AFG

EC Consultation assessing the adequacy of macroprudential policies for non-bank financial intermediation (NBFI)

Executive summary

AFG warmly thanks the EC for the opportunity to provide a contribution to this targeted consultation.

AFG fully shares the objectives of the European Commission, building upon the workstreams of the IMF, FSB and IOSCO: a robust and efficient regulatory and supervisory framework is of paramount importance for the competitiveness of the European financial industry. By ensuring financial stability, with liquid and transparent markets, we can foster the private investors' confidence on which rely the risk sharing, in the context of Capital Markets Union (CMU), and the search of steady source of funding of the European economy.

AFG is supportive of these objectives and is ready to contribute through these responses with the strong conviction that the European asset management industry must be a vector for stability of the financial sector, diversification of funding sources in addition to banks, and fulfill its role as a vital source of liquidity for the real economy. Most of the comments and proposals formulated by AFG will naturally be related to this industry.

Many important topics are covered through this consultation paper. AFG would like to highlight some of them:

The "NBFI" concept blends many different types of market participants, creating a risk of confusion and a need for clarification. AFG would prefer to drop this notion and promote a safe practice where actors are simply referred to by their names: Insurance companies, CCP, family office, OEF, MMF, pension funds, hedge funds, …

Rather than having a focus on NBFI, it should be more appropriate to draw a line between regulated and unregulated entities but also EU and non-EU ones. The international regulatory community should obviously pay more attention to the unregulated sector as opposed to already well-regulated markets such as the EU markets.

However, regarding the EU markets, they are indeed a matter of improvement. Unlike the US market, it is a fragmented landscape. Accordingly, the coordination between NCAs and between NCAs, NCBs and ESAs should be improved, notably through data sharing. Funds managers currently face many reporting requirements, of many types, in many formats, with different frequency. There is room to reduce the reporting burden by streamlining the corresponding

requirements. They should be improved to adopt the principle of burden reduction: '*report only once with one single template and timeline.*"

Unmitigated liquidity mismatches should be fully addressed with the liquidity management tools (LMTs) wide adoption in Europe resulting from the review of the UCITS/AIFM directives. This "game changer" will bring Europe to the forefront regarding liquidity risk management. Parallelly, measures should be taken to improve the client base knowledge, at least the composition of the liability structure by categories of investors.

A broader range of collaterals for settling variation margin calls should be considered. With the ability to use as collateral high-quality assets other than cash, counterparties would have limited need to sell assets.

It is key to preserve two characteristics of supervision that are deemed fundamental according to AFG: proximity and reactivity. Crisis should be treated rapidly and locally, when possible, by ensuring an efficient dialogue between the NCA and the fund manager.

Unlike banks, large asset managers cannot be seen as "global systemically important" because of their business models : management company as such cannot become insolvent as it mainly manages the assets of its clients and not its own assets. The clients are ultimately bearing the economic risks.

For large cross-border asset managers, the recognition of the notion of group and the designation of a lead NCA is necessary.

Regarding ESMA, we believe that its existing mandate could evolve to integrate competitiveness, such as the FCA, but also the European sovereignty.

We believe that VNAV MMF, with the Marked to Market valuation principle, proved to be resilient under the prevailing MMF regulation and cannot be seen as mean of liquidity risks amplification. Increasing liquidity buffer individually or collectively is useless and inefficient, and bears negative side effects, notably procyclicality during periods of stress markets.

We are not opposed to the introduction of an EU-wide stress test. It must help to better understand the interconnectedness between the various financial participants. It should be properly collaborative and targeted. Moreover, it should not be only an additional layer that creates further burden for asset managers. By giving back valuable information, this exercise could give the regulators the opportunity to bring benefit to the industry through an appropriate feedback loop.

Responses to the EC consultation

I. 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?

AFG response

AFG is of the opinion that this question is biased as it pre-supposes that descriptions of the systemic risks' sources in the report are correct and globally accepted. But NBFI is a quite broad term, covering many different types of players. This diversity should be properly taken into consideration.

For instance, regarding UCITS and AIFs, AFG considers that their activities do not represent any source of systemic risks or vulnerabilities, being already highly regulated at both European and national level. As a matter of fact, the consultation paper provides several examples, but none of them being a UCITS or an AIF.

At first, AFG suggests the establishment of a mapping of the supervision level for all the NBFI sector. Such mapping will highlight the heterogenous situation of NBFIs and more particularly, the existence of some actors' categories which are neither well identified nor regulated. AFG believes that potential sources of systemic risks or vulnerabilities might reside in such actors' categories (for instance, Archegos Capital Management).

Another factor of destabilization, such as in the case of Gamestop, is the massive behavioral of small actors or individuals, acting through social media to perform automated purchases, which can lead to vulnerabilities.

In addition, we believe that such mapping is also necessary due to the interconnectedness between actors in the financial sector. Indeed, regulating only part of the perimeter will prove inefficient.

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.

AFG response

Regarding exposure to regulated funds:

UCITS are subject to strict investment rules designed to mitigate such risks: counterparty risk limits, credit risk spreading rules, … Gross and adjusted leverage figures are daily computed and are subject to restrictions rules

For AIF, reporting obligations are extensive and include data on the characteristics of the AIF (type, strategy, concentration of investors) along with detailed

information on assets (principal exposures, exposures by asset type and regional investment focus), as well as several risk features (market risk, liquidity profile, use of leverage and stress test results).

Regarding exposure to non-regulated entities like Archegos, the most significant risks for credit institutions are precisely the absence of the previous items. Bank risk oversight is a difficult task to achieve because of the existence of many types of exposure and types of counterparties. Reporting requirements on exposure could potentially be improved with a view to build a global assessment of the risks at a macro level.

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.

AFG response

AFG believes that regulated NBFIs such as asset managers or investment funds such as UCITS or AIFs are key providers of liquidity for the real economy and essential when more "classical" canals (like banking credit) are disturbed.

For instance, during the March 2020 turmoil, EU VNAV (Variable NAV) MMFs were not importantly impacted and helped in providing liquidity, alongside central banks. EU VNAV MMFs remains in their ratios.

In addition, the wider EU regulatory framework related to investment funds has already been enhanced through the AIFM/UCITS Directives' Review at Level 1, to be complemented by 2026 at Level 2 regarding Liquidity Management Tools, which will thus help secure this crucial liquidity provider function.

The diversity of actors amongst the regulated NBFI can be regarded as a source of stability for the financial sector and should be preserved.

