Finance Watch

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Consultation by the European Commission on shadow banking

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Preliminary remarks

One hundred years ago the whole financial system was a shadow banking system as it operated without comprehensive regulation or credible public backstops. However its inherently unstable and risky nature led governments to conclude that it needed to be stabilized through prudential regulation, the provision of last resort liquidity from central banks and deposit insurance schemes.

The re-emergence of the shadow banking system over the past thirty years, partly driven by a change in who holds financial assets and the resulting increased demand for short term liquid assets[1] and by regulatory arbitrage, dramatically changed the structure of the financial system. Non-bank credit intermediation significantly increased the profitability of financial institutions and the availability of cheap procyclical credit but also greatly increased systemic risk. Even though shadow banking activity has declined markedly from its peak, increased capital and liquidity requirements for banks and insurance companies make it likely that shadow banking will remain an important part of the financial system in the future, albeit probably in a different form.

Ten years before the current crisis the bail out of hedge fund Long Term Capital Management was the first shadow banking bail out, before the Federal Reserve's implicit backstop of the shadow banking system in the wake of Lehman's failure[2], and a clear warning about the systemic risks posed by unregulated leverage, maturity transformation and interconnectedness.

In order to define shadow banking and the related scope of the legislation, we need to answer a few fundamental questions: what are we trying to achieve

[1] "Shadow banking and financial stability" Adair Turner (2012)
[2] Pozsar et al (2010)

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and what are the issues that we want to address?

Our understanding is that the main purpose here is to address systemic risks and regulatory arbitrage arising in the credit intermediation process performed outside of the regulated traditional banking.

We understand the overarching aim to be the reduction of the risk of collapse of parts of the financial system and the related risks of disruption in the provision of essential services such as lending with damaging consequences for the society and the economy. While this is already addressed to a great extent for the banking industry, the aim is to address similar risks located in non-regulated part of the financial system.

The reduction of regulatory arbitrage is a closely related aim, as it undermines prudential regulation aimed at systemic risk.
So we are not trying to regulate all types of lending, but rather focusing on non-bank lending carrying specific features of bank lending that entail specific risks from a systemic point of view. The purpose is also not to stop altogether non-bank credit intermediation but just to ensure that the risks it generates are monitored and addressed.
Similarly while some of the activities and entities might already be regulated for other purposes such as consumer protection, this should not preclude an investigation into whether it is necessary to add a systemic risk dimension to existing regulations.

Building on the two core issues of systemic risk and regulatory arbitrage, the subsequent question can be: what are the factors of systemic risk in the provision of non-bank lending? We see several factors, as we will discuss in our answers to the questionnaire, from conflicts of interest along the credit intermediation chain to heightened procyclicality.

The next step is to identify which activities along the shadow credit intermediation chain carry these risk factors, whether or not they are systemically important today.
Given the quickly evolving nature of shadow banking, we favour a functional approach by economic substance of activity over an approach by activity and entity. We feel that such an approach would produce a more stable definition over time and reduce the risk of regulatory arbitrage. We therefore welcome the first pillar of the Commission's definition.
It would be very easy to create tomorrow a new activity similar in substance to repo or securities lending but with a slight difference and a different name, that might fall outside the scope of regulation.
We also feel that, while it is indispensible to identify which entities are carrying currently such activities, an approach only by entity might be more static and would need to be very nuanced. As an example, not all hedge funds, ETFs or money market funds pose equivalent systemic risks.

We agree however with the need to be specific in order to have a workable definition for the purpose of setting rules, but feel that it is important to put the focus on the economic substance and give a non exhaustive list of activities and entities as the Commission has done while monitoring the emergence of new equivalent activities and related systemic risks.

Once we have defined the issues to address and the scope, and before deciding how to address them, it is important to think about the potential impact of regulating shadow banking, as a significant regulation of shadow banking if successful would have a major impact on business models, profitability, the architecture of the financial system and its stability but also possibly on the cost and availability of credit.
This raises several fundamental questions, such as how much non-bank credit intermediation is desirable even if fully independent from banking, whether it can ever be stable through credit cycles without prudential regulation, or how much systemic risk is acceptable for the benefit of additional procyclical supply of credit.
Recent developments in the banking industry such as the originate-and-distribute model and the rise of secured funding also raise the question of where we want the risk to be located in the system: should it be held inside institutions that are designed to hold and manage it and are on the radar of the regulator, or outside?

Finally we look forward to seeing a detailed impact assessment on the application of a bank-like regulation of shadow banking activities and its impact on lending and growth.

