

MEMO# 34165

May 31, 2022

EBA Finalizes Draft RTS on Identifying "Shadow Banking Entities" for Purposes of Large Exposure Reporting by Banking Organizations

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TO: ICI Members

ICI Global Members

Global Regulated Funds Committee SUBJECTS: Financial Stability

International/Global

Money Market Funds RE: EBA Finalizes Draft RTS on Identifying "Shadow Banking Entities" for Purposes of Large Exposure Reporting by Banking Organizations

Under the EU Capital Requirements Regulation (CRR), a banking organization must report to supervisory authorities its ten largest exposures to "shadow banking entities which carry out banking activities outside the regulated framework." The European Banking Authority (EBA) has finalized draft regulatory technical standards (RTS) to specify criteria for identifying shadow banking entities for purposes of this reporting requirement.[\[1\]](#) The draft RTS identify money market funds (MMFs) as being in scope, despite opposition from ICI Global and others.[\[2\]](#) Non-MMF UCITS and similarly regulated non-EU funds are excluded.

The EBA will submit the draft RTS to the European Commission for endorsement. The RTS will be subject to scrutiny by the European Parliament and the Council before being published in the Official Journal of the European Union and coming into force in the EU.

Background information and brief highlights from the EBA's final report are provided below.

Background - 2015 EBA guidelines

The CRR, adopted in 2013, is intended to decrease the likelihood of individual banks becoming insolvent. Pursuant to Article 395(2) of the CRR, the EBA issued guidelines in 2015 for banks to follow in setting internal limits on their exposures to "shadow banking entities," defined as entities that carry out banking activities outside the regulated framework. The CRR defines "exposure" as "any asset or off-balance sheet item."

The 2015 guidelines state that funds prima facie should be considered shadow banking

entities because they "tend to engage in maturity and liquidity transformation and are generally regarded as outside the traditional banking sector." The guidelines indicate that some funds, however, are sufficiently regulated such that they need not be treated as shadow banking entities. In particular, the guidelines state that the UCITS Directive "prescribes a robust set of requirements under which undertakings for collective investment in transferable securities, 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."

Notwithstanding this exclusion, the 2015 guidelines treat all MMFs, including those that adhere to the UCITS Directive, as shadow banking entities. According to the guidelines, this treatment is appropriate "because, as acknowledged by the European Commission in its proposal for a regulation on MMFs (under negotiation), the average size of an MMF far exceeds the average size of a UCITS fund and, as acknowledged by the [Financial Stability Board (FSB)] and other institutions such as the International Organisation of Securities Commissions and the [European Systemic Risk Board (ESRB)], the systemic risks posed by such funds (in particular having regard to their interconnectedness with the banking sector) have not been addressed to an adequate degree through existing regulatory measures. Therefore, at this stage (in particular, pending agreement on the Commission's legislative proposal) the EBA includes all MMFs within the scope of the definition of shadow banking entity."

Final Report on Draft RTS

A separate provision of the CRR—Article 394—requires a bank to report to supervisory authorities its ten largest exposures to "shadow banking entities" and calls on EBA to develop RTS to specify the criteria for the identification of shadow banking entities.

The report talks at length about shadow banking and the shadow banking risks identified to date by the FSB and the ESRB. It proceeds to note that the FSB/ESRB approach to monitoring the non-bank financial sector is not compatible with the purpose of the CRR, which is to decrease the risk of individual banks becoming insolvent. Further, the report confirms that the EBA intended to base the RTS as much as possible on its 2015 guidelines.

The draft RTS identify MMFs as shadow banking entities, noting that MMF vulnerabilities identified during the Covid-19 crisis are still to be addressed and that stress within that market segment "could trigger severe liquidity issues for institutions and institutional investors." The EBA acknowledges that the EU Money Market Fund Regulation, adopted in 2017, has made "the framework under which MMFs operate more robust and safer." It then points to the "ongoing review" of the MMFR and concludes that it is "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."

As with the 2015 guidelines, the draft RTS exclude non-MMF UCITS based on EBA's conclusion that such funds do not present the same level of credit risk as "unregulated" funds. The report further states that "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."

Rachel H. Graham
Associate General Counsel & Corporate Secretary

endnotes

[1] EBA, [Final Report: Draft Regulatory Technical Standards on criteria for the identification of shadow banking entities under Article 394\(4\) of Regulation \(EU\) No 575/2013](#) (23 May 2022).

[2] See [ICI Memorandum 33865](#) (Oct. 26, 2021), summarizing ICI Global [comment letter](#) to the EBA.

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