Response form for the Consultation Paper on the Guidelines on liquidity stress testing in UCITS and AIFs

1 February 2019

European Securities and Markets Authority

Date: 1 February 2019

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions in Annex I. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **1 April 2019**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

Q1 Insert your responses to the questions in the Consultation Paper in the present response form.

Q2 Please do not remove tags of the type <ESMA_QUESTION_LST_1>. Your response to each question has to be framed by the two tags corresponding to the question.

Q3 If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.

Q4 When you have drafted your response, name your response form according to the following convention: ESMA_LST_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_LST_ABCD_RESPONSEFORM.

Q5 Upload the form containing your responses, **in Word format**, to ESMA's website (www.esma.europa.eu under the heading "Your input – Open consultations").

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection
Information on data protection can be found at www.esma.europa.eu under the heading Legal Notice.

Who should read this paper?

The main stakeholders to whom these guidelines would apply are managers of UCITS and EU AIFMs as well as EU depositaries overseeing UCITS and EU AIFs. The paper will also be of interest to trade associations, investors and consumer groups relating to UCITS and EU AIFs.

General information about respondent

Name of the company / organisation	ASSOGESTIONI
Activity	Investment Services
Are you representing an association?	☒
Country/Region	Italy

Introduction

Please make your introductory comments below, if any:

<ESMA_COMMENT_LST_1>

Assogestioni[1] welcomes the opportunity to respond to the ESMA consultation paper on the Guidelines on liquidity stress testing in UCITS and AIFs.

First of all, we wish to evidence the general appreciation of the proposed Guidelines that embody an accurate and mature reflection on the liquidity management challenges on LST practices that respectively characterise and have been taken up within our industry. We consider that the proposals could enhance and/or finetune the existing practice, placing greater emphasis where needed (e.g. around gradual steps towards improved profiling for investor types), all while recognising the value of existing regulation and the need to avoid unnecessary or disproportionate additional burdens.

We strongly support principles-based Guidelines allowing the requirements to be tailored to some of the funds' key features, as, for instance, dealing frequency, underlying portfolio holdings that may be hard to value or model in a stress scenario, investor profiles as well as the terms of the investment management agreements.

However, LST, as in general all stress test, are very attractive but they are neither always feasible nor relevant. Notwithstanding their sophistication and assuming access to the most complete and precise data sets can be guaranteed, it yields only partial results. Risk drivers that determine price and liquidity dynamics and relative stress testing is indeed a complex issue. 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. It is always necessary, therefore, to supplement these inputs with qualitative information based on the experience and sound judgment.

Asset managers should apply their best effort to ensure they can meet investor redemption requests according to the fund rules, as part of their fiduciary rule. However, there are factors that are outside the control of asset manager and liquidity shock cannot easily be predicted by any model. Therefore, asset manager should dispose of all relevant tools to carry out its roles in an evolving context.

A pragmatic approach should always be possible, bearing in mind that stress tests should be used as information points to highlight potential problems and possible risk reduction. We deem indeed fundamental having an appropriate governance and oversight, including being subject to appropriate reporting and escalation procedures but allowing the necessary flexibility to asset managers, also in line with a proportional approach. We very welcome the clarification that these guidelines should be adapted to the nature, scale and complexity of the fund. However, it should be clarified that the proportionality principle should not be

[1] Assogestioni is the Italian investment management association representing the interests of members who manage funds and discretionary mandates around € 2,016 billion (as of December 2018). Assogestioni 's ID number in the EU Transparency Register is 89046007765-76. For more information, please visit www.assogestioni.it.

subject to the condition “where relevant”. It must be a clear understanding that LSTs are appropriate and based on the proportionality principle.

We therefore encourage ESMA to review some part of the proposed Guidelines and explanatory considerations:

- to allow the selection of LST as relevant as possible that could add value to the risk management process and oversight. As an example, we disagree with the prescriptive use of reverse stress testing for all funds. Also, the prevision of aggregate LST raises some concerns, even if, in this case, some flexibility in their possible use is already acknowledged.
- to provide a list of possible practices or examples in the explanatory considerations, rather than suggesting more prescriptive guidance.

Moreover, since LST are part of the broadly (liquidity) risk management process, it is essential that regulators provide managers a wide array of appropriate tools to deal with potential liquid crisis. We invite ESMA to work to assist convergence on Liquidity Management Tools available in different national markets.

Finally, in risk modelling, the availability of data is quite critical. MiFID II has begun to make improvements on availability of data, but there is still work to do and ESMA could support the different stakeholders, and definitely the market, in improving the availability of comprehensive and good quality trading and other market liquidity data for OTC instruments, such as bonds and derivatives.

<ESMA_COMMENT_LST_1>

a) : What additional costs and benefits would compliance with the proposed Guidelines bring to the stakeholder(s) you represent? Please provide quantitative figures, where available.

<ESMA_QUESTION_LST_1>
We appreciate, in general, the principal-based approach adopted by ESMA in the proposed Guidelines allowing the requirements to be tailored. Indeed, asset managers use different LST approaches to safeguard the interest of participants.

However, some of the proposed Guidelines or indications included in the explanatory explanations may have a material impact on the procedure already developed. We would then support a more proportionate approach with the aim of including LST guidance which could add value to the process also in a context of a cost and benefit analysis.