Therefore, we wish to underline the importance of better regulation of non-regulated NBFIs, such as (off-shore) hedge funds, which can implement hedging strategies that can affect market liquidity.

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.

AFG response

Regarding systemic liquidity risk, AFG is of the opinion that it is essential to recognize the diversity of entities encompassed by the NBFI definition, which are subject to different regulations (or to some extent, not being regulated).

With respect to liquidity contributors and liquidity consumers, we invite to refer to our response to Question 3 above.

Actors such as asset managers and UCITS or AIFs are already well regulated. For instance, the UCITS and AIFM Directives already include extensive rules on liquidity risk management and leverage limitation, through all levels of regulations (Level 1, but also Level 2 and Level 3).

In addition, measures on liquidity management tools (to be applied from 2026 at EU level, but already in force in France) will reinforce the current regulatory framework and help funds to manage massive outflows in case of market stress.

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.

AFG response

According to AFG, at funds' level, leverage is already regulated (please refer to answers provided under Question 4 above). The notion of excessive leverage is more related to derivatives or credit, being a banking issue rather than an asset management issue.

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

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.

AFG response

Such policies should be designed to ensure the competitiveness of EU NBFIs is preserved and that their capacity to diversify financing sources for companies is properly taken into consideration.

NBFIs such as asset managers, funds, insurers, pension funds, provide funding outside of the traditional banking system, contributing to diversification and resilience in financial markets. One important characteristic to bear in mind is that NBFIs are well-positioned to drive sustainable investment, thus helping small and medium companies for their green transition.

The main limitations for the financing of SMEs are deriving from macroprudential policies and are linked to two main issues:

The heavier cost of capital for investors, especially insurers, compared to other investment is a very strong incentive that drives away the investments from SMEs asset class with great efficiency. This is also true for the underdeveloped securitisation market in the EU compared to other jurisdictions (especially US), which could provide a more sustainable and diversified funding stream for small businesses, directly or through a refinancing of the lending through securitisation for banks. For insurers, LTEI regulation does not provide sufficient clarity to be applicable for SME investment.

The application of LTEI regulation on SME investment would be particularly advantageous for the capital cost treatment regarding the usual high volatility of this asset class. Indeed, given that SME are more volatile, their prudential cost makes them irrelevant for investing.

Also, the proposed Value for money regulation would have another terrible effect on SME, channelling money towards large capitalization and driving investments further away from this asset class.

Lastly, macroprudential policies could encourage the creation of specific investment vehicles, like SME-focused funds, that aggregate and direct investments toward small businesses, with the ability to participate to IPOs. For instance, allowing NBFIs to create and manage funds with favourable capital requirements for SME loans or equity investments encourages more institutional investment in SMEs.

II. OVERVIEW OF EXISTING MACROPRUDENTIAL TOOLS AND SUPERVISORY ARCHITECTURE IN EU LEGISLATION

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.

AFG response

In France, money markets are key short-term financing markets and money market funds are major investment vehicles. They are all managed as Variable NAV (VNAV) funds, and they make the bulk of Euro-denominated MMFs throughout Europe.

In terms of the distribution of money market funds within the euro zone, France is by far the leading country with more than 50% market share.

French MMF are actively managed, and the size of the liquidity buffer is constantly adapted to anticipate the behavior of the investors. These latter are mainly institutional investors.

Liquidity buffers are also adapted according to the market conditions. However, when the market liquidity is largely deteriorated, the MMF can no longer provide liquidity to its shareholders. At some point of extreme lack of liquidity (frozen markets), the only size of liquidity buffer which is appropriate is 100 % of the Net Asset value.

An increase in liquidity buffer during market crisis, decided by a competent authority, if publicly disclosed, may trigger uniform behaviors such as "dash for cash" phenomenon and foster a "first mover advantage" effect which is always detrimental to the remaining investors. Increasing collectively the liquidity buffer will produce a procyclical effect, which is the opposite of the search of market stability.

MMF are structurally and permanently buyers of short-term debts. Increasing MMF liquidity buffer will limit this key function. Issuers could face difficulties of funding. This will be ultimately detrimental to the Short-term funding market as a whole.

Giving authorities power to increase liquidity buffer may circumvent the investment policy of the MMF as disclosed in the fund documentation.

This may also be contradictory with the fact that the primary responsibility for liquidity risk management remains with the manager, as stated in the revised UCITS Directive and AIFMD,

Moreover, it is worth high-lighting the fact that defining a priori what is (by essence) a liquid asset is particularly difficult and even short term government Bills that are deemed to be liquid have experienced periods of squeeze, volatility or il-liquidity during episodes like the US shutdown, the euro zone break up or any other country specific issues (ie: Greece, Italy, UK...). Before imposing any additional buffer of so called "liquid assets", we should make sure that at any given time, these assets will not become the next source of stress.

Accordingly, AFG believes that the most efficient solution is to retain for VNAV funds managers to the possibility to individually increase these buffers on a fund-by-fund level above the "minimum regulatory" one as it was the case during previous stress episodes. It is also key to promote and maintain regular exchanges with local NCA especially during crisis periods.

To conclude, VNAV funds have already countercyclical buffers as no automatic trigger is linked to the ratios. MMFR gives also the right to go under the level as long as no new longer-dated investment is done. AFG believes it is a necessity to keep this flexibility.

AFG also believes that a liquidity crisis is also managed with LMT and their deployment under the revised UCITS Directive and AIFMD is a matter of improvement to limit the consequences of an event of system-wide financial stability risks

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.

AFG response

AFG believes that fund managers are best placed, as professionals, to manage dynamically the size of the liquidity buffer rather than ESMA or ESRB. Market timing decisions can only be efficient with sufficient proximity to the underlying market with a close knowledge of the liability structure of each fund. There is also a need for seasoned professionals to timely decide how to manage the liquidity buffer.

AFG members acknowledge that MMF managers should keep a close contact with their NCA. And regarding ESMA and ESRB , similarly, it is essential to have them keep in close contact with NCAs and NCBs more importantly during market stress.

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?

AFG response

AFG fully shares with the Commission the desire to simplify and streamline the reporting requirement and to ensure more efficient data sharing, while minimizing the burden for reporting entities.

Main difficulties are (1) to collect information of quality and (2) get clarity on methodologies to be used.

To be reviewed in more details for existing data fields. More precision would be welcome on the methodologies to be used on different fields of the quarterly MMFR regulatory reporting.

