

Unit E3 – Macroprudential Policy
DG FISMA
European Commission
1049 Brussels
Belgium

Submitted via the consultation portal and fisma-nbfi-consult@ec.europa.eu

22 November 2024

Dear Sir/Madam,

AIMA response to the European Commission (“EC”) targeted consultation document, Assessing the Adequacy of Macroprudential Policies for Non-Bank Financial Intermediation

The Alternative Investment Management Association (“AIMA”)¹ is pleased to respond to the EC’s consultation² on this important, multi-faceted and often misunderstood subject. The CP is the latest in a long series of policy papers focusing on the macroprudential impact of the increase in non-bank financing to the real economy from a wide range of bodies. This debate has been largely driven, and therefore framed, by central banks following regulatory changes they made which have reduced banks’ appetite for lending. This, in turn, has led to the rise of alternative sources of credit.

A key challenge for the EU is to access capital to invest in its economy. This can only be done sustainably by diversifying the sources of capital available. The reluctance of banks to fulfil their traditional role as the main source of capital makes it all the more important that other forms of financial institutions are able

¹ The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA’s fund manager members collectively manage just over US\$4 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage over US\$2 trillion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA’s website, www.aima.org.

² EC, “[Targeted Consultation Document: Assessing the Adequacy of Macroprudential Policies for Non-Bank Financial Intermediation \(NBFI\)](#)” (22 May 2024) (the “CP”).

to support the EU's economic growth and competitiveness and make it more resilient when raising capital, and not stifling those providers with inappropriate and/or bank-like regulation.

We therefore welcome the CP's recognition that a "one size fits all" approach to the very wide range of institutions covered by the term "non-bank financial intermediation" ("NBFIs") is inappropriate.³ However, continuing to frame the debate in binary "bank" and "non-bank" terms is unhelpful and misleading. That approach effectively characterises anything that is not a bank as posing some, often unspecified, potential risk to the financial system because it is not a bank and so is not subject to banking regulation. This carries with it the incorrect underlying assumption that non-banks are lightly or less regulated compared with banks and that non-bank regulation is in some way inferior to that for banks. In most jurisdictions, open-end funds ("OEFs"), including money market funds ("MMFs"), and closed-end funds, pension funds, insurers and all the other financial institutions that are considered NBFIs have very different business models, products and services compared to banks and are subject to regulations that recognise the issues peculiar to them. These regulations are robust and thorough going.

When DG FISMA takes this debate forward, a clearer articulation of the exact nature of the risks any further changes to macroprudential regulation are intended to address would also be welcome. The current debate uses terms that are very high level, emotive and do not indicate the nature of the supposed risks. A good example is the concept of "hidden" leverage. In relation to OEFs that are alternative investment funds ("AIFs"), it is hard to imagine how any leverage could be "hidden" by AIFs given the detailed reporting requirements that are in place under the Alternative Investment Fund Managers Directive ("AIFMD"). This includes the disclosure on a fund-by-fund basis of the five largest counterparties to which the AIF is exposed.⁴

A different approach could be to articulate the circumstances under which systemic or unacceptably high levels of disruptions may arise. This may better allow the participants to be identified along with their role and degree of significance or potential impact they may have.

Extensive work continues to take place in parallel to and as a result of this ongoing debate. The European co-legislators have been made aware of concerns from institutions such as the European Systemic Risk Board ("ESRB") and others on macroprudential policy.⁵ The newly revised AIFMD and UCITS Directive⁶ reflect the co-legislators conclusions on their view of such concerns. This current work should not be used as an opportunity to undermine or amend this newly agreed legislation.

We also note that the European Securities and Markets Authority ("ESMA") is formulating the "level 2" detailed rules required by the AIFMD Review Directive. The level 2 measures must respect the primary legislation that enables it. Level 2 measures should not be used as an opportunity to change the co-legislators' conclusions. We welcome the CP's statement that the CP's intent is, "not to revisit recent legislative agreements."⁷

³ See *id.* at 14.

⁴ See, e.g., [Delegated Regulation 231/2013](#) ("AIFMR"), at page 83.

⁵ See, e.g., the letter from Francesco Mazzaferro, Head of ERB Secretariat to John Berrigan, Director General of DG FISMA, "[ESRB considerations regarding the AIFMD](#)" (3 February 2020).

⁶ Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds ("AIFMD Review Directive").

⁷ See CP, *supra* note 2, at 7.



We provide further details in the annex. We would be happy to elaborate further on any of the points raised in this response. For further information, please contact James Hopegood, Director of Asset Management Regulation and Sound Practices (jhopegood@aima.org).

Yours faithfully,

A handwritten signature in blue ink, appearing to read "J. Król", is positioned above the typed name.

