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European Banking Authority
Tour Europlaza
20 avenue André Prothin,
92400 Courbevoie
France

Via electronic submission: www.eba.europa.eu

Consultation Paper: Draft Regulatory Technical Standards on Criteria for the Identification of Shadow Banking Entities – Article 394(4) of the European Union Capital Requirements Regulation

Dear Sir/ Madam:

State Street Corporation (“State Street”) welcomes the opportunity to comment on the consultation paper issued by the European Banking Authority (“EBA”) regarding the development of draft regulatory technical standards (“RTS”) for the identification of “shadow banking entities”. The draft RTS are intended to enable financial institutions subject to the European Union Capital Requirements Regulation (“EU CRR”), to meet the requirements of Article 394(2), as amended, which mandates among other matters, the reporting by financial institutions of their “ten largest exposures to shadow banking entities which carry out banking activities outside the regulated framework”.¹ While we generally welcome the EBA’s efforts to support financial institutions’ compliance with the reporting requirements of Article 394(2), we strongly oppose its recommendation that money market funds (“MMFs”) should be designated as “shadow banking entities”, an approach that does not reflect the well-established role of MMFs in the EU capital markets, and the extensive body of regulation that governs their

¹ Regulation (EU) 2019/ 876 of the European Parliament and of the Council Amending Regulation (EU) 2013/575 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) 2012/648 (20 May, 2019)

structure, operation and investment profile. Our concerns regarding the EBA’s approach to MMFs is long-standing and is reflected in the observations that we made in our response to the EBA draft guidelines for limiting financial institutions’ exposures to shadow banking entities in June 2015, an approach that we believe creates an unwarranted and potentially detrimental perception of the risk posed by MMFs.²

Headquartered in Boston, Massachusetts, State Street is a global custody bank which specializes in the provision of financial services to institutional investor clients. This includes investment servicing, investment management, data and analytics, and investment research and trading. With \$43.3 trillion in assets under custody and administration and \$3.9 trillion in assets under management, State Street operates in more than 100 geographic markets.³ We conduct banking operations in the EU primarily through our Germany-headquartered wholly-owned subsidiary, State Street Bank International GmbH (“SSBI GmbH”), with branch locations throughout the EU. SSBI GmbH is designated as a significant institution and is directly supervised by the ECB pursuant to the Single Supervisory Mechanism. In addition, we offer a range of investment fund products through State Street Global Advisors Europe Limited, a wholly-owned subsidiary of State Street Global Advisors Incorporated, with branch locations in selected EU countries.

As a general matter, the EBA’s approach to determining the scope of counterparties that should fall within the definition of “shadowing banking entities” for the purposes of compliance with Article 394(2) of the EU CRR involves a process of elimination, starting from the general definitions of non-bank financial institutions used by the European Systemic Risk Board and the Financial Stability Board, with various categories of counterparties then excluded from the definition based on the presence of a regulatory framework or other considerations that in the view of the EBA sufficiently mitigate potential financial stability risk. When discussing MMFs, the EBA begins its analysis by acknowledging that these funds are authorized by, and subject to, the rules of either the Undertaking for Collective Investments in Transferable Securities Directive (“UCITS Directive”) or the Alternative Investment Fund Managers Directive (“AIFM Directive”), as well as the specific requirements of the EU Money Market Fund Regulation (“MMFR”) adopted in June 2017 after the finalization of the EBA guidelines for limiting financial institutions’ exposures to shadow banking entities in order to better address potential financial

² ‘Consultation Paper (EBA/CP/2015/06) – Draft EBA Guidelines on Limits on Exposures to Shadow Banking Entities which carry out Banking Activities Outside a Regulated Framework under Article 395, Paragraph 2 of the Capital requirements Regulation’, State Street Corporation Comment Letter (19 June, 2015).

