POSITION PAPER

ESBG response to EBA consultation on the revised Guidelines on limits on exposures to shadow banking entities under the CRR

ESBG (European Savings and Retail Banking Group)

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ESBG

Question. 1. Do you experience any difficulties in your identification process of SBEs, especially regarding whether the SBE definition as specified in Commission Delegated Regulation (EU) 2023/2779 is clear enough or do you see room for improvement or need for an update (please explain/provide clear examples)?

The definition of shadow banking entities (SBEs) set out in Commission Delegated Regulation (EU) 2023/2779 represents a significant improvement compared to previous frameworks. In particular, the reliance on a single, comprehensive regulatory instrument, without introducing additional standalone definitions, contributes positively to consistency and reduces the risk of overlapping or contradictory interpretations.

At a conceptual level, the definition is well-structured, combining an activity-based approach with the explicit inclusion of certain categories of entities, as set out in Article 1, thereby providing a solid basis for the identification of SBEs. However, institutions in some cases encounter challenges in applying the definition, which raise concerns regarding both legal certainty and the risk-based nature of the framework.

A key difficulty arises from the reliance on criteria that are not sufficiently operational or verifiable in practice, leading to conservative or automatic classifications. This is particularly evident in two areas:

First, with regard to third-country institutions from jurisdictions for which no equivalence act exists, the application of the exclusion under Article 1(2)(f)(i) of Delegated Regulation (EU) 2023/2779, based on compliance with the Basel Core Principles for Effective Banking Supervision (BCP), lacks clarity. Institutions face significant challenges in determining whether a given supervisory framework meets these principles, given the absence of consistent, up-to-date and publicly available assessments by the International Monetary Fund's Financial Sector Assessment Programme (FSAP). As a result, exposures to such institutions are frequently classified as SBEs by default, irrespective of their prudential soundness. This concern is particularly relevant for exposures such as trade finance, which play a key role in supporting international trade and the real economy, and whose prudential treatment should remain aligned with their underlying risk profile.

Second, some members have reported challenges in relation to of alternative investment funds (AIFs), in particular with regard to the application of the criterion set out in Article 1(1)(c)(iii). In their view, this criterion may raise more fundamental issues in terms of consistency with the overall logic of the Regulation. Unlike other categories identified in Article 1, where classification is based on objective and verifiable regulatory elements, such as authorisation status or measurable characteristics, the provision relies on the absence of an explicit prohibition in fund documentation.

According to these members, the identification of certain AIFs as SBEs may be driven by a formal documentation-based criterion, rather than by a substantive assessment of their activities or risk profile. In practice, this leads to the automatic classification of a wide range of AIFs, irrespective of whether they engage in credit intermediation, and creates a presumption of inclusion in the absence of explicit information to the contrary. This effect is particularly pronounced in cross-border and third-country contexts, where documentation may be incomplete, non-standardised, or not readily accessible.

Considered altogether, these issues indicate that, while the framework is conceptually sound, its current design can lead to outcomes that are not fully aligned with a risk-

based approach, and may introduce unnecessary constraints on exposures that support the real economy.
In light of these challenges, there is scope for targeted improvements to enhance both the clarity and the operational usability of the definition. In particular, consideration could be given to:

- providing greater supervisory guidance or, where appropriate, more standardised and transparent references (for instance, through publicly available benchmarks or indicative lists) in relation to the application of Article 1(2)(f)(i); and/or

- refining the criterion set out in Article 1(1)(c)(iii) to ensure that identification is based on objective, verifiable and risk-relevant elements, rather than on formal or default assumptions.

Such adjustments would preserve the overall structure of the framework, while ensuring that it can be applied in a consistent, proportionate and risk-sensitive manner across institutions.

Question 2. Does the current guidelines' framework for setting internal aggregate and individual limits on exposures to shadow banking entities (as described in the principal and fallback approaches) provide sufficient flexibility and clarity for your institution's risk management practices? Are there specific aspects of the approach that you find challenging or would suggest improving?

We generally consider the existing framework of the guidelines to be appropriate and workable. There are currently no significant difficulties in implementation; however, the guidelines are operationally complex. Improvements could lie in greater standardisation of the central coordination of borderline cases.

For many institutions, the fallback approach represents a tried-and-tested and operationally efficient basis for limiting aggregate risk exposures to SBEs. In particular, the link to core capital is advantageous, as it enables a clear focus on risk-bearing capacity and ensures a transparent presentation of overall risk. Against this background, we are clearly in favour of retaining the fallback approach. The same applies to the principal approach.

Question 3. Do you encounter challenges in obtaining sufficient data on SBEs (e.g., leverage, liquidity profile, interconnectedness, portfolio quality) to apply the principal approach? If so, please describe the main obstacles and how they affect your ability to comply with the Guidelines.

Yes, institutions encounter significant challenges in obtaining sufficient and reliable data on SBEs, which directly affect their ability to consistently apply the principal approach.

