

# Additional Responses and Reference Notes

## EU COMMISSION CONSULTATION ON MACROPRUDENTIAL POLICY FOR NON-BANK FINANCIAL INTERMEDIARIES

### About the Investment Association

The Investment Association (the IA) champions the interests of the UK-based investment management industry. We represent 250 investment managers, a third of whom are headquartered in the EU. Collectively, they operate from 642 offices across the EU and have more than 2,100 funds domiciled in the EU.

Our members put €10.6 trillion to work in the global economy, representing 37% of the €28.6 trillion in assets managed in Europe. They manage €2.5 trillion for European savers and invested €843 billion into EU businesses and projects last year while providing access to global investment opportunities.

Our mission is to make investing better. Better for our clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers.

### Background comments and executive summary

The IA welcomes the opportunity to respond to this consultation concerning a possible macroprudential framework for Non-bank Financial Intermediaries (NBFIs). We share the Commission's objective of ensuring the NBFI sector is resilient, of which regulated investment funds are a smaller subset. Significant work has recently been conducted through the AIFMD and UCITS review with this objective in mind, and we welcome the opportunity to comment further.

As per the EU's Better Regulation Principles, any policy interventions, if indeed they are to be pursued by the Commission, must be balanced, proportionate, and evidence-based. We welcome the Commission's nuanced approach in this consultation by considering **unmitigated** liquidity mismatch and **excess** leverage, as opposed to assuming that liquidity variances or leverage are inherently systemic risks. Nonetheless, in our response below we challenge several of the fundamental assumptions that feature in the Commission's assessment, alongside other policy publications from international policymakers.

**Firstly, the assumption is that all NBFIs should be considered a single, distinct sector compared with the banking sector.** This oversimplifies the significant differences between different constituencies of NBFIs, particularly when considering the varied nature of their business model, client base, service offering, extent of regulation, and degree of supervision. As John Schindler, Secretary General of the Financial Stability Board (FSB), put it in a recent speech, "calling it the non-bank sector may have been appropriate for a

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while, but the time has come to stop referring to it as if it is monolithic”<sup>1</sup>. The diversity of the NBFIs sector must be a starting point when considering any policy intervention.

Furthermore, it implies that risks observed in market-based activity arise only from the NBFIs sector rather than potentially emanating from, or being exacerbated by, other parts of the financial system or the interaction of different entities in specific market contexts. Recent notable failures, such as the collapse of Silicon Valley Bank (SVB) and the near failure/rescue of Credit Suisse, should remain critical touchpoints in any debate about financial stability. So, too, should the relative performance of EU Money Market Funds in 2020 and other liquidity events since, which have helped to demonstrate, in real-time, the resilience of the current EU regulatory framework for investment funds. For macroprudential policy to be effective, a system-wide consideration is needed of banks and NBFIs together rather than assessing NBFIs singularly.

**Secondly, the risks presented as grounds for policy intervention are often conceptual rather than based on evidence.** We understand the suggestion that regulators need to prepare for and be able to respond to potential new risks in the system rather than being unduly constrained by specific lessons from previous crises. However, the starting point for this discussion must be rooted fundamentally in the available evidence base and the nature of the activities under scrutiny.

We believe insufficient evidence has been provided to meet the proportionality threshold warranting policy intervention. The literature on the subject has too often failed to make the case for real financial stability risk – the possibility of an event threatening the function of the broader financial system or the real economy<sup>2</sup>. Market volatility alone should not be cited as evidence of systemic risk. Financial markets, whether formal trading venues such as recognised exchanges or less formal, such as “Over-the-Counter” (OTC) bilateral trading, are price discovery and exchange mechanisms where the price of assets fluctuate driven by supply and demand, regardless of the circumstances where these arise.

**Thirdly, for asset managers and asset management products, such as investment funds, the agency role of asset managers is critical when assessing any systemic risk posed by this sector.** Asset managers are not managing their own money – this is money entrusted to them by investors. While individual securities allocation decisions are typically made by asset managers, the decisions on whether to enter or exit markets are frequently not – they will, in most cases, reflect the decisions of the end investors. Where they can meet redemption requests without (in the case of a fund) harming the interests of other investors, they are under an obligation to meet these redemption requests – it is not for the asset manager in this scenario to take a view on whether it is a good time for the investor to exit the market. As such, this mirrors rather than amplifies the allocation decisions being taken by investors across the market as a whole.

Additionally, the assets managed are segregated from asset managers’ own balance sheets and those of other investors. The segregation of assets is a feature that significantly limits the possibility of transmitting risks to other entities. Segregation acts as a firebreak.

**Fourthly, we agree with the Commission’s conclusion in its 2023 report that it is unnecessary to fundamentally revisit the Money Market Fund (MMF) Regulation.** As the Commission’s report explored in detail, European MMFs proved their resilience in the face of considerable outflows in the March 2020 Covid and the September 2022 UK gilt market stresses. We agree that a small number of enhancements could be made to the framework via targeted amendments, such as removing the regulatory link between breaching liquidity thresholds and activating liquidity management tools and removing restrictions around the use of government securities in liquidity thresholds.

