Frankfurt am Main,
19 June 2015

BVI's response to the Consultation on 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 (EBA/CP/2015/06)

BVI[1] appreciates the opportunity to comment on the EBA's suggestions for limiting credit institutions' exposures to shadow banking entities. As representatives of the German investment fund industry, we would like to focus our submission on the definitions of shadow banking entities and credit intermediation activities performed by such entities, since these aspects of the consultation paper are of utmost relevance for BVI members. Hence, we are highly committed to assisting the EBA in setting the right parameters for identifying the risks associated with shadow banking.

Preliminary remarks

When reading the consultation paper, it appears that the EBA has not taken into sufficient consideration the FSB work on shadow banking conducted so far. In particular, the FSB workstream WS3 has committed substantial efforts to assessing the extent to which non-bank financial entities (other than MMFs) are involved in shadow banking. In its final report from 29 August 2013, the FSB recommends to judge financial entities' involvement in shadow banking "by looking through to their underlying economic functions rather than legal names or forms". Starting from this premise, the FSB refines a framework of five economic functions to which authorities should refer for identifying the sources of shadow banking risks in non-bank financial entities[2]. These five economic functions all represent different forms of non-bank credit intermediation and are in addition characterised by features that either increase systemic risk or facilitate regulatory arbitrage.

Against this background, **two fundamental objections** must be raised in respect of the draft guidelines as consulted by the EBA:

- The definition of "credit intermediation activities" proposed by the EBA is much broader in that it also includes activities "similar" to bank-like activities and by reference to Annex 1 point 11 of the CRD explicitly comprises also portfolio management and advice. However, portfolio management and advice are not specific banking activities, but primarily performed by asset managers who are subject to sector-specific prudential regulation and supervision. In addition, neither portfolio management nor advice give rise to maturity/liquidity transformation, credit risk transfer or leverage in relation to the appointed manager and hence, miss the relevant characteristics of shadow banking activities.

- The approach proposed by the EBA results in a blanket treatment of all AIFs representing a legal subcategory of investment funds as shadow banking entities without paying regard to the economic functions as elaborated by the FSB. This is clearly contrary to the FSB's intention to provide for

[1] BVI represents the interests of the German investment fund and asset management industry. Its 89 members manage assets in excess of EUR 2.6 trillion in UCITS, AIFs and assets outside investment funds. As such, BVI is committed to promoting a level playing field for all investors. BVI members manage, directly or indirectly, the assets of 50 million private clients over 21 million households. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

[2] Cf. the FSB Report „Strengthening Oversight and Regulation of Shadow Banking. Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities" from 29 August 2013, page 2 and 3 (the FSB Report).

BVI
Bundesverband Investment
und Asset Management e.V.

Contact
Phone +49 69 15 40 90 0
www.bvi.de

BVI Berlin
Unter den Linden 42
10117 Berlin

BVI Brussels
Rue du Trône 14–16
1000 Bruxelles

BVI Frankfurt
Bockenheimer Anlage 15
60322 Frankfurt am Main

Executive Board
Thomas Richter CEO
Rudolf Siebel MD

.BVI

international consistency in assessing the risks posed by non-bank financial entities by looking through to the underlying economic functions or activities[3]. As elaborated in more detail below, European AIFs comprise a broad universe of investment vehicles ranging from regulated retail or professional funds with UCITS-like strategies to highly leveraged hedge funds not bound by legal limits in terms of e.g. risk spreading or leverage. Moreover, many European AIFs already apply the policy tools recommended by the FSB in order to mitigate potential shadow banking risks associated with investment funds[4]. Hence, such adequately regulated AIFs must not be considered shadow banking entities.

Furthermore, in the open hearing on 18 May 2015, the EBA inquired about the reasons underlying investments by banks in investment funds. From the German perspective, the EUR 166 billion AuM invested by banks in German “Spezialfonds”[5] are mainly used for the management of the own assets and capital backing a bank’s pension obligations. Such fund investments are essential in particular for smaller banks which lack the necessary resources and expertise in order to decide on the appropriate asset allocation/investment strategy and to conduct their own investments on capital markets. Generally speaking, such direct investments may prove unattractive from the cost-benefit-perspective for all credit institutions not subject to the direct ECB supervision. In addition, it must be recognised that small savings and mutual banks which form an established part of the German banking sector conduct their business on a regional scale by granting loans to, or taking deposits from, local companies and residents. Thus, their activities involve specific risks present in a certain region. Such banks use investment funds, “Spezialfonds” in particular[6], in order to diversify their risk profile. For instance, by investing in a broadly diversified real estate portfolio, they are able to spread and mitigate market risk arising from local mortgage loans.

