

Contribution to the Consultation on Shadow Banking (Green Paper)

The Czech Republic appreciates the efforts of the Commission in area of shadow banking and welcomes the opportunity to participate in the Commission's consultation by providing the following comments.

General Comments

Generally, we agree with the aim to further analyze the shadow banking system. We believe that it is vital to adopt a single global approach to the shadow banking that will be applied in a coherent and coordinated way. This will allow reaching a common/general goal of preventing circumvention of regulation and regulatory arbitrage. We are also of an opinion that the EU approach to the shadow banking should not materially deviate from the principles and recommendations of the BCBS, IOSCO and other authorities coordinated by the FSB that are working on the internationally recognized standards.

Firstly, we believe that it is necessary to undertake an impact study to identify all the possible effects of the currently introduced new regulatory rules relating to shadow banking before additional regulatory rules are considered and/or introduced. It is important to stress that many of the regulatory rules, which are about to come into force, will also affect the shadow banking institutions and their activities. Therefore, it is crucial to consistently implement the entire existing regulatory rules and then verify whether any systemic risks remain intact, which needs to be further regulated. It is vital to mention that the current regulation of financial markets is already quite wide, so it is necessary to give a careful consideration to a possible extension of the existing regulation. Thus, we believe that the current course of action concerning the shadow banking sector should be based on a consistent use of all existing powers and tools that supervisors have at their disposal and a strict enforcement of existing regulatory requirements.

We also feel that it is important to draw attention to the fact that the shadow banking systems are not homogeneous. For instance, in some countries, the shadow banking sector is highly developed and represents a significant share of the overall financial system, while in other countries the shadow banking sector is relatively insignificant. It is therefore important to maintain or create an adequate room for monitoring and evaluating the development and adoption of any direct measures at the level of Member States. This assumption is actually fully consistent with international recommendations on the shadow banking and it is in accordance with the general principle of proportionality and effectiveness of supervision and regulation.

To specific consultation questions:

WHAT IS SHADOW BANKING?

We agree with the proposed definition of shadow banking and emphasize that there must be a global definition of shadow banking that is sufficiently general, especially due to the dynamic development in this area. Moreover, we also consider necessary to refine the key

terms integrated in the definition, in particular the terms "credit intermediation" and "regular banking system". We consider a precise definition crucial for the purposes of forecasting detailed analysis of existing regulation on shadow banking, for consistent identification of shadow banking risks, for the proposed monitoring of shadow banking, clarification of mutual ties, etc. It is also important to stress that inaccurate understanding of the scope of the definition could lead to adverse reactions by markets, rise to undue public expectations, etc., and in extreme cases even to a moral hazard or the reputation endangerment of the regulatory and/or supervisory authorities.

Regarding the list of shadow banking entities, we would like to propose clarifying the list in order to eliminate potential duplications (e.g. "securitization" and "transfer of risk"). It is also crucial to allow a clear identification of an institution based on a provided institution's description (e.g. "other types of investment funds" or "products with deposit-like characteristics, which make them vulnerable to massive redemptions").

WHAT ARE THE RISKS AND BENEFITS RELATED TO SHADOW BANKING?

We share the view that the existence of shadow banking may be beneficial for the financial system. For instance, it could be an alternative source of financing of the economy at a time when there is a lack of liquidity in the financial markets and the presence of reluctance to lend. Shadow banking contributes to the creation of a competitive environment in the financial markets as well.

Generally, we agree with the argument that the shadow banking activity creates new risks. However, we would like to point out that the list cannot be considered definitive, i.e. it has to be an open list, because financial markets are constantly evolving and adapting to new regulatory rules.

We also consider appropriate to further elaborate on the following:

- significant risk based on the complexity and/or a lack of transparency of products, structures or activities in the area of shadow banking,
- risks with the potential to significantly disrupt the "level playing field", for example, due to a lower cost, no regulation of shadow banking entities or unfair business practices, and
- considerable risks of misleading or other unwanted presentation of products, structures or activities of shadow banking entities.

WHAT ARE THE CHALLENGES FOR SUPERVISORY AND REGULATORY AUTHORITIES?

We deem that any possible strengthening of internationally coordinated monitoring of the shadow banking institutions and their activities may prove to be helpful. However, it is first necessary to thoroughly examine the impact of existing regulation, which is already quite broad, and assess the need for its further expansion. At the same time, we believe that there is not enough convincing evidence indicating that there is a need to urgently adopt a set of new EU regulatory rules. It may also be reasonably assumed that the extent and severity of the shadow banking risk affecting the reliability and safety of the financial system as a whole varies significantly across the individual countries and regions.

We view important that there is a pre-specified list of entities that should provide the desired

data and information, which is essential for the collection of relevant information on the shadow banking system. In this context, it is important to consider the issue of additional costs associated with providing data and the possible lack of capacity in the case of the relevant authorities, as well as the shadow banking institutions. It is also crucial carefully examine the current data sources.

We believe that it is necessary to stress that it is vital to prevent the possibility of reducing the awareness of national authorities in connection with the centralization of the shadow banking monitoring and related risks at the EU level.

WHAT REGULATORY MEASURES APPLY TO SHADOW BANKING IN THE EU?

In our opinion, it is essential that all proposed regulatory measures are properly implemented and subsequently their effects are analyzed, even their mutual relations. Moreover, we would support undertaking changes to the existing regulations, if there has been founded a robust evidence supporting the review and possible extension of existing regulation. Similarly, we support the assessment of the ESMA's "soft" rules effectiveness and their potential correction undertaken based on the assessment results, the possible inclusion of selected recommendations into legally binding provisions in order to strengthen their enforcement, etc. At the same time, it may be advisable to examine the current regulation (incl. regulatory rules which are about to come into force) relevant to the "shadow banking". We believe that such a review may indicate some unjustified measures which should be removed from the EU legal framework in order to strengthen the effectiveness of the legislative framework and/or to avoid unnecessary regulatory costs for market participants.

OUTSTANDING ISSUES

Generally, we agree with the selection of the five key areas that will be focus of further scrutiny by the Commission. However, we have some reservations. We have a number of doubts concerning the analysis of the part one - Banking Regulation. We believe that this part unclearly and inaccurately informs reader about the current scope of the CRD. Therefore, we recommend undertaking a clarification of the current text in the sense that the scope of existing prudential rules integrated in the CRD applies not only to credit institutions, but also to investment firms.

In connection with the analysis of part 2 - Asset management regulation issues, there are discussed the money market funds. In this part, we are lacking an adequate assessment of the causes of risk associated with money market funds, which is not the fund itself, but rather misleading presentation of the product by its sellers (especially if it is a bank) in conjunction with a poor understanding of the product by the investors. As a result, we suppose that the most efficient regulation to reduce the risk of a run on the money market funds is a proper monitoring and compliance with the rules regarding offering of money market funds and its presentation.

We believe that the consideration should be given to the examination of the banks' large exposure limits to the shadow banking entities, if proven based on the collected data that banks are highly dependent on the shadow banking entities and that the current setting of the reporting obligations concerning the large exposures does not adequately capture such exposures.

Finally, presently, we consider necessary to complete already begun mapping of the shadow banking in the EU.