We specific refer to the requirements on reverse stress testing which are likely to require specific implementation for asset managers, with consequently administrative cost and burden that seems highly disproportionate with not certain benefit for all funds. The LST frequency and the validation of the model also have an effect on the procedure and on costs. Additional costs could also arise from the implementation of LST for the initial stage in a fund's life.

Finally, also the timing for the implementation period have an impact on costs. We would encourage ESMA to define an appropriate timeframe of no less than 18 months to allow asset managers to properly implement and/or revise the existing LST.

<ESMA_QUESTION_LST_1>

b) : Do you agree with the scope of these Guidelines? Should certain types of funds be explicitly excluded from these Guidelines? Should MMFs remain in-scope of these Guidelines?

<ESMA_QUESTION_LST_2>
As regards the scope of the Guidelines we have the following remarks.

- Existing UCITS guidelines on LST on collateral (ESMA/2014/937, paragraph 45). It should be clarified that existing UCITS guideline on LST on collateral should be considerate replaced by the proposed Guidelines. For a better regulation, having two separate Guidelines dealing with the same aspect should be avoided.

- MMFs: we agree with ESMA where in paragraph 3 b) states that the new regulatory framework on MMF established by the MMFR and ESMA Guidelines exclusively applying to MMFs may conflict with the proposed Guidelines. For better clarity and in order to avoid operational issues, when an MMF asset manager is due to comply for the same MMF with different regulatory requirements, we are in favour of excluding MMFs from the scope of the proposed Guidelines.

- Closed-ended funds: leveraged closed-ended funds are proposed to be included in the scope of the Guidelines, while it is not clear if also unleveraged closed-ended funds are in the scope. Since the common and most important source of liquidity risk (redemptions requests) is absent in these funds and ESMA acknowledges that different tools from LST could be available for the preparation to the fund closure and liquidation (see paragraph 65) we query the value of adapting these Guidelines for closed-ended funds. For example, Guideline 13 which calls for combining assets and liabilities is not appropriate for closed-ended funds. We believe that AIFMD framework could be sufficient for all closed-ended funds and we would suggest excluding these types of funds from the scope of the Guidelines.

- ETFs: we are favourable to the inclusion of ETFs in the scope, as they are investments funds too.

<ESMA_QUESTION_LST_2>

c) **: Is additional clarity required regarding the scope of these Guidelines? Is additional clarity required regarding the meaning of 'nature, scale and complexity' of a fund? Are there circumstances in which it would, in your view, be inappropriate for a UCITS to undertake LST?**

<ESMA_QUESTION_LST_3>
We strongly support the application of a principle of proportionality, we therefore agree with ESMA proposal in introducing flexibility on how LST should be implemented based on the nature, scale and complexity of a fund. For the time being, we see no merit in further clarifying of the meaning of "nature, scale and complexity".

In addition, we propose to clarify that the proportionality principle should not be subject to the condition "where relevant" as indicated in paragraph 3 d). It must be a clear understanding that LSTs are appropriate and based on the proportionality principle.

<ESMA_QUESTION_LST_3>

d) **: What are your views on when the Guidelines should become applicable? How much time would managers require to operationalise the requirements of these Guidelines?**

<ESMA_QUESTION_LST_4>
Asset managers have implemented LST in different ways, reflecting appropriately specific characteristics of the different funds managed with the final aim of safeguarding the interest of investors. So, it is difficult to estimate the time that will be required to implement and/or revise their LST. Another unknown factor is linked to the fact that the proposed Guidelines and explanatory considerations would be only known once finalized.

Since ESRB finds that the great majority of asset managers already undertake LST and the implementation takes more time the more granular the Guidelines are, we do not believe it is necessary to establish a tight implementation timeframe. We believe that, in any case, an appropriate timeframe should be, at least, 18 months.

<ESMA_QUESTION_LST_4>

e) **: Do you agree with the proposed approach of setting out a list of Guidelines all funds should follow, and the provision of explanatory considerations to help managers comply with those overarching Guidelines? Do you see merit in including some of the explanatory considerations in the final Guidelines?**

<ESMA_QUESTION_LST_5>
We agree broadly with the approach proposed where explanatory considerations are separate from the proposed Guidelines. In addition, we do not see merit in including some of the explanatory considerations in the final Guidelines.

Guidelines should remain high-level principle and the explanatory considerations should help asset managers in their comprehension with further indication and not obligations.

However, since the language used in the explanatory considerations seems sometime more prescriptive than the proposed Guidelines we encourage ESMA to review its approach. Some practical examples where it appears that some of given explanatory considerations are also requirements that should be taken into account are addressed in the responses below.

<ESMA_QUESTION_LST_5>

f) : Do you agree with the proposed Guidelines? What amendments, if any, should ESMA make to its proposed Guidelines?

<ESMA_QUESTION_LST_6>
While agreeing in general with the proposed Guidelines we have the following remarks:

6.1. Frequency of LST (Guideline 4). We agree with Guideline 4 where it states that LST should be conducted at least annually, as this is in line with AIFMD.