To quote Vickram Pandit, chief executive of Citigroup in a recent article[3] “you cannot address systemic risk unless you tackle things other than banks.” We therefore welcome the Commission’s green paper and consultation on shadow banking.

a) Do you agree with the proposed definition of shadow banking?

We agree with the proposed definition of shadow banking. As discussed above, we especially support the functional approach of the first pillar which should enable the definition to be both relatively stable over time and comprehensive enough.

[3] Financial Times « New threats emerge from the shadows » (April 9, 2012)

We also welcome the fact that the list of activities and entities displayed is not meant to be exhaustive to account for the fact that shadow banking evolves very quickly and economic substance is thus preferable over form.

As mentioned, while we recognize the need to list specific activities and entities in order to be able to set up rules, we hope that the list will remain secondary to the pillars and non exhaustive, and that regulators will monitor on an on-going basis the emergence of activities with similar substance.

b) Do you agree with the preliminary list of shadow banking entities and activities? Should more entities and/or activities be analysed? If so, which ones?

We agree with the preliminary list of shadow banking entities and activities and suggest the possible addition of credit rating agencies.

Even though issues linked to rating agencies are already addressed through different packages, their core role in enabling and implicitly promoting the development of the shadow banking system makes them an essential link, so we wonder whether the provision of external credit assessment in a grade format might also deserve to be added to the list of activities.

Most investors do not analyse individual loans from a pool and often rely on external ratings. The role of CRAs is thus even more crucial when they rate securities than when they rate companies, and risk assessment failures might compound the impact of potential poor risk assessment or carelessness from loan originators linked to principal/agent conflicts of interest.

In the absence of external ratings, it is likely that shadow banking would not have experienced such a strong development over the past decades.

The core importance of external ratings in shadow banking is compounded as well by their hard wiring into some asset managers' mandates, and the fact that these mandates do not distinguish adequately between structured and corporate ratings[4].

[4] Pozsar et al (2010)

c) Do you agree that shadow banking can contribute positively to the financial system? Are there other beneficial aspects from these activities that should be retained and promoted in the future?

We agree that shadow banking can offer a positive contribution in some cases, though we express some reservations on some benefits listed in the green paper.

i) We understand the argument that shadow banking can provide alternatives to bank deposits for investors, in particular those seeking to invest amounts above the deposit insurance schemes caps, however the absence of such schemes makes the alternative more susceptible to runs.

ii) We recognize the existence of specialisation benefits, most of which are located in the "external"[5] or "parallel" shadow banking system, but only when they enable shadow banking to operate more cheaply and with less leverage than traditional banking or lend to non bankable risk[6].

iii) Shadow banking can constitute alternative funding for the real economy, typically through corporates' asset securitisation. Shadow banking funding can however be procyclical and is often so strongly linked to both traditional banking and market channels that the benefit of such alternative funding when traditional banking and capital markets are temporarily impaired is limited. We recognize also the usefulness of secured funding in circumstances of extreme market confidence crisis, even though it can raise a number of issues that we will discuss later.

iv) We find the diversification argument debatable in most cases, first because a significant part of shadow banking is deeply linked to and does not function independently from traditional banking, and also because even a completely independent parallel banking system offers very limited diversification benefits due to global system interconnectedness[7] and the well-known rise of correlations during crises.

Finally agreeing with chairman of the Financial Services Authority Adair Turner[8], we think that "*securitisation might be a good thing, but not in its pre-crisis shadow banking form. That it would be desirable if we saw the further development of the credit intermediation channel which connects non-leveraged long-term investors to long-term borrowers - a channel which includes for instance, the direct purchase of corporate bonds by insurance*

[5] Pozsar et al (2010)
[6] Carey, Post, and Sharpe (1998)
[7] As described in the following part, interconnectedness does not only come from mechanical direct links
[8] "Shadow banking and financial instability" Adair Turner (March 2012)

companies or pension funds and which could include purchases of tranched and pooled securitisations. But that is inherently risky if these channels involve leverage and maturity transformation unconstrained by the prudential arrangements which apply to banks. And that it is therefore unlikely that securitised credit will return on a safe basis to its pre-crisis volumes, given that we know that a large proportion of it existed only because of leverage, maturity transformation and neglected risks."

d) Do you agree with the description of channels through which shadow banking activities are creating new risks or transferring them to other parts of the financial system?

Yes we agree with the description, and we would suggest asset managers' practices as an additional channel of risk transfer.