In this context, we also believe that the EBA should take into regard the broader political debates at the EU level. The initiative on capital markets union (CMU) recently launched by the EU Commission aims very clearly at enhancing capital flows from retail and institutional investors, including banks, to the real economy and at promoting investment funds as facilitators of such investments. European Long-Term Investment Funds (ELTIFs) facilitating investments in long-term projects such as infrastructure are considered an essential cornerstone of the CMU. Yet, according to the definition of shadow banking entities proposed by the EBA, ELTIFs representing a sub-category of AIFs would qualify as shadow banking entities and investments by banks in ELTIFs would be curtailed by the proposed risk limits and control mechanisms. The same would apply to other European AIFs with investment focus on infrastructure, real estate or other long-term assets.

Detailed suggestions

Our comments to the consultation paper are focused on the definitions of shadow banking entities and credit intermediation activities relevant for the scope of application of the future EBA guidelines. Thus, we would like to confine our specific reply to the first question for consultation.

Q1: *Do you agree with the approach the EBA has proposed for the purposes of defining shadow banking entities? In particular:*

[3] Cf. the FSB Report, page 6.
[4] Such tools comprise especially measures for managing redemption pressures in stressed market conditions (redemption fees, gates, suspension of redemptions), general management of liquidity risk and limits on leverage, cf. the FSB Report, section 3.2.1 on page 14 to 17.
[5] As of 31 March 2015; source: BVI statistics.
[6] For further explanation on German ”Spezialfonds“, please refer to the Annex to our reply, sections 2 and 3.

- *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.).*

We support the proposal from the EBA to exempt entities subject to consolidated supervision from the definition of shadow banking entities. Furthermore, we wish to clarify that the exemption should apply to both banking and insurance groups, given that both are submitted to prudential regulation at the EU level respectively under the CRD and the Solvency II frameworks.

Otherwise, however, we have significant objections to the approach proposed by the EBA for the purpose of defining shadow banking entities which we explain in detail in points 1-4 below (in chronological order of paragraph 6 of the draft guidelines).

1. "Credit intermediation activities" are not present in the function of portfolio management and advice

The proposed definition of "credit intermediation activities" is much broader than the approach followed by the FSB in its work on shadow banking issues. Specifically, it refers to activities "similar" to bank-like activities and is thus very imprecise from the applicant's perspective. Moreover, by reference to point 11 of Annex 1 of CRD, it also treats "at least" portfolio management and advice as credit intermediation activities.

We strictly oppose to such classification. Portfolio management and advice are investment services regulated on separate grounds under the MiFID framework. These services are primarily performed by asset managers being authorised investment firms subject to a separate set of prudential rules. In addition, portfolio management and advice may also be provided by other qualified market participants such as fund managers authorised for the purpose of collective portfolio management under the UCITS Directive or AIFMD, or also by credit institutions.

Hence, it must be recognised that portfolio management and advice are in no case comparable to bank-like activities. On the contrary, these services do not require a banking licence and are thus attributable to the securities sector.

Moreover, when applying the economic perspective required by the FSB, it is quite clear that portfolio management and advice do not raise any systemic concerns associated with shadow banking at the level of the entity performing these functions. If at all, maturity transformation, liquidity transformation, leverage or credit risk transfer may occur in the client/fund portfolios as a result of management decisions or advice. These risks are subject to separate consideration in relation to investment funds and will be discussed in more detail below. They do not materialise, however, in respect of the service provider who is not acting on own account, but managing its clients' assets or advising on the respective allocation of investments. Since client's assets are separated from the asset manager's or advisor's own assets and held in either client accounts or in case of investment funds in segregate accounts by the appointed depositary, risk transmission to the service provider is conceptually not possible.