However, we suggest redrafting the second part of the proposed Guidelines 4 in line with a principle-based approach. No specific frequency indication should be suggested (i.e. quarterly or a more frequent programme) but only a general recommendation of a possible more frequent programme of LST, depending by the asset manager valuation. Indeed, we agree that the asset manager should determine the need for an increased frequency of LST based on the characteristics of the fund, taking into account nature, scale and complexity other than its liquidity profile. Also according to UCITS, periodic stress test and scenario analysis should be conducted where appropriate.

In line with above, we would suggest the following amendments:

- Guideline 4 LST should be conducted at least annually and employed at all stages in a fund's lifecycle, where appropriate. **~~It is recommended that a~~ A** more frequent programme of LST **could** be employed, **where appropriate ~~quarterly or even more frequently if required by the characteristics of the fund~~**. Flexibility is allowed for on this issue dependent on the nature, scale and complexity of the fund and its liquidity profile.

6.2. Use of LST's outcome (Guideline 5). We do not agree with point c) and d) of the proposed Guidelines where LST is presented as being part of (assisting in) investment decision-making. We believe that LST could not be the best tool to guide a fund's portfolio construction, nor asset allocation. LST is above all a risk management tool and it serves to better manage a fund's liability side commensurately with the investment strategy in normal and stressed condition.

In the implementation of LST, the design of the flexibility of governance structure and oversight set-up will be key in ensuring that managers will be allowed to exercise their best judgements based on evolving market dynamics. In this sense, setting limits regarding fund liquidity should not be mandatory for all funds. Funds limits are different from key risk indicators and/or liquidity score/threshold that are usually used in the monitoring of the liquidity risk. We recommend using the language "threshold" rather than "limit" which is not binding and stringent and give emphasis also on qualitative aspects. The focus should be on the need to set threshold that trigger actions: liquidity managements requires the application of both quantitative and qualitative analysis.

In line with above, we would suggest the following amendments:

- Guideline 5 LST should provide outcomes which can be used to:
  a) Help ensure the fund is sufficiently liquid, as required by applicable rules and redemption terms stipulated in **prospectus or fund rules, whichever relevant ~~fund documentation.~~**
  b) Strengthen the ability of managers to manage fund liquidity in the best interests of investors, including in planning for periods of heightened liquidity risk.
  c) Help identify potential weaknesses of an investment strategy**~~, and assist in investment decision making~~**.
  d) Assist risk management monitoring **~~and decision-making~~**, including**~~,~~ where appropriate~~,~~ setting** relevant **~~limits~~ thresholds** regarding fund liquidity. This may include ensuring the results of LST can be measured through a comparable metric, such as a key risk indicator.

6.3. Gross redemption (Guideline 7). Since the use of gross redemption may not always be meaningful (for example, for funds with a diversified bases, the potential gross redemption of the biggest investors is not useful for the simulation), we would suggest to make its use optional.

In line with above, we would suggest the following amendments:

- Guideline 7 LST should be applied to in-scope UCITS and AIFs and adapted appropriately to each fund, depending on its nature, scale and complexity, including by adapting:
  The frequency of LST (as per Guideline 4).
  g) The types of scenarios employed to create stressed conditions, which should always be sufficiently severe, but plausible.
  h) Assumptions regarding investor behaviour (gross and**/or** net redemptions) and asset liquidation.
  i) The complexity of the LST model, which should account for the complexity of the fund's investment strategy.

6.4. Scenarios (Guideline 8). Among the possible use of the output of LST there is the identification of situations and scenarios within which LMTs or other measured are required to cover potential redemption requests. Given the extreme variety of implementation of LST, we would suggest some flexibility in the definition of the types of scenario that are requests to be simulated, taking into account also the availability of data in addition to the nature, scale and complexity of the fund. Since historical scenario may not suit in all cases, we would suggest making optional LST based both on hypothetical scenario and on historical scenario.

In addition, as already anticipated in our response to Q1, we disagree with the proposal of making reverse stress mandatory, especially for UCITS funds. UCITS underlying is based on liquid assets and cash and the scenario that could arise to simulate the point at which the fund would no longer be liquid enough to honour requests to redeem units of fail could lead to very implausible conditions. We rather consider reverse stress testing as another possible tool that could be used to enhance the liquid risk management process in some cases, however it should not be mandatory for all funds (please see also our response to Q8). In this context, we note that under paragraph 18 of ESMA's "Guidelines on stress tests scenarios under Article 28 of the MMF Regulation" of 21 March 2018, reverse stress testing is also seen as a non-mandatory tool ("may also be of benefit").

In line with above, we would suggest the following amendments:

- Guidelines 8: LST should employ hypothetical and**/or** historical scenarios, **as appropriate** ~~**, and reverse stress-testing**~~. In doing so it should not over-rely on historical data, particularly as future stresses may differ from previous ones.

The explanatory considerations should be integrated with the reference to reverse stress testing as a possible further tool.

Should the reverse stress testing be maintained, we recommend introducing the reference 'where appropriate' in Guideline 8, leaving that therefore to the manager's discretion.

6.5. Asset liquidation method (Guideline 10). For the liquidation of assets, we would suggest to refer to a broad principle rather than recall two specific approaches that could be used, i.e. liquidation cost and time to liquidity. We believe that the proposed Guidelines is unnecessary detailed. ESMA recognises indeed, in paragraph 24, that these approaches are typically employed by managers, but other approaches may (and should) be adopted as appropriate to the fund.

