Assogestioni response to the European Commission's Consultation on a macroprudential policies for non-bank financial intermediation (NBFI)

General remarks

Assogestioni[1] welcomes the opportunity to contribute to the discussion on the adequacy of macroprudential policies for NBFIs in the EU.

We support policymakers' efforts to strengthen financial markets as making the EU an even safer place for individuals to save and invest over the long term is a key objective of the CMU.

We therefore welcome the recognition in the Consultation Paper that much has been and is being done in the EU investment fund sector in terms of micro and macro-prudential policies, both in terms of supervision and regulation. Indeed, specific sectorial provisions are designed to mitigate the fund-level risks, to enhance the resilience of the industry and to safeguard financial stability.

The further measures introduced in this direction by the recent review of the AIFMD and UCITSD are additional welcome steps. We refer in particular to the harmonization of the rules on liquidity management tools that could be used in each Member State to respond to potential financial stability externalities and to the work on an integrated reporting system which could achieve several objectives including, among others, ensuring the usefulness and quality of data collection (also to better understand potential vulnerabilities), improving efficiency and effective data sharing and reducing the reporting burden.

Enhancing fund investor protection and financial stability are complementary objectives. The diversity and specificity of investment funds with a market-to-market valuation should be well recognized as the fund industry plays a crucial and a distinct economic role from banks and other NBFIs in channelling investors' savings into the real economy through an accessible and efficient vehicle. Asset managers operate under a principle-agent business model. By helping to manage the financial risk of the investments that investors directly carry, asset managers are obliged to inform investors about investment strategies and risk profiles according to strict transparency requirements, including redemption terms and suspension model.

Without recognizing the nature of investment funds, inappropriate macroprudential policy tools could potentially increase risks and have unintended consequences for both funds and the long-term investments they facilitate. In fact, certain measures (such as liquidity buffers or the supervisory activation of LMTs for a subset of funds) could discourage risk-taking of investments in European financial markets through funds, create incentives to run, introduce unlevel playing field between investors in

[1] Assogestioni is the trade body for Italian asset management industry and represents the interests of members who manage funds and discretionary mandates around € 2,463 billion (as of September 2024).

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investments in funds and other investors, and may even act as a drag on fund performance and investor returns.

It is important to remember that a lot of political initiatives have been promoted to enhance awareness and resilience in the last years which still need to be finalized, implemented and assessed. For example, it should be ensured that asset managers use and calibrate LMTs properly; the proposal for a Consolidated Tape for market data transparency, which includes a centralized hub (also) for bond instruments, is on the run. The EMIR reporting REFIT will provide a lot of new information on the use of derivatives, given the scale of the intervention, whose quality and usability should be duly assessed. The construction/revision of an integrated EU reporting for investments funds is only at the beginning and the mandate given to ESMA might need to be complemented by other policy actions. In addition, Common Supervisory Actions, to help convergence and supervisory practices, are increasingly being used by ESMA and NCAs to point out oversight gaps and to enhance the effectiveness of existing regulatory, supervisory, and operational measures.

Therefore, we believe that there is scope, at the time being, to consider the actual micro and macro prudential tools for investment funds sufficient, even if there is a need for increased scrutiny into some specific segments. As some regulators express[2], "*the event put forward as examples of NBFI vulnerabilities differ widely from one another and, therefore, each of them call for a careful and specific analysis*".

Furthermore, with regard to macroprudential supervisory coordination, Assogestioni believes that it would not be necessary to strengthen the coordination powers of ESMA - and of other EU bodies- and to create enhanced coordination mechanisms for the adoption of macroprudential measures in the fund sector. Indeed, there are already several coordination mechanisms in the current regulatory framework on which ESMA and NCAs could rely; therefore, the focus should be on making the best use of what is already available and underpinning coordinated action with an appropriate analytical framework.

In particular, with regard to large asset management companies we believe that there is no reason to strengthen supervisory coordination for them in order to address systemic risk, as there is no correlation between the size of the manager and its systemic relevance, and the current passporting regime already ensures that management companies are supervised by a single supervisor. More broadly, going beyond the mere purpose of the Consultation to assess the adequacy of macroprudential policies for NBFIs, we believe that national supervision remains the best option for the asset management industry, given the national specificities of each Member State and the conflicts of law that could arise from supervisory integration.

[2] Consob, CNMV, AMF, FMA A macro-prudential approach to asset management, 15 April 2024.

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However, more coordinated and effective macroprudential supervision could be achieved by promoting the convergence of supervisory data, building an integrated reporting system and developing an appropriate analytical framework.

The complexity and interconnectedness of sectors, activities, market and participant as well as existing data gaps make it difficult to understand vulnerabilities and transmission channels in order to protect the financial system as a whole from large systemic events. An appropriate analytical framework based on a holistic and empirical approach, consistent supervisory data from across the financial system (banks and NBFIs), other than proper risk metrics could be helpful.

The EU's priority should be to develop supervisory capacity to identify pockets of risk even beyond the investment funds sector and the need for consistent and high-quality data for an effective systemic risk supervision is a cornerstone.

From a theoretical point of view, regular EU system-wide stress tests could be a beneficial exercise if they will help authorities and market participants to gain more insight into how all market participants behave in a given scenario, and how their possible interactions could amplify shocks to the EU financial system. However, modelling and estimating macroprudential effects is challenging and while they can help identify areas that deserve greater attention, they face a number of limitations. A macroprudential perspective alone is, therefore, insufficient to determine whether a policy response is needed.