Therefore, we request the EBA to delete the reference to point 11 of Annex 1 of the CRD from the list of activities counting as credit intermediation. We also suggest waiving the imprecise elements of the definition of credit intermediation activities such as the supplement "or similar activities" in the first and the phrase "at least" in the second sentence. Such elements create substantial legal uncertainty for both the affected market participants and the NCAs supposed to apply the guidelines. The remaining elements of the definition, especially the criteria of maturity transformation, liquidity transformation or credit risk transfer should leave sufficient scope for interpretation in order to account for new structures or innovations that may create shadow banking risks.

Consequently, the definition of credit intermediation activities should read as follows:

> "*Credit intermediation activities* means bank-like activities involving maturity transformation, liquidity transformation, leverage~~,~~ **or** credit risk transfer~~ **or similar activities**~~.
>
> These activities include ~~**at least**~~ those listed in the following points of Annex 1 of the CRD: points 1 to 3, 6 to 8, 10~~, **11**~~."

Should this request not be satisfied for any reason, we urge the EBA at least to adapt the list of "excluded undertakings" in a manner clearly encompassing UCITS managers and authorised AIFM. In this respect, please refer to our comments in section 4 below.

2. Blanket treatment of EU AIFs as shadow banking entities is not justified

The proposal to treat all European AIFs as shadow banking entities contradicts the recommendations of the FSB WS3 on shadow banking, overstates the potential risks associated with fund activities, disregards the existing regulation of AIFs at the EU and national level and is inconsistent with other streams of EU regulation. For the sake of clarity, the arguments supporting these theses are presented in the **Annex** to our reply.

Against this background, we first of all fundamentally disagree with the proposal in section 6 (3) (k) (ii) of the draft guidelines to exclude from the definition of a shadow banking entity investment funds established in third countries which are subject to a UCITS-equivalent supervision, but not to provide for an exclusion of EU AIFs which are regulated and supervised at national level in a manner equivalent to the UCITS standards. This approach should be revised and linked to a balanced treatment of EU AIFs in line with the relevant potential for shadow banking risk.

Furthermore, it is clear on the basis of the arguments presented in the Annex that AIFs cannot be considered a uniform fund category, but should be differentiated according to the quality of their regulation and the intrinsic systemic risk. From the German perspective, most open-ended AIFs are regulated and supervised in a manner equivalent to the UCITS regime and thus must not be qualified as shadow banking entities.

In light of the pending discussion on the BSR Regulation, it appears appropriate to confine the proposed EBA guidelines to AIFs employing leverage on a substantial basis. Such AIFs might be deemed a potential source of systemic risk due to their highly leveraged activities. Such approach would also ensure convergence of regulatory treatment under both the BSR Regulation and the AIFMD which imposes stricter reporting requirements on substantially leveraged AIFs precisely because of their potential to contribute to the built-up of systemic risk[7].

In addition, consideration must be given to AIFs which are entitled to originate loans in accordance with national regulation and/or specific fund rules. To date, no EU norm for such loan-originating AIFs exists and the standards of product set-up (closed-ended or open-ended, professional and/or retail etc.) and the management of credit and liquidity risk may accordingly vary across Member States. While being convinced that such loan-originating “debt funds” can be designed in a manner avoiding shadow banking risks of maturity/liquidity transformation and excessive leverage, we are also aware that these funds engage in credit intermediation in the most direct way, i.e. by acting as substitutes to bank lending. **Thus, it could be contemplated to treat loan-originating AIFs as potential shadow banking entities for the purpose of the draft EBA guidelines. However, this should only apply as long as a European standard for “debt funds” which adequately tackles potential shadow banking issues is not in place.** The treatment of loan-originating AIFs under the EBA guidelines should be in any case reviewed against such EU standard. Moreover, the EBA should be aware that the EU frameworks for specific types of AIFs such as EuSEFs, EuVECAs and, most recently, for ELTIFs all enable the relevant funds to grant loans to the qualifying portfolio undertakings[8]. The treatment of these sub-categories of AIFs should be in line with the general classification of loan-originating funds. Lastly, we believe that the potential classification as shadow banking entities should not pertain to AIFs which grant loans to entities such as SPVs in which they hold interests for investment purposes[9].