Moreover, it is worth noting that in the LST are made some assumptions on how a manager would liquidate assets under normal and stressed conditions. Asset manager should retain the option to decide which approach would be most appropriate at the time of trading to adjust portfolio composition in the interest of investors.

In line with above, we would suggest the following amendments:

- Guidelines 10: LST should enable a manager to assess not only the **possible approach** ~~**time and/or cost**~~ to liquidate assets in a portfolio, but also whether such an activity would be allowed given:
  a) The objectives and investment policy of the fund.
  b) The obligation to manage the fund in the interest of unitholders.
  c) Any applicable obligation to liquidate assets at limited cost.
  d) Any obligation to maintain the risk profile of the fund following liquidation of a portion of its assets.

6.6. Liabilities different from redemptions (Guideline 11). We would suggest updating the language of the Guideline 11 coherently with paragraph 44. where it states that a manager should include liabilities different from redemptions (other liabilities) in LST "where appropriate", instead of "where applicable". For example, when other types of potential source of risk could be of material impact in line with the requirements of Article 47(1)(b) of the Delegated Regulation (EU) n. 231/2013.

- Guideline 11 - LST should incorporate scenarios relating to the liabilities of the fund, including both redemptions and other types of potential sources of risk to liquidity emanating from the liability side of the fund balance sheet (where ~~**applicable**~~ **appropriate, i.e. which may have a material impact on liquidity**).

6.7. Aggregate stress testing (Guideline 14). We agree with ESMA when acknowledging that should be up to the asset manager to assess whether aggregate LST would be appropriate to the fund(s) under management. However, we wonder if this stress test, even if applicable where appropriate by asset manager, should be included in the proposed Guidelines rather than considered as another possible tool that may be used.

Aggregation would also imply combing both sides of the fund balance sheet, where there is no interconnectedness between funds and with different investor base. The outcome of aggregate LST should then be reflected on the individual funds – which might not be always meaningful.

We suggest therefore to delete the proposed Guideline 14 and recall it in the explanatory considerations, indicating aggregate stress testing as a further possible tool that may be used together with reverse stress testing.

In line with above, we would suggest the following amendments:

- ~~**Guideline 14 Aggregate LST should be undertaken by managers where appropriate.**~~

The explanatory considerations should be updated coherently.

<ESMA_QUESTION_LST_6>

j) : Do you agree with the proposed explanatory considerations regarding LST of fund assets?

<ESMA_QUESTION_LST_7>
In general, we have the following remarks:

- <u>Maintain the appropriate flexibility</u>: explanatory considerations sometimes are more prescriptive than the proposed Guidelines. A list of possible practices rather than the use of "should" would be more appropriate in a context where there are not prescriptive rules;

- Update the reference to “prospectus” or “fund documentation” to “prospectus or fund rules, whichever relevant”. The contractual relationship between fund and investors that defines also the redemptions rules is governed by national contract law. Since the proposed Guidelines refers several times to prospectus (for example, in the note 21, or in paragraph 32), which could not be the document governing the contract relationship, we would suggest updating the Guidelines accordingly.

Please refer to the answers below for specific questions.

<ESMA_QUESTION_LST_7>

k) : What are your views on the requirement to undertake reverse stress testing, and the use of this tool?

<ESMA_QUESTION_LST_8>
As already indicated in our response to Q6, we believe that proportionality should also apply to the design of the stress scenario; the reverse stress scenario should not be mandatory.

We take note that for ESRB reverse stress testing could complete the total stress-testing exercise and could provide beneficial insights into the behaviour of the investment fund until its point of failure (explanation of the economic rational of Recommendation C – Stress testing).

However, we consider its mandatory introduction in the context of asset management premature, given the low degree of precision of liquidity models under stress conditions and that the modelling of broader economic weakness is always a challenge.

In addition, since reverse stress testing should highlight weakness in line with the objective and investment policy of the fund to address specific issues to avoid possible problems in the future, we wonder if reverse stress testing could be always add value in a context of cost and benefit analysis. For example, the UCITS underlying is based on liquid assets and cash and the scenario that could arise to simulate the point at which the fund would no longer be liquid enough to honour requests to redeem units of fail could be based on to very implausible conditions.

As far as we know, reverse stress testing is neither used by Italian UCITS asset managers nor it is an industry standard in the context of the liquidity risk management for asset management. Therefore, we believe managers should not be obliged to apply reverse stress testing, but they should only be encouraged, as the principles in the proposed Guidelines already do, to explore possible vulnerabilities, including tail risks, and improve their contingency planning with different tools, including reverse stress testing.

Therefore, we would recommend to update the proposed Guideline n. 8 and the paragraph 28 of the explanatory considerations.

<ESMA_QUESTION_LST_8>

l) : Do you see merit in providing further considerations for managers on the use of data relevant to asset liquidity, particularly in circumstances when data is scarce?

<ESMA_QUESTION_LST_9>
We appreciate ESMA when it recognizes in paragraph 29 limitations relating to the availability of data and in paragraph 35, dislocations in asset prices and insufficient price transparency in stressed market conditions. Risk drivers that determine price and liquidity dynamics and relative stress testing is indeed a complex issue, being influenced by the idiosyncratic risk and the endogenous risk of the financial system: not all risk factors can be appropriately modelled with only quantitative approaches and it is necessary also to take care of some "expert judgment" to adapt the approach as appropriate.