From an operational perspective, it should be noted that, under the current framework, a significant number of exposures fall below the materiality threshold of 0.25% of Tier 1 capital and are therefore not subject to a detailed assessment under the principal approach. This threshold plays a critical role in ensuring proportionality, as extending the full requirements of the principal approach to all exposures would entail a substantial increase in operational burden, without necessarily leading to more risk-sensitive outcomes. Maintaining this threshold is therefore essential to the practical functioning of the framework.

At the same time, even where the principal approach is applicable, institutions face material obstacles in accessing the data necessary to assess key risk indicators, such as leverage, liquidity profiles, interconnectedness or portfolio quality.

Some members also report challenges in relation to the availability and reliability of information on certain categories of entities, in particular AIFs. As highlighted in relation to Article 1(1)(c)(iii) of Delegated Regulation (EU) 2023/2779, current regulatory requirements do not ensure that fund documentation provides clear and verifiable information on the conduct of lending activities or the acquisition of credit exposures. As a result, institutions are often confronted with uncertainty in the classification of the entity as an SBE, and insufficient data to assess its actual risk profile, which are both prerequisites for the effective application of the principal approach.

This lack of reliable and standardised information may furthermore lead institutions to rely on the fallback approach, even in cases where the underlying risk profile of the exposure would not justify it. Such an outcome highlights a misalignment between the intended risk-based nature of the framework and its practical implementation.

More broadly, these challenges reflect the absence of standardised, accessible and sufficiently granular data sources for certain SBEs, including in cross-border contexts. In this regard, improvements in the availability and standardisation of information would significantly enhance the usability of the framework. For instance, the inclusion of structured and mandatory disclosures in fund documentation, combined with their progressive integration into European-level data infrastructures such as the European Single Access Point (ESAP), could facilitate a more consistent, efficient and risk-sensitive application of the principal approach over time.

Overall, these considerations underline the importance of maintaining proportionality safeguards, including the materiality threshold, and enhancing data availability and transparency, in order to ensure that the principal approach can be applied in a manner that is both operationally feasible and aligned with the underlying risk of exposures.

Question 4. Under what circumstances does your institution apply the fallback approach, and what challenges have you faced in determining when it should apply? Do you see need for further clarification regarding the trigger conditions for the fallback approach?

Under the fallback approach, a total portfolio limit of 25% of Tier 1 capital applies. This means that the aggregate of all risk positions vis-à-vis SBEs must not exceed 25% of Tier 1 capital. In this respect, the fallback approach conservatively limits portfolio risk arising from SBEs and thus adequately reflects the supervisory authority’s intentions.

Institutions with an insignificant SBE portfolio frequently apply the fallback approach, as the significantly higher administrative requirements for applying the principal approach are far too onerous for such small positions.

The fallback approach is also applied by institutions with larger SBE portfolios if certain information (e.g. interconnections, volatilities and evidence of the adequacy of the credit analysis, compliance with the BCP) is not available (or cannot be made available) or if the amounts involved are very small (see also questions 3 and 6).

The fallback approach enables a pragmatic and manageable limitation of risk exposures to SBEs in line with the defined risk strategy. There is currently no perceived need for further clarification regarding the trigger conditions.

Question 5. Did your institution experience operational challenges in integrating the binding SBE definition of the Delegated Regulation (EU) 2023/2779 into your internal limit framework?

The incorporation of the binding definition of SBEs did not cause any significant operational difficulties. It should be noted, however, that implementation is resource-intensive and requires considerable staff capacity.

Question 6. Being part of the removed SBE definition, the previous threshold of 0.25% of the eligible capital for recognising exposures falling under the EBA/GL/2015/20 is deleted in the draft updated GL. Will there be any impact (costs, time required, etc.) for your institution? Please elaborate.

The removal of the current materiality threshold of 0.25% of Tier 1 capital would lead to a significant increase in operational costs. Some institutions estimate that the number of entities to be reviewed each month could increase tenfold. The assessment of whether a SBE exists would then be required even when granting micro-loans, including those arising from account overdrafts or credit card limits. However, such micro-amounts are of no significance in terms of risk – even in the shadow banking sector. Furthermore, obtaining the necessary information is in some cases associated with considerable effort. In particular, an increase in the volume of risk exposures to be identified and analysed would be expected, which would result in significantly higher expenditure of time and resources (staff and IT). This represents an additional burden that, from a proportionality perspective, should be avoided at all costs. In our view, the current threshold contributes significantly to a practicable and risk-oriented implementation of the guidelines.

Furthermore, given the link to reporting and disclosure requirements, we see no need to abolish the materiality threshold. In our view, this is the wrong approach. In future, all institutions will be required to report their total exposure to SBEs, even if these exposures are so small overall that the institutions apply the so-called fallback approach to limit their total exposure to shadow banking entities within their internal risk management. Against this background, the EBA proposes abolishing the materiality threshold currently applicable to the guidelines. Instead, this threshold should also apply to reporting and disclosure, taking into account proportionality and materiality. Pursuant to Article 430(6) of the CRR, the EBA is granted discretion to design the new reporting obligation in accordance with the second subparagraph of Article 394(2) of the CRR.