In this context, the EBA should bear in mind that lending engagement by AIFs represents a new investment concept with very low, if any, market penetration as to date. Therefore, the fact that a few AIFs may grant direct loans in accordance with the relevant fund rules should in any case not be used as a pretext for the sweeping treatment of European AIFs as shadow banking entities.

As a result, we urge the EBA to accept the following amendments to the definition of excluded undertakings with regard to investment funds (subsection (3)(k)):

(k) **collective investment** undertakings ~~**for collective investment in transferable securities**~~:

(i) within the meaning of Article 1 of Directive 2009/65/EC (as amended);

(ii) established in third countries where they are authorised under laws which provide that they are subject to supervision considered to be equivalent to that laid down in Directive 2009/65/EC;

(iii) within the meaning of Article 4(1) k) i) of Directive 2011/61/EU (as amended) with the exception of:

- **undertakings employing leverage on a substantial basis according to Article 111(1) of Delegated Regulation (EU) 231/2013 and**

[7] Cf. Article 25(4) of AIFMD in connection with Annex IV of Delegated Regulation (EU) 231/2013. Specifically, such reporting encompasses the overall level of leverage employed by the AIF, a breakdown between leverage arising from borrowing and leverage embedded in financial instruments, the extent to which the AIF’s assets have been reused, the identity of the five largest sources of borrowed cash or securities and the amount of leverage acquired from each of those sources.

[8] Cf. Article 3 b) and e) ii) of Regulation (EU) 345/2013, Article 3 b) and e) iv) of Regulation (EU) 346/2013 and Article 10 (c) of EU Regulation on European Long-Term Investment Funds (Parliament’s version adopted on 20 March 2015).

[9] This clarification is necessary in order to take into regard situations where loans are provided to entities such as SPVs held by the fund as means of investing in the underlying assets. Investments via SPVs are indispensable for legal reasons in some market sectors such as real estate.

- **undertakings which are entitled to originate loans pursuant to their fund rules or articles of association, except for the purpose of investing in the borrower's underlying assets;** […]

3. European MMFs pose no shadow banking risks

We disagree with the proposed classification of European MMFs as shadow banking entities. By far the most European MMFs are authorised as UCITS and thus subject to the full set of rules applicable under the UCITS Directive. In addition, UCITS MMFs (and non-UCITS MMFs authorised under national law and hence qualifying as AIFs) are also bound to comply with the CESR's Guidelines on a common definition of European MMFs which impose further restrictions in terms of eligible assets and weighted average maturity/life of the fund portfolio[10]. Therefore, MMFs and especially UCITS MMFs are the most intensely regulated fund category in Europe. In particular, the implementation of the CESR's Guidelines represented a major and decisive step towards greater transparency, providing a sound base for limiting the MMF's susceptibility to runs or other systemic risks.

Nonetheless, should the EBA follow the FSB/IOSCO in their continuing assertion of shadow banking risks associated with MMFs, we insist that this risk potential be eventually evaluated on the basis of the EU Regulation for MMFs currently debated in the EU-Parliament and the Council. Since the EU Regulation is supposed to tackle potential systemic concerns associated with European MMFs[11] and to implement the FSB/IOSCO recommendations in the European market, MMFs should in principle cease to qualify as shadow banking entities as soon as they fall under and comply with the new MMF Regulation. **In order to avoid negative repercussions for banks currently invested in MMFs and the – temporary – stigma for the affected funds, we suggest that the implementation of exposure limits to MMFs by banks be at least postponed and effectuated only after the reassessment of shadow banking risks on the basis of the final text of the EU Regulation.** Such postponement is also necessary because the definition of MMFs included in the draft guidelines is different from the currently valid denomination under the CESR's Guidelines and refers to the scope of application of the future EU Regulation which does not yet correspond with a specific market segment.