Jiří Król
Deputy CEO, Global Head of Government Affairs

ANNEX

AIMA has answered some, but not all, of the questions in the CP in detail below. Where questions are addressed to regulators or are on topics of less relevance to AIMA members, such as MMFs, they have been omitted but the original question numbering from the CP has been retained for ease of reference.

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?

Historically, the examination of systemic risks and vulnerabilities has focussed on institutions that are already subject to extensive regulation and reporting requirements and so provide a ready source of information. We are concerned that this has meant that less attention has been paid to the role of direct holders of assets where data on their activities is not so readily available. They may behave in a correlated manner during times of stress, but are not subject to the same level of regulation as asset managers, funds and other NBFIs.

Banks themselves should also be discussed as a source of systemic risk. As we have noted in the covering letter, there is an underlying assumption that non-banks pose risks which banks, by virtue of their regulatory regimes, do not. Practical experience does not bear this out, as evidenced by the recent events at Silicon Valley Bank and Credit Suisse. We discuss this further in our response to Question 2.

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.

Exposure is a two-way street. Banks' own shortcomings on risk management can also be major factors in creating the kinds of risks the CP is concerned about. For example, the 2021 Credit Suisse Group special committee of the board of directors report on Archegos Capital Management referred to exactly this issue:

*"The Archegos default exposed several significant deficiencies in [Credit Suisse's] risk culture, revealing a Prime Services business with a lackadaisical attitude towards risk and risk discipline; a lack of accountability for risk failures; risk systems that identified acute risks, which were systematically ignored by business and risk personnel; and a cultural unwillingness to engage in challenging discussions or to escalate matters posing grave economic and reputational risk. The Archegos matter directly calls into question the competence of the *business and risk personnel who had all the information necessary to appreciate the magnitude and urgency of the Archegos risks, but failed at multiple junctures to take decisive and urgent action to address them.*"⁸ (Emphasis added)*

One outcome of the CP should be to reframe the terms of this debate to recognise that NBFIs do not pose a distinct or unique set of risks to credit institutions' balance sheets.

The Archegos episode also reiterates a point that AIMA and others have been making that information in relation to Archegos was available, but firms and regulators did not avail themselves of it. We do not consider the Archegos experience to be either systemic in nature or justification for any increase in reporting. We do, however, believe that more coordinated and accessible reporting would be beneficial.

⁸ Report of Paul, Weiss, Rifkind, Wharton & Garrison LLP, "Credit Suisse Special Committee of the Board of Directors Report on Archegos Capital Management" (29 July 2021), at 2, available at [Archegos info kit – Credit Suisse](#).

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.

The CP uses the *family office* Archegos as an example of the consequences of a failure of an NBFi. We note that similar entities operating in the EU are likely to require registration under MiFID and as such be subject to MiFID trade reporting requirements. The episode is noteworthy not because an NBFi failed without an impact on wider financial stability but because of the impact it has on a commercial bank for the reasons Credit Suisse itself set out as discussed in our reply to question 2. It illustrates the issue that significant losses at commercial banks may create solvency risks which have the potential to create system risks.

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.

As we discussed in the covering letter, this debate would benefit from a clearer articulation of circumstances under which systemic or unacceptably high levels of disruption may arise. This may better allow the participants to be identified along with the role and degree of significance or potential impact they may have. The focus on NBFis as a very large and amorphous group along with the exclusion of banks as potential creators and transmitters of risk is preventing this debate from moving forward.

AIMA's response to the recent FSB consultation on liquidity preparedness for margin and collateral calls draws attention to features which could lead to issues with liquidity.⁹ For example, the requirement for collateral to be in cash only forces participants to withdraw cash in a way that may cause banks to have liquidity issues. The solution to this specific problem lies in a regulatory change to allow near-cash to be used as collateral.

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.

The use of ill-defined and emotive terms continues to be a feature of the debate on liquidity and leverage in investment funds. Recent unwarranted and misleading terms include "hidden" and "excessive" have been used in relation to leverage. We do not recognise either of these terms as valid descriptions or meaningful measures for asset managers, or the regulatory bodies or academics promulgating them, to use or refer to.

In the context of investment funds, our understanding of the term "excessive" is that it should be applied to any situation where there are greater than normally expected levels of leverage or of redemption requests. The CP discusses the case of Archegos as an example, but it is at a very high level and in relation to a family office that is a type of entity not subject to the regulatory requirements that apply under the AIFMD or the UCITS Directive and related legislation. Nor does the CP have any discussion of a threshold where "normal" moves to "excessive".

The EU Capital Requirements Regulation ("CRR")¹⁰ contains a definition of "risk of excessive leverage":

⁹ See AIMA's response is available at <https://www.fsb.org/2024/07/public-responses-to-consultation-on-liquidity-preparedness-for-margin-and-collateral-calls/>.

