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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 para. 2 CRR

State Street Corporation[1] welcomes the opportunity to comment on the Consultation Paper ("CP") on draft Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under the Capital Requirements Regulation (CRR).

State Street Corporation (NYSE: STT) is one of the world's leading provider of financial services to institutional investors including investment servicing, investment management and investment research and trading. With €30.6 trillion in assets under custody and administration and €2.5 trillion[2] in assets under management as of 31 March 2015, State Street operates in more than 100 geographic markets worldwide, including the US, Canada, Europe, the Middle East and Asia.

State Street recognises the importance of institutions having sufficient information about their counterparties in the shadow banking sector, in order that they may make informed decisions about their exposures to the sector. However, we have a number of reservations about the EBA's proposed

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[1] State Street Corporation's identification number in the European Transparency Register is 2428270908-83.
[2] Assets under management include the assets of the SPDR® Gold ETF (approximately €30 billion as of March 31, 2015), for which State Street Global Markets, LLC, an affiliate of SSgA, serves as the distribution agent.

draft guidelines and believe they have the potential to negatively impact the financing of the real economy.

We believe the proposed approach for defining shadow banking entities is too wide, lacks sufficient clarity and will fail to clearly establish which entities/firms will be in scope of the proposed limits. We advocate the reconsideration of the inclusion of alternative investment funds ("AIFs") which are already subject to a strict regulatory and prudential framework under the Alternative Investment Fund Manager's Directive ("AIFMD") and we believe similar consideration should be given to removing Money Market Funds ("MMFs") from the proposed scope since they will be subject to stress testing, liquidity and diversification requirements under the forthcoming EU Regulation on MMFs.

In relation to the EBA's proposed processes and control mechanisms, we question the approach of using aggregate limits since we believe potential risks could be better addressed via other means such as the ICAAP/Pillar 2 assessment. Further to this, if the EBA does decide to introduce aggregate and individual limits, we strongly advocate an exemption for certain custody related services given the crucial role they in ensuring the smooth functioning of global financial markets.

Above all, we believe the proposed approach fails to take into account that many of the entities/firms that would be in scope of the exposure limits are already subject to a large number of regulatory initiatives that have been introduced in recent years that are specifically aimed at reducing risk in financial markets and in certain financial activities. The proposed approach would mean that these entities would be doubly impacted and restricted in what activities they could undertake which in turn would negatively impact their ability to finance the real economy. Indeed, we believe the proposed approach lies in stark contrast to the Commission's desire to see progress in unlocking non-bank sources of finance for the real economy and significantly undermine the Capital Markets Union ("CMU") initiative.

Please find below our responses to the questions raised in the Consultation Paper.

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.
- 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.).

State Street does not agree with the EBA's approach for the purposes of defining shadow banking entities. In our view, the definition is too wide and too unclear and therefore does not allow to clearly establish which entities/firms will be in scope of the proposed limits. This creates uncertainty that would make the application of such limits by credit institutions difficult and that could also result in driving firms that would be captured by the definition into other, most likely riskier sources of funding.

While the EBA rightly considers Undertakings for Collective Investment in Transferable Securities ("UCITS") management companies and funds to be outside of the scope of the shadow banking definition, we strongly disagree with the proposal to consider all AIFs regulated under the AIFMD as well as any type of MMF as shadow banking. In the case of AIFs, this approach does not recognise the framework and prudential requirements that the AIFMD has established for such funds. Furthermore, with regards to MMFs, many of these funds operate under the existing rules of the UCITS framework with the remainder being governed by the AIFMD. In addition, all EU-domiciled MMFs will be subject to new additional stress testing, liquidity and diversification requirements under the upcoming EU Regulation on MMFs.

We therefore urge the EBA to exclude all AIFs authorised under the AIFMD as well as all EU-domiciled MMFs that are either authorised under the UCITS or the AIFM Directive from the scope of the shadow banking definition.

In general, the proposed definition does not sufficiently take into account the regulatory initiatives that have been introduced over the last few years, aimed at regulating financial markets and/or certain financial activities and that directly or indirectly relate to firms that would be captured by the EBA's definition. Examples of such regulations are the new European derivatives regulatory framework (including risk mitigation, central clearing and reporting), the overhaul of the Markets in Financial Instruments Directive, and the revised rules on short-selling. We would encourage the EBA to consider the new regulatory framework as it applies to the firms that are considered by the EBA to be shadow banking and to coordinate its proposals with the outcomes of the new regulatory framework. In our view, there is a risk that activities to be deemed shadow banking will be doubly impacted and restricted which will be to the detriment of the non-bank financing of the economy and therefore in conflict with the objectives of the CMU.

Moreover, State Street would welcome further clarity on the reference to third country equivalence. More specifically it is unclear which 3rd country equivalence process the EBA intends to utilise for the purposes of ascertaining which third country firms are subject to requirements that are equivalent to the non-MMF UCITS requirements. Not only would the suggested approach create a lot of uncertainty but would also, as the experience with equivalence assessments under other regulations such as EMIR has shown, result in a lengthy equivalence decision process that would further extend the uncertainty on how to treat certain exposures.

Question 2: Do you agree with the approach the EBA has proposed for the purposes of establishing effective processes and control mechanisms? If not, please explain why and present possible alternatives.