Therefore, we recommend supplementing Title III of the draft guidelines (final provisions and implementation) by a second sentence which should read as follows:

> **"Exposure limits to MMFs should apply only after the adoption of the EU Regulation on Money Market Funds and following the reassessment of the MMFs' treatment as shadow banking entities for the purpose of these guidelines."**

4. UCITS and AIF managers should be excluded from the shadow banking entity definition

By way of precaution, and in addition to our requests in section 1 above, we solicit an explicit exclusion of UCITS and AIF managers from the definition of shadow banking entities. UCITS and AIF managers' core activity is the (collective) portfolio management which takes place on account of fund investors/clients and does not entail any risks for the fund managers' balance sheets. In addition, UCITS and AIF managers are admitted to a limited range of ancillary activities such as investment advice, safekeeping of fund units or, in case of AIFM, reception and transmission of orders which generally do not involve any risks associated with shadow banking. On the other hand, UCITS and AIF

[10] Cf. Boxes 2 and 3 of CESR's Guidelines on a common definition of a European money market fund dated 19 May 2010 (CESR/10-049).
[11] Cf. recital 6 of the EU Regulation's text adopted by the European Parliament on 29 April 2015.

managers are subject to sector-specific prudential regulation involving a mandatory authorisation by the NCA[12]. As part of the authorisation process, UCITS and AIF managers are i.e. required to have sufficient initial capital and own funds, to present a sound business plan and to demonstrate sufficiently good repute and experience of the persons effectively conducting their business as well as suitability of their shareholders[13]. In addition, the AIFMD stipulates that the fund manager's own funds shall be invested in liquid assets or assets easily convertible to cash in the short term and must not include speculative positions[14]. Some jurisdictions, including Germany, apply this standard also to UCITS management companies[15].

Taking into regard these characteristics, it should be clear that UCITS and AIF managers do not fulfil either of the criteria for shadow banking entities as specified in section 3.1.2, para. 7 of the consultation paper. Nonetheless, in view of the inclusion of portfolio management and advice in the range of relevant activities (cf. our comments in section 1 above), UCITS and AIF managers run the risk of being classified as shadow banking entities and their relationship to banks being constrained by the respective exposure limits. In our understanding, such limits might also apply to shareholdings by banks in fund management companies since such shareholdings also create a relevant exposure. However, it should be pretty obvious that a bank's stake in a UCITS or AIF management company being an authorised entity subject to prudential regulation and supervision should not be considered a potential source of shadow banking risk.

In our view, UCITS and authorised AIF managers should be able to benefit from the exclusion in subparagraph (3)(e) of the proposed definition of "excluded undertakings". However, the qualitative element of such exclusion (*"subject to prudential and supervisory requirements comparable to those applied to institutions in terms of robustness"*) gives considerable leeway for interpretation and hence exposes fund managers to legal uncertainty. **In consequence, we request the EBA to clarify that UCITS and authorised AIF managers qualify for the exclusion in subparagraph (3)(e). Alternatively, UCITS and AIF managers could be specifically added to the list of excluded undertakings by inserting a following new subparagraph:**

> **(m) UCITS management companies within the meaning of Article 2(1) b) of Directive 2009/65/EC and AIFM within the meaning of Article 4(1) b) of Directive 2011/61/EU which hold an authorisation pursuant to chapter II of that Directive.**

[12] With the exception of small AIFM (managing unleveraged closed-ended AIFs with aggregated AuM not exceeding EUR 500 Million) and AIFM managing solely group-owned assets not exceeding EUR 100 Million which are only subject to registration with the authorities, cf. Article 3(2) and (3) of AIFMD.

[13] Cf. Article 7(1) and (2) of the UCITS Directive, Article 7(2)(c), Article 8(1) of AIFMD.

[14] Cf. Article 9(8) of AIFMD.

[15] Cf. § 25 para. 7 of the German Capital Investment Code (KAGB).

ANNEX: Arguments pro differentiated consideration of shadow banking risks imminent in European AIFs (addendum to section 2 of our reply)

The proposal to treat all European AIFs as shadow banking entities (a) contradicts the recommendations of the FSB WS3 on shadow banking, (b) overstates the potential risks associated with fund activities, (c) disregards the existing regulation of AIFs at the EU and national level and (d) is inconsistent with other streams of EU regulation.