¹⁰ See the CRR which is available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013R0575>.

“risk of excessive leverage’ means the risk resulting from an institution's vulnerability due to leverage or contingent leverage that may require unintended corrective measures to its business plan, including distressed selling of assets which might result in losses or in valuation adjustments to its remaining assets”.¹¹

This is a high-level definition which leaves a great deal of flexibility in its interpretation. Applying such definitions to the activities of the universe of NBFIs may cause complexity and confusion, particularly as there is no standard definition of leverage across them.

This focus on “excessive” leverage also fails to take account of the work on leverage by global standard setting bodies such as the FSB and IOSCO and its implementation has been going on since the aftermath of the Global Financial Crisis (“GFC”). Since that time, many jurisdictions have put in place extensive new regulatory requirements for leverage. In the investment funds space, these include restrictions on the use of collateral, in some instances limits on the overall levels of leverage (or the ability to impose them), extensive reporting requirements regarding the levels and types of leverage employed and reporting regarding the major counterparties.

Attempts have been made to standardise how leverage is defined and reported, in particular by IOSCO which carries out an annual survey of levels of leverage across major asset management jurisdictions in both open-end and closed-end funds.¹² IOSCO further divides open-end funds between hedge funds and other types, for example, mutual funds.

Different leverage metrics

Measurements of leverage in OEFs are less sophisticated than those used by banks. Both allow for netting and hedging, that is, where holdings of one asset offset the risk of another or when derivatives are used to reduce or manage risks. But the rules for hedge funds and other investment funds do not incorporate a wide range of adjustments to reduce the impact of certain types of derivatives on the overall measurements of leverage. Banks by contrast can use risk-sensitive ‘add-ons’ which reduce the impact of derivative exposures in their leverage measurements.

The ability of banks to apply these add-ons has led to a distorted picture of concentrations of leverage in the financial system. For example, banks make add-ons available for holdings in interest rate derivatives, FX derivatives, credit derivatives, equity derivatives and commodity derivatives. The Basle II methodology allows offsetting of up to 40% for commodity derivatives. It can be up to 10% for credit derivatives and for interest rate derivatives, up to 1.5%.¹³

In contrast, investment funds are largely confined to netting positions and hedging, subject to strict matching rules. For example, one large Global Systemically Important Bank (“G-SIB”), in its 2023 full year results, states that it has a leverage ratio of 4.6% at the end of 2023 as calculated in accordance with the Capital Requirements Regulation 2 (“CRR2”). Expressing this differently (as an equity multiplier), the bank is therefore approximately 20x levered. However, were the G-SIB’s leverage to be calculated as if it was as hedge fund using the gross notional exposure (“GNE”) methodology under the AIFMD, a very different picture emerges.

¹¹ *Id.* See CRR Article 4(1)(94).

¹² See the January 2024 edition of IOSCO’s [Investment Funds Statistics Report](#).

¹³ See Bank for International Settlements, CRE52 – Standard approach to counterparty credit risk, available at https://www.bis.org/basel_framework/chapter/CRE/52.htm.

The G-SIB's balance sheet of €2.5 trillion can be used as a proxy for an investment fund's gross assets under management ("GAUM"). It then has an off-balance sheet exposure of €34.6 trillion and its tier 1 capital, a proxy for an investment fund's net asset value ("NAV") is €123 billion.

On these figures, the G-SIB's GNE calculation under an approximation of the AIFMD requirements would have been:

(Balance sheet + off-balance sheet exposure) divided by the tier 1 capital

(€2.5 trillion + €34.6 trillion)/€123 billion = 301.6

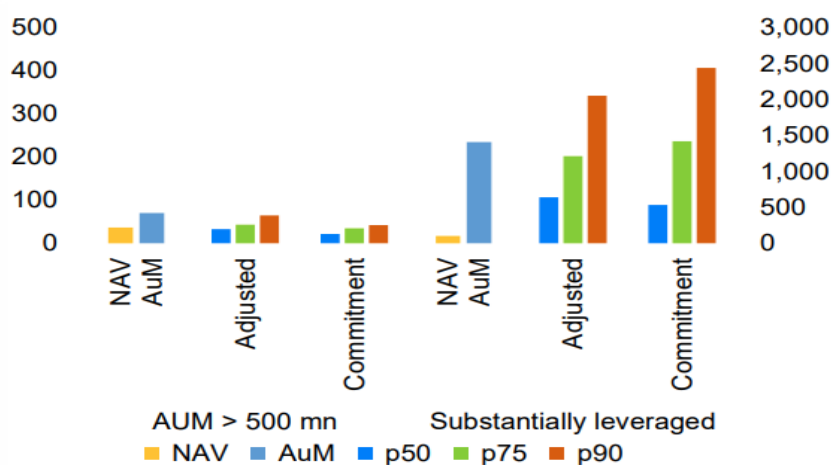
This figure of 301.6x leverage (expressed in percentage terms this is over 30,000% of equity) is thus ten times higher than the 'regulatory' leverage measure for banks which dramatically deflates off balance sheet derivatives exposures. This is significantly higher than the 90th percentile of most leveraged hedge funds, using a similar methodology as Figure 1 below shows. So, when hedge funds' and banks' leverage is compared using the same methodology we see that banks are exposed to potentially much more leverage than hedge funds, yet their balance sheet is more illiquid and more at risk of runs. As we discuss in the covering letter, we do not see how leverage in alternative investment funds can be described as "hidden" given the thorough-going and extensive reporting requirements set out in AIFMD Annex IV.