The literature of recent years has begun to make significant contributions, however the lack of data, including volumes for specific instruments remain some a significant obstacle to a robust modelling. Even when available, bond volumes are linked to individual issues and particularly subject to change. There is still work to do and ESMA could support the different stakeholders, and definitely the market, in improving the availability of comprehensive and good quality trading and other market liquidity data for OTC instruments, such as bonds and derivatives.

In this context, it is not clear the meaning of "validation" requested in paragraph 29 and in paragraph 71 of the proposed Guidelines. Does it mean verification of the LST or a validation by a third party not involved in the modelling of LST? If it is the latter, in line with a proportional approach, we would suggest that the data/model used by asset manager should be duly documented rather than validated. If an internal model would be applied, for example, by the risk management function, it is probably that a validation should be made by a third party, if no other internal functions have the competence, causing cost increase. This issue should be strongly considered in a benefit/cost analysis.

<ESMA_QUESTION_LST_9>

m) : Do you agree with ESMA's wording regarding the asset liquidation method used in the LST model? How would you describe the asset liquidation method used by you or the managers you represent?

<ESMA_QUESTION_LST_10>
Broadly, we have no particular observations with the proposed wording about the asset liquidation methods and we tend to agree with paragraph 33 where are not recall the terms of some possible approaches ('vertical slicing' and 'waterfall' approach) in order to acknowledge how funds are managed in practice and in accordance with applicable rules.

However, as already indicated in the response to Q6, it is worth noting that it isn't always feasible to reflect the asset liquidation method a priori because some flexibility in line with the use of professional judgement would be also part of the asset manager decision to decide which approach is considered most appropriate in the market at the time of trading.

In line with above and with the overarching principle of a proportionate and flexible suggestions in the explanatory considerations we would suggest the following amendments in paragraph 32:

"The method of liquidating assets in a LST should **~~always:~~**
- **~~accurately~~** reflect how a manager **~~would~~ could** liquidate assets during normal and stressed conditions in accordance with applicable rules, either legal requirements (according to UCITS Directive) or self-limitations via prospectus **or fund rules, whichever relevant**".

As regards the language, in line with our response to Q7, we also suggest updating the reference to "prospectus" or "fund documentation" to "prospectus or fund rules, whichever relevant" in paragraph 32 and 33.

- "Comply with applicable obligations for the fund to maintain the risk profile envisaged by **~~fund documentation~~ prospectus or fund rules, whichever relevant".**
- "[…] (e.g. specific "self-set" prospectus **~~rules~~ or fund rules, whichever relevant.**

<ESMA_QUESTION_LST_10>

n) : Do you agree with ESMA's wording regarding 'second round effects'? What is your current practice regarding modelling 'second round effects'?

<ESMA_QUESTION_LST_11>

Modelling second rounds effects is difficult and we agree with ESMA that the Guidelines should not engage in the debate around its concept. Since funds should not make the liquidity of the market and different tools may be used in certain circumstances, we would than encourage ESMA to ensure consistent availability of different types of liquidity tools across jurisdictions. Therefore, we suggest ESMA not to refer to the concept of second rounds at all in the explanatory considerations, but only to focus on the fact that in the LST the manager should reflect on how it could liquidate assets during normal and stressed conditions. The FSB itself does not use the term 'second round effect' in its recommendations.

<ESMA_QUESTION_LST_11>

o) : What are your views on the considerations on difficult to model parameters, such as price uncertainty? What is your current practice concerning this issue?

<ESMA_QUESTION_LST_12>
We, in general, agree with the ESMA considerations on difficult to model parameters.

Liquidity stress-testing and redemption risk modelling, notwithstanding their sophistication and assuming access to the most complete and precise data sets can be guaranteed, yield only partial results. For instance, there are inherent limitations to the use of historical observations, as well as in the use of data to analyse price behaviour which tends to be limited during normal markets and large when recorded in stressed markets. Necessarily therefore, these inputs must be supplemented by qualitative information based on the experience and sound judgment of individuals.

In this context, we fully support the ESMA example for fund of funds where manager should pay particular regard to the interaction with the manager's contingency planning and how the manager will react to the material level of assets in the portfolio experiencing price uncertainty.

<ESMA_QUESTION_LST_12>

p) : Do you agree with ESMA's considerations on LST in funds investing in less liquid assets? What amendments should be made to the proposed wording? Do you think that ESMA should outline additional and/or specific Guidelines to be made in any other fund or asset types, such as ETFs?

<ESMA_QUESTION_LST_13>
We tend to agree with ESMA's analysis.

However, as regard the possible development of guidance on the definition of less liquid assets by authorities, we would strongly caution against any liquidity "bucketing" regime established via regulation or legislative initiative. Instead, we insist that such categorisation continue to be carried out only internally within each asset management company, while also drawing from qualitative elements like the judgement and experience of the asset management. This would also avoid some herding effect with possible unintended consequences on financial stability.

Moreover, certain asset classes are intrinsically illiquid, whereas other may be so only temporarily. These aspects should not be confused. Should closed-ended fund maintained in the scope of the Guidelines, whether a fund is open-ended or a close-ended fund investing in less liquid assets could also be taken into consideration.

