Guernsey Financial
Services Commission

EBA
One Canada Square (Floor 46)
Canary Wharf
London E14 5AA| UK

19 June 2015

Dear Sir/Madam

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 Guernsey Financial Services Commission (**"the GSFC"**) welcomes the opportunity to comment on the European Banking Authority's (**"EBA's"**) consultation draft guidelines on limits on exposures to shadow banking entities.

The Commission is the regulatory body for the finance sector in the Bailiwick of Guernsey. The Commission's primary objective is to regulate and supervise financial services in the Bailiwick, with integrity and efficiency, and in so doing help to uphold the international reputation of the Bailiwick as a finance centre. The Commission is the only financial services regulator within the Bailiwick.

The Commission shares the EBA's concerns for the stability of the financial system and supports moves to safeguard the provision of credit to the real economy and orderly functioning of financial markets by proportionate and appropriate limits of the exposure of the banking system to shadow banking entities.

The Bailiwick is a third country jurisdiction with respect to EU financial regulation and as a result the Commission restricts its response to issues relating to third country equivalence mainly arising out of proposed definitions.

We have therefore limited ourselves to responding to question one.

Yours faithfully

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Cc Philip Nicol-Gent, General Counsel, Guernsey Financial Services Commission

Q1: 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?

- Do you agree with the proposed approach to the exclusion of certain undertakings, including the approach to the treatment of funds? In particular, do you see any risks stemming from the exclusion of non-MMF UCITS given the size of the industry? If you do not agree with the proposed approach, please explain why not and present the rationale for the alternative approach(es) (e.g. on the basis of specific prudential requirements, redemption limits, maximum liquidity mismatch and leverage etc).

As stated by the EBA itself within the consultation paper "the general approach proposed by the EBA is to exclude from the scope of the definition of 'shadow banking entities' entities that are subject to an appropriate prudential framework either as a result of prudential consolidation or, where entities are not within the scope of consolidation, certain sector-specific prudential frameworks which are deemed to cover for the risks posed by the bank-like activities of the entity."

The result of this is that a range of exclusions are required to create this definition. Again to directly quote the consultation paper (*but our underline, our italics*):

-Excluded undertakings means:

(1) undertakings included in consolidated supervision on the basis of the consolidated situation;

(2) undertakings not included in consolidated supervision but which are supervised on a consolidated basis by a third country competent authority pursuant to the law of *a third country which applies prudential and supervisory requirements that are at least equivalent to those applied in the Union*;

(3) undertakings which are not within the scope of point (1) and (2) but which are:

a) credit institutions;
b) investment firms;
c) third country credit institutions if the third country applies prudential and supervisory requirements to that institution that are at least equivalent to those applied in the Union;
d) recognised third country investment firms;
e) financial institutions authorised and supervised by the competent authorities or *third country competent authorities and subject to prudential and supervisory requirements comparable to those applied to institutions in terms of robustness*;
f) entities referred to in points (2) to (23) of Article 2(5) of the CRD;
g) entities referred to in Article 9(2) of the CRD;
h) insurance holding companies, insurance undertakings, reinsurance undertakings and third-country insurance undertakings and third-country reinsurance undertakings *where the supervisory regime of the third country concerned is deemed equivalent*;
i) undertakings excluded from the scope of Directive 2009/138/EC on the taking up and pursuit of the business of insurance and reinsurance in accordance with Article 4 of that Directive;

j) institutions for occupational retirement provision and institutions within the meaning of point (a) of Article 6 of Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision, *and third country institutions carrying out equivalent business and subject to prudential and supervisory requirements comparable to those applied to institutions* within the meaning of point (a) of Article 6 of Directive 2003/41/EC in terms of robustness shall be treated as exposures to institutions.