This amply demonstrates that epithets such as "excessive" or "hidden" cannot be meaningfully applied to leverage in investment funds when compared with the banking sector as levels of leverage of higher magnitude supported by a more fragile balance sheet are deemed to be acceptable in the banking sector.

Figure 1¹⁴

HF leverage

Highest level of leverage across fund categories



Note: NAV and AuM of EU AIFs using leverage on a substantial basis and leveraged AIFs managing more than EUR 500mn, in EUR bn (LHS); leverage measured by the adjusted method and the commitment method, for the median, the 75th percentile and the 90 percentile, in % (rhs). Data for the EEA30, in 2022.

Sources: AIFMD database, National Competent Authorities, ESMA.

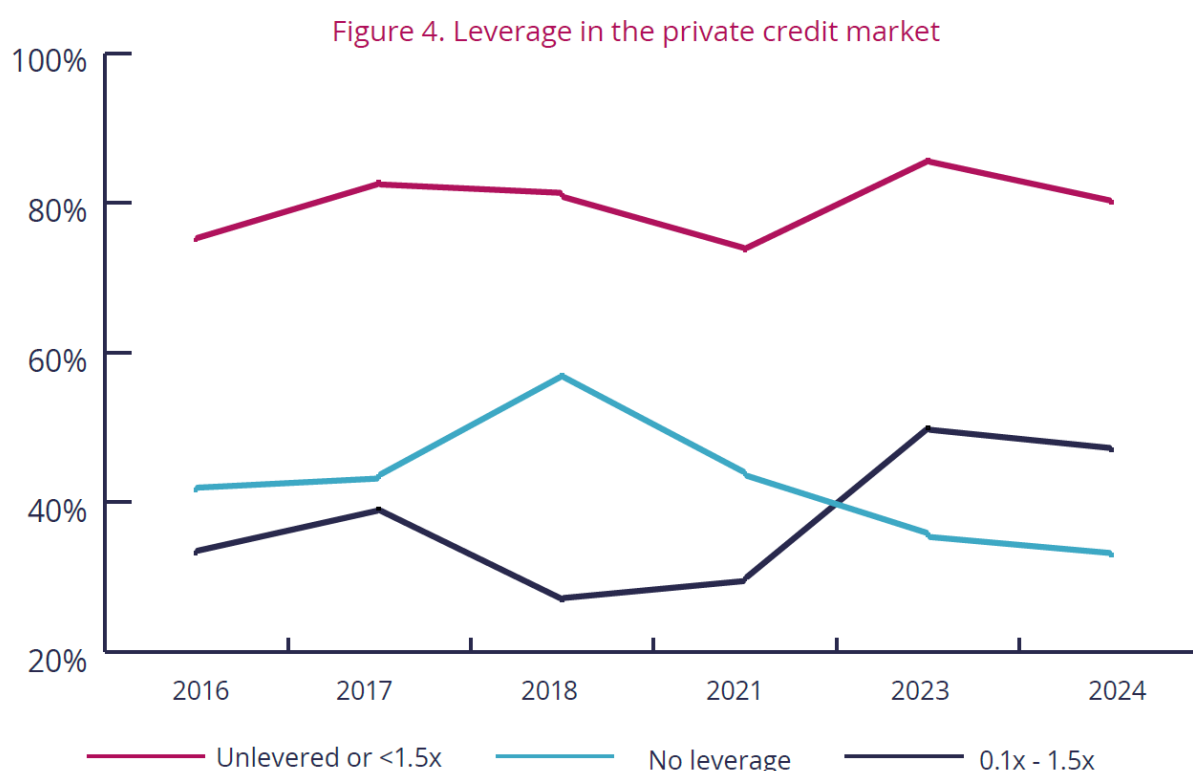
¹⁴ Originally published in the European Securities and Markets Authority 30 January 2024 TRV Risk Analysis, Assessing risks posed by leveraged AIFs in the EU, page 7 at, https://www.esma.europa.eu/sites/default/files/2024-01/ESMA60-1389274163-2572_TRV_article_-_Assessing_risks_posed_by_leveraged_AIFs_in_the_EU.pdf

Leverage in private credit funds

Private credit firms generally use little to no leverage, with the vast majority of private credit firms either using no leverage or leverage at levels below a 1.5 debt-to-equity ratio.