We believe that robust risk management, strong governance, convergence of supervisory data and supervision, together with more information on market dynamic and appropriate education to make informed investors decisions remain the critical elements to support the maintenance of financial stability.

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1. Key vulnerabilities and risks stemming from NBFI

Question 1. Are there other sources of systemic risks or vulnerabilities stemming from NBFIs' activities and their interconnectedness, including activity through capital markets, that have not been identified in this paper?

The Commission's analysis provides a valuable starting point, but a more sophisticated framework might be helpful. This should include precise definitions of "systemic risks", that the EU should seek to address, and the outlining the "critical market functions" the EU should seek to preserve.

A more holistic approach is needed to assess how different financial sectors, regardless of whether they are buyers or sellers or of their regulatory status (regulated or not regulated, NBFI or not), can contribute to or undermine financial system resilience, considering also that, within a single sector, the risks borne by market participants may substantially differ.

While investment funds are key market intermediaries, the assessment of systemic risk posed by the fund sector is still evolving and debated.

Despite frequent shocks over the last couple of years, investment funds (except MMFs) only sold assets during March 2020, begging the question why end-investors redeemed from funds in March 2020 while remaining invested in March 2022 during the invasion of Ukraine and throughout 2022 and 2023 when central banks sharply increased interest rates.

Single investors are free to decide to access or leave the market, and also the collective nature of an open-ended investment fund helps to mitigate some potential effects coming from multiple investors' decisions to redeem their shares, as they balance between who wants to divest and who wants to invest or remain exposed in financial market. Especially in case of stressed market conditions, advisory to retail investors and bilateral exchanges with the institutional ones are essential elements that might help resilience and the capacity of the investment fund sectors to absorb shocks.

It is worth reminding that in open-ended funds, investors can redeem fund shares on demand, however there is a great diversity that should be duly considered to get an overarching picture of the system. Heterogeneity is across sectors and sub-sectors, on the investment strategy (cash vs derivatives), on the liquidity profile (redefining and maintaining a certain liquidity e.g., by adapting their trading patterns to market conditions), on the client base (retail vs institutional) and in case of stress, the liquidation approach and the LMTs selected, included their calibration.

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In this respect, and in consideration of the high regulated nature of EU investment funds, we share the ESMA view[3] that "*we need to be careful and differentiate risks that are macroprudential in nature and need to be addressed by macroprudential tools, from risks resulting from inadequate regulation or lack of proactive supervision and enforcement. Let's ensure that the macroprudential framework is not there to compensate for loopholes in the regulation and/or supervision*".

Question 2. What are the most significant risks for credit institutions stemming from their exposures to NBFIs that you are currently observing? Please provide concrete examples.

Question 3. To what extent could the failure of an NBFI affect the provision of critical functions to the real economy or the financial system that cannot easily be replaced? Please explain in particular to which NBFI sector, part of the financial system and critical function you refer to, and if and how you believe such knock-on effect could be mitigated.

Referring to the fund sector, insolvencies are unlikely to occur. Unlike debt-financed institutions (incl. deposits for banks), investment funds raise capital through "equity" issuance, their asset are segregated and not exposed to asset manager balance sheets. The net asset value (NAV) fluctuates on market conditions, mitigating the risk of a systemic shock and they are typically not highly leveraged.

Over the years, the EU has introduced many safeguards to ensure that investment funds would not contribute to the build-up of systemic risks (please see below).

EU regulatory framework:

- All investment funds, whether UCITS, MMFs, or AIFs, are directly or indirectly regulated products. It notably means that these funds must obtain an authorisation, or at the very least notify their supervisors in a few cases, to market their units or shares to investors.
- UCITS funds are subject to several product rules that reduce financial stability risks (e.g., asset eligibility rules, concentration limits, borrowing prohibition, and leverage limits). MMFs have a specific regime (MMFR), i.e. with dedicated liquidity requirements and concentration limits, along with an ad hoc stress-testing regime whose parameters are updated annually by ESMA. Finally, while AIFs have more leeway, they nonetheless have to comply with self-imposed leverage limits, which usually remain quite low.
- management companies have to maintain sound liquidity management policies, ensure that their investment strategy and redemption policy are consistent, conduct regular stress testing exercises to ensure with sufficient

[3] Macroorudential policy for investment funds conference. Keynote speech form Verena Ross, 20 May 2024

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certainty that funds can remain resilient even during stressed market conditions. In the next future, they will all have, at the minimum, two LMTs if are not MMF.

· National Competent Authorities have a wide array of supervisory powers that they can use to address well-documented financial stability threats: they can conduct on-site or off-site investigations, require the cessation of any practice that is contrary to applicable rules, introduce leverage limits, suspend the issue or redemption of shares, and even withdraw an authorisation granted to a UCITS or a management company.

Question 4. Where in the NBFI sectors could systemic liquidity risk most likely materialise and how? Which specific transmission channels of liquidity risk would be most relevant for NBFI? Please provide concrete examples.

A comprehensive understanding of systemic liquidity events in NBFI necessitates a holistic analysis of both liquidity demand and supply of all market players, not only NBFI. As a results, one should have more information on the possible dynamics and interplay between market players, within the limit of the models and analysis.

The EU's priority should be developing supervisory capabilities to identify pockets of risks even beyond the investment funds sector and the need for consistent and high-quality data for an effective supervision of systemic risk is a cornerstone.