³ As of 30 September, 2021.

stability risk.⁴ We note, in this respect, that the EBA explicitly affirms that these additional requirements “make the framework under which MMFs operate more robust and safer”.⁵

Notwithstanding these various considerations, the EBA concludes its analysis by asserting that MMFs should be included within the definition of “shadow banking entities” based on concerns expressed by various regulators, including the European Securities and Markets Authority (“ESMA”), that the “COVID-19 pandemic (was) a challenge for MMFs...with many EU MMFs facing liquidity issues during the period of acute market stress in March 2020”.⁶ Furthermore, it also notes ongoing efforts to consider reform measures that would further enhance the resilience of MMFs, observing in turn that the designation of such funds as “shadow banking entities” should be maintained until “such (additional) reforms are in place.”⁷ We strongly oppose the EBA’s approach and note its potential to profoundly alter the existing understanding of MMFs outside of the EU legislative process. Our comments below are therefore primarily responsive to Question 7 of the consultation paper.

There are a several factors which account for our strong opposition to the approach adopted by the EBA. First, while it is indisputable that global financial markets faced substantial turmoil in March 2020 that created an unprecedented demand for short-term liquidity, MMFs were not the cause of this instability. Indeed, whereas the global financial crisis was primarily driven by excessive risk-taking and related solvency concerns at certain large financial institutions, the market turmoil of March 2020 was triggered by an external event, specifically a once in a century public health crisis that brought about a near total shut down of the global economy. Furthermore, the pressures observed in March 2020 were not limited to MMFs, also extending to short-term funding markets generally, including the market for United States Treasuries and other widely traded sovereign obligations. Similarly, the high-levels of structural liquidity held by MMFs helped absorb substantial initial client outflows, subsequently supported by the sale of less liquid assets in a manner entirely consistent with the investment mandate of MMFs and their responsibility to prudently manage risk. As such, the use of the market turmoil in March 2020 to characterize MMFs as facing particularly high levels of idiosyncratic risk is misplaced and should not be used as a pretext by the EBA for their characterization in EU regulation as “shadow banking entities”.

Second, the overview of MMFs provided by the EBA in the consultation paper, including the various regulatory requirements which they must meet under EU law, substantially understates both the importance of MMFs to the EU and the comprehensiveness of the regulatory

⁴ Directive 2014/91/EU of the European Parliament and of the Council Amending Directive 2009/65/EC on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investments in Transferable Securities as Regards Depositary Functions, Remuneration Policies and Sanctions (23 July, 2014); Directive 2011/61/EU of the European Parliament and of the Council on Alternative Investment Fund Managers and Amending Directives 2003/41/EC and 2009/65/EC and Regulations EC No. 1060/ 2009 and EC No. 1095/2010 (8 June, 2011) and Regulation (EU) 2017/1131 of the European Parliament and of the Council on Money Market Funds (14 June, 2017).

⁵ ‘Consultation Paper – Draft Regulatory Technical Standards on Criteria for the Identification of Shadow Banking Entities under Article 394(4) of Regulation EU N. 575/ 2013, European Banking Authority (26 July, 2021); paragraph 84, page 26.

⁶ EBA Consultation Paper, paragraph 85, page 26.

⁷ EBA Consultation Paper, paragraph 89, page 27.

framework that govern their activities. MMFs play a crucial role within the EU capital markets and are highly prized by a wide variety of investors and businesses for their ease of use, compelling investment benefit and conservative risk profile. For corporate treasurers, MMFs provide an operationally simple, cost-effective investment vehicle that is principally used for cash and liquidity management purposes. This reflects the structure of MMFs, which focus on the preservation of capital, and which provide investors with cost-effective access to investment expertise and issuer diversification. While MMFs do endeavor to provide investors with a relatively favorable yield position, this is not their primary goal, which instead centers on assuring adequate liquidity to support day-to-day activities, such as the management of employee payroll and other similar operational expenses. Furthermore, MMFs function as a simple, stable and well-understood source of short-term funding for a broad range of issuers in the EU. This includes financial, corporate, municipal and other government entities, which use MMFs to support their cash flow needs.