For instance, the calculation methodology of the weight of each security can be done from different perspectives (which impacts their contribution to the different key performance and risk indicators).

We believe that stipulating the methodology would avoid bias between asset managers and bring more clarity in the regulatory reports.

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?

AFG response

Additional elements on the knowledge of the investor base, particularly on investor concentration: in France MMF have a very good knowledge of the investor base. This knowledge could be completed by additional elements. However, these elements are often available indirectly, through distribution channels (distributors, account holders, sub custodian banks). Moreover, in France, many MMF are also distributed through employee savings schemes with specific intermediary account holders.

This implies that these third-party distributors must be ready to share freely these additional elements.

Strengthened supervision and remediation action in case liquidity risks are detected. For instance, ESMA, after consulting the ESRB, could assess the effectiveness of corrective measures for liquidity risks, with NCAs providing a report indicating how the risks have been addressed;

Stress tests are useful risk management tools, but some care must be taken in their interpretations and the conclusions that can be drawn from them. Indeed, VNAV French MMF are actively managed, and their investment portfolios evolve constantly. Accordingly, stress tests' outcomes can change rapidly. And the fund manager potentially must adapt its portfolios dynamically to manage liquidity risks. Simultaneously, the underlying market conditions can also change at a fast pace,

especially during crisis. In the context of a fast-moving environment, it is difficult to see how ESMA, after consulting the ESRB, could assess corrective measures for liquidity risks in a timely manner.

Fund managers, helped by their risk managers, constantly assess the liquidity risks and LMT are designed and adapted to mitigate it when necessary. With regard to LMT, AFG shares the common view that anti-dilution tools are key and promotes the selection of the liquidity fees for MMF.

Improved reporting for supervisory purposes (including stress testing), such as timely access to data on portfolio composition and disclosure of underlying data and simulation models to NCAs, while minimising the reporting burden; and

Starting with effective exploitation of existing stress tests and sharing the results with the asset management community could be a good way to enhance the work performed by asset managers in this area. Then, it would be easier to assess how the stress testing framework could be improved.

A Union-wide stress test run, e.g. by ESMA in coordination with the ESRB, at fund and asset management group levels.

The union-wide stress test run seems to be inspired by the stress test exercise run by the EBA on the banking sector. It is important to bear in mind that MMF are not banks. Their portfolio composition is changing more rapidly than any other type of OEF because the maturity of a money market instrument is very short. Duration and size of liquidity buffer can potentially change on a daily basis.

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?

AFG response

AFG is usually reluctant to any new stress tests requirement. However EU-wide stress tests could potentially bring benefits to the MMF industry provided that:

- The reporting requirements are streamlined across jurisdictions.
- The sharing of data is effective across authorities. Currently data collected are underexploited.
- Rules have to be adapted according to the type of MMF: LVNAV, VNAV, …
- It should not simply be an additional layer to the existing stress tests, which creates further burden.

. It should be only seen as a risk management tool;

. It should not be used to justify additional investment rules (or constraints on liquidity buffers);

. The results should be disclosed and should provide a better understanding of the market and its participants.

Reverse distribution mechanism

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

AFG response

The reverse distribution mechanism was linked to (or decided during) a period of negative interest rates.

In France, MMF are VNAV type. Thanks to the Marked to market process applied and their functioning no issue was raised when interest rates went below zero. Accordingly, no specific mechanism was deemed necessary.

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

AFG response

VNAV funds were not impacted in practice during that period. Their portfolios are permanently following a marked to market valuation process.

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.

AFG response

AFG do not believe that such requirements will improve the liquidity of the market. Money market instruments have by nature short maturity which is not well adapted to the functioning of trading venue.

So far, a trading venue for money market instruments has not demonstrated an increase in the level of liquidity. Previous experiments were not conclusive. Consequently, regulatory requirements should not take into account admission to a trading venue.

Issues management, database updates, characteristics dissemination should be processed with a much higher frequency and with many greater number of instrument issues than on equivalent equity markets. The latter cannot be considered as a matter of inspiration.

But more than having a mandatory trading venue, AFG believes that a proper functioning of the market for bank commercial papers is essential to ensure a minimum level of liquidity during crisis.

As a matter of fact, MMFs are significantly invested in commercial papers and other short-term banking securities. As of the end of February 2020, 47.9% of the banking exposure of French money market funds was concentrated in French banks. According to the AMF study titled "Detailed Analysis of the Portfolios of French Law Money Market Funds During the COVID-19 Crisis in Early 2020," "securities issued by commercial banks accounted for nearly 50% of the total assets of French MMFs before the crisis, amounting to €179.9 billion at the end of February 2020. A month later, French MMFs held only €134.9 billion in bank securities, representing a decrease of €44.9 billion. In relative terms, bank securities accounted for just 41.8% of the total 'securities + cash', reflecting a decline of 6.2 percentage points."

The activity in the short-term banking securities market during times of crisis is a crucial source of liquidity, enabling the fulfillment of redemption requests from clients exiting money market funds. Therefore, it is beneficial to analyze the incentives that allow banks to play a stabilizing role in cases of liquidity stress in the markets. Are they capable of repurchasing their own paper (and possibly that issued by other banks), and if not, what are the constraints?

During the crisis, one identified constraint was related to compliance with banking ratios. It proved advantageous to relax these ratios at certain moments during the crisis to facilitate market activity. Specifically concerning the relationship with banks during this episode, the AMF noted that "some management companies indicated to the AMF that banks primarily supported the market for securities with maturities of less than one month, as holding these securities did not penalize their Liquidity Coverage Ratio (LCR)."

VNAV money market funds operate like any other investment fund in managing third-party assets: their liquidity is inherently reflected by the liquidity of the underlying markets. **Therefore, the proper functioning of the market for bank commercial papers is essential for effectively managing the liquidity of money market funds.** The AMF study shows that "the reduction in the net assets of French

MMFs had a particularly pronounced impact on French banks. [...] For the major French banks, the withdrawal of MMFs accounted for approximately 40% of the securities held at the end of February."

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?

AFG response

During the lifetime of OEFs, NCA receives fund reportings related to UCITS and AIFs which allow for such a monitoring. By contrast, regarding Non-Regulated OEFs, NCA have no possibility of monitoring.

Accordingly, competent authorities have already access to a large pool of data. Key question today is about the effective use and analysis of this information by competent authorities, from an individual and aggregated perspective.