To identify areas that would deserve further attention, European Commission should ensure that authorities have access to sufficiently comprehensive datasets for their financial stability analyses. Because holistic financial analyses require consistent data across capital markets, every market participant should report, directly or indirectly, certain information to their authorities.

We believe, in general, that data sharing between supervisors should be enhanced and the reporting system should be improved in order to avoid reporting duplications and to promote data standardization amongst different jurisdictions. Investment funds sector already reports quite extensive information, however remain certain data gaps in other NBFI that may prevent authorities from conducting comprehensive analyses:

- Limited Visibility into Non-EU Entity Activity: Non-EU entities primarily report transaction data through broker-dealers, leaving a significant portion of EU capital markets partially outside regulatory oversight.
- Incomplete Data from Non-Regulated Entities: While non-regulated entities are indirectly subject to statistical and transaction reporting, they are not subject to supervisory reporting requirements. This limits the ability of central banks to fully assess the risks these entities pose, particularly off-balance sheet exposures.

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Question 5. Where in the NBFI sectors do you see build-up of excessive leverage, and why? Which NBFIs could be most vulnerable? Please provide concrete examples.

Leverage remains a relatively low phenomenon in the European investment funds sector, primarily used for risk management rather than seeking increased exposure.[4] The ECB itself acknowledged in 2016 that investment funds, unlike traditional banks, maintain significantly lower leverage ratios: "*Compared to the traditional banking sector where assets are often more than 10-30 times the size of equity, leverage in the investment fund sector is low with total assets much less than twice the amount of equity*"[5].

These low levels can be attributed to two primary factors: a stringent regulatory environment designed to safeguard investor interests and the inherently simple structure of European funds, which generally do not employ leverage to enhance returns.

The regulatory framework governing investment funds imposes strict limits on leverage. Pursuant to Article 83(2) of the UCITS Directive, the UCITS funds are prohibited from borrowing cash for investment purposes. Furthermore, on synthetic leverage the UCITS Directive limits their net exposure to 200% (including physical assets). The AIFMD requires management companies to establish net leverage limits for AIFs, as stipulated in Article 25(3) of the directive. During the authorization process, NCAs assess the proposed level of leverage and may require additional safeguards from the management company. NCAs can also impose specific leverage limit for some investment type (in Italy, the leverage is limited to 1.5 for reserved AIFs that invest in loan).

The low leverage results of the investment funds are also confirmed in a Working paper series of the ECB[6] of 2024 where the authors states that "*Under UCITS III, leverage can be used for investment purposes, whit not need to match specific assets, but is limited. On the other hand, the Alternative Investment Fund Managers (AIFM) directive does not include leverage limits, but corresponding funds are usually only moderately leveraged, with the exception of hedge funds.*"

Question 6. Do you observe any systemic risks and vulnerabilities emerging from crypto assets trading and intermediaries in the EU?

[4] EFAMA, Open-ended funds and resilient capital markets, July 2023, pp. 28 - 32.
[5] ECB, Shadow banking in the euro area: risks and vulnerabilities in the investment fund sector, Occasional Paper Series, No 174, June 2016, p. 26.
[6] Banks and non-banks stressed: liquidity shocks and the mitigation role of insurance companies. ECB Working Paper Series, n. 3000, Matthias Sydow, Gábor Fukker, Tomasz Dubiel-Teleszynski, Fabio Franch, Sébastien Gallet, Helmut Gründl, Stelios Kotronis, Debora Miccio, Michela Pellegrino, Sebastian Schlütter, Matteo Sottocornola.

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Question 7. Considering the role NBFIs have in providing greater access to finance for companies and in the context of the capital markets union project, how can macroprudential policies support NBFIs' ability to provide such funding opportunities to companies, in particular through capital markets? Please provide concrete examples.

Enhancing investment fund's investor protection and financial stability are complementary objectives.

However, ill-suited policy tools could potentially heighten risks and lead to unintended consequences for both funds and the long-term investments they facilitate, mainly where measures such as cash buffers or capital requirements would discourage risk-taking in European financial markets and act as a drag on fund performance and investor returns.

Maintain the right flexibility for an asset manager to react depending on current and potential market condition is fundamental.

A macroprudential policy for NBFIs could positively impact the Capital Markets Union (CMU) agenda if it effectively addresses liquidity imbalances during stress periods without imposing undue regulatory burdens.

In addition, in case of market stress, the treatment of investment funds in the same manner as other investors is crucial. Differentiating between funds and direct investors could create an unlevel playing field, penalizing clients who invest through funds and hindering the industry's ability to deliver economies of scale crucial for capital market success.

3. Unmitigated liquidity mismatches

3.1 Money Market Funds (MMFs)

Supervisory powers

Question 8. What are pros and cons of giving the competent authority the power to increase liquidity buffer requirements on an individual or collective basis in the event of system-wide financial stability risks? Under which other situation do you believe MMF liquidity buffers should be increased on an individual or collective basis by the competent authority? Please explain.

Assogestioni strongly opposes giving the NCAs the power to increase MMF liquidity buffers on and individual or collective basis to mitigate systemic risk and ensure market stability. Despite acknowledging the differences between banks and investment funds, the consultation paper proposes a "bank-specific" solution.

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Since liquidity buffers could have unintended consequences and prompt pro-cyclical behaviors from investors and manager, we therefore disagree of empowering NCAs to increase MMF liquidity buffer.