(i) Deposit-like funding structures not subject to prudential regulation are indeed exposed to runs when they conduct liquidity / maturity transformation. The absence of explicit access to public backstops and the weakness of private backstops during the crisis heighten this risk, as does the investment in instruments such as asset backed securities indirectly exposed to leverage and liquidity transformation.

(ii) Shadow banking contributes to the build-up of high hidden and unregulated leverage, that is also much more procyclical than in traditional banking because of the more prevalent use of secured funding that makes leverage sensitive to both the value of collateral and the entity's own perceived creditworthiness.

(iii) We agree that regulatory arbitrage and the resulting regulatory race to the bottom are key issues and one of the reasons for the existence of entire parts of the shadow banking system.

(iv) Interconnectedness can lead to shadow banking risk and disorderly failures being easily transmitted to the banking sector through direct borrowing and contingent liabilities from the banking sector and through fire sales of assets leading to downward prices spirals.

We would also add one additional contagion channel.

Asset managers' practices constitute in our view a powerful transmission channel. Investors holding assets from both traditional banking and shadow banking create a link between the two by selling profitable and sound assets to lock-in positive returns, whenever they experience losses on other unrelated assets.
As an example, global macro investors closed out carry trades in many

emerging currencies during Russia's crisis, leading to declines in currencies whose countries had no economic links with Russia.
Similarly, as described by FSA chairman Adair Turner[9], "*losses in the UK mortgage market have been far lower than in the US (..) but UK securitised lending collapsed as dramatically as US, not because of credit losses incurred, but because of the dramatic shrinkage of the investor base of leveraged and maturity transforming vehicles such as SIVs and ABCP conduits.*"
If anything this contagion channel reinforces the need to have comprehensive equivalent regulation across the whole financial system for systemic risk purposes, as everything can be correlated, even when no economic links exist.
Finally, the practice of rehypothecating client assets further strengthens interconnectedness through endangering client asset recovery, thus creating conditions for domino effects.

e) Should other channels be considered through which shadow banking activities are creating new risks or transferring them to other parts of the financial system?

In addition to the risks mentioned in the Green paper, we see four additional risks:

(i) Conflicts of interests along the credit intermediation chain create incentives for lower lending standards, lower accountability and overly aggressively structured securities. As developed by Ashcraft and Schuermann[10] the credit intermediation chain creates several key frictions when it is not conducted by one entity: mortgage lenders are incentivized to engage in predatory lending, abuse their informational advantage over the arranger, asset managers might not be incentivized to conduct adequate due diligence on behalf of the investors, etc..

As sound lending practices and strong accountability are of utmost importance, conflicts of interests leading to bad incentives in these areas are in our view a key risk of shadow banking.

As noted in a recent EPFSF briefing paper on shadow banking, "*European market for residential mortgage securitizations (..) experienced far lower losses during the crisis than its US counterpart, because asset quality was higher and originate-to-distribute business models were less prevalent*."

[9] "Shadow banking and financial instability" Adair Turner (March 2012)
[10] "Understanding the securitization of subprime mortgage credit" Ashcraft and Schuermann (2007)

(ii) Flawed credit risk transfer and securitisations without effective credit risk transfer create also significant risks in our view. Flawed credit risk transfer occurs when entities have not fully transferred the credit risk, as developed by the Financial Stability Board[11], for example when an entity faces the risk to buy back an asset it has sold or when it has purchased credit protection from a seller not likely to meet its obligations.

Securitisation without effective risk transfer as described by Acharya et al.[12] occurs for example when "*commercial banks set up conduits to securitize assets while insuring the newly securitized assets using credit guarantees. The credit guarantees were structured to reduce bank capital requirements, while providing recourse to bank balance sheets for outside investors*."

Weak credit risk transfer and absence of effective transfer can lead to insufficient loss absorbent bank capital and underestimation of true risks.

(iii) The procylicality of shadow banking is also one of the major issues, as it can be significantly more important than in traditional banking due to the bigger exposure to market risks in the credit creation process: the more prevalent use of secured finance leads to both asset and liability sides being exposed to asset prices fluctuations whereas in traditional banking, only the asset side is exposed, when loans are secured against assets[13].

As has been demonstrated[14], the combination of secured finance and marked-to-market accounting practices can create self-reinforcing cycles between asset prices, market liquidity and funding liquidity through both changes in collateral value and haircuts and in haircuts percentages.

Given the tendency of financial markets to be prone to "irrational exuberance" and their equally important tendency to experience temporary extreme risk aversion, an increased exposure on market fluctuations exacerbates the risks from procyclicality of credit creation, leverage and liquidity.