ESMA together with NCAs has developed a Data Quality Engagement Framework (DQEF) to assess and enhance the level of the quality of the data reported under AIFMD and MMFR.

According to an ESMA report (2023 Report on Quality and Use of Data)

"Given some of the issues identified above, e.g. lack of improvement between 2022 and 2023 and lack of proactiveness in certain jurisdictions, DQEFs ESMA and the NCAs are planning to shift towards a risk based approach to address the most impactful issues at EU level"

Regarding Data processed by ESMA on MMF and AIF reporting, the report seems to suggest that some room of improvement exists indeed.

The review of the AIFMD supervisory reporting and the introduction of a new supervisory reporting for UCITS funds should be a great opportunity to enhance the monitoring of liquidity profile. RTS and Guidelines on LMT to be adopted by ESMA by April 2025 should help standardizing information reported to competent authorities on the adoption and key characteristics of these tools.

One should not forget that the liquidity profile of OEFs is not limited to the redemption frequency. It is also closely linked to the liquidity of the underlying markets. Accordingly, markets conditions should naturally be included in the monitoring of the NCA.

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?

AFG response

A broad range of data is used by asset managers to monitor the liquidity risk of their investment funds. Both asset and liability side must be jointly monitored.

On the asset side, marketable volumes are one of the most relevant data monitored in order to have a dynamic view over time of the volumes that can be sold under normal market conditions and under 'stressed' conditions.

On the liability side, the fund manager needs to estimate the risk of redemptions to which its fund may be exposed, using the same logic as that adopted for assets, i.e. under normal market conditions and under "stressed" conditions. The most relevant data are those needed to assess the investors behavior and eventually build a redemption curve if knowledge of the liability structure is sufficiently detailed.

The liquidity risk itself is estimated by comparing the analyses carried out on the assets and liabilities sides. The results of stress tests to be conducted by the asset management company are of course included in this monitoring.

Liquidity risk management is also reviewed at the occasion of liquidity risk committees held on a regular basis internally (monthly or quarterly). If necessary, the frequency of these committees is increased, typically in case of stress in the market.

The professional guide on the management of liquidity risk, published by AFG, provides more detailed examples of relevant data and asset-liability matching indicators (link to AFG guide)

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?

AFG response

As referred to in previous answers there is room of improvement on the processing of the data collected by competent authority throughout the life of a fund. Recently ESMA performed data quality tests called Data Quality Checks (DQC) on MMF and AIFM reports on a quarterly and half-yearly basis respectively in order to ensure the completeness, consistency and accuracy of the data received. According to ESMA "2023 Report on Quality and Use of Data" , data processing seems to be at an early stage.

Reporting data may be completed by additional data. But AFG believes that data collected so far are quite exhaustive.

During stressed market conditions where an LMT activation is at stake, there is usually an intensive dialogue between the fund manager and its NCA. AFG believes these exchanges are of the utmost importance due to the proximity of the NCA.

All this regular information comes in addition to the one received when a new investment fund is created. This approval phase by the competent authorities is also material to validate that the liquidity risk profile is properly taken into consideration according to the investment fund's specific features, with proper redemption policy, selection of relevant LMTs and methodology to determine their calibration.

AFG believes that a close dialogue between the fund manager and its NCA provides the warranty that adjustments on LMT are done for the best interest of the investors.

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

AFG response

Under stressed market conditions, investors may potentially exit funds pre-emptively in order to receive a higher NAV that does not take into account the higher cost of liquidating the assets within the OEF.

AFG believes it is of the utmost importance to make sure that these investors will not be able to redeem their shares “for free”. It is particularly critical for many reasons.

Firstly, if these liquidity costs are not “billed” to the redeeming investors, they will be supported by the remaining investors. This will be detrimental to them and will represents an unfair treatment. The equal treatment of the investors is one of the cornerstones of fiducial duty of the asset management industry.

Secondly, if these investors were invested directly in the underlying market, they would directly support these costs.

Finally, these liquidity costs help to avoid the dilution effect by making these investors reluctant to redeem. Under stressed market conditions, they may represent a substantial amount which must however be pass on “in full” with no cap. It must have a deterrents effect for the investors willing to redeem for “wrong reasons” and must avoid “fires sales”.

Anti-dilution LMTs are here to mitigate this potential risk and ensure a fair treatment

To quote IOSCO final report (dec 2023) on liquidity management tool :

“Anti-dilution LMTs can address these concerns by passing on the costs of liquidity to transacting investors by adjusting the price at which they transact. These tools form an important part of an overall liquidity risk management framework for OEFs.”

In case of market stress, asset managers should be able to activate the LMTs relevant for this type of situation. This is one of the major changes introduced with the revision of the AIFMD and the UCITS directive. ESMA has consulted to produce some RTS on the characteristics of each LMT that can be selected and some guidelines on the situations that should trigger the activation for each type of LMT. The objective is to ensure effective standardisation of elements to be taken into consideration for activation of LMTs at the EU level.

In addition, close dialogue between the industry and the competent authorities usually occurs and is key during stressed market conditions. It is acknowledged that any new crisis is different from previous ones and that answers to be provided need to be adapted accordingly. So far such dialogue has taken place at national level. Coordination at EU level with intervention of ESMA could be of value to ensure consistency in the answers to be provided.

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?

AFG response

The calibration of swing factors in one of the difficulties encountered in measuring and monitoring liquidity risks. We acknowledge that this calibration exercise may be challenging in some cases. And the IOSCO report on anti-dilution tool (dec 2023) acknowledges that it should be carried out on "best effort" basis.

More precisely it refers more to the access of sufficient and reliable data notably for fixed income products. The introduction of a consolidated tape by asset class should facilitate this access, and address these difficulties.

Unlike banks, asset management companies may have limited data regarding their end clients. Fund distributors may not be keen to share information related to their end clients, even under the form of anonymized typology – while the free sharing with fund managers of such end-client typology would enhance further the anticipation of any risk related to redemptions.

Indeed, the evolution of the liability structure of the OEF is a key element to monitor liquidity risks. Some categories of investors tend to redeem in advance followed by others. Some behaviors patterns occur and could be anticipated by the fund manager.

With regards to the available tools, many are already in place to monitor and measure liquidity risk. Asset managers are already well equipped to apply a gradual approach when market stress starts to develop:

. Modification of the investment policy, recalibration of cash buffers, overdrafts with the depositary of the fund if necessary;

. Activation of selected LMTs according to predetermined internal thresholds;

. In more extreme situations, the decision to activate gates or suspend the fund orders.