Recent regulatory developments, such as the AIFMD/UCITS review and the FSB/IOSCO recommendations on OEF liquidity management, emphasize the importance of assigning primary responsibility for liquidity management to fund managers. Any modifications to liquidity buffer requirements imposed by public authorities would directly contravene this principle.

Question 9. How can ESMA and ESRB ensure coordination and the proper use of this power and what could be their individual roles? Please provide specific examples or scenarios to support your view.

Reporting requirements

Question 10. In view of the new UCITS supervisory reporting obligations and improvements to AIFMD reporting, how could reporting requirements under the MMFR be aligned, simplified and improved to identify stability risks (such as liquidity risks) and to ensure more efficient data sharing?

In the UCITSD and AIFMD review there is a mandate to streamline and make a more integrate system of reporting, but MMFs are out of scope. Therefore, it might be valuable to make an assessment to reduce reporting obligation also for MMFs and ensure more efficient data sharing.

Broadly speaking, there is a need to simplify reporting and avoid overlaps between different pieces of EU legislation. At UE level MMFs reporting is regulated by MMFR and ECB Regulation. Differences in the reporting come both in terms of content, frequency and data collection methods.

Stress testing framework

Question 11. Do you believe that the proposed enhancements to the stress testing framework listed above are sufficient to identify and mitigate liquidity risks effectively? If not, what specific elements would you suggest including in the strengthened supervision and remediation actions for detecting liquidity risks?

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Question 12. What are the costs and benefits of introducing an EU-wide stress test on MMFs? Should this stress test focus mainly on liquidity risks?

Reverse distribution mechanism

Question 13. What are your views on the EU ban on a reverse distribution mechanism by MMFs?

Question 14. Can you provide insights and data on how the reverse distribution mechanism has impacted in practice the stability and integrity of MMFs?

Liquidity and short-term instruments

Question 15. Should regulatory requirements for MMFs take into account whether the instrument they are investing in is admitted to trading on a trading venue (regulated markets, multilateral trading facilities or organised trading facilities) with some critical level of trading activity? Please explain your answer.

3.2 Other open-ended funds (OEFs)

Link between liquidity mismatch and liquidity risks

Question 16. How can NCAs better monitor the liquidity profile of OEFs, including redemption frequency and LMTs, in order to detect unmitigated liquidity mismatches during the lifetime of OEFs?

It is important to remind that the "NAV" of an open-ended fund reflects market prices and fund investors bear the risk of market fluctuations, unlike banks which have an obligation to meet liabilities, including the repayment of the principal of their depositors. With this important difference in mind and given the complexity and diversity of the fund sector, we believe that a risk-based approach is necessary other than fundamental.

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In this context, the EU's robust regulatory framework developed over the past decade empowers supervisors to closely monitor the liquidity profile and the sound liquidity risk management process of the fund sector in all stages of a fund's life (from the design phase to the investment process) and address any deficiencies identified other than to be better preparate for challenges in future periods of stress. Therefore, ensuring that all market participants comply with minimum regulatory requirements is essential.

- Asset managers already provide detailed information on fund characteristics, including liquidity profiles, during authorization and ongoing supervision. Some information is collected directly using a harmonized EU template (AIFMs/AIFs reporting, MMFs reporting). Other information is collected without common template but through ECB reporting requirements. The recent AIFMD/UCITS review[7] will further enhance this reporting, where additional information could be collected on a periodic or ad hoc basis where necessary for the effective monitoring of systemic risk or in exceptional circumstances in order to ensure stability and integrity of the financial system.

- ESMA's Article 25 AIFMD Guidelines[8] provide a suitable framework for assessing fund risk, considering factors like leverage, liquidity, and concentration. By starting from such factors, supervisors can identify if there are some pockets of vulnerabilities that can spread into markets.

- Stress tests can help identify potential vulnerabilities, but it is important to remind that they also have limitations. ESMA and ECB stress tests conducted over the years to assess the resilience of the fund industry under various adverse scenarios, while valuable, may not fully capture real-world shocks. These tests often apply uniform shocks, ignoring fund-specific differences and manager responses. Additionally, they may not consider broader market dynamics and feedback loops. It is always necessary, therefore, to supplement these inputs with qualitative information based on the experience and sound judgment.

- The use of Common Supervisory Actions (CSAs) by ESMA with NCAs facilitated discussions among NCAs in order to ensure that both market participants and NCAs are better preparate. The use of CSA has been increased over the last years and in the CSA on UCITS liquidity risk management, ESMA states that "*Overall, NCAs reported that most UCITS managers have demonstrated that they have implemented and applied sufficiently sound liquidity risk management processes. However, the exercise also identified shortcomings in a few cases and the need for improvements in certain key areas. Consequently, NCAs are following up with market participants to address the supervisory findings identified in the CSA at the individual and collective level.*" While in CSA on the valuation of UCITS and open-ended Alternative Investment Funds (AIFs) across the EU ESMA states that "*it is*

[7] Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds, March 2024.
[8] ESMA, Guidelines on Article 25 of Directive 2011/61/EU, June 2021.

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important that NCAs' supervision addresses the deficiencies identified in the course of the CSA exercise and keeps paying close attention to potential valuation issues arising from less liquid assets, whose nature can amplify the structural liquidity mismatches of certain types of investment funds. This is particularly true for funds investing in Private Equity (PE) assets and Real Estate (RE) which might be more exposed to revaluation risks in light of the heavy reliance on long-term models and the illiquidity of their assets."