(iv) The lack of explicit effective backstop is another issue, as private sector guarantees failed to support the shadow banking system during the crisis and the "*Federal Reserve's 13(3) emergency lending facilities that followed in the wake of Lehman's bankruptcy*" amounted to "*a backstop of all the functional steps involved in the shadow credit intermediation process*[15]." Given the

[11] "Shadow banking: strengthening oversight and regulation" FSB (Oct 2011)
[12] "Securitization without risk transfer" Acharya, Schnabl, Suarez (2009)
[13] although banks increasingly use secured funding themselves
[14] "Shadow banking and financial instability" Adair Turner (March 2012)
[15] Pozsar et al (2010)

above mentioned high procyclicality of shadow banking, its greater exposure to asset prices fluctuations and the manic-depressive behaviour of financial markets, this absence of effective private backstops makes the shadow banking system very unstable.

f) Do you agree with the need for stricter monitoring and regulation of shadow banking entities and activities?

Yes. As the risks and transmission channels described above need to be addressed, we fully agree with the need for stricter monitoring and regulation of shadow banking entities and activities.

g) Do you agree with the suggestions regarding identification and monitoring of the relevant entities and their activities? Do you think that the EU needs permanent processes for the collection and exchange of information on identification and supervisory practices between all EU supervisors, the Commission, the ECB and other central banks?

Yes. We agree with the need for permanent proactive processes to identify and monitor relevant entities and their activities as well as the emergence of new risks and new activities and entities. We think that such processes should involve as much as possible non EU supervisors and central banks as well.

h) Do you agree with the general principles for the supervision of shadow banking set out above?

We agree with the general principles for the supervision of shadow banking, except the third one stating that the Commission should "*take into account existing supervisory capacity and expertise*" in its approach to supervising shadow banking entities. We strongly believe that capacity and resources need to be adjusted to the supervision needs and not the other way around.
We also hope that the macro-prudential implications of current and new regulation will be included as well: as several key reforms are currently underway, we feel that it is important to monitor closely their interactions and the emergence of possible unintended consequences with macro-prudential impact.

i) Do you agree with the general principles for regulatory responses set out above?

We agree with the general principles for regulatory responses proposed, and welcome the proposed principles of forward-looking, adaptable regulatory measures subject to assessment and review.
The quickly evolving structure of the financial ecosystem makes the monitoring of systemic risks a difficult task that requires both specific effective regulation but also humility, adaptability and constant forward-looking monitoring to be able to notice and address unknown-unknown risks as they emerge.

Indirect regulation is obviously important, all the more as a significant part of the shadow banking system is "internal" and appropriate consolidation rules would thus better align economic substance and legal form and address to a great extent issues stemming from shadow banking. However such an approach alone would obviously be insufficient as even an independent shadow banking system would create stability issues, thus the two additional and complementary approaches proposed by the Commission are indispensible.
Extending the scope of existing regulation is very sensible, as some shadow banking activities are sharing similar economic substance and similar risks with traditional banking that need to be regulated for stability purposes in an equivalent manner.

j) What measures could be envisaged to ensure international consistency in the treatment of shadow banking and avoid global regulatory arbitrage?

The current momentum on both sides of the Atlantic to address shadow banking issues provides an opportunity to analyse in depth best practices and most effective rules on each side, as is currently done through the comparison of securitisation rules in the European Union and in the US to identify the safest practices. This should be expanded to other areas such as rehypothecation and differences between US GAAP and IFRS balance sheet treatment of securitised assets. Lehman's failure showed the cost of UK permissive rules on rehypothecation.

Secondly, when noticeably different rules are maintained in different key financial centres, regulators need to bear in mind the weaker rules in other areas that might impact their geographical area when monitoring the build-up of systemic risks, in order to both maintain a comprehensive view of the risks and build cases for action.

Regulators could also allocate resources in the same way that banks do to identify regulatory arbitrage opportunities, so that their understanding of future arbitrage opportunities does not lag behind the private sector. Just as banks have desks dedicated to "tax optimisation" or "balance sheet advisory", regulators should as well dedicate seasoned professionals to this task.

k) What are your views on the current measures already taken at the EU level to deal with shadow banking issues?

We feel that the current measures already taken go in the right direction, such as the CRD IV capital treatment of liquidity lines to SIV and conduits and IFRS work on consolidation of SBS entities, but should in some cases be strengthened.

Typically the "skin in the game" requirement is in our view currently too low to have a meaningful impact, and should be extended to other entities along the shadow banking credit intermediation chain.