a. Contradiction with FSB recommendations

As indicated in our preliminary remarks, the FSB recommends to categorise non-bank financial entities "not by *legal forms* or *names* but by *economic function* or *activities*, and (to) provide international consistency in assessing their risks"[16]. Seen from that angle, the universe of AIFs cannot be associated with a specific economic function or activity. The EBA should recognise that the term "AIF" or alternative investment fund comprises any collective investment vehicle in worldwide terms that is not UCITS. Hence, AIFs are per se all third country funds and EU vehicles managed by authorised or registered AIFM. EU AIFs also cannot be perceived as a uniform fund category. On the contrary, the variety of fund solutions formally classified as AIFs is very broad and ranges basically from retail funds regulated and supervised in a UCITS-equivalent manner, but with a somewhat different investment focus (e.g. on real estate) to highly leveraged hedge funds or specialised closed-ended funds investing e.g. in infrastructure or private equity. In Germany, a lion's share of the open-ended AIF market[17] is attributable to "Spezialfonds" which are regulated and supervised investment vehicles dedicated to professional investors. Not only the degree of AIF regulation at national level, but also the markets in which AIFs invest and the investment strategies they pursue/investment techniques they employ display considerable differences. **Hence, it is clear that under the FSB approach, AIFs must not be submitted to a blanket treatment in terms of their shadow banking risk.**

Moreover, an assessment of AIFs based on the five economic functions endorsed by the FSB can only result in AIFs following very specific investment strategies being classified as shadow banks. This might pertain in particular to "MMF-like" AIFs with very low risk investment objectives or to AIFs investing in long-term/complex illiquid instruments which are redeemable upon demand or within short time frames, since such vehicles feature a liquidity/maturity mismatch relevant from the systemic perspective[18]. However, also in this regard, it must be noted that the FSB recommends targeted policy tools to be applied to such vehicles in order to mitigate potential shadow banking risks. Such tools comprising i.e. measures for managing redemption pressures in stressed market conditions (redemption fees, gates, suspension of redemptions), general management of liquidity risk and limits on leverage[19] are already present in many AIFs to the extent matching a fund's investor profile and liquidity needs. In our understanding, AIFs featuring such adequate tools which suppress the relevant shadow banking concerns should be no longer considered shadow banking entities.

b. Potential systemic risks by AIFs are fundamentally overstated

In explaining the rationale for limiting shadow banking exposures, the EBA states that "shadow banks are generally not subject to prudential regulation, do not provide access to deposit guarantee schemes

[16] The FSB Report, page 6.
[17] Roughly 92 % as of 31 March 2015; source: BVI statistics.
[18] Cf. section 2.1 on page 6-7 of the FSB Report.
[19] Cf. section 3.2.1 on page 14 to 17 of the FSB Report.

to investors and do not have access to central bank liquidity"[20]. All these features are not relevant for EU AIFs and other investment funds for the following reasons:

- Prudential regulation: AIFs and other investment funds do not need capital requirements at the vehicle level, since they are fully funded by the own capital of their investors. Investments by AIFs are subject to clear limits on leverage imposed either by national regulation or by the fund rules[21]. In this context, it should be noted that AIFs are already considered to apply leverage on a substantial basis if the exposure to market risk exceeds 300% of the fund's NAV according to the commitment approach[22]. In addition, the competent NCA is entitled to impose limits on the level of leverage employed by AIFs or other restrictions in terms of AIF management if deemed necessary for systemic reasons[23]. Other elements of a prudential framework are fully reflected in the regulation of the fund manager under the AIFMD and frequently also in the national fund rules (cf. our comments below).

- Access to deposit guarantee schemes: The portfolio assets of AIFs are segregated from the manager's assets and held in custody by the appointed depositary. AIF's cash must be booked on accounts held with an entity subject to adequate regulation and supervision. The depositary is responsible for overseeing the AIF's cashflows and verifying the ownership rights in relation to assets not subject to the custody obligation (e.g. titles resulting from derivative contracts or real assets)[24]. As a result, AIFs are fully shielded from the manager's insolvency and hence feature NO issuer risk which might justify coverage by deposit guarantee schemes.

- Access to central bank liquidity: Central bank liquidity is not requisite for AIF operations. AIF's liabilities towards counterparties and investors are monitored on an ongoing basis and dealt with as part of the internal liquidity and risk management. In particular, AIF must ensure coherence between the adopted investment strategy, the liquidity profile and the redemption policy of the fund[25]. In this respect, AIFs can employ a range of tools such as redemption fees, gates or even suspend redemptions in accordance with the relevant national law.