Taking into account efficiency and proportionality, and the intention announced by the supervisory authorities to reduce the regulatory burden, the materiality threshold should be incorporated into the Delegated Regulation or the CRR itself, thereby making it generally applicable to SBE. At the very last, however, the threshold should remain within the scope of the guidelines.

Question 7. How does your institution determine the appropriate risk tolerance level for exposures to shadow banking entities within your overall business model and risk management framework? Which quantitative internal limits – either at the individual or aggregate level – do you apply on exposures to SBEs? Please describe the criteria, methodologies, or governance processes used to set these limits, and share any challenges or best practices you have encountered in their implementation.

Under the fallback approach, a total portfolio limit is set by the regulator in line with the applicable caps under the large exposure regime. The regulatory total portfolio limit thus corresponds to a maximum of 25% of Tier 1 capital.

As a rule, institutions have set lower internal limits, taking buffers into account, so that, in line with their defined risk strategy, they can take timely action should they approach the regulatory limit. As part of a best practice, a regular review of utilisation takes place (in some cases linked to an early warning traffic light model), as well as an annual review of the adequacy of the set limits.

Question 8. How do the internal aggregate and individual limits on exposures to shadow banking entities interact with the SREP process (as framed by Article 97 and Article 98 of Directive 2013/36/EU) and the competent authorities' assessment under Pillar 2? Are there any aspects of the guidelines or the SREP process that you believe require further clarification or adjustment to ensure effective supervisory review?

Question 9. How might the introduction of specific individual or aggregate limits on exposures to shadow banking entities affect your institution's willingness or ability to engage in activities giving rise to exposures to SBEs (e.g., lending, investment, intermediation, SFTs)? Please explain any potential impacts – positive or negative – on credit provision, market liquidity, or risk sharing, and provide examples or evidence from your institution's experience.

The obligation to introduce specific individual limits for SBEs would significantly complicate lending in some areas, partly because the issue of shadow banking currently plays no or only a minor role in credit processes, partly due to the provisions in the risk strategy. Furthermore, shadow bank-related individual risk limits are not defined separately, but fall under the existing limits within the framework of the respective individual credit process. These must fall within the limit framework of the allocated (sub-)portfolio limits. The processes in the institutions already provide that any customer wishing to enter into a transaction requiring approval with the institution is subject to an assessment and analysis appropriate to that customer (sector, size, country, etc.). The result is the approval or rejection of the transaction. The updating of customer data and the regular or ad hoc risk assessment takes place upon submission of new creditworthiness-relevant documents, further business enquiries or other relevant information.

Even today, the lending business is closely monitored by internal audit, auditors and the supervisory authority, ranging from the individual transaction level right up to the strategic documents of the individual institutions. We therefore do not see any added value in imposing restrictions through hard limits. On the contrary, the positive aspects on the financial market mentioned in the consultation paper would be curtailed. The introduction of specific individual limits for SBEs would thus entail an additional layer of complexity with corresponding operational costs, which we consider neither sensible nor necessary.

In the case of a fixed limit set out by regulatory authorities or legislation, we assume that the introduction of such individual or aggregate limits on exposures to SBEs would impair institutions' willingness or ability to engage in relevant activities such as lending, investment, intermediation or securities financing transactions. A fixed limit would not take into account institutions' individual ability to assess and mitigate shadow banking risks. We would also like to point out that there are differences between various types of SBE – for example, under the European regulation, a hedge fund is clearly significantly riskier than a money market fund. These differences can be taken into account within the current framework. It is therefore conceivable that, if fixed individual limits were introduced, there might be a reluctance to take on risk exposures to certain SBUs, e.g. money market funds. This could then tend to have a negative impact on market liquidity.

Furthermore, a fixed limit at institution or group level could limit the lending capacity of the institutions concerned within the EU and shift lending to countries outside the EU. Particularly in view of the resulting competitive disadvantage compared to institutions outside the EU, a fixed limit should therefore be avoided.

Last but not least, we would like to point out that specific requirements, such as the substitution of collateral, would exploit the fixed limit if the collateral issuer is classified as an SBE. Apart from the fact that this represents an extreme operational burden, we consider this to be completely disproportionate in view of the reduced risk. It could potentially lead to higher costs and greater complexity without offering corresponding benefits for risk management.

In view of the already conservative nature of the fallback approach and the regulatory requirement for such a limit, additional aggregate limits are not necessary. From a regulatory perspective, too, we believe that the current requirements are, on the whole, better suited to ensuring that institutions address the risks associated with their exposures to SBEs than a more mechanical method of counting risk positions towards a predetermined overall limit.

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping its 32 members in 27 European countries, which bring together 859 savings and retail banks, strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. Advocating for a proportionate approach to banking rules, ESBG unites 859 European banks, which together employ 620,000 people driving innovation at 37,000 branches. ESBG members have total assets of € 6,35 trillion, provide € 3,72 trillion in loans to customers, and serve 163 million Europeans seeking retail banking services. ESBG members commit to further un-leash the promise of sustainable and responsible 21st century banking.

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