Private credit funds do not engage in significant maturity transformation, a key source of systemic risk in the banking sector. Instead, they often match the duration of their investments with their funding, reducing the risk of sudden liquidity crunches that could trigger a cascade of counterparty defaults.

Figure 2¹⁵



Where private credit firms employ an open-end fund model, they typically do so in a limited way with significant restrictions and liquidity risk management tools. The tools they use include:

- Lock-up periods to prevent redemptions for a pre-determined period, typically at least a year.
- Ex-ante investor level gates which set a pre-determined limitation on the amount of invested capital a given investor can redeem at one time.
- Ex-ante fund level gates which set a pre-determined limitation on the aggregate amount that all investors in a given fund can redeem at one time.
- Prescribed redemption windows which allow investors to only redeem at predetermined intervals, typically semi-annually.

¹⁵ This chart was first published in AIMA's 2024 paper "Reassessing Systemic Risk in Nonbank Financial Institutions", at 11, available at <https://www.aima.org/compass/insights/private-credit/nonbank-financial-institutions.html>.

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

Regulators globally are paying close attention to the development and trading of crypto assets, but since the sector represents only about 1% of global securities markets, we do not view it as posing a systemic risk.¹⁶ However, we believe all financial market participants, including crypto asset intermediaries, should be regulated appropriately. AIMA is leading efforts to develop sound practice guides for its manager members interested in crypto assets, covering areas such as custody, trading, valuation and accounting, and we would be happy to share our expertise in this area.

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.

The unrelenting focus on perceived risks in NBFIs, especially asset managers and funds, despite many rounds of rulemaking is a major threat to their ability to provide funding to the real economy. NBFIs such as asset managers and the funds they manage are subject to extensive prudential, conduct, financial stability and reporting rules. The continued search for risks they *might* pose, despite any compelling evidence to prove those risks actually exist, is undermining confidence in this key sector. The continual negative focus by international, EU-wide and national central banks on possible risks from NBFIs only serves unnecessarily and irrationally to undermine confidence in a key element of the EU's financial architecture which serves the needs of the EU's real economy.

We would also urge the CP to take greater account of the unconcentrated nature of the asset management industry and its very wide range of investors who are routinely based in jurisdictions other than those of the funds they commit capital to. AIMA alone has over 2,000 members in over 60 countries.¹⁷ It is estimated that in Europe alone there are over 4,500 asset management companies.¹⁸

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?

As we note in our covering letter, for the purposes of both AIFs and UCITS, the CP should respect the recent changes to the AIFMD and UCITS Directive which have so recently been approved by the co-legislators who had the opportunity to take such issues into account.¹⁹ The newly-approved amendments should be put in place and their efficacy assessed before any further changes are considered. ESMA's current work developing the level 2 requirements must also respect these recently revised directives.

¹⁶ See French AMF paper on Decentralised Finance available at https://www.amf-france.org/sites/institutionnel/files/private/2024-07/2024_defi_synthese-papier-discussion-amf_veng.pdf.

¹⁷ See AIMA in Numbers, available at <https://www.aima.org/about/aima-in-numbers.html>.

¹⁸ See EFAMA's Our Industry in Numbers, available at <https://www.efama.org/about-our-industry/our-industry-numbers>.

¹⁹ See the AIFMD Review Directive, *supra* note 6.

Link between liquidity mismatch and liquidity risks

Question 16(a).²⁰ How can NCAs better monitor the liquidity profile of OEFs, including redemption frequency and [liquidity management tools (“LMTs”)], in order to detect unmitigated liquidity mismatches during the lifetime of OEFs?

OEFs and their managers already have extensive ex-ante tools available to ensure no unmitigated liquidity risks are built into OEFs. There are thorough-going rules on how OEFs must be designed so that dealing frequency and redemptions are coherent with the liquidity profile of the underlying assets as well as the needs of the target investors. They also have access to a very wide range of LMTs to manage any liquidity stresses that might emerge. As we allude to in our response to question 11, this access to such tools has recently been strengthened by the AIFMD Review Directive.

NCAs should also use the tools they have, be they when authorising OEFs or supervising these on-going requirements, rather than assuming further tools or interventions are necessary. For example, NCAs should make use of the twice yearly UCITS risk reporting and the Annex IV reporting of AIFs.