We appreciate the EBA's evident concern to ensure that there is a fair and appropriate treatment of third country firms by inclusion of various references to comparable or equivalent regulatory approaches for varying types of entities. As a third country jurisdiction we are keen to ensure the EU attains the greatest degree of consistency and transparency to the equivalence process. As we recently stated in our response to the European Commission's Green Paper consultation on Capital Markets Union 'We believe the EU should specifically prioritise creating a market that attracts international investment into Europe and allow access to the EU market by appropriately regulated third country jurisdictions that can demonstrate equivalence with a regulatory regime applied universally across all EU Member States.'

We have concerns however that the exact wording referring to third country equivalence (underlined and italicised) in each case above differs. Our concerns are that this differing language will preclude a consistent approach to the issue. In the absence of a universal or omnibus equivalence process discrepancies and inconsistencies are likely to occur.

Equivalence processes, where they exist, differ across differing types of financial intuition, depending on the EU Directive or EU Regulation that generates the primary regulatory oversight, and the significance or application of the equivalence assessment will differ. For example: CRR and Solvency II for credit institutions and insurance undertakings respectively where equivalence has applications for credit risk under CRR and market access under Solvency II. Of note also is the fact that under the EU AIFMD the regulatory regime for AIFs and AIFMs is deliberately distinct to the general regime for investment firms. Whilst the present approach is to treat AIFs as non-exempt, if this were to change subsequent to the consultation process we would note this distinction is not accommodated in the excluded undertakings section.

We note the recent equivalence decisions under CRR[1], or more precisely the Commission implementing decision of 12 December (Decision 2014/908/EU) which came into force on

[1] The decision stated: 'The equivalence has been determined by an outcome-based analysis of the third country's regulatory and supervisory arrangements which tests their ability to achieve the same general objectives as the Union's supervisory and regulatory arrangements. The objectives refer, in particular, to the stability and integrity of both the domestic and the global financial system in its entirety; the effectiveness and adequacy of protection of depositors and other consumers of financial services; the cooperation between different actors of the financial system, including regulators and supervisors; the independence and the effectiveness of supervision; and the effective implementation and enforcement of relevant internationally agreed standards. In order to achieve the same general objectives of the Union's supervisory and regulatory arrangements, the supervisory and regulatory arrangements of the third country should comply with a series of operational, organisational and supervisory standards reflecting the essential elements of the Union's supervisory and regulatory requirements applicable to relevant categories of financial institutions. Taking into account independent assessments by the international organisations, such as those carried out by the Basel Committee on Banking Supervision, the International Monetary Fund and the International Organization of Securities Commissions, the Commission has assessed the supervisory and regulatory arrangements of certain third countries applicable to credit institutions, investment firms, and exchanges. This analysis has enabled the Commission to evaluate the equivalence of third country arrangements.'

1 January 2015, was relevant to the treatment of credit risk only in the context of Articles 107(4), 114(7), 115(4), 116(5) and 142(2) of the Regulation.

We have no doubt as to the objectivity of the assessment and process that led to this decision but there was little transparency. As a third country that is deemed equivalent for credit institutions we received no communication of this decision, nor explanation as to the cause of the omission from consideration of equivalence for investment firms.

In this regard we welcome the acknowledgement of the EBA to the importance of this issue in this consultation and through the publication of its questionnaire on the assessment of equivalence with the European regulatory and supervisory framework. To this event, we would welcome further continued dialogue on this point and volunteer to contribute and participate in any working or expert groups that may be deemed desirable or necessary to develop a successful resolution of this issue.

About the Commission

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The Commission ensures the Bailiwick's regulatory framework and practice meets international standards and is a committed participant in discussions of international standards. It does so through membership of, or association with, the following international organisations.

- The International Organisation of Securities Commissions (IOSCO) - as a member.
- The International Association of Insurance Supervisors (IAIS) and the Offshore Group of Insurance Supervisors (OGIS) - as a member.
- The Group of International Finance Centre Supervisors (GIFCS).
- The Organisation for Economic Co-operation and Development (OECD) - through the United Kingdom's membership.
- The Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL).

Through its membership of the Group of International Finance Centre Supervisors, it works with:

- The Basel Committee on Banking Supervision (BIS).
- The Financial Action Task Force (FATF) on money laundering.