Question 16. [To NCAs/EU bodies] What is the supervisory practice and your experience with monitoring and detecting unmitigated liquidity mismatches during the lifetime of OEFs?

Question 17. What is the data that you find most relevant when monitoring liquidity risks of OEFs?

Implementing a sound and comprehensive liquidity risk management requires a nuanced and holistic approach, considering the changing nature for liquidity over time.

Liquid and liquidability are key topics for an open-ended investment fund. For our knowledge there is no single risk measure that can be used to draw definitive conclusion and risk manager assess them on a periodic basis.

Effective risk management requires a balance between practical measures and an awareness of the unexpected. Sound judgment and prudence are crucial when setting risk management policies and parameters. Risk management techniques usually include both quantitative measure and qualitative methods.

Different scenarios can be used for business as usual and for stressed market conditions to ensure that the liquidity risk of taken position and their contribution to the overall risk profile of the fund are accurately measured on the basis of sound and reliable data.

Several approaches and liquidity risk metrics could be used, and them could not necessarily based on banking rules given the different characteristics of investment funds. As ESMA already recognizes[9] the HQLA (high-quality liquid asset) approach, used for banks under Basel III liquidity regulatory requirements, penalizes, by construction, fund investment in less liquid asset classes. Time to liquidation approach would be helpful and in this regard one scenario could recognise that a portion of the activities held by an investment fund could be reasonable liquidated every day (i.e. the time to liquidate is not necessary the longest period where the entire position could be reasonable liquidated). The liquidation approach and the

[9] ESMA Economic Report Stress simulation for investment funds, 2019.

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analysis of the impact on the fund's investment compliance and risk limits when it sells assets, especially in a stress scenario, are key aspects to take into accounts.

ESMA already identified some relevant factors that are suggested to be considered in their guidelines on liquidity stress testing in UCITS and AIFs[10] and it is important to highlight that ESMA is not prescriptive on the methods to be used in line with a nuance and holistic approach.

Question 18. [To NCAs/EU bodies] What supervisory actions do you take when unmitigated liquidity mismatches are detected during the lifetime of an OEF?

Question 19. On the basis of the reporting and stress testing information being collected by competent authorities throughout the life of a fund, how can supervisory powers of competent authorities be enhanced to deal with potential inconsistencies or insufficient calibration between the LMTs selected by the manager for a fund or a cohort of funds and their assets and liabilities liquidity profile? How can NCAs ensure that fund managers make adjustments to LMTs if they are unwilling to act? How could coordination be enhanced at the EU level?

Given the diversity of the fund industry, it cannot be assumed that all asset managers have the same risk management approach or apply the same LMTs.

Asset managers should remain primarily responsible for the liquidity management within their funds, including the selection and implementation of those LMTs that they consider most appropriate with respect to the specific features of their fund, in both normal and exceptional circumstances, and competent authorities must play their role in oversight.

In our view, competent authorities are already equipped with a broad range of supervisory tools with several and increasing escalation measures. They may suggest general guidance to the market, ask more information, conduct investigations, mandate the discontinuation of non-compliant practices, impose leverage constraints, suspend share issuance or redemption, and even revoke authorizations[11]. Persistent and flagrant breaches of liquidity management rules or supervisory directives must be met with appropriate sanctions, potentially culminating in the revocation of a manager's license.

At EU level, the Common Supervisory Action is a useful tool to enhance coordination between NCAs. In this sense the CSA made on UCITS liquidity risk management[12], conducted in response to the COVID-19 market downturn of March 2020 concluded that "*overall, most UCITS managers have demonstrated that they have implemented*

[10] ESMA, Guidelines on liquidity stress testing in UCITS and AIFs, July 2020.
[11] Articles 98 UCITS, 25(3), 43, 46 AIFMD.
[12] ESMA, Public statement on results of the 2020 Common Supervisory Action (CSA) on UCITS liquidity risk management, March 2021.

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and applied sufficiently sound LRM processes". Nevertheless, the ESMA also identified certain areas for improvement on which NCA have assessed the need to carry out general and/or more targeted interventions on their national markets.

Question 20. [To asset managers] What measures do you find particularly effective to measure and monitor liquidity risk in stressed market conditions?

Please see our answer to Q17.

Question 21. [To asset managers] What difficulties have you encountered in measuring and monitoring liquidity risks and their evolution? Are there enough tools available under the EU regulations to address liquidity mismatches?

We believe that there are enough tools available under the EU regulations to address liquidity risks.

The recent UCITSD and AIFMD review has further improved the liquidity management framework and the EU legislation already requires management companies to maintain effective liquidity management policies. Among other, this includes aligning investment and redemption policies, developing robust liquidity risk management systems, such as defining and maintaining a liquidity profile (e.g. by adjusting their trading strategies to market conditions), using liquidity management tools (LMTs), and conducting regular stress testing.

The EU's approach to fund liquidity management is widely recognized as best practices, as evidenced by the *IOSCO Thematic Review on Liquidity Risk Management Recommendations*[13].

Scarcity of some data and idiosyncratic information in volumes remain key challenges in the modelling. In this regard, more data for non-equity instruments that could come from the future EU Consolidate Tape may higher the level of transparency that can be used by all market players, included asset managers.

Moreover, it would be helpful if CCPs provide additional public disclosures regarding their margin models to allow market participants to incorporate these models in their stress testing exercises. It is equally important to ensure that clearing members' collateral policies are sufficiently transparent to those investors who use their services, as brokers may impose additional margin requirements on their clients on top of those required by CCPs.