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

Typically managers will:

- Determine asset liquidity by simulating the time it would take to liquidate each asset in full in both stressed and normal conditions;
- Assess fund liabilities such as redemption scenarios, investor types and concentrations and likelihood and magnitude of possible margin calls; and
- Combine those to determine the redemption coverage ratio which is the extent to which portfolio positions could be converted to cash to cover redemptions over a range of time horizons.

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?

LMTs are applied on a fund-by-fund basis by managers who have a full understanding of their underlying characteristics and the investors in them. Given this, uniformity in the use of LMTs should not be a regulatory goal as it may lead to LMTs being applied unnecessarily in some funds and provide more sophisticated investors with the ability to anticipate redemptions to the detriment of others.

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

Stress testing represents an important tool within the liquidity risk management framework, allowing risk managers to ensure that a fund can meet redemptions in a range of environments. To analyse the impact stressed markets on the liquidity of a portfolio, risk managers should consider the liquidity in light of

²⁰ The CP has two questions numbered 16. For ease of reference, we have designated the first to appear as Question 16(a) and the second as Question 16(b).

redemptions in both normal and stressed market conditions. Stresses can be applied to assets, fund redemptions, other fund liabilities or a combination of these, depending on the intended scenario. The outcome will provide the liquidity risk managers with insights on how different liquidity stress scenarios may impact the funds and hence will contribute operational readiness to mitigate these.

In stressed markets, some data can become misleading or unsuitable for decision-making, especially during periods of extreme volatility. When previous data is no longer reliable, a back-to-basics approach is essential for managing fund flows and redemption requests. Simple, time-tested data becomes invaluable when new liquidity data lacks a proven track record, and trading volumes are unreliable. The following data becomes particularly important:

- Historical redemption requests in stressed periods (if available);
- Unencumbered cash;
- Pro rata liquidation;
- Redemption coverage ratio.

Stress testing involves simulating various adverse scenarios to assess the impact on an institution's liquidity position. This can help identify potential vulnerabilities and ensures preparedness for different stress conditions.

One EU-based AIMA member provided this example of how it looks at this issue as an illustration which will be useful to consider:

“Liquidity risk monitoring: on a monthly basis we compare a situation where all fund investors would request redemption (taking into account the investor notification period and the redemption gate) with portfolio liquidity, as such reflecting a stressed scenario from an investor redemption perspective. As a CTA with a highly diversified portfolio invested in very liquid assets (assets need to meet predetermined liquidity constraints and actual market liquidity is monitored and experienced on a daily basis) this overview has until now never indicated a liquidity mismatch.

Should a market stress scenario occur with significant adverse effects on a broad set of asset classes and geographical regions, which may among others lead to much higher-than-expected margin calls, we would have enough LMTs available to address a liquidity mismatch and protect investor interests. We have described various market stress scenarios in general, qualitative terms (e.g. substantial number of markets closed or counterparty default). ...

The monthly overview referred to above is also reported to our regulator on a quarterly basis as part of the AIFMD Annex IV reporting, which, together with all other reporting in place on e.g. portfolio positions and fund counterparties, should give them sufficient information to monitor liquidity risk we believe.”²¹

In addition to techniques to measure and monitor liquidity risk, other redemption tools are available in some jurisdictions in “extraordinary” circumstances to meet unexpected redemptions. Asset managers

²¹ Case study supplied by an AIMA manager member in response to question 20 to be published anonymously.

and funds should perform regular reviews of the redemption tools available to different fund types in varying jurisdictions.

In stressed markets, the accuracy of some liquidity analytics may depend on trading activity, market data transparency and the availability and accuracy of data points such as trade sizes, trade prices, trade directions, evaluated prices, bid/ask spreads as well as broker prices and sizes. This may lead to a deterioration of accuracy in stressed conditions. It is therefore helpful to compare them with trading data such as realised transaction costs, broker prices and sizes. If there is a recurring gap between them then these can be narrowed by applying multipliers at the sector or global level.

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?

Average daily trading volumes are a central input to market participants' liquidity risk stress testing. They give a sense of the volume of instruments that can be traded without the need to sell below the market price. One challenge market participants face is that the ability to carry out a similar assessment for fixed income securities is constrained by the poor quality of post-trade fixed income market data. It is fragmented and inconsistent, making it difficult to utilise and of limited use to our stress testing models. We therefore welcome efforts to implement a consolidated tape for the EU. Once operational, the tape will help to improve the simulation of liquidity risk through greater transparency in OTC bond and derivatives markets. Having the most up to date market data is central to liquidity stress testing. Importantly, the tape should also help to avoid instances of broker pricing becoming stale where the price data on screen differs from the prices of actual trades (as happened in March for example).

