Leibniz Institute for Financial Research SAFE
Sustainable Architecture for Finance in Europe

SAFE Finance Blog

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The SAFE Regulatory Radar in September

New rules to tackle shadow banking, improve consumer protection, and recommendations for addressing nature-related financial risks

At the end of each month, the SAFE Regulatory Radar highlights a selection of important news and developments on financial regulation at the national and EU level.

CRR: Specifications for identifying shadow banking entities

Credit institutions must follow new rules when reporting their exposures to shadow banking entities. On 6 September 2023, the European Commission adopted Regulatory Technical Standards (RTS) specifying the criteria for the identification of shadow banking entities, as required by the Capital Requirements Regulation.

In recent years, non-bank financial institutions have faced severe liquidity issues. Given their close links to the traditional banking sector, these institutions could pose a risk to the financial system. As highlighted in a recent SAFE Finance Blog post by SAFE Fellow Elke König, there is an urgent need to address the dangers posed by these institutions, which have become an essential part of the financial ecosystem but are still largely outside the scope of regulation. This delegated regulation aims to provide banks with additional clarity on the definition of shadow banking to achieve consistency in reporting across banks and improve banking supervision.

In this regard, it sets out criteria for identifying shadow banking and non-shadow banking entities. In particular, it identifies entities as non-shadow banking entities if authorized and supervised by specific other legal acts. Institutions are not considered as shadow banking entities if they are explicitly exempted or excluded from the Capital Requirements Directive (CRD), the European Market Infrastructure Regulation (EMIR), and the Solvency II Directive. All other entities providing banking activities and services are defined as shadow banking entities. The technical standards also set out criteria for excluding entities located in third countries from being considered shadow banking entities. For example, they state that third country entities monitored by a supervisor who applies the Basel Core Principles do not pose a significant financial stability risk and, therefore, should not be identified as shadow banking entities. In addition, the standards provide a list of services and activities which should be considered banking services and activities.

These standards, which were formally adopted as Delegated Act, will now be transmitted to the European Parliament and the Council for scrutiny. They will enter into force on the twentieth day following their publication in the Official Journal.

CCD II: New rules to protect consumers from over-indebtedness

Members of the European Parliament have adopted new rules to protect consumers from over-indebtedness. On 12 September, the European Parliament announced the adoption of the Consumer Credit Directive II (CCD II), which will repeal the Directive from 23 April 2008 (CCD I).

While the CCD I harmonized compliance rules for consumer credit at the EU level, improved transparency, and thus raised consumer protection standards, the recent digital transformation has brought significant changes to the consumer credit market. The revised legislation will address the resulting challenges.

For example, CCD II covers a broader range of products, such as "buy now, pay later" products, and extends the scope of the previous legislation to include credit agreements below 200 euros and up to 100,000 euros. To prevent over-indebtedness and ensure responsible lending practices, a creditor will have to carry out a proper assessment of a consumer's creditworthiness. Non-bank creditors and credit intermediaries (except for micro, small, and medium-sized enterprises) will be subject to an authorization and registration procedure. Competent national authorities will supervise them. Consumers will also have the right to early repayment, to reduce the total cost of their credit, and to withdraw from a credit agreement without giving any reason within 14 days. The SAFE Regulatory Radar of December 2022 described the provisional agreement between the European Parliament and the Council of December 2022 in more detail.

The directive will enter into force on the twentieth day following its official publication.

Nature-related financial disclosures and risk assessment

A set of voluntary requirements is to help companies and financial institutions integrate nature-related issues into decision-making, risk management, and disclosure. On 19 September 2023, the Task Force on Nature-related Financial Disclosures (TNFD) published its final recommendations. The TNFD is a global, market-led, science-based, and government-supported initiative to provide a framework for companies and financial institutions to report and assess nature-related issues.

The published framework includes 14 recommended disclosures covering nature-related dependencies, impacts, risks, and opportunities. In addition, the Task Force has developed a set of cross-sector and sector-specific metrics to support the assessment and disclosure of positive and negative impacts on nature. The need for consistent metrics echoes a recent SAFE White Paper that examines the current state of corporate biodiversity reporting. It finds that current disclosure is largely non-standardized, lacking quantification, details, and clear targets.

Based on the experience of the closely related Task Force on Climate-related Financial Disclosures (TCFD), the TNFD is likely to be used in three interrelated ways:

- As a basis for voluntary standards, such as the International Sustainability Standards Board (ISSB).
- As a basis for mandatory corporate reporting regulations.
- For direct voluntary adoption by companies.

The need to address nature-related issues is underscored by the Network of Central Banks and Financial Supervisors for Greening the Financial System (NGFS) in their Conceptual Framework for Nature-Related Financial Risks published on 7 September 2023. The network aims to guide central banks and financial supervisors in assessing and addressing nature-related financial risks. To this end, it defines nature-related financial risks and concepts. It provides a risk assessment framework for identifying sources of physical and transition risks, assessing economic risks to, from, and within the financial system. As a next step, the network aims to fill modelling and data gaps, mainly through developing nature-related scenarios.

Public consultations

- **European Commission**: Public consultation on an assessment of the Sustainable Finance Disclosure Regulation (SFDR). The deadline is 15 December 2023.
- **International Organization of Securities Commissions (IOSCO)**: Call for feedback on proposed good practices on leveraged loans and collateralized loan obligations. The deadline is 15 December 2023.

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