These measures do not yet comprehensively prevent regulatory arbitrage nor significantly address the identified risks located in shadow banking entities, as evidenced by several prominent EU banks' claims that Basel III will increase incentives to shift assets to shadow banking. There is therefore a strong need for additional regulation and we have high expectations for future regulations building on this green paper.

l) Do you agree with the analysis of the issues currently covered by the five key areas where the Commission is further investigating options?

(i) Banking regulation:
We agree with the stated objectives. As flawed risk transfer towards shadow banking entities is one of the risks of shadow banking, recapturing it is indeed a key objective.
We also support limiting banks' excessive exposure to shadow entities and improving banks' disclosure requirements of their exposure to shadow banking entities to address interconnectedness.

We fully support the examination of consolidation rules for shadow banking entities and believe that this is one of the most important issues to address. As mentioned earlier, we feel that the "internal shadow banking sub-system" should be fully consolidated in banks' balance sheets, since it exists in most cases only for regulatory arbitrage purposes. Only a truly independent or parallel shadow banking system should exist outside of the traditional banking

system.

Finally since shadow banking shares many features and risks of bank lending, we support the examination of extending some CRD IV provisions such as caps on leverage and maturity transformation to non-deposit taking finance companies in order to level the playing field between banking and shadow banking and reduce the potential for regulatory arbitrage.

(ii) Asset management regulation issues:
We agree with the issues identified with ETFs, however we think that these issues should be addressed for all funds that engage in liquidity/maturity transformation and direct or indirect use of leverage, and that either fund or are funded by banks, or hold similar assets to banks. In our view it is these features that can create systemic risk concerns and they can be present in many types of funds but do not necessarily exist in each fund of a specific type.
Regarding the risks they can cause, we agree that liquidity mismatches, collateral quality and management need to be monitored and regulated, as well as leverage using a comprehensive definition of it.

Regarding money market and other mutual funds specifically, we agree with the Financial Stability Board that the main concern is the risk of runs, compounded from a systemic point of view by their important role in financing traditional banking and by the support that they receive from parent banks.

We agree that the risk of runs comes mostly from credit and liquidity risks. We recognize that the amortized cost valuation approach of constant net asset value money market funds increases the risk of runs but are not convinced about the importance of this risk and the need to address it.
Admittedly the conversion to variable net asset value would reflect more accurately their nature, but we are more concerned about enhanced money market funds investments in asset backed securities, as they can gain an indirect exposure to leverage and liquidity transformation and are thus significantly more risky.
The fact that asset management mandates do not distinguish adequately between structured and corporate ratings compounds the problem by giving the wrong incentives.
Finally as money market funds do not have access to public backstops and as parent banks sponsoring through the acquisition of troubled assets or the provision of capital and guarantees proved to be an unreliable model, there is an even greater need to reduce the risk of runs by increasing the margin of safety, either via the introduction of redemption gates or higher liquidity requirements.
We therefore hope that the Commission will build on ESMA's Guidelines on a common definition of European money market funds to regulate money market funds investments in asset backed securities, in particular those

whose liquidity can decline quickly in times of stress, through tighter eligibility criteria on assets.

(iii) Securities lending and repurchase agreements:
We fully agree with the assessment that the greater role of securities lending and repurchase agreements in the financial system has led to an increase in global leverage and procyclicality that cause systemic concerns and need to be addressed.

We also agree with the issues described. We need to investigate the need for stricter rules on prudent collateral management, in particular on assets eligibility, re use of collateral and haircut / margin management.
We support as well the FSB assessment that the reinvestment of cash collateral received from securities lending creates credit risk and liquidity risk due to maturity transformation and is therefore a bank-like activity.

Rehypothecation creates significant issues, such as increased procyclical leverage, increased interconnectedness, and dilution of clients' claims on their assets in case of failure of their prime-broker as was evidenced post Lehman's failure. It might therefore be worth investigating the benefits of US securities laws and regulations prohibiting brokers and dealers from rehypothecating and commingling their clients' securities in most circumstances.

Additionally, as "*the top ten investment banks" from 2002 until 2008 "consistently held approximately seventy to eighty percent of the prime brokerage services market*"[16] the concentration in prime brokerage might create "too big to fail" issues that may need to be investigated.

We agree as well with the need to increase transparency in order at least to be able to assess counterparties' aggregate transactions and collateral pools and the potential impact of their default on the market.