A second challenge relates to limited visibility into omnibus accounts for OEFs. Fully liquidity stress testing a fund requires understanding of how its underlying investors might behave. For institutional investors, it is possible for asset managers to open a dialogue and anticipate their liquidity needs. For retail funds, or those that are intermediated by distribution networks, modelling investor behaviour is more complicated, as the aggregation of flows limits managers' visibility of the end-investor. Therefore, policymakers should consider convening a working group of all actors involved in the fund distribution chain, with a view to determining the viability of improving the flow of critical information on underlying investors. The group should also consider any potential unintended consequences for the competitiveness of European funds that rely on ex-EU distribution. Specifically, data on the types of investors transacting in omnibus accounts, the size and concentration of investor holdings, and industry-wide data on historical worst-case redemptions would all help better inform manager assessments of potential redemption patterns.

Nevertheless, as regards liquidity mismatches, we hope that the ongoing revisions to the Regulatory Technical Standards and guidelines regarding LMTs called for under the AIFMD Review Directive will result in the consistent availability of the nine listed LMTs to address any liquidity mismatches in OEFs. These revisions should be allowed sufficient time to take effect before considering whether any additional measures might be required. We also hope that ex ante liquidity management tools that do not meet the four corners of those RTS and guidelines will continue to be permitted where managers choose to employ them.

Accurate and timely data is essential for effective liquidity risk management. However, obtaining high-quality data in real-time can be difficult, leading to potential gaps in monitoring. Designing stress tests that accurately reflect potential market conditions is complex. It requires sophisticated models and assumptions, which can be challenging to validate and calibrate.

The EU has implemented several tools and regulations to address liquidity mismatches:

- The EU has frameworks in place, such as the UCITS Directive and AIFMD, which include provisions for liquidity management and risk monitoring, and now under the AIFMD Review Directive, will mandate the availability of nine types of LMTs such as swing pricing, redemption fees, dilution levies, in-kind redemptions, and suspension of dealings to manage liquidity risks in investment funds and the selection of at least two LMTs from those nine types by the fund manager for each AIF/UCITS with limited exceptions.
- EU regulations mandate regular liquidity stress testing for investment funds to ensure they can withstand adverse market conditions.²²
- Authorities require detailed reporting on the liquidity profiles of funds and enhanced disclosure to investors about liquidity risks and the use of LMTs.
- The ESRB recommends a diverse set of macroprudential liquidity tools to address systemic risks, including guidelines for stress testing and the use of anti-dilution tools.
- We understand that while these tools and regulations provide a robust framework for managing funds' liquidity risks, their effectiveness depends on proper implementation and continuous adaptation to evolving market conditions.

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

Data availability is the main challenge. As noted in response to Q. 21, better data would improve estimates of end-investor behaviour and redemption patterns. The limitations of market data also impact estimates of margin calls, where it can constrain managers' ability to assess market dynamics that drive margin calls. However, beside this, a major challenge market participants face in calibrating worst-case and stress-case scenarios related to redemptions and margin calls, is the limited information made available to them by intermediaries, especially CCPs.

We welcome the changes introduced in the recent review of the European Market Infrastructure Regulation ("EMIR") which provide that CCPs will provide information to clearing members in order to allow their clients receive required levels of transparency on margin calls and CCP margin models. We note that ESMA, in consultation with European Banking Authority and the European System of Central Banks, will develop regulatory technical standards specifying the scope and format of the exchange of information between CCPs and clearing members and between clearing members and their clients. We welcome the fact that the new rules will enable firms to get a better understanding of their future potential liquidity needs when clearing centrally by requiring margin models to be more transparent. We agree that it is easier for a firm to plan liquidity needs if it can understand what sort of margin calls it may face, particularly in a situation of stress.

We continue to call for standardisation of CCP disclosures and implementation of audit requirements to ensure those disclosures are accurate, consistent, and timely. Improving the quality of the data in these feedback loops will be central to enhancing the sophistication and accuracy of market participants' stress testing models. We also note behavioural factors as a challenge: predicting investor behaviour during

²² See, e.g., ESMA, "[Guidelines on liquidity stress testing in UCITS and AIFs](#)" (16 July 2020).

stress events is complex. Panic selling or herd behaviour can exacerbate liquidity issues and are difficult to model accurately.

As already noted, model assumptions used in stress testing models, such as correlations and volatilities, may not hold true in extreme market conditions. Different jurisdictions may have varying regulatory requirements for stress testing, making it challenging for global institutions to comply uniformly.

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 NBFIs sector(s) you refer to in your answer?

In relation to funds, greater transparency from CCPs in order to better anticipate margin calls would improve preparedness, as would an expansion of the eligible collateral for margin calls and better sharing of market data.

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

AIMA's response relates to AIFs/UCITS and their managers. However, all types of relevant financial institutions should have in place robust governance for managing margin and collateral calls, thorough-going stress-testing, in depth reviews of their collateral management arrangements to ensure its availability and regular engagement with counterparties.