<ESMA_QUESTION_LST_13>

q) : Do you agree with the considerations regarding LST on items on the liabilities side of a fund's balance sheet?

<ESMA_QUESTION_LST_14>

We agree with ESMA that redemptions are the primary source of liquidity risk. On the other potential source of liquidity risk coming from some liability types, we suggest a more proportionate approach, bearing in mind the nature and the materiality of liquidity risk from such liabilities. In line with the requirements of Article 47(1)(b) of the Delegated Regulation (EU) n. 231/2013 there should be a general statement that only material liabilities should be part of LST (please see also our response to Q6). In addition, as already requested, we propose to clarify that the explanatory considerations are only examples on how the proposed Guidelines could be implemented.

As regard incorporation of investor behavioural model/analysis, we welcome the emphasis on better understanding a fund's investor base as an area for further improvements, where funds are typically marketed and sold via third-party distributors. Practical challenges, nevertheless, remain in the form of client omnibus/nominee account structures that offer limited transparency on the ultimate beneficial fund share/unitholders.

In addition to the scarce and incomplete information on clients, other issues could come on the different views on the confidence on investor behaviour modelling predictive.

We therefore suggest that asset manager should make "reasonable efforts" to improve their understanding of the investor base, collecting information from intermediaries where possible/appropriate.

With regard to items proposed on the liabilities side, please refer also to our answers to questions 15 to 18. We would only anticipate that we do not agree also with reverse stress on the liabilities side as well as LST on certain other types of liabilities.

<ESMA_QUESTION_LST_14>

r) : Do you agree with the considerations specifying the LST of redemptions and other types of liabilities may need to be considered distinctly, given a fund could potentially limit redemptions but not other sources of liquidity drain?

<ESMA_QUESTION_LST_15>
We agree that liquidity risk could come not only from redemptions and we also support ESMA when it leaves the asset managers the decision to include other types of liabilities different from redemption in their LST, where appropriate. Other types of potential source of risk should not always be subject to LST but only when they could materially affect the liquidity risk.

As regards derivatives, CESR only requires that there is a monitoring process in place to ensure that financial derivative transactions are adequately covered. IOSCO also recommends that data on liabilities such as potential margin calls, should be assessed alongside potential redemption demands without a recommendation to conduct, in addition, LST under normal and stressed conditions. We therefore request ESMA to clarify that there is only a need to monitor but not a requirement to conduct LST for these liabilities in any case.

In addition, regards the potential events which may be simulated on LST on other types of liabilities, the reference to "counterparty risk" for securities financing transaction/EPM is not strictly a liquidity concern and should thus be removed from the text of the explanatory considerations. More in general, we disagree with LST on collateral because there are already strict requirements for the quality of collateral in place (such as EMIR and ESMA guidelines on ETF and other UCITS issues).

Liquidating of collateral of defaulted counterparts is different from regular LST.

Moreover, we note from ESRB that there could be liquidity demands arising from the use of collateralised transactions with an impact on the financial stability (macro-level) however this issue should be distinguished from the micro-level perspective and tasks of managers in fulfilling their responsibilities under UCITS and AIFM Directives. The new SFTR reporting requirements will help supervisory authorities to get an overview of any potential risks arising from SFT (macro-level) and the discussion on LST on collateral should not be part of the ESMA guidelines of LST.

<ESMA_QUESTION_LST_15>

s) : Do you agree with the requirement to reverse stress test items on the liabilities side of the fund balance sheet?

<ESMA_QUESTION_LST_16>
In line with the comment made on the assets side in the response to question 8, we strongly disagree that scenarios coming from reverse stress testing should also be mandatory on the liabilities side.

Therefore, we support the ESMA approach for the scenario on net redemption in paragraph 44 of the explanatory considerations where it includes the reverse stress scenario as a possible example. While we do not agree with paragraph 50 where reverse stress scenario is mandatory on other types of liabilities.

<ESMA_QUESTION_LST_16>

t) : Do you agree with the requirement to incorporate investor behaviour considerations into the LST model 'where appropriate'? Are there cases which you believe it would not be appropriate, and should these be detailed in these Guidelines?

<ESMA_QUESTION_LST_17>
In general, we support ESMA when it recognises in the proposed Guidelines 12 the use of a proportional approach. The acknowledgment of the type of investors and the inclusion in the modelling of behaviour considerations could indeed raise some issues. So a proportionate approach is welcomed. One of the key challenges in liquidity management, and in LST, is indeed taking into appropriate account the uncertainty in future investor behaviour both in normal market conditions and, in particular, in stressed markets.

In this sense, the explanatory considerations should better reflect this proportionality. For example, paragraph 45 should be updated to reflect that the exercise of simulation of redemptions requests for different type of investors may be (instead of "is") appropriate in some circumstances.

In addition, we wonder if this exercise could provide value added information, for fund distributed among different channels and in presence of a very fragmentated holding.

We therefore suggest that asset manager should make "reasonable efforts" to improve their understanding of the investor base, collecting information from intermediaries where possible/appropriate.

<ESMA_QUESTION_LST_17>

u) : What do you think about ESMA's Guideline stating that managers should combine LST results on both sides of the balance sheet?

