European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

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Consultative Document *"Green Paper on Shadow Banking"*

Ladies, Gentlemen,

The European Association of Co-operative Banks (EACB) welcomes the opportunity to comment on the European Commission's Consultative Document "Green Paper on shadow banking".

We organized our response in form of a general letter rather than providing full answers to all the questions. Nevertheless, we touched upon important issues relating to shadow banking.

Please find our remarks on the following pages.

We will remain at your disposal,

Yours sincerely,

Hervé Guider
General Manager

Volker Heegemann
Head of Legal Department

- **ADOPTING A GLOBAL APPROACH**

In general, we support the initiative taken by the Commission, IOSCO and FSB to examine the possible threats posed by shadow banking activities and entities. These should be addressed in an appropriate way in order to anticipate and prepare for any potential future developments that may threaten the stability of the European Union's financial system.

However, we would like to stress shadow banking activities are performed globally. Thus, a global approach or at least an approach attuned with other major regulators outside Europe (e.g. the US and in Asia) is pivotal.

- **WAYS TO TACKLE SHADOW BANKING**

There are several proposals to tackle shadow banking by further regulating banks as clients of the shadow banking entities. We acknowledge that by this method the risk of contamination to banks from failing shadow banking entities is reduced. However, the risks entailed in the core activities of shadow banking entities are neither assessed nor effectively tackled. Thus, a better and easier way to evaluate effect would rather be achieved by directly regulating the shadow banking activities than using indirect regulation.

In general, the same financial activities and the same financial risk should be treated in the same way by the regulators, and the market participants should comply with those rules if for them that specific financial activity or financial risk is material and/or the financial activity of the entity is considered to be material. There is thus a need to apply the principle of proportionality principle. The same treatment should relate to accounting and prudential issues, as well.

We understand the need to equip supervisors with appropriate measures to detect shadow banking risks in an early stage and monitor them adequately in order to reduce threats to long-term financial stability. Off-site monitoring with adequate IT support should not have unbearable costs for supervisors. However, we believe that a broadening of the tools of supervisors is not the full answer to anticipate and prepare for potential systemic shadow banking risks. In this regard we are of the opinion that:

- Supervisors can work closer together and should share available information.
- EBA, ESMA and EIOPA should work closely together.
- Supervisors should gain more expertise in understanding, recognizing and assessing the worth and risks of financial market activities as well as shadow banking activities. Supervisors and the financial industry should consider different ways of cooperation in order to make knowledge of experienced bank employees available to supervisors.

- **EVALUATING THE IMPACT OF A NEW REGULATION**

The objective of the measures taken to regulate shadow banking activities should be to ensure more stable and responsible financial markets. During the impact assessment (IA) phase of the regulation special consideration should be given to the effects of indirect regulation of the shadow banking activities on the whole financial system. Indirect

regulation might lead to a greater risk of over-regulating the banking system with impact on economic growth while missing the target for shadow banks.

Furthermore, each kind of shadow banking activity has its own specificities and is subject to different risks. Thus, a clear assessment must be made to determine the possible systemic risks arising from that specific kind of shadow banking activity and whether the new rules lead to reducing risk in each specific case.

- **CONSIDERING EACH KIND OF SHADOW BANKING ACTIVITY SEPARATELY**

❖ **Differences between shadow banking activities**

As indicated in the FSB report of April 2011 the legislative bodies should focus on activities raising particular concerns in terms of systemic risk and regulatory arbitrage.There are important differences between all the activities and entities that should be taken into consideration. Credit risk, liquidity risk and operational risk are all important risk types of these entities, depending on the risk profile of the fund. Therefore, we are of the opinion that primarily unregulated activities, which may jeopardize the stability of the financial system, should be the main objective of initiatives by the European Commission.

Possible measures should be tailored to address and mitigate the particular risk entailed by a specific shadow banking activity and previously determined through the ex-ante evaluation. In general, the possible systemic risks from shadow banking activities are of a different nature than the risks of banking activities. One of the main risks for banking is the collapse of the banking system because of a bank run. However, if specific shadow banking activities e.g. have a relevant role in the maturity transformation, as it happened in structured transactions, the lack of ongoing liquidity can easily expand and cause systemic problems. Another example could be a disorderly failure of shadow banking activities because of a (sudden) material decline of the value of collateral (collateral shortfall). The tools for tackling such risks (banking and shadow banking) available to the regulators should be adjusted to the different channels through which risks are created and spread.

❖ **Careful consideration of new regulation**

There are some areas where we believe that additional regulation should take into consideration the entity to which it is addressed to and provide different approaches for different entities. For example, in case new rules are envisaged for securities lending and repos activities, we believe that as far as they are performed within a banking activity, they should not be regulated within a new framework but can be addressed in the framework of existing banking regulation and supervision. In case they are not performed within the banking activity, a new framework could be envisaged. Nevertheless, any kind of new regulation in this regard should not leave a room for regulatory arbitrage to the detriment of credit institution, for which specifically the repo business is a core activity for managing liquidity.

❖ **Careful consideration of sectoral regulation**

We see the complications arising from re-use and re-hypothecation of collateral because it possibly creates a chain of collateral takers and possible shortages when the collateral takers make use of the collateral. In general attention should be given to the increasing demand of collateral and therefore a possible shortage of collateral as a result of already existing regulatory initiatives like EMIR and Title VII DFA in the US. When considering regulating the shadow banking system (regarding collateral) this development should be taken into account.