As described earlier, secured funding issues range from increasing procyclicality to creating a self-reinforcing perception that unsecured debt is riskier, as the more secured funding a company engages in, the riskier its unsecured debt becomes through a decline in recovery rates. The resulting risk of crowding out on the issuance of senior unsecured bank debt and increasing subordination of senior unsecured creditors thus need to be addressed, as well as the issue of total asset encumbrance, in a context of rising popularity of covered bonds and rating agencies having not fully

[16] "Standardization of securities regulation: rehypothecation and securities commingling in the United States and the United Kingdom" Mariya Deryugina

adjusted to the corresponding declines in recovery rates[17].
Thus it might be worth investigating the FSA's request in 2005 that banks disclose their covered bonds issuance if it exceeds 4% of total assets, and the possibility offered to the regulator to request a bank to raise more capital if it rises above a certain threshold.

We find it important as well to remember that one of the purposes of securities lending is to provide securities for short sellers, and to the extent that it helps market making it is a useful activity, however we have also recently witnessed the consequences of aggressive short selling.

Finally we also note with interest IMF's assessment in a recent paper[18] that, "*with dealers' ability to borrow and re-pledge collateral having become more restricted post-Lehman, new collateral mines and mining techniques are being explored - see the increasing prominence of corporations as securities lenders in the US and elsewhere, and the recent innovation of collateral upgrade swaps with pension funds and insurers in the UK respectively. These are examples of off-balance sheet related cross-border interconnectedness and collateral chains that regulators need to attend to*."

(iv) Securitisation:
We fully agree with the main issues described: transparency, standardisation, retention and accounting requirements.
Standardisation and the introduction of a cap to structures' complexity are indeed necessary to avoid the re-emergence of overly complex leveraged and risky structures whose main purpose is often to increase leverage, profits for the seller, or enhance the credit quality of very poor loans that should not have been provided in the first place.

Retention is also a key tool to address the previously mentioned conflicts of interests along the credit intermediation chain. While we feel that banks' retention requirement of their securitisations should be increased, we feel that it is very important to introduce this requirement also for other entities along the intermediation chain in order to address comprehensively this issue.
Some other actions along the chain as described by Ashcraft and Schuermann might also help tackling the remaining conflicts of interests[19].

Increasing transparency is a difficult but fundamental task in order to enable better risk assessments and hopefully to reduce investors' reliance on

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[17] Financial Times "Heavy (covered bonds) encumbrance (8 March 2012)
[18] "The Nonbank-Bank Nexus and the Shadow Banking System" Zoltan Pozsar and Manmohan Singh (2011)

[19] "Understanding the securitization of subprime mortgage credit" Ashcraft and Schuermann (2007)

external ratings.
On this last point, as much as we understand the intention behind the requirement to provide guidance on methodologies and underlying assumptions[20], we feel that rating agencies should be forbidden from providing their methodologies to arrangers and collaborating with them to help find the most "rating efficient" structures, as such behaviour introduces biases and magnifies the impact of rating agencies models' flaws.
Accounting requirements on consolidation need to be both reviewed and harmonized between the EU and US as discussed earlier.

Finally we feel strongly that it is necessary to extend to securitisation the discipline of regulation on liquidity, leverage and maturity transformation, as this technique shares similar features and risks with traditional bank lending.

(v) Other SB entities

Finance companies and securities entities providing credit guarantees to the shadow banking system are amongst the shadow banking entities listed by the Commission, and it might be worth investigating whether they are able to deliver on their guarantees even in stressed scenarios: regulators should investigate the resources that they have facing their commitments and take into account their exposure to procylicality that might weaken them when they need to be strong.

m) Are there additional issues that should be covered? If so, which ones?

n) What modifications to the current EU regulatory framework, if any, would be necessary properly to address the risks and issues outlined above?

o) What other measures, such as increased monitoring or non-binding measures should be considered?

We do not have specific comments on the three questions above.

END

[20] 2011/0361 (COD)

About Finance Watch

Finance Watch is an independently funded public interest association dedicated to making finance work for the good of society.

Its mission is to strengthen the voice of society in the reform of financial regulation by conducting advocacy and presenting public interest arguments to lawmakers and the public. Finance Watch's members include consumer groups, housing associations, trade unions, NGOs, financial experts, academics and other civil society groups that collectively represent a large section of European citizens.

Finance Watch's founding principles state that finance is essential for society in bringing capital to productive use in a transparent and sustainable manner, and that the legitimate pursuit of private interests by the financial industry should not be conducted to the detriment of society.

For further information, see www.finance-watch.org

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