[13] IOSCO, Thematic Review on Liquidity Risk Management Recommendations, November 2022.

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Question 22. [To asset managers] What are the challenges in calibrating worst-case and stress-case scenarios related to redemptions and margin calls?

Risk drivers that determine price and liquidity dynamics are not static. The literature of recent years has begun to make significant contributions, however the lack of data, including volumes for specific instruments remain a significant obstacle to a robust modelling. In any case, modelling broader economic weakness is always a challenge and there could be a low degree of precision of liquidity models under stress conditions. History does not encompass every probable future scenario, and it is always necessary, therefore, to supplement these inputs with qualitative information based on experience and sound judgment.

It is worth remembering that the nature and scale of market crises cannot always be predicted, even with the best data and modelling.

Stress testing

Question 23. [To NCAs and EU bodies] When monitoring or using results of liquidity stress tests, are you able to timely collect underlying fund data used by managers and the methodology used for the simulation? Are there other aspects that you find very relevant when monitoring the stress tests run by managers?

Question 24. [To NCAs and EU bodies] How do you use information collected from stress tests at fund level for other supervisory purposes and for monitoring systemic risks?

Question 25. [To NCAs and EU bodies] What are the main benefits and costs of introducing a stress test requirement at the asset management company level and how could this be organised?

Under ESMA Guidelines on stress testing[14], *"[a] manager should aggregate LST across funds under its management where it assesses such an activity to be appropriate for those funds".*

Aggregate stress testing is not mandatory as there are possible limitation in doing such exercise (other than costs). Investment funds are set up as separate legal structures managed according to their single investment strategies, with different risk profile and investor base. Therefor a liquidity ratio of one fund could be enough to fulfil the underling payment obligation of that fund, but for another fund the

[14] ESMA, Guidelines on liquidity stress testing in UCITS and AIFs, July 2020, point 72: "*A manager should aggregate LST across funds under its management where it assesses such an activity to be appropriate for those funds.*"

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same liquidity ratio would be not enough because of a different investor structure, risk profile or other additional payment obligations resulting of different investment strategies. In these cases, the particular circumstances of each fund would need to be looked at in isolation and the results of aggregate LST stress test may be useless.

3.3 Other NBFIs and markets

Other NBFIs

Question 26. What are your views on the preparedness of NBFIs operating in the EU in meeting margin calls, and on the ways to improve preparedness, taking into account existing or recently agreed EU measures aimed at addressing this issue? Please specify the NBFI sector(s) you refer to in your answer?

Question 27. What are relevant risk metrics or tools that can be used to effectively monitor liquidity and margin preparedness across all NBFI entity types? Please provide examples specifying the sector you refer to.

Pension Funds

Question 28. How can current reporting by pension funds be improved to improve the supervision of liquidity risks (e.g. stemming from exposure to LDI funds, other funds or derivatives), while minimising the reporting burden? What can be done to ensure effective look-through capability and the ability to measure the impact of unexpected margin calls? Please provide examples also for other NBFI sectors.

Question 29. What would be the benefits and costs of a regular EU-wide liquidity stress test for pension funds and with what frequency? What should be the role of EU authorities in the preparation and execution of such liquidity stress tests?

Short-term funding markets

Question 30. What would be the benefits and costs of creating a framework or a label in EU legislation for certain money market instruments (such as commercial papers) to increase transparency and standardisation? Should the scope of eligible instruments to such framework/label be aligned with Article 3 of Directive 2007/16/EC60? If not, please suggest what criteria would you consider for identification of eligible instruments.

Question 31. Would the presence of a wider range of issuers (notably smaller issuers) to fund themselves on this market, and therefore diversify their funding sources, be beneficial or detrimental to financial stability?

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Question 32. What are your views on why euro-denominated commercial papers are in large part issued in the 'EUR-CP' commercial paper market outside the EU? What risks do you identify? Please provide quantitative and qualitative evidence, if possible.

Question 33. What could be done to improve the liquidity of secondary markets in commercial papers and certificates of deposits?

Question 34. Considering market practice today, is the maturity threshold for 'money market instruments' (up to 397 days) in the Eligible Asset Directive 2007/16 sufficiently calibrated for these short-term funding markets?

Question 35. Do you think there is a risk with the high concentration of this market in a few investors (MMF and banks)? Please elaborate.

Question 36. How could secondary markets in these money market instruments attract liquidity and a more diverse investor base, while relying less on banks buying back papers they have helped to place?

Question 37. What are the benefits and costs of introducing an obligation to trade on trading venues (regulated markets, multilateral trading facilities and organised trading facilities) for such instruments?

Question 38. Can the possibility to trade on a regulated venue increase the chances of secondary market activities in a systemic event, for instance by acting as a safety valve for funds that need to trade these assets before maturity (especially when facing strong redemption pressures, like for MMFs)?

Commodities markets

Question 39. How would you assess the level of preparedness of commodity derivatives market participants in terms of meeting short-term liquidity needs or requests for collateral to meet margins? Please rank from 1 to 5 (lowest to highest) the level of preparedness for the following participants by sector: insurance companies, UCITS funds, AIFs, commercial undertakings, investment firms, pension funds.

Question 40. In light of the potential risk of contagion from spot markets or off-exchange energy trading to futures markets, do you think that spot market participants should also meet a more comprehensive set of trading rules for market participation and risk management? Please elaborate on your response.