To conclude: asset management companies are well prepared to face such situations.

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

AFG response

We acknowledge that this calibration exercise may be challenging in some cases. This is notably due to the fact that each crisis is different from the previous one and makes very complex the capacity to anticipate which assumptions should be taken into consideration and in which proportion.

As explained in the previous question, lack of data on the liability side makes redemption scenario difficult to calibrate.

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?

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?

AFG response

Currently, it is only possible to meet variation margin calls by posting cash. Some measures could reduce asset sales stemming from margin calls in the future. AFG considers that a broader range of collaterals for variation margin calls should be contemplated in order to reduce the procyclical demand for cash during stressed market conditions.

Highly-liquid assets such as sovereign bonds, shares of money market funds (MMFs) or even shares of funds fully invested in sovereign bonds should be considered as eligible collateral along with the appropriate haircut. It is this is already possible in certain jurisdictions for MMFs (e.g., the U.S. Commodity Futures Trading Commission (CFTC)).[1]

MMFs are highly regulated, well-diversified, short-term vehicles that invest in short term money markets. They are also presumed as eligible cash equivalent vehicles for their investors (please see AFG response attached on the ESMA consultation regarding the report on highly liquid financial instruments with regards to the investment policy of central counterparties)

These proposals should be carefully considered in order to detect possible unexpected side effects. But AFG sees merits in investigating further.

AFG would also like to remind that European regulated funds do not represent the bulk of the derivatives market. The example of Archegos capital management shows that focus should be given to the highly leveraged actors in the derivative markets**.** Such NBFI, during stressed times, have an extensive use of the repo market (and fire sales). By this way, they disseminate the liquidity crisis to other market participants because of their high leverage, precisely.

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.

AFG response

Regarding the monitoring of the liquidity and margin preparedness of NBFIs, a way to improve it would be to capture some types of NBFIs which are currently Not Regulated in order to make them Regulated.

For instance, based on the Archegos / Crédit Suisse case, it appeared that family offices are usually Non-Regulated NBFIs, while they may generate significant systemic risks on financial markets. There are at least two ways to solve the situation:

- Make family offices become Regulated NBFIs;
- Ensure that banking supervisors appropriately monitor banks in their compliance and fair assessment of their counterparty risks.

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.

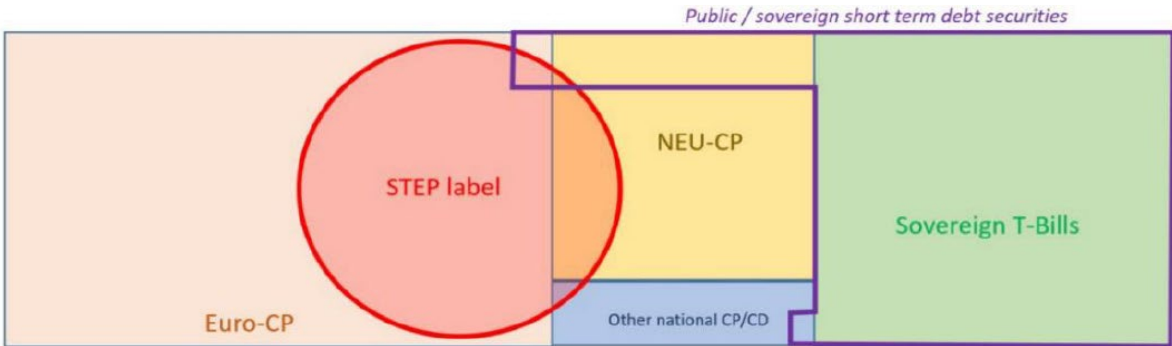
Question 29. What would be the benefits and costs of a regular EU-wide liquidity stress test for pension funds and with what frequency? What should be the role of EU authorities in the preparation and execution of such liquidity stress tests?

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.

AFG response

Label initiative already exists notably with STEP (Short-Term European Paper) which is a voluntary label that can be applied to ECP, NEU CP, and domestic CP of euro area countries. It partially covers ECP and NEU CP markets, and may not fully cover the entire EU markets as illustrated in the figure below:



Source: AMF.[14]

AFG acknowledges that a global framework or label should bring more transparency and standardization regarding documentation, settlement time, enhanced reporting ...

We should also assess the benefits and costs from an issuer perspective, notably because the issuers will be called to contribute by financing this label. More transparency should obviously help new issuers to step into CP market. But standardization should not be "pushed" too far because some issuers are looking for flexibility.

The NEU CP market, based in Paris, can be seen as a good example of what can be a future EU framework. The NEU CP program was created following the French authorities' reforms of 2016. It has been sponsored by key players and the Banque de France. This commitment of the French authorities was an important element to ensure the success of NEU CP.

At the EU level, a similar framework should be also sponsored by the ESA's or at least the ECB. It must not be an opportunity for an additional layer of regulation, but a framework designed to get better access to information and market data linked to volume and prices. The existing STEP label could potentially be leveraged and strengthened with a view to building this sought-after label.

Regarding the eligibility criteria, we believe that what matters is that money market instruments stay eligible to MMF as MMF are by far the largest investors.

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?

AFG response

A wider range of issues is beneficial to financial stability. MMF managers could benefit from a wider investment universe which could help them to deliver better return to investors. Steady MMF performance could attract more investors in MMF and ultimately better finance the economy. We should not forget that STFM can be seen as the first step of the CMU because banks are by far the largest issuers. (Within the euro area banks account for ~70% of the amount outstanding as of May 2023).

Regarding small issues, MMF managers are facing specific problems. The credit assessment done by analysts is time consuming. With small programs of a few hundred millions euro there is no interest to allocate resources. MMF managers will not be able to invest more than €10 or €20 million for MMF with assets under management of several tens of billions.

Moreover, the valuation is more complicated to process as market data are not updated sometimes. There is no guarantee of buying back if the issuer has no access to the ECB. Liquidity is less good and access to information is harder.

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?

AFG response

The current level of transparency and reporting must be increased. MMF managers needs updated market data such as the volume of issue, valuation data, list of CP issue from a single issuer, ...

Compared to the bond market it is much more difficult. These products are not standardized, available in public or vendors databases. Managers often face technical issues with IT system or with their back office for the management and booking of the orders.