EU MMFs are subject to an extensive, well-defined and rigorous set of regulatory standards. This includes the UCITS Directive, which provides a harmonized framework for the authorization, organization and sale of investment funds to retail investors, and the AIFM Directive which provides a comprehensive set of rules governing professional investor access to more specialized alternative funds. Furthermore, EU MMFs are also subject to the MMFR, which established four types of MMFs with varying structures and investment goals, as well as common standards for minimum liquidity, portfolio diversification, and the management of investment risk. More recently, regulatory bodies in the EU have issued various guidance to further promote the resilience of EU investment funds. This includes ESMA guidelines on liquidity stress testing for UCITS and alternative investment funds in July 2020, and ESMA guidelines on stress test scenarios for MMFs in December 2020.⁸

Unlike banks and other types of financial institutions, MMFs do not employ leverage to maximize investor returns and are subject to stringent restrictions on the composition of their portfolio assets. Finally, MMFs are prevented by Article 35 of the MMFR from receiving sponsor support, thereby dramatically limiting potential interconnection risk with the banking sector. As such, we view the EBA's recommendation to classify MMFs as "shadow banking entities" as highly misleading and as likely to create unnecessary confusion among market participants regarding the rigor of their regulatory construct. We note, in this respect, that there are certain investors that may be constrained by financial or risk considerations from making use of any investment vehicle that is characterized in regulation as a "shadow banking entity", thereby creating the strong potential for disruption in current investor and business behavior without the benefit of a more detailed and comprehensive legislative review.

Third, while we recognize that the unprecedented and acute pressure faced by the short-term funding markets in March 2020 has prompted a broad review of the regulatory framework for

⁸ 'Guidelines on Liquidity Stress Testing in UCITS and AIFs', European Securities and Markets Authority - ESMA 34-39-897 (July 16, 2020) and 'Guidelines on Stress Test Scenarios under the MMF Regulation, European Securities and Markets Authority – ESMA 34-49-289 (16 December, 2020).

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MMFs in the EU, and that certain additional reforms for such funds are likely, we do not believe that it is appropriate for the EBA to anticipate the outcome of this review within the context of its work on draft RTS for the purposes of compliance with the reporting obligations of Article 394(2). Indeed, the fact that existing regulations for MMFs are under review with the goal of further enhancing their resilience, is not an adequate reason to incorporate MMFs within the definition of “shadow banking entities” prior to the review’s conclusions. This is especially true since the MMFR, which was specifically enacted to further enhance the resilience of MMFs, is required by legislation to undergo a review of its effectiveness three years after enactment, or by 21 July, 2022, a few short months after the close of the EBA consultation. We strongly reiterate, in this respect, that the EBA’s recommendation to designate MMFs as “shadow banking entities” is not without broader consequence, given its potential to alter the common understanding of and usage of MMFs by investors and businesses alike. As such, the conclusion that “the risks associated with MMFs have not been fully addressed by prudential requirements in the (EU)” is premature, and the decision of the EBA to designate MMFs as “shadow banking entities” for the purposes of its draft RTS should be withdrawn pending further review by the EU co-legislators.⁹

Thank you once again for the opportunity to comment on the matters raised in the consultation paper. To summarize, while we welcome the EBA’s efforts to clarify expectations regarding implementation of the reporting requirements of Article 394(2) of the EU CRR, we strongly oppose its recommendation to categorize MMFs as “shadow banking entities”. This reflects our concern that unprecedented market turmoil in March 2020 is inappropriately being used by the EBA, without proper regard for the vital role of MMFs in the EU and the robust regulatory framework in which they operate, to alter the current, well-established understanding of MMFs outside of the normal legislative process. We therefore urge the EBA to reconsider its approach and to withdraw the designation of MMFs as “shadow banking entities” for the purposes of Article 394(2) reporting.

Please feel free to contact us should you wish to discuss the contents of this submission in greater detail. We welcome the opportunity to further engage with the EBA on this matter and we stand ready to provide whatever assistance may be appropriate.

Sincerely,



Stefan Gmuer
Chief Executive Officer
State Street Bank International GmbH



Kris Wulteputte
Chief Risk Officer
State Street Bank International GmbH

⁹ EBA Consultation Paper, preamble draft Commission Delegated Regulation (5), page 30.