

16th June 2015

**RESPONSES TO BE SENT VIA
ONLINE QUESTIONNAIRE**

Dear Sirs

Response to the European Banking Authority ("EBA") Consultation Paper: Draft EBA Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395 para.2 Regulation (EU) No. 575/2013 (the "Consultation")

The Loan Market Association ("LMA") welcomes the opportunity to provide a response to the EBA in respect of the Consultation and hopes that its comments will be useful in the EBA's upcoming review.

The LMA is the trade body for the EMEA syndicated loan market and was founded in December 1996 by banks operating in that market. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 600 institutions across 60 nationalities and consists of banks, non-bank investors, law firms, rating agencies and service providers. The LMA has gained substantial recognition in the market and has expanded its activities to include all aspects of the primary and secondary syndicated loan markets. It sees its overall mission as acting as the authoritative voice of the European loan market vis à vis lenders, borrowers, regulators and other interested parties.

The Consultation has as its objective to examine the issues raised by the draft EBA Guidelines, which propose criteria on setting limits on European Union (EU) institutions' exposures to shadow banking entities. The purpose of the Guidelines is to increase the resilience of the EU's financial system, whilst not overlooking the important role that shadow banks play in lending to the private sector, enhancing the efficiency of the financial sector by enabling better risk sharing, maturity transformation and fostering liquidity in the market. With this in mind, having consulted with our members, we would like to respond to the Consultation's question on the EBA's approach to defining shadow banking entities.

In our view, banks, non-banks and corporates will be negatively impacted by the unintended consequences of this regulation as currently drafted.

Question 1. Do you agree with the approach the EBA has proposed for the purposes of defining shadow banking entities? In particular, do you consider that this approach is workable in practice? If not, please explain why and present possible alternatives.

Whilst we are supportive of the overarching objective to increase the resilience of the EU's financial system, we do not agree with the approach the EBA has proposed for the purposes

of defining shadow banking entities. The Consultation has defined shadow banking entities as entities that:

Carry out credit intermediation activities, defined as bank-like activities involving maturity transformation, liquidity transformation, leverage, credit risk transfer or similar activities; and are not within the scope of prudential consolidation nor subject to solo prudential requirements under specified EU legislation (or equivalent third country legal frameworks). Entities referred to in Article 2(5) and Article 9(2) of Directive 2013/36/EU (CRD) are also not to be regarded as shadow banking entities.

Whilst we support the move away from the FSB paper on shadow banking, which attempts to categorise by vehicle type rather than the activity it carries out, we still have the following additional concerns:

- a) the EBA has defined shadow banking entities too broadly and without an adequate assessment of which activities fall within the definition. We are specifically concerned that this definition would capture any entity whose business happens to include lending or credit, regardless of whether this is the entity's main business;
- b) the general reference to "bank-like activities" is overly broad as it could be seen to cover any entity whose activities involve "maturity transformation" and/or "leverage". Although it appears that for the purpose of the guidelines these activities must be "bank-like", further clarification is required as to exactly what this means; and
- c) the EBA lists examples of entities that carry out credit intermediation and this includes a broad list, for example special purpose vehicles. We would stress the importance that shadow banking should be identified by reference to economic activity and not vehicle type. It should be noted that the same sort of "entity" for labelling purposes can pose very different levels of risk. In addition, entities that do not feature in a pre-determined list could carry out the same activity as one that does. Simply regulating entities by way of vehicle categorisation is potentially dangerous, and could lead to unintended consequences for low risk investment vehicles. Furthermore, we consider that it would be very difficult to categorise shadow banking entities accurately, particularly given the rate of financial product/vehicle evolution, which could potentially render any definitions outdated within a short space of time.

As a result, we do not consider the definition, as currently drafted, is workable in practice particularly because corporates, borrowing through their Treasury companies could be captured. This reduces these entities' access to credit with an ultimate cost to employment and growth.

Furthermore, banks will be required to make a determination on a borrower-by-borrower basis as to whether that borrower falls within this definition. Assuming that it will not be permissible simply to accept a borrower's undertaking that it does not engage in these activities, it will therefore be necessary for each bank to establish a set of metrics to classify borrowers. Such metrics will presumably have to be objective rather than judgement-based, and (presumably) based on publicly available data. It is almost impossible to envisage such a system not coming up with significant unintended consequences; the most important of which is that commercial businesses whose data inadvertently contravenes such metrics may find themselves cut off from the banking system as a whole as a source of finance. Given the

number of borrowers this could capture, this will be an extremely difficult task to manage. It seems to us that the "definition" contained in the consultation paper is not capable of being reduced to easily applicable metrics, and is in fact designed primarily as a guide to the application of expert judgement. If this is the case, such judgement should be exercised by the public sector, and not be left to individual banks.

In order to mitigate these concerns, it is our view that a concept of materiality should be introduced at the very least. The LMA raised a similar point when it responded on CRD IV in May 2012, which related to the drafting/interpretation of the legislation and its possible impact for the syndicated loan market. In the end, the following definitions were included in Article 142(5):

'unregulated financial sector entity' means an entity that is not a regulated financial sector entity but that performs, as its main business, one or more of the activities listed in Annex I to Directive 2013/36/EU or in Annex I to Directive 2004/39/EC"

and, with respect to Article 411(1):

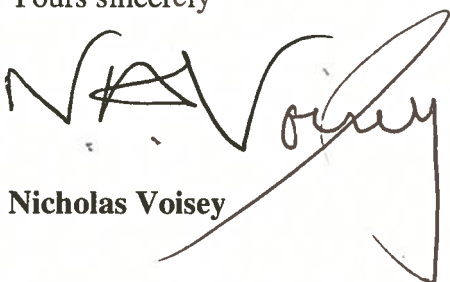
'financial customer' means a customer that performs one or more of the activities listed in Annex I to Directive 2013/36/EU as its main business, or is one of the following "

In our view, by adding a concept of materiality will mean that companies, which carry out these activities as an ancillary part of their business, are not caught by the legislation. It also permits institutions to carry out a practical and meaningful assessment as to whether an entity falls within these definitions.

Conclusion

We would be happy to discuss any aspect of this response with you in more detail and to meet with you as required. If we can be of any further assistance, please do not hesitate to contact me via email at nicholas.voisey@lma.eu.com or by telephone on 020 7006 5364.

Yours sincerely

A handwritten signature in black ink, appearing to read 'N. Voisey', with a long horizontal stroke extending to the right.

Nicholas Voisey