Question 41. How can it be ensured that the functioning of underlying spot energy markets and off-exchange energy trading activity does not lead to the transmission of risks to financial markets?

Other markets

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Question 42. To what extent do you see emerging liquidity risks or market functioning issues that can affect liquidity in other markets? Can you provide concrete examples?

4. Excessive leverage

4.1 Open-ended funds (OEFs)

Question 43. What are other tools than those currently available under EU legislation which could be used to contain systemic risks generated by potential pockets of excessive leverage in OEFs?

The possibility to impose leverage limits under EU legislation is amply sufficient.

Question 44. What are, in your view, the benefits and costs of using yield buffers for Liability-Driven funds, such as it was done in Ireland and Luxembourg, to address leverage?

Question 45. While on average EU OEFs are not highly leveraged, are there, to your knowledge, pockets of excessive leverage in the OEF sector that are not sufficiently addressed? Please elaborate with concrete examples.

Question 46. How can leverage through certain investment strategies (e.g. when funds invest in other funds based in third countries) be better detected?

4.2 Other NBFIs and markets

Question 47. Are you aware of any NBFI sector entities with particularly high leverage in the EU that could raise systemic risk concerns?

Question 48. Do stakeholders have views on macroprudential tools to deal with leverage of NBFIs that are not currently included in EU legislation?

Question 49. [To NCAs and EU bodies:] Are you able to timely identify (financial and synthetic) leverage pockets of other NBFIs (such as pension funds, insurance companies and so on), especially when they are taken via third parties or complex derivative transactions? Please elaborate on how this timely detection of leverage could be obtained?

Question 50. How can it be ensured that competent authorities can effectively reconcile positions in leveraged products (such as derivatives) taken via various legal entities (e.g. other funds or funds of funds) to the ultimate beneficiary?

Commodities markets

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Question 51. What role do concentrated intraday positions have in triggering high volatility and heightening risks of liquidity dry-ups? Please justify your response and suggest how the regulatory framework and the functioning of these markets could be further improved?

5. Monitoring interconnectedness

Question 52. Do you have concrete examples of links between banks and NBFIs, or between different NBFI sectors that could pose a risk to the financial system?

Question 53. What are the benefits and costs of a regular EU system-wide stress test across NBFI and banking sectors? Are current reporting and data sharing arrangements sufficient to perform this task? Would it be possible to combine available NBFI data with banking data? If so, how?

From a theoretical point of view, regular EU system-wide stress tests could be a beneficial exercise if it will help authorities and market participants to have more insight on how all market participants (banks and NBFIs) behave during certain scenario, and how their possible interactions might amplify shocks to the EU financial system.

However, due to significant limitations and challenges of system-wide stress test modelling, this exercise should not underpin macroprudential policy decisions.

While we acknowledge the importance of comprehensive and consistent reporting, we contend that system-wide stress tests should prioritize the analysis of dynamic market conditions, and no ad hoc information should be requested at the fund industry.

Investments funds already provide a substantial amount of data to authorities through various reporting regimes. This data should be sufficient to analyze the mechanisms that contributed to recent crises.

Question 54. Is there a need for arrangements between NBFI supervisors and bank supervisors to ensure timely and comprehensive sharing of data for the conduct of an EU-wide financial system stress tests? Please elaborate.

Question 55. What governance principles already laid out in existing system-wide exercises in the EU, such as the one-off Fit-for-55 climate risk scenario analysis or the CCP stress tests conducted by ESMA, could be adopted in such system-wide stress test scenario?

Question 56. [To NBFIs and banks] In your risk management practices, do you run stress tests at group level, and do you monitor the level of

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interconnectedness with (other) NBFIs (within and beyond your own sector; e.g. portfolio overlaps)?

6. Supervisory coordination and consistency at EU level

6.1 Open-ended funds (OEFs)

Question 57. How can we ensure a more coordinated and effective macroprudential supervision of NBFIs and markets? How could the role of EU bodies (including ESAs, ESRB, ESAs Joint Committee) be enhanced, if at all? Please explain.

With reference to the asset management sector, more coordinated and effective macroprudential supervision could be achieved by favoring the convergence of supervisory data and improving the reporting system, without any need to enhance the role of EU bodies.

ESMA should become the single data hub for supervisory data on capital markets.

Accordingly, NCAs, which receive reports from asset managers, would share this information with ESMA, and would be allowed to access ESMA's database to monitor their local markets. Data convergence would enable authorities to access the necessary information without duplicating the reporting obligations on market participants. This would be particularly beneficial since the reporting burden might be heavy on asset managers, especially in periods of stress, when different authorities may require additional information to monitor the situation while asset managers should instead be focusing primarily on facing the crisis.

In the same perspective, one measure that could increase the oversight and resilience of the fund industry and might need further policy attention, could be the construction of an integrated supervisory reporting for investment funds, which would ensure the usefulness and quality of data collection (also to better understand potential vulnerabilities), improve efficiency and data sharing amongst authorities and reduce the reporting burden. Some initial steps in this direction could be adopted in the context of ESMA's mandate to adopt RTS aimed at improving and streamlining reporting obligations in the fund sector, which might however need to be complemented by other actions.

Enhanced coordination mechanism (implementation and adoption of NMMs)

Question 58. How could the currently available coordination mechanisms for the implementation of macroprudential measures for OEFs by NCAs or ESAs (such as leverage restrictions or powers to suspend redemption on financial stability grounds) be improved?