Unlike bond or equity market, most activity takes place in the primary issuance market. And during stressed times, all players are in the same direction which gives the secondary market a "binary" aspect. Obviously, new players should step into the CP and CD markets. The liquidity should first be improved to attract them and then makes this market enter into a virtuous circle. But currently the main issuers are banks, and to be pragmatic, AFG believes that there is no actor better placed to improve liquidity.

The AMF wrote that "...the reduction in the holding of securities by an MMF does not necessarily reflect a specific concern regarding the issuer, but rather in a case of stress such as that of the end of March (2020), an ability to sell the securities. Many banks agreed to play the game and thus animated the secondary market for certificates of deposit by buying back their own issues from those who wanted to sell them. Some were also able to intervene in the securities of other banks, with the intention of bringing them to the ECB's refinancing window."

The AFG's suggestion on this aspect is to consider implementing facilitating measures at the bank level such as:

- introducing an incentive for banks to buy back the CPs they issue at market conditions, in the event of a degraded market and upon decision in concert with the authorities, by releasing constraints related to Basel rules and the use of their balance sheet, temporally.

- allowing, exceptionally and on a case-by-case basis, to deviate from the LCR if market liquidity is deemed to be sufficiently degraded.

The AFG recalls other suggestions for additional measures to better manage liquidity in the event of a crisis. Access to the Central Bank in the event of a crisis requires the intermediation of banks – such as the corporate securities buyback programs by the central banks of the Eurosystem ECB PEPP / CSPP. The Banque de France was very active, which was not the case for all central banks, when it came to proposing prices to money market intermediaries (brokers) solicited by French funds; the central banks did not seek to know on whose behalf the brokers were depositing axes, so it was impossible to know the need represented by money market funds, while the Fed's MMFLF program clearly provided for banks to provide axes on behalf of money market funds in particular

It will therefore be useful:

- to trace on whose behalf axes are deposited;

- to study the possibility of reserving part of the program for money market funds;

- to allow greater flexibility in ECB programs (by avoiding late effective implementation of the PEPP a too much inertia in the program when the market returns to buying and avoid the crowding out effect;);

- and possibly to study the opportunity of an ECB facility on reverse repos as suggested by the European Commission report[1] on money market funds of July 2023 which mentions the Overnight Reverse Repo Facility (ON RRP) in the US. US money market funds are liquidity providers under this Fed facility against Treasuries as collateral at an agreed rate, very often higher than the rate of tripartite repos (repos with the market). It would be interesting to have such a program with the ECB because it would avoid resorting to instruments with rates below deposit rates and in situations where banks do not want the liquidity of money market funds.

The European Commission wrote in this 2023 report on MMF :

"In principle, this contagion dynamic would be avoided if MMFs could invest their cash in instruments for which a rapid withdrawal would not lead to market contagion. One instrument that satisfies this requirement would be a deposit at the central bank itself. A case study of such an arrangement can be found in the US, where MMFs may place their excess cash with the US Federal Reserve's overnight reserve repo (ON RRP) facility. In addition to preventing contagion dynamics in situations of liquidity crunch, this facility also puts the US MMF sector

[1] Report to the European Parliament and the Council on the functioning of Regulation (EU) 2017/1131 on money market funds (the MMF Regulation) https://finance.ec.europa.eu/document/download/26bd5442-fe36-436d-a11b-82857953d170_en?filename=230720-report-money-market-funds_en.pdf

at an advantage compared to EU MMFs in terms of flexibility in managing their liquidity inflows." "The decision about opening such a liquidity facility to MMFs however is beyond the competencies of the European Commission and lies in the ECB remit."

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?

AFG response

AFG considers that this maturity threshold is sufficiently calibrated for the 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.

AFG response

It is a wholesale market with low margin. It is difficult to improve this concentration risk. Aligning rules between the different types of MMF (VNAV, LVNAV, ...) could be detrimental to the market and enhance the concentration.

There is currently a lack of public data to assess the risk. With the MMFR reporting requirement (art 27) ESMA should have some element of answer. Unfortunately, no feedback was given to the industry so far.

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?

AFG response

Proposals formulated in question 33 could potentially provide the conditions to improve the liquidity in secondary markets which in turn should help to attract new market players, in a virtuous circle.

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?

AFG response

The costs will be much higher than the benefits. For an MMF manager perspective, there will additional costs linked to the connection with theses trading platforms along with reconciliation issues.

Some issuing companies need flexibility. The standardization of the instruments will not favor the market.

Such a measure could be considered if the structure of STFMs looked like equity markets. This is absolutely not the case. While a given issuer generally has only one equity instrument traded on the stock market, with a one-off primary issue (when listed, through IPOs), the same issuer may have plenty of short-term instruments issued on the STFMs, as frequently, for some of them, as every day. Consequently, standards of trading prevailing on the equity market cannot be transposed into the STFMs, as their respective instruments cannot be compared on both numbers and frequency of issuance standpoints. Mandating participants of STFMs to trade through a given channel rather than another will impair their liquidity rather than improve it.

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.

AFG response

Insurance companies: 4 because of solvency II provisions.

commercial undertakings: 1

AIFs: 3 or 4 due to the potential leverage this type of fund can possibly have.

UCITS: 5 due to the current regulatory framework

Investment firms: 1 or 2 due to a less constraint regulation

Pensions funds: the level of preparedness depends on the current regulatory constraints.

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

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?

III. Excessive leverage

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?

AFG response

The EU regulation already provides several tools regarding leverage control. Extensive pieces of information are already reported to competent authorities. And priority is to ensure that information received is properly exploited.

Theoretically, unlimited leverage is possible but only for non-public AIFs. In the case leverage is > 300%, more detailed reporting on the leverage and on any change in this leverage is requested.

More generally many survey reports that leverage remains at a low level in the EU.

In conclusion, AFG is of the view that systemic risks generated by excessive leverage in OEF is very limited in the EU markets.

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.

AFG response

AFG does not see such pockets.

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

AFG response

The UCITS directive authorizes the investment in funds established in third countries provided that foreign funds are subject to an equivalent supervision and (art 50 e (ii)) :

"the level of protection for unit-holders in the other collective investment undertakings is equivalent to that provided for unit-holders in a UCITS, and in particular that the rules on asset segregation, borrowing, lending, and uncovered sales of transferable securities and money market instruments are equivalent to the requirements of this Directive;"

Consequently, no leveraged strategy can be invested by funds under the UCITS directive.