In addition, we disagree with the EBA's interpretation of the potential systemic risks associated with AIFs. Against the backdrop of the EU and national frameworks governing the AIF business, such risks as depicted in section 3.1.1. of the consultation paper appear to be materially overstated. Specifically, we would like to note the following:

- Run risk and/or liquidity problems: AIFs are subject to strict standards of liquidity management including definition of qualitative and quantitative risk limits and liquidity stress tests[26]. Moreover, open-ended AIFs have at their disposal adequate tools to deal with liquidity shortages, including the possibility to suspend redemptions. AIFs are also not marketed as substitutes to bank deposits, but targeted at investors with longer investment horizons consistent with the fund's investment objectives. In Germany, regulated professional AIFs ("Spezialfonds") are often set up for one/a few investors and hence are able to duly anticipate and to take steps in order to serve the individual redemption needs.

[20] Cf. para. 23 of the consultation paper.
[21] Cf. Article 15(4), 23(5), 25(3) of the AIFMD.
[22] Article 111(1) of Regulation (EU) 231/2013 (AIFMD Implementing Regulation).
[23] Cf. Article 25(3) of the AIFMD.
[24] Cf. Articles 85-90 of the AIFMD Implementing Regulation.
[25] Article 16(2) AIFMD, Article 49 of AIFMD Implementing Regulation.
[26] Cf. Article 48 and 49 of AIFMD Implementing Regulation.

- Interconnectivity and spillovers: Many AIFs are subject to diversification rules equivalent to the UCITS regime stemming from national regulation. In Germany, this pertains also to “Spezialfonds” set up for professional investors[27] which are generally bound by the UCITS provisions on eligible assets and investment limits[28]. “Spezialfonds” are also subject to the UCITS counterparty risk limits and the relevant collateral requirements[29]. Hence, the risk of spillover to the banking sector inherent in AIFs is in many instances comparable to the situation under the UCITS Directive.

- Excessive leverage and procyclicality: It is true that there is no regulatory limit on AIF leverage at the EU level. However, as stated above, all AIFs are under the obligation to define the maximum level of leverage which must be appropriate and observed at all times, and to report on its implementation to investors and competent authorities. AIFs employing leverage on a substantial basis, i.e. exceeding 300% of the fund’s NAV, are submitted to enhanced reporting requirements and . In addition, regulatory leverage limits may apply under the applicable national law. In Germany, many “Spezialfonds” observe the exposure limit of 200% applicable to UCITS which is then enshrined in the fund rules.

- Opaqueness and complexity: The AIFM business being management of AIFs is extensively regulated in accordance with sector-specific prudential principles and subject to authorisation and supervision by the authorities. In particular, the ownership structure and the composition of the governing bodies form part of the AIFM scrutiny during the authorisation process. Furthermore, the AIFMD regime provides for comprehensive regulatory reporting in terms of both AIFM and AIF which encompasses details on employed strategies and portfolio concentrations as well as individual positions and risks of each managed AIF[30]. In fact, the reporting requirements are so sophisticated that almost two years after entry into force of the AIFMD, ESMA is still not in the position to receive and process reports submitted by AIFMs. In addition, AIFs facilitate extensive disclosure to investors both before investing and on regular basis. The periodical information to investors comprises in particular any new arrangements for liquidity management, current risk profile and description of the risk management systems in place and in case of leveraged AIFs any changes to the maximum level of leverage an AIF may employ as well as the actually employed level of leverage[31].

c. Effects of EU and national AIF regulation are disregarded

It is nearly ironic to claim that the activities of European AIFs are inadequately regulated. The AIF manager – AIFM – is an authorised entity[32] subject to regulation and supervision fully equivalent to the UCITS Directive. In this context, it should be recognised that the regulatory regime for AIFM already comprises the decisive elements of a sound fund framework. This pertains in particular to the requirements concerning the AIF risk and liquidity management, AIF valuation as well as rules on AIF depositary.