AIFs and UCITS often use some combination of the following:

- *Redemption Coverage Ratio*: Measures the ability of funds to meet redemptions.
- *Stress Testing*: Simulates adverse market conditions to assess the impact on liquidity and margin requirements.
- *Liquidity Gap Reports*: Analyse mismatches between asset liquidity and liability maturities.
- *Redemption Gates and Suspension Policies*: Tools to manage liquidity by limiting redemptions during periods of stress.
- *Value at Risk (VaR)*: Estimates the potential loss in value of the fund's assets over a defined period for a given confidence interval.
- *Leverage Ratios*: Monitors the extent of borrowing and its impact on liquidity and margin calls.
- *Property Valuation Frequency*: Regularly updating property valuations to reflect current market conditions and liquidity.

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.

In the event there are concerns about the liquidity and transparency of commodity derivatives, we note that there are mandatory clearing requirements for derivatives and clearing, and where they are not mandatory, will be encouraged. It is a central characteristic of clearing that the instruments subject to it are sufficiently standardised, liquid and transparent. For example, Article 4 of EMIR when dealing with the criteria for central clearing refers to: (i) the degree of standardisation of the contractual terms and the operational process of the OTC derivative, (ii) the volume and liquidity of the relevant OTC derivative, and (iii) the availability of fair, reliable and generally accepted pricing information in relation to the relevant OTC derivative. Such requirements result in a reduction of risk posed by centrally cleared commodity derivative contracts. A number of exchanges also impose position limits on commodity derivatives. These limits are applied for spot months and also overall exposure across all months.

Other markets

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?

As we have noted in our response to question 5, we question the concept of “excessive” leverage. For OEFs there are already extensive tools available both in terms of governance, counterparties and, where deemed necessary, caps. Information on who the main counterparties are is also readily available to securities regulators via Annex IV reporting. We do not see the need for further tools to be made available.

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.

No there are not. Please see our responses to questions 5 and 43.

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

As we have already discussed, the EU already has extensive reporting requirements for funds on the leverage they use and their counterparties. However, we do recognise the challenges involved in data sharing across global jurisdictions. More consideration could be given to sharing data with non-EU jurisdictions making use of the existing IOSCO memoranda of mutual understanding which already provides a framework.²³

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

Please see our responses to questions 5 and 43.

²³ For further details on IOSCO's work, see <https://www.iosco.org/v2/about/?subsection=mmou>.

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

We do not believe macroprudential tools for fund managers or funds are necessary or appropriate. Please see our response to the Central Bank of Ireland's 2023 discussion paper 11 on the macroprudential regulation of investment funds.²⁴ We do see merit in developing more effective channels of data sharing as we discuss in our response to question 46.

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

While we see merit in jurisdictions performing system-wide stress testing similar to that being carried out by the Bank of England, we question the practicality of it being done on an EU-wide rather than member State by Member State basis. The logistics of such an exercise would be extremely complicated.

Question 54. Is there a need for arrangements between NBFIs 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.

Please see our responses to questions 46 and 53.

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

Please see our responses to questions 46 and 53.

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.

As we note in our response to 46, macroprudential measures are neither necessary or appropriate for investment funds and investment fund managers. As we discuss in the response to question 53, we do see merit in jurisdictions carrying out system-wide stress testing.

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?

Please see our response to question 57.

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

Please see our response to question 57.

²⁴ See Central Bank of Ireland, "Discussion Paper 11 - An approach to macroprudential policy for investment funds" (18 July 2023), available at <https://www.centralbank.ie/financial-system/financial-stability/macro-prudential-policy/nbf/macroprudential-policy-for-investment-funds>, and AIMA's response, available at https://www.centralbank.ie/docs/default-source/publications/discussion-papers/discussion-paper-11/aima-response-to-dp11.pdf?sfvrsn=eb25611a_7.

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 NBFIs sectors or only for a specific one.

As we have discussed in our responses to questions 3 and 4, “NBFIs” encompass a very wide universe of entities which are themselves subject to extensive rules designed to reflect their sectors and prevailing business models.

Please also see our responses to questions 46 and 48 which discuss greater data sharing.

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

We have not been presented with any evidence to suggest that this is an issue. The existing cooperation mechanisms are more than sufficient to supervise such firms.

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.

Please see our response to question 62.

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)?

Please see our response to question 62.

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 NBFIs sectors?

Please see our response to question 62.

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.

We have not been presented with any evidence to justify any such a radical extension of the ESAs powers. Such interventions would also have the strong potential to create confusion and resource burdens on both entities and national regulators.

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

No. We are concerned that the FSB workplan for NBFIs has a high potential for being counterproductive as it undermines confidence in NBFIs. We explain this issue in detail in our covering letter.