Regarding AIFs, rules are less stricter and leverage is possible However, in the case the leverage is > 300%, more detailed reporting on the leverage and on any change in this leverage is requested. However, this type of highly leveraged funds is quite limited inside in the EU.

Even if a highly leveraged strategy is indirectly invested (through a fund), the maximum loss is limited to the money invested only.

Regarding asset management, two rules are considered always true: a fund cannot make default and all losses are supported by the investor.

For a better detection of leverage strategy, some specific stakeholders should be targeted: the custodian banks of the funds implementing a leverage strategy through bank overdraft, its auditors, the lender or the derivatives counterparty or the leverage provider.

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

AFG response

Existing rules have been adopted to avoid this type of concern for regulated entities.

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

AFG response

Banks have put in place mature and efficient risk framework to monitor their leverage with each counterparty and type. The risk framework system is subject to regular review and audit by external parties and supervisors. As far as the macroprudential framework is concerned, the leverage criteria is the most heavily weighted indicator in the G-SIB assessment grid (20%).

Similarly, the existing framework for EU investment funds has already introduced robust rules to address such concerns with quite extensive transparency requirements. The priority should be on assessing how this information is effectively analysed and how coordination between public institutions, including on data sharing, can be enhanced to make the most of this information.

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?

AFG response

The "Interconnectedness" between NBFIs and between banks and NBFIs is clearly more difficult to monitor as there is a lack of market data on aggregated exposures.

Most of data about derivatives, risk exposures and counterparties, although complex and not readily functional, is currently available to EU regulators and supervisors either through trade repositories or supervisory/regulatory reporting.

If used and shared appropriately among EU regulators and supervisors, this would enable a better understanding and limit the reporting burden on market participants.

Ultimately, we recommend that regulators and supervisors should enhance cooperation among relevant authorities across jurisdictions (including in the EU), and invest into data analysis capacities.

Commodities markets

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?

IV. 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?

AFG response

Clearly the Archegos case with Crédit Suisse generated a systemic risk, leading ultimately to the bankruptcy of Crédit Suisse.

That is why, as a priority for policymakers to find a way to tackle the Non-Regulated NBFIs.

In addition, two types of actions should be initiated by policymakers:

- Vis-à-vis banking supervisors, to make sure they effectively monitor banks, when banks have to comply appropriately with their obligations on assessing counterparty risks;
- Vis-à-vis securities regulators, to make sure they effectively apply MiF and MAR obligations, when ensuring market surveillance.

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?

AFG response

AFG is, in principle, reluctant to accept the proposals of a new stress test exercise. Usually, such stress tests will turn out to be costly to implement. And many stress tests are already required, with little feedback.

However, AFG acknowledges that, if some conditions are met, EU system-wide stress tests would be beneficial to the industry if a deep understanding of the interconnectedness between the various market participants is achieved. With a clear view of the behaviors of the various players in time of stress, results should be much more instructive than some theoretical assumptions not supported by relevant data so far. It would also help to detect portfolio overlap which can explain amplification mechanisms during crisis.

Other interesting mechanisms which can be detected are the various hedging strategies. Credit default swap positions can, for instance, be hedged by an equity portfolio. By such links, crisis dissemination can occur across markets that are deemed to be independent.

By including participants to a very large extent, some vulnerabilities or behaviors could potentially be detected, thanks to the macro prudential perspective adopted. ("More is different")

Many preliminary conditions should be taken into account:

The design of such an exercise would be key in view of the implication it will require from participants. These latter must be closely involved or consulted. The scenarios should be designed collectively.

Similarly to SWES, it should be a targeted exercise with a precise view of it is to be tested and what dimension of the financial stability do we want to assess.

Many existing challenges have to be overcome: the lack of data in some cases (i.e. non-regulated NBFI that should be part of the stress test), fragmented nature of EU markets, ...

Non-Eu participants should also be associated like Hegde Funds adopting aggressive investment strategy including excessive leverage. The markets do not stop at the EU borders.

It would also make sense to make the most of similar exercises already conducted in other jurisdictions (mainly in the UK).

Lastly it is essential that results of this stress testing are shared with the participants with appropriated feedback loops

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.

AFG response

There is indeed a need for a better coordination between NBFI supervisors and bank supervisors. And this is broader than for stress testing only.

Authorities should explore new ways to overcome impediments to sharing data across EU and other jurisdictions, to be able to effectively monitor the build-up of leveraged and concentrated positions, amplification channels, sources of vulnerabilities (see response for question 50).

This would require a more streamlined and comprehensive data sharing/data analysis strategy between EU supervisors and the various NCAs in EU Member States; using existing data (and therefore refrain from imposing additional reporting requirements to regulated NBFI or banks).

The ultimate objective should be a better understanding of existing interconnectedness between banks and NBFIs, and how this should be addressed in case of market stress. It should also be used to avoid unnecessary duplication of reporting requirements and lead to a single format and unified timeline of reporting across NCAs and for securities regulators and central banks when applicable.

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

AFG response

AFG strongly believes that a more coordinated and effective macroprudential supervision of NBFIs and markets will be beneficial to all stakeholders. In view of extensive reporting requirements for both banks and regulated NBFIs (as EU investment funds), there is no lack of data to perform effective macroprudential supervision of all market participants.

In priority, following actions should be considered:

1. Ensure effective data sharing between EU institutions for the data that is already collected. This would facilitate EU bodies to identify and mitigate any potential vulnerabilities.

2.Identify the data gaps within the NBFI entities and activities which may be a source of systemic risk and where reporting obligations may need to be enhanced.

3.Remove any unnecessary reporting of data which has no added value and/or that cannot be effectively exploited by EU bodies

Sector-specific regulators are knowledgeable about their areas, while the FSB 's global approach may add unnecessary layers. Central bank tools are designed for macroeconomic measures, but the mandates of National Competent Authorities (NCAs) are frequently overlooked.

Whatever initiative is designed to enhance more coordinated supervision, it should prioritize measures that do not undermine competitiveness and should not come at an additional cost to European actors.

Indeed, any macroprudential policy should analyze risks in a precise and aggregated manner according to the principle of "burden reduction: report only one".

V. SUPERVISORY COORDINATION AND CONSISTENCY AT EU LEVEL

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.

AFG response

European regulation framework already provides for information communication from both asset managers and investment funds to their national authorities. There should be data sharing between EU institutions and effective use of all the data collected. This should be achieved before envisaging any additional reporting request.