<ESMA_QUESTION_LST_18>
In our understanding the combination of LST results on both sides of the balance sheet is, in general, a standard practices. We agree with ESMA approach that recognize the necessary flexibility on how such combination may be implemented, as different methods may be used and there is no one approach for all funds.

In a similar way, we understand that comparing LST results from more than one fund may be a further suggestion and it is not prescriptive. We see merit in clarifying this point.

<ESMA_QUESTION_LST_18>

v) : What are your views on ESMA's Guideline that aggregated LST should be undertaken where deemed appropriate by the manager?

<ESMA_QUESTION_LST_19>
As already indicated in our answer to Q6, we agree with ESMA when acknowledging that should be up to the asset manager to assess whether aggregating LST is appropriate to the fund(s) under management. However, we wonder if this stress test, even if applicable where appropriate, should be included in the proposed Guidelines rather than considered just as another available tool.

Aggregation would also imply combining both sides of the fund balance sheet, where there is no link between funds and the investor base is different. The outcome of aggregate LST should then be reversed to each fund.

We suggest therefore to delete the proposed Guideline 14 but recall it in the explanatory considerations, aggregate stress testing as another available tool, together with reverse stress testing.
<ESMA_QUESTION_LST_19>

w) : What is your experience of performing aggregated LST and how useful are the results?

<ESMA_QUESTION_LST_20>
In our knowledge, aggregate LST are not standard practice among Italian asset managers.

<ESMA_QUESTION_LST_20>

x) : What are your views on ESMA's considerations concerning the use of LST during a fund's lifecycle?

<ESMA_QUESTION_LST_21>
During the fund's lifecycle, asset manager should operate with diligence and proceed with their own assessment of all the various risks associated with the investment itself, including market, credit and liquidity risks. Liquidity risk management considerations must at all times attempt to strike a balance between honouring investor redemptions in a timely and fair manner with the objective of the fund.

In this sense, we believe that asset managers should put in place, among all, appropriate liquidity risk management processes, in both normal and stressed market conditions, to ensure that for fund managed, the investment strategy, the liquidity profile and the redemption policy are consistent. Among the tools available, they may also use LST, but, again, its use should not be mandatory as well as its modelling should not be prescriptive.

We noted that the explanatory considerations are more detailed and prescriptive when compared to the proposed guidelines and this would contradict the principle based-approach.

Our understanding of the proposed Guidelines 4 ("LST should be […] employed at all stage in a fund's lifecycle, where appropriate") is that asset managers may apply or not apply LST in the different stages of a product, depending on the potential of the LST to effectively contribute to supporting the decision-making process. However, in the explanatory considerations, ESMA seems to recognise that only one case where that LST could be not appropriate and other tools could be used i.e. in the preparation for fund closure and liquidation.

We therefore encourage ESMA to align the explanatory considerations on the use of LST during a fund lifecycle to a more principle based approach, with particular reference to paragraph 48 where, pending the NCA discretion, LST could be required in order to help demonstrate a fund will be likely to comply with applicable rules, including regarding the ability of the fund to meet redemption requests in normal and stressed conditions.

In addition, among the different use of LST during a fund's lifecycle, we have the following observations:

- As regard the fund launch, LST may be of limited value and a more qualitative and expert judgment approach could be used in practice where only estimation on portfolio size, type of client and asset class are available. In addition to model portfolio, another possible practice is the use of standard term for comparable funds without undertaking LST, where the asset manager lunches a fund similar to the existing one. Where no similar fund is available, there will be no sufficient production of data for running a regular stress test program. This would result in different outcomes when the LST is running again after the lunch. There it would be essential recognise that also a qualitative judgement of liquidity risk of the fund under normal and stressed condition could be used before launch.

- During the period of enhanced liquidity stress, the role of LST is not clear, since in advance of potential stressed market conditions, LST should help improve contingency planning to ensure that the interests of investors are safeguarded, and funds investors are being treated fairly (integration of LST in the overall approach and properly documented, including the circumstances requiring escalation). So, during period of liquidity stress, LST may help in monitoring the potential to reduce the liquidity profile as far as possible. It should be at discretion of the managers to choose the measures which would be appropriate in a stressed situation.

<ESMA_QUESTION_LST_21>

y) : What is your experience of the use of LST in determining appropriate investments of a fund?

<ESMA_QUESTION_LST_22>
LST could not be the best tool to guide a fund portfolio construction, nor asset allocation in either product design phase or on an ongoing basis. We believe that LST is above all a risk management tool and it serves to better manage a fund's liability side commensurately with the investment strategy in normal and stressed condition.

In the implementation of LST, flexibility of how governance and the oversight set-up structure/process are key in ensuring that managers exercise their best judgements based on evolving market dynamics.

<ESMA_QUESTION_LST_22>

z) : In your view, has ESMA omitted any key uses of LST?

<ESMA_QUESTION_LST_23>
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<ESMA_QUESTION_LST_23>

aa) : Do you agree with ESMA's Guideline that LST should be undertaken in all cases annually, but that it is recommended to undertake it at least quarterly, unless a different frequency can be justified? What is the range of frequency of LST applied on funds managed by stakeholder(s) you represent?

<ESMA_QUESTION_LST_24>
We agree with the proposed frequency foreseen in the proposed Guideline 4 calling for LST at least on an annual basis, as this is in line with AIFMD.