---

[27] Spezialfonds mit festen Anlagebedingungen („Spezialfonds“ with defined fund terms).
[28] Modifications are only allowable subject to investors‘ consent, cf. § 284 para. 2 (1) of the German Capital Investment Code (Kapitalanlagegesetzbuch – KAGB).
[29] Cf. § 27 para. 7 and 8 of the German Derivative Ordinance (Derivateverordnung).
[30] Cf. Article 110 and in particular Annex IV of the AIFMD Implementing Regulation.
[31] Cf. Article 23(1),(2),(3) and (4) of AIFMD.
[32] With the exception of small AIFM (managing unleveraged closed-ended AIFs with aggregated AuM not exceeding EUR 500 Million) and AIFM managing solely group-owned assets not exceeding EUR 100 Million which are only subject to registration with the authorities, cf. Article 3(2) and (3) of AIFMD.

The missing EU regulation of investment assets and limits to be observed by AIFs is often replaced by national rules and may vary between different types of AIFs. In Germany, rules governing AIFs and AIFMs are part of the Capital Investment Code (KAGB) which represents an integrated legal framework for investment funds covering also UCITS. Under the KAGB, open-ended retail AIFs are submitted to UCITS-equivalent rules on investment restrictions and diversification of assets. “Spezialfonds” mentioned above are also an essential part of the German fund market with currently 1,310 billion AuM[33]. “Spezialfonds” are regulated investment funds traditionally targeted at institutional investors which are subject to the supervision by BaFin and have been in existence long before the AIFMD entered into force. As already explained, open-ended “Spezialfonds” are generally required by regulation to comply with the UCITS framework concerning eligible assets and investment limits, unless investors request specific modifications due to their particular needs. A large portion of “Spezialfonds” sticks to the UCITS rules in their product set-up.

d. Inconsistency with other regulatory work at EU level

The general treatment of AIFs as shadow banks contradicts with other workstreams at EU level which impact the relations between credit institutions and investment funds:

- Large exposure regime: According to Article 7 of the Delegated Regulation 1187/2014, AIFs as investment vehicles are deemed not to constitute additional exposure if their legal and operational structure prevents the manager from redirecting any cash flows to third parties and if institutions receive only payments from the AIF’s underlying assets. These conditions apply to a broad range of AIFs, including German open-ended “Spezialfonds”. In particular, the mandatory appointment of a depositary under rules equivalent to the UCITS regime warrants protection of AIF’s cash flows. In addition, payment titles of AIF investors are generally confined to redemptions out of the fund assets. As a consequence, credit institutions are allowed to disregard such AIFs for the purpose of applying large exposure rules. The proposals in the consultation paper at hand run counter to this equal treatment of AIFs and UCITS with regard to risk aspects under the large exposure regime. In fact, the approach under Article 7 might be altogether jeopardised if banks were required to implement exposure limits and specific risk management processes in terms of their exposure to AIFs. As a result, exposure from AIFs would be accounted for twice: in relation to the underlying assets under the large exposure rules and in relation to the investment vehicle under the consulted guidelines.

- Capital Requirements Regulation: The CRR defines items associated with particularly high risk. In this context, AIFs are considered as exposures with particularly high risk, except where the AIF’s mandate does not allow for taking up of leverage in excess of the level admitted under the UCITS Directive (total exposure not exceeding 200% of a fund’s NAV)[34]. As a consequence, institutions are required to assign a 150 % risk weight to AIF exposures which do not qualify for the exemption. Exempted AIF exposures are treated with the regular risk weight.

- Banking structural reform: It can be anticipated from the Council negotiations that the blanket ban on credit institutions in terms of acquiring or retaining investments in AIFs as proposed by the Commission in Article 6(1)(b) will be replaced by a more differentiated approach. The latest compromise proposals by the Latvian Presidency uphold such ban only in terms of AIFs employing leverage on a substantial basis. In accordance with Article 111(1) of the AIFMD Implementing

[33] By 31 March 2015, source: BVI statistics.
[34] Cf. Article 128(2)(b) of Regulation (EU) 575/2013.

Regulation, leverage in an AIF is deemed to be substantial if the AIF exposure calculated under the commitment method exceeds three times its net asset value. Discussions in the EU Parliament seem to move in a similar direction.