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<sup>1</sup> [Building bridges: the case for better data and coordination for the non-bank sector](#): Speech by John Schindler, Secretary General of the Financial Stability Board, at the Eurofi Financial Forum 2024 in Budapest, 12 September 2024

<sup>2</sup> This is in line with the definitions used by global policy makers. In their 2009 joint report to the G20, the FSB, IMF and BIS define systemic risk as “a risk of disruption to financial services that is (i) caused by an impairment of all or parts of the financial system and (ii) has the potential to have serious negative consequences for the real economy.” ([Guidance to Assess the Systemic Importance Financial Institutions, Markets and Instruments: Initial Considerations](#), Oct 2009)

However, some of the reforms proposed, particularly giving EU bodies and NCAs the power to increase liquid asset thresholds for certain MMFs or during stressed periods, could negatively impact the resilience of MMFs and destabilise Short-Term Funding Markets (STFMs). Greater focus is instead needed on improving the functioning, efficiency, transparency and diversity of participation in STFMs, and we welcome considering these in this consultation.

We do not consider that group wide stress tests should be imposed on investment management firms. Such tests are only relevant to entities that carry balance sheet risk. As investment management uses an agency-based model, where assets are segregated from those of the manager, other products and mandates, investment managers do not typically carry any material balance sheet risk, making group stress tests meaningless. We also do not believe that stress testing of products at a group level in most cases is likely to yield any meaningful results, given that even similar funds can experience market challenges in different ways, depending on factors such as their respective investor bases.

**Finally, while we do not offer a view on how the EU's supervisory responsibilities should be assigned between national regulators and EU bodies such as the ESAs, we emphasise the importance of ensuring a consistent and coherent approach to supervision reflecting a common regulatory framework.** In this context, we also emphasise that asset managers are best placed, having the best understanding of their products, portfolio characteristics, investor base and the trading environment they are experiencing, to make informed decisions on appropriate interventions in response to stressed events and interventions by NCAs and/or EU bodies should only be on an exceptional basis.

## Additional Responses

### Chapter 1: Key Vulnerabilities and Risks Stemming from NBFIs

**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.**

To be able to undertake sound counterparty credit risk assessments, banks must have appropriate transparency over their counterparties, including access to timely, frequent and accurate financial information on their activities and balance sheet strength. This is particularly important where counterparties are unregulated, as they are not subject to a regulatory framework and supervisory scrutiny on their activities. We encourage EU bodies and national governments to work with banks and their associations to identify and remove any legislative barriers that exist to banks receiving this information.

It should also be emphasised that failures in the banking sector disrupt the provision of critical services to NBFIs along with other commercial and individual customers. Silicon Valley Bank's (SVB) failure in March 2023 impacted venture capital and private equity investments in the technology sector. The near collapse and subsequent rescue of Credit Suisse, also in March 2023 (in part due to a loss of confidence following both the collapse of SVB and previous losses incurred in the Archegos default) resulted in broader concerns to holders of other AT1 (contingent convertible) securities, given the more favourable treatment of equity holders over AT1 holders by the Swiss National Bank. This inverted the normal creditor order and, therefore, changed the risk calculation for asset managers holding AT1 securities. Had other central banks not acted quickly to reassure investors of the normal creditor order for AT1 securities in the EU and other jurisdictions, this could have resulted in less investment in AT1s and therefore a capital funding challenge for banks. This points to maintaining investor protection being additive to financial stability, rather than a competing consideration, suggesting a more holistic consideration being required when considering the

risks to the financial system, rather than separating NBFIs and banks, or only considering risks posed to banks by NBFIs.

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

This is different from banking, where, due to leverage arising from lending and money creation activities, the bank can only ever pay a portion of creditors, such as depositors, at any time. A run on bank deposits can lead to a bank becoming insolvent and unable to pay depositors their money. This scenario has been observed in several bank collapses, most notably Silicon Valley Bank in 2023.

The IA welcomes and supports the adoption of a wider liquidity management toolkit in the recent amendments to the AIFM and UCITS directives. A broad toolkit is essential for managers to be able to manage microprudential risks. But the benefits of these tools are not limited to the management of microprudential risks. These tools are also invaluable in preventing the transmission of risks to the broader financial system. For example, swing pricing in an investment fund removes any first-mover advantage from buying assets when there is a larger deviation between mid-prices and spreads, removing an incentive to time redemptions in stressed markets. The ability to gate or suspend redemptions reduces the pressure for fire sales in the event of a liquidity crunch, reducing pressures on the overall market. Requirements for investment funds to maintain global exposure limits or to operate within disclosed maximum leverage limits prevent funds from building excessive leverage levels.

Of course, the asset management industry would welcome and support initiatives to improve liquidity in key markets, particularly fixed income and short-term funding markets. However, investment funds in many jurisdictions already have the tools to manage current levels of liquidity and prevent unmitigated liquidity mismatches. The amendments mentioned above to the AIFM and UCITS Directives will ensure that these tools are available in all EU jurisdictions.

## Reference Notes

### Question 2

Note 1: [Consultation on Guidelines for counterparty credit risk management](#) issued by the BCBS, April 2024

### Question 28

Note 2: Consultation Paper on the draft Opinion on the supervision of liquidity risk management of IORPs, EIOPA, 2024.

Note 3: See Figure 1, Annex II of the consultation document on the draft Opinion.

Note 4: [Using leveraged liability-driven investment](#), TPR, 2023

### Question 35

Note 5: [Viewpoint lessons from Covid19: Experience of European MMFs in Short Term Markets](#), BlackRock, July 2020

### Question 44

Note 6: Feedback Statement to CP157: Macroprudential measures for GBP liability driven investment funds, CBI, 2024