") [\[3\]](#) on its background note, *Shadow Banking: Scoping the Issues*, published in April

2011 (“FSB Note”). [\[4\]](#) In that letter we outlined our concerns with the FSB’s definition, which was referenced in the Green Paper. In our letter to the FSB, we urged them to reevaluate the “universal bank” framework, and carefully consider the long history of parallel systems for intermediation that capital markets and banks provide as well as the extensive regulatory framework applicable to funds registered under the Investment Company Act of 1940. We similarly urged the Commission to proceed cautiously and ensure that any responses be carefully balanced and targeted, taking account of the unique features of existing regulatory frameworks that govern capital markets activities, including for investment funds, fund managers and securities markets.

Asset Management Regulation - ETFs and Money Market Funds

In the Green Paper, the Commission acknowledged that it was considering ETFs and money market funds. The Commission also noted the FSB’s work on ETFs and money market funds as well as recent consultations on ETFs by the European Securities and Markets Authority (“ESMA”). New guidelines related to money market funds also have been recently introduced in Europe. With respect to modifications to the existing European framework for ETFs and money market funds, we urged the Commission to spend time evaluating reforms that have already been implemented or may soon be implemented, including the consideration of the costs and the benefits of any reforms.

On ETFs, we referred the Commission to the Institute’s comment letter to the FSB in May 2011 [\[5\]](#) and two recent letters submitted to ESMA on UCITS ETFs. [\[6\]](#) On money market funds, the Institute directed the Commission to our comment letter on the April 2012 consultation report, *Money Market Fund Systemic Risk Analysis and Reform Options*, by Technical Committee of International Organization of Securities Commissions (“IOSCO”). [\[7\]](#) We disagreed with the suggestion that the financial crisis of 2007-2008 highlighted that U.S. money market funds are particularly “susceptible” to runs and also noted the changes to U.S. law that have made U.S. money market funds even more liquid, transparent and stable than ever before. We also challenged the argument that requiring money market funds to float their NAV would reduce the tendency of money market funds to experience large redemptions during periods of extreme financial stress. We noted that requiring U.S. money market funds to use mark-to-market pricing in lieu of amortized cost pricing would not, under normal circumstances, cause the shares of such funds to float and therefore would not be ultimately helpful in addressing the risks identified by policymakers.

Securities Lending and Repurchase Agreements

For securities lending and repurchase agreements, the Green Paper stated that both the Commission and the FSB were examining current practices, identifying regulatory gaps and considering inconsistencies among jurisdictions. The Institute directed the Commission to its May 2012 comment letter on the interim report by the FSB’s Workstream on Securities Lending and Repos (“SL Report”) [\[8\]](#) in which we described a number of regulatory requirements designed to protect investors and which also serve to allay financial stability concerns highlighted in the SL report as well as in the Green Paper. Our comment letter on the SL Report also described recent work in the United States related to tri-party repos. We recommended that the Commission continue to study and consider securities lending and repo issues along with other regulators and policymakers.

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Attachment

endnotes

[1] See European Commission, Green Paper: Shadow Banking, March 19, 2012, available at http://ec.europa.eu/internal_market/bank/docs/shadow/green-paper_en.pdf.

[2] Green Paper at 2.

[3] Letter from Paul Schott Stevens, President and CEO of the Investment Company Institute to the Secretariat of the FSB, June 3, 2011, available at <http://www.ici.org/pdf/25258.pdf>.

[4] FSB, *Shadow Banking: Scoping the Issues*, April 11, 2011, available at http://www.financialstabilityboard.org/publications/r_110412a.pdf.

[5] In response to the FSB's April 2011 note on ETFs, *Potential Financial Stability Issues Arising from Recent Trends in Exchange-Traded Funds*, the Institute submitted a comment letter describing the laws applicable to ETFs registered under the Investment Company Act of 1940, including requirements regarding conflicts, liquidity and securities lending, that mitigate the concerns raised by the FSB. Letter from Karrie McMillan, General Counsel of the Investment Company Institute to the Secretariat of the FSB, May 16, 2011, available at <http://www.ici.org/pdf/25189.pdf>

[6] See Letter from Karrie McMillan, General Counsel, to Steven Maijoor, Chair, ESMA, September 30, 2011, available at <http://www.ici.org/pdf/25540.pdf> (supporting certain disclosure proposals for UCITS ETFs and raising questions regarding possible changes to the redemption policies of UCITS ETFs) and Letter from Karrie McMillan, General Counsel, to Steven Maijoor, Chair, ESMA, March 30, 2012, available at <http://www.ici.org/pdf/26012.pdf> (expressing strong concerns regarding proposed guidelines related to either (i) a requirement for a fund or its management company to ensure investors can sell their shares whenever the market is open by requiring the fund or its management company to ensure market makers continue to transact, take action to replace market makers if they fail to do so or make arrangements so shares can be sold back to the fund or the management company; or (ii) require UCITS ETFs to accept redemptions directly from secondary market investors at any time).

[7] *Money Market Fund Systemic Risk Analysis and Reform Options*, CR07/12, Technical Committee of IOSCO (April 27, 2012), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD379.pdf>.

[8] Letter from Robert C. Grohowski, Senior Counsel, to the Secretariat of the FSB, May 25, 2012, available at <http://www.ici.org/pdf/26196.pdf>.

abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.