Although we support the approach taken to allow firms to rely on their own internal framework and risk appetite to set internal limits and although we acknowledge that this is a possibility foreseen in Article 395 para 2 CRR, we continue to question the overall proposal to establish aggregate limits as we do not consider this a sectoral risk. This could be better addressed via other means such as the ICAAP/Pillar 2 assessment, which specifically covers concentration risk rather than the large exposure regime which is intended to address default of single/groups of connected counterparties.

It is also important that the requirement for establishing effective process and effective mechanisms should be applied on a consolidated basis only, so as to be consistent with the firm's approaches to systems and control more generally and to ensure that the requirement is not disproportionately burdensome.

Question 3: Do you agree with the approach the EBA has proposed for the purposes of establishing appropriate oversight arrangements? If not, please explain why and present possible alternatives.

State Street agrees with the proposed approach. However, sufficient time for the implementation of these requirements should be granted.

Question 4: Do you agree with the approaches the EBA has proposed for the purposes of establishing aggregate and individual limits? If not, please explain why and present possible alternatives.

State Street does not agree with the proposed approaches. As highlighted above, we question the proposal to establish an aggregate limit, given that the EBA mandate for developing these guidelines, as set out in the CRR, explicitly refers to setting either aggregate or individual limits. Therefore in proposing both aggregate and individual limits, in our view, the draft guidelines exceed the CRR mandate.

Furthermore, should the EBA decide to introduce such limits, we would strongly recommend providing for an exemption for certain custody-related services. Custody banks play a key role in the smooth functioning of global financial markets by facilitating payments in relation to the settlement of securities, foreign exchange, derivative, commodity and other market transactions. As part of this custodial function, custody banks provide temporary liquidity to market participants, extending, for example, provisional credit to institutional investors to smooth timing differences between the making and receiving of payments in connection with the settlement of a securities transaction, or providing overdrafts in relation to securities settlement delays or fails. Such extensions of credit are typically intraday, but can extend multiple days as well. These provisional extensions of credit may be large, but are always short-term, and are typically secured by a lien on the assets of the institutional investor. Similarly, custody banks may receive excess liquidity from market participants, through deposits from institutional investors related to securities sales, income received, or other operational activities. Such excess liquidity is typically placed by custody banks on a short-term basis with central banks. Applying the exposure limits to custody related limits would impact the ability of custody banks to provide these types of credit exposures which would lead to implications for the smooth functioning of the global payment and settlement system. It would also be incoherent to require managers of alternative funds and of UCITS funds to appoint depositaries which however are subject to restrictions and limitations of their capacity to provide the necessary custody services. There is regulatory precedent for treating such short-term, operational exposures differently than other credit exposures, including within the Capital Requirements Directive itself which recognizes the need for flexible treatment of operational and payments-related exposures. We would urge the EBA to follow a similar approach should exposure limits to shadow banking be introduced.

Similarly, we would encourage the EBA to consider the treatment of exposures related to central clearing activities. The revised EU capital framework provides for the preferential treatment of such exposures. Including them into the proposed exposure limits would therefore be contrary to the approach taken in the wider capital framework.

Question 5: Do you agree with the fallback approach the EBA has proposed, including the cases in which it should apply? If not, please explain why and present possible alternatives. Do you think that Option 2 is preferable to Option 1 for the fallback approach? If so, why? In particular:

- Do you believe that Option 2 provides more incentives to gather information about exposures than Option 1?
- Do you believe that Option 2 can be more conservative than Option 1? If so, when?
- Do you see some practical issues in implementing one option rather than the other?

The inclusion of a ‘fall back’ approach runs the risk of setting a de facto limit of 25% should banks be unable to meet the data requirements that would enable them to use the principle approach by 1 January 2016.

Should the EBA nevertheless decide to introduce a fall back approach, it should only require an individual limit and not an aggregate limit. If an aggregate limit is still introduced, we would strongly recommend setting it higher than 25%. In order to ensure an appropriate limit is set and one which does not stifle the financing of the real economy, we strongly urge that a full impact assessment is carried out. In addition we would suggest a staged implementation on the basis of a Quantitative Impact Study (“QIS”) for setting limits.

With regards to the options proposed by the EBA, State Street prefers option 2. Option 1 is unnecessarily restrictive as it does not recognise that firms might have information on some of their exposures to shadow banking entities but on all of them. Option 2 instead would allow firms to use the principal approach and therefore provides incentives for firms to collect information their exposures to shadow banking entities.

Question 6: Taking into account, in particular, the fact that the 25% limit is consistent with the current limit in the large exposures framework, do you agree it is an adequate limit for the fallback approach? If not, why? What would the impact of such a limit be in the case of Option 1? And in the case of Option 2?

Setting a clear limit to shadow banking would introduce for the first time a sectoral exposure limit and set a precedent. We do not believe that this is the right approach to follow and we would like to reemphasize that the EBA's mandate in the CRR does not require the setting of such an aggregate limit (see also our response to Question 4).

With regards to the limit of 25% itself, it is not possible to comment on its suitability; we therefore consider it essential that a full EU QIS is undertaken before such a limit is introduced. A QIS would also address the general concerns with regards to the impact limits may have on the financing of the real economy.

Thank you once again for the opportunity to comment on the important matters raised within this CP. Please feel free to contact me should you wish to discuss State Street's submission in greater detail.

Sincerely,

Dr. Sven S. Kasper
Senior Vice President
Director EMEA, Regulatory, Industry and Government Affairs