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Under the current regulatory framework there are already several coordination mechanisms on which ESMA and NCAs can rely (i.e. art. 9 of ESMA Regulation, art. 98(4) UCITS / 50(5h) AIFMD, 25 AIFMD, art. 84(3) UCITS and 50(5) AIFMD, art. 84(2b) UCITS / 46(2j) AIFMD) and these seem to be, in general, sufficient.

Indeed, macroprudential measures have a limited role to play in the asset management sector, as confirmed by the few times these mechanisms have been used. The last one was the ESMA technical advice on investment restrictions for liability-driven investment funds managing GBP-denominated AIFs in Ireland and Luxembourg.

With specific regards to fund suspension, it is worth highlighting that a NCA may require the suspension in the interest of the public (other than the unit-holders). It should be considered a last resort measure as the actual use of a direct intervention power by a public authority on a subset of investment funds would likely be interpreted as a widespread concern, which could trigger investor panic. If certain markets experience excessive volatility, NCAs should consider closing these markets rather than suspending funds, which usually account for a limited share of the market. This would allow all investors to be treated equally, regardless of how they access the market (directly or through investment funds). The activation of this macroprudential measure, especially during a stress period, would certainly deserve close cooperation between NCA.

Question 59. What are the benefits and costs of introducing an Enhanced Coordination Mechanism (ECM), as described above, for macroprudential measures adopted by NCAs?

Assogestioni believes that an Enhanced Coordination Mechanism (ECM) for macroprudential measures in the fund sector would be unnecessary, since under the current regulatory framework, there are already several coordination mechanisms on which ESMA and NCAs can rely. Accordingly, rather than amending the UCITS/AIFMD framework again, the focus should be on using the existing coordination powers in the best way. This could be achieved also by developing an appropriate analytical framework, in order to substantiate any coordinating action with concrete evidence. Moreover, considering the limited role of these measures in addressing vulnerabilities in the asset management sector (as outlined in our response to Q58), introducing an additional layer of coordination for their activation would be excessive and disproportionate.

Question 60. How can ESMA and the ESRB ensure that appropriate National Macroprudential Measures (NMMs) are also adopted in other relevant EU countries for the same (or similar) fund, if needed?

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Assogestioni believes it would be important to stress that that the only EU body competent for promoting supervisory convergence in capital markets should be ESMA. The ESRB should only be an observer in that matter.

Question 61. Are there other ways of seeking coordination on macroprudential measures and possibly of reciprocation? What could this system look like? Please provide concrete examples/scenarios and explain if it could apply to all NBFI sectors or only for a specific one.

As underscored in our response to Q57, convergence of supervisory data and the development of an integrated reporting system should be sufficient to achieve better supervisory coordination on macroprudential measures.

Supervisory powers of EU bodies

Question 62. What are the benefits and costs of improving supervisory coordination over large (to be defined) asset management companies to address systemic risk and coordination issues among national supervisors? What could be ESMA's role in ensuring coordination and guidance, including with daily supervision at fund level?

We believe that there is no reason to improve supervisory coordination over large management companies to address systemic risk, since there is no correlation between the size of the manager and the systemic relevance of the funds under its management, as management companies act on behalf of their investors and do not engage in proprietary trading.

In more general terms, reinforcing supervisory coordination over large management companies would be unnecessary as the current passporting regime already ensures that management companies are supervised by a single supervisor. Accordingly, Assogestioni believes that national supervision remains the best option for the asset management industry, given the national specificities of each Member State and the conflicts of law that might arise from supervisory integration.

On such ground, we believe that ESMA should not be given enhanced coordination powers over large asset management companies. Moreover, we are concerned that this proposal might extend beyond the ultimate purpose of the consultation which is to assess the adequacy of the macroprudential policies for NBFIs.

Question 63. What powers would be necessary for EU bodies to properly supervise large asset management companies in terms of flexibility and ability to react fast? Please provide concrete examples and justifications.

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As explained in our response to Q62, we believe that ESMA (as well as any other EU body) should not be given enhanced coordination powers over large asset management companies. This would be unnecessary given the absence of correlation between the size of the asset manager and its systemic relevance, and the effect already achieved by the current passporting regime of preventing supervisory fragmentation. Moreover, supervisory integration would make supervision in the EU more complex, while national supervision remains the best option for the asset management industry.

Question 64. What are the benefits and costs of having targeted coordinated direct intervention powers to manage a crisis of large asset management companies? What could such intervention powers look like (e.g. similar to those in Article 24 of EMIR)?

<u>6.2 Other NBFIs and markets</u>

Question 65. What are the pros and cons of extending the use of the Enhanced Coordination Mechanism (ECM) described under section 6.1 to other NBFI sectors?

ESAs and ESRB's powers during emergency situations

Question 66. What are the benefits and costs of gradually giving ESAs greater intervention powers to be triggered by systemic events, such as the possibility to introduce EU-wide trade halts or direct power to collect data from regulated entities? Please justify your answer and provide examples of powers that could be given to the ESAs during a systemic crisis.

Integrated supervision for commodities markets

Question 67. What are the benefits and costs of a more integrated system of supervision for commodities markets where the financial markets supervisor bears responsibility for both the financial and physical infrastructure of the commodity futures exchange, including the system of rules and contractual terms of the exchange that regulate both futures and (cash/physical) forward contracts?

International coordination

Question 68. Are there elements of the FSB programme on NBFI that should be prioritised in the EU? Please provide examples.

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