However, we suggest redrafting the second part of the proposed Guidelines 4 that should remain, as much as possible, principle based. No specific frequency indication should be suggested (i.e. quarterly or a more frequent programme) but only a general recommendation of a possible more frequent programme of LST, depending by the asset manager valuation. Indeed, we agree that the asset manager should determine the need for an increased frequency of LST based on the characteristics of the fund, taking into account nature, scale and complexity.

Concerning the additional recommendation in the explanatory statement to undertake LST, in line with the comments made on the Guideline 4, we would suggest deleting also here the quarterly frequency indication.

As regard factors which may increase the frequency, we believe that an extensive use of derivatives does not entail necessarily complex investment strategies; we would then suggest deleting the example.

Finally, as regard factors which may decrease the frequency, we would suggest adding the “Lower risks from liabilities, such as a diversification investor base”.

<ESMA_QUESTION_LST_24>

bb) : Should ESMA provide more prescriptive Guidelines on the circumstances which can justify a more/less frequent employment of LST?

<ESMA_QUESTION_LST_25>
No, we believe that the proposed Guidelines should remain based on principle. As regard explanatory considerations, as already suggested, these should only be further suggestion and/or examples and not specific obligations. The need for a frequency of LST lower than annually should left at the discretion of the fund’s managers.

<ESMA_QUESTION_LST_25>

cc) : Do you agree that LST should be employed outside its scheduled frequency (ad-hoc) where justified by an emerging/imminent risk to fund liquidity?

<ESMA_QUESTION_LST_26>
We believe that the LST, or part of it, could be employed outside its scheduled frequency, at asset manager discretions, including anticipation of reasonably foreseeable stressed market conditions. We would therefore suggest a more generic wording.

<ESMA_QUESTION_LST_26>

dd) : What are your views on the governance requirements regarding LST?

<ESMA_QUESTION_LST_27>
We agree with ESMA proposal regarding the governance requirements, however we have some remarks on validation and back-testing.

In line with our response to Q9, it is not clear the meaning of “validation” requested in paragraph 71 and in paragraph 29 of the proposed Guidelines. Does it mean verification of the LST or a third-party validation? If it is the latter, in line with a proportional approach we would suggest that the data/model used by asset manager should be duly documented rather than validated. If an internal model was applied, for example, by the risk management function, it is likely that a validation should be made by a third parties, if no other internal functions have the competence for its validation, affecting also costs.

As regard back-testing, we do not agree about their use. The availability of historical data relating to liquidity risk is overall poor compared with that for market risk, the effect on losses could only be theoretical if the assets are not sold, moreover, as far as we know, it is not a market practice to use back-testing for the validation of the LST.

Since there is no reference in the text of the explanation considerations to back-testing but only in the heading of paragraph 71, the word 'back-testing' should be deleted.

<ESMA_QUESTION_LST_27>

ee) : Should more information be included in the UCITS RMP and AIF RMP?

<ESMA_QUESTION_LST_28>
We agree with the ESMA proposal to include in the RMP all the relevant information about the LST policy of a fund. We do not deem necessary to prescribe further information that should be included as a minimum.

<ESMA_QUESTION_LST_28>

ff) : Do you have any views on how managers which delegate portfolio management can undertake robust LST, independently of the portfolio manager, particularly when the manager does not face the market?

<ESMA_QUESTION_LST_29>
Different model organisations could be used by asset managers and we believe that would not be appropriate suggesting a prescriptive approach.

We would only suggest deleting the reference in paragraph 73 to investment adviser's own LST since advisors give only recommendation to their clients while the final decision is taken by asset managers.

<ESMA_QUESTION_LST_29>

gg) : Do you agree with the proposed Guideline for depositaries on carrying out their duties regarding LST?

<ESMA_QUESTION_LST_30>
The proposed Guidelines 15 states that "Depositaries should verify a fund has documented procedures for its LST programme. This could include reviewing the UCITS RMP and/or AIF RMP to confirm that the manager carries out LST on the fund".

Paragraph 75 and 78 of the explanatory considerations clarify that depositaries should check that managers have declared that a LST is in a place and that the proposed Guidelines do not require to a depositary to replicate the LST undertaken by a manager.

However, the second sentence of the proposed Guidelines 15 and paragraph 76 raise doubts on possible different interpretation around verification procedure adopted by depositaries.

It is our understanding that the duty of depositaries as proposed by ESMA seems oriented towards a formal verification of LST and not on its judgment or to challenge it. Then, we encourage ESMA to further clarify this concept and update the Guidelines and the explanatory consideration accordingly. For example, we would not see the value added by the second sentence of the proposed Guideline 15 and we suggest deleting it.
<ESMA_QUESTION_LST_30>

hh) : In your experience do depositaries review the UCITS RMP and AIF RMP as a matter of course?

<ESMA_QUESTION_LST_31>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_LST_31>

ii) **: Do you see merit in ESMA publishing further guidance on the reporting of results of liquidity stress tests? If so, in your view how should ESMA require that results be reported?**

<ESMA_QUESTION_LST_32>
No, we do not see merit in ESMA publishing further guidance on the reporting of results of LST.

<ESMA_QUESTION_LST_32>