In addition, enhanced communication and coordination should be regarded at authorities' level. A key element in that respect would be an increased dialogue across NCAs, between NCAs and ESAs and between securities supervisors and central banks. This would allow to preserve two fundamental characteristics of efficient supervision: proximity and reactivity.

Improvements in the effectiveness of supervision could also be a better regulation of non-yet regulated NBFIs and investment funds.

Supervisory coordination should also be considered from a competitiveness and sovereignty standpoint: enhanced coordination and dialogue could lead to an increase in the competitiveness of the European financial market. Therefore, we believe that competitiveness should be integrated as a specific mission for ESMA, fostering a more predictable legal environment for our industry and ensuring the link between the rulemaking and the market practices.

We believe that the existing ESMA mandate could evolve to integrate this specific mission and that this will contribute to develop and reinforce ESMA competencies while considering as well appropriate articulation with NCAs.

We also believe that integrating competitiveness as a specific mission for ESMA would contribute to reducing discrepancies with other national regulatory authorities that have explicitly incorporated competitiveness into their mandates. For instance, recent legislation in the UK mandates the Financial Conduct Authority (FCA) to support the long-term growth and international competitiveness of the UK economy. Other jurisdictions such as Japan or Singapore also include competitiveness as specific mission of their financial authorities.

Lastly, we would like to highlight that such integration would be in line with the recent mission letters in relation to the commissioner designate for financial services and savings and investment union.

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?

AFG response

The European regulatory framework applicable to both asset managers and investment funds already introduced this type of coordination on certain very specific cases. This is for instance the case through the provisions of article 25 of the AIFM Directive regarding the supervision of the use of leverage and of related systemic risk in the financial system.

Further coordination across NCAs and between NCAs and ESMA should be further deployed. ESMA could play a coordination role to ensure that this type of coordination is effective, both on a day-to-day basis (typically to avoid multiple reporting requirements in different formats, with different timelines) and when specific events require this type of cooperation.

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

AFG response

We believe that the key role should remain at the level of the NCAs. NCAs already have two paramount advantages for efficient supervision: reactivity and proximity.

ESMA could play a more active role of information coordination and concertation by fostering an increased dialogue but the NCAs should continue to implement the regulatory framework. ESMA could also be instrumental in data sharing with the introduction of a datahub where all data collected would be available for all EU public bodies.

In terms of supervision, we are of the opinion that a greater supervision convergence can be achieved through the form of a "lead supervisor" of a NCA instead of a direct supervision from ESMA.

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?

AFG response

We believe that the local NCA should remain in charge.

In parallel, an increased dialogue between authorities should be encouraged, to foster a better circulation of information and a better concertation between authorities.

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.

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?

AFG response

Firstly, we believe that there is no "global systemically important" asset manager in European Union.

Likewise, we are of the opinion that an european investment fund cannot be regarded as systemically important. European regulatory provisions applicable to European funds and European asset managers are already strict and aim at protecting their clients and also markets' stability. Local NCAs already have direct intervention powers.

Regarding daily supervision at fund level, given their proximity and their reactivity, local NCAs seem to be the best placed for supervision.

Nevertheless, we believe that supervision integration could be increased at European level, benefiting to the global ecosystem. A prerequisite for this integration would be the recognition of the notion of group at the European level in case of large cross border asset managers, in order to reduce the reporting burden and organizational issues with respect to intra-group and intra-EU delegation arrangements.

We underline that such notion of group is to be regarded from a legal standpoint and does not imply any systemic dimension for cross border asset managers.

This recognition of the notion of group would ensure that large asset management groups in the European Union could benefit from a greater supervision convergence. In this respect, we believe that such supervision could take the form of a "lead supervisor" of a NCA.

A “lead supervisor” NCA would allow to maintain two fundamental characteristics of an efficient supervision: proximity and reactivity.

The designation of a “lead supervisor” NCA could also be done on an objective basis, to avoid any “forum shopping”, for instance using the criterion of the NCA of the parent company of the relevant asset management group or the criterion of the number of employees in a Member State. Indeed, other criteria, such as the assets under management, could evolve over time and hinder legal certainty, which is crucial for the competitiveness of our industry.

The approach of a “lead supervisor” NCA could apply both to EU and non-EU asset management groups operating in the European Union, contributing to build a level playing field between the actors. The reduction of the reporting burden is induced by a convergence in supervision is also to be directly related to the European Commission initiative of 25% reduction of the reporting burden.

In this framework, ESMA's role could be to foster dialogue, between NCAs, but also between NCAs and ESMA, to facilitate convergence and pragmatism in supervision.

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.

AFG response

Please refer to question 62.

As mentioned previously, large asset managers should not be supervised in a different manner. No additional powers should given to EU Institutions, it is key that asset managers / management companies keep discretion and flexibility on selecting and activating any mechanism at their disposal in case of market stress (and under normal conditions as well).

When required, close dialogue between the asset manager/ management company is the key priority instead of activating some tools in an automated and/or prescriptive way. Coordination between NCAs as mentioned previously should also be more efficient than such powers. In case of cross-border asset managers, designation of a lead supervision (as mentioned previously) could also contribute to a enhanced supervision approach.

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)?

AFG response

Firstly, we would like to reiterate that asset managers cannot, in our view, be regarded as systemic actors.

Asset managers manage assets on behalf of and for the account of their clients, they do not hold the assets, which constitutes a major difference with banks.

Secondly, the notion of a crisis of asset management companies is not defined. Given their specificities, compared to banks, we do not see what type of events could have major consequences for the markets. Article 24 of EMIR was specifically drafted for CCPs, whose role cannot be compared to asset management companies. In case of difficulties, like for instance in 2020, NCAs contacted directly asset managers to follow-up and prevent any difficulties that could have arisen. We do not see the necessity to enact such practices. Moreover, in case of important redemptions, monitoring systems and reporting already exist. NCAs at their level already have the possibility to establish dedicated measures.

Instead of direct intervention powers, we believe that large asset managers could benefit from a convergence of supervision through the mechanism of a lead NCA, with the acknowledgment of the notion of group at the European level, as we developed it under Question 62 above.

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?

AFG response A more integrated supervision should obviously bring benefits for commodities markets. But rules and contractual terms are numerous and varied according to the characteristic of each type of commodity. Accordingly, the costs are expected to be high.

International coordination

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

AFG response We believe that such program is not well adapted for asset managers. Please refer to question 64.