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Subject: EBF Response to EC’s Targeted Consultation assessing the adequacy of macroprudential policies for NBFI

QUESTIONS 1 TO 7

Please consider how the question applies to different NBFI sectors (entities and markets) and specify the NBFI sectors concerned when providing a response. Please also provide quantitative evidence, where possible.

General and Introductory Remarks:

- We believe that any future legislative changes, if envisaged by the European Commission (EC), should consider the diversity of Non-Bank Financial Intermediation (NBFI) market players (regulated or not regulated). As highlighted in the Consultation Paper by the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS),[1] the NBFI sectors are characterised by high diversity in terms of business models, risk profiles, etc. The impact that their individual failure would have on the financial system or on end-investors/other non-financial counterparties would differ across the sectors, too;

- In the European Union (EU), all NBFI entities are already subject to stringent financial and market legislations (MMF regulation, EMIR, Solvency II, AIFMD, etc.) which include macroprudential and microprudential tools. Existing rules and their effective role in the monitoring of liquidity and leverage management must be clearly understood and taken into account before envisaging any additional constraints. Overly prescriptive requirements or an additional NBFI layer of irrelevant regulation would be very harmful for the functioning of markets and “one size fits all” solutions would be totally inappropriate;

- The NBFI sectors can be therefore approached from two angles. They can be approached with a regulatory view, focusing on the regulation applying to the entity, or it can be approached from an activity-based view. Integrating these views allows to decompose NBFIs into two categories: i) financial activities that fall within a regulatory framework, such as IFR, UCITS, Solvency II, AIMFD, etc., and ii) financial activities outside an EU regulatory framework, such as family offices, big tech and crypto-brokers operating outside of the EU;

- Being aware of the increasing interconnection of the banking system with non-banking actors, we welcome the increasing interest and the initiatives that seek to analyse potential risks associated with NBFIs and their potential contagion

[1] “Enhancing the Resilience of Non-Bank Financial Intermediation. Progress report”, Financial Stability Board, 2024 (link)

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channels to banks. Yet, **potential issues relating to the unregulated part of NBFIs will not be solved by imposing more regulation on banks**;

- The first key idea we would like to highlight is that **systemic risks and vulnerabilities deriving from the NBFI sectors should not be addressed through additional constraints on EU banks**. Such situation would push additional volumes of business to the non-regulated/supervised sectors and ultimately would increase systemic risk. Besides, banks should not become the main data provider or the main channel to seek data on some NBFIs that are not submitted to transparency requirements. In this regard we argue that efforts should be made to limit the banks reporting burden and data requirements;

- It is the regulatory and supervisory communities' responsibility to identify non-regulated NBFIs and collect information from these entities. Most of data about derivatives, risk exposures and counterparties of most NBFI entities is currently available to EU regulators and supervisors either through trade repositories (under the EMIR) 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 and data requirements 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 dedicated data analysis capacities**;[2]

- Moreover, we would like to emphasise the global dimension of financial markets. Introducing new measures that would apply only to players and products domiciled in the EU would not allow to address properly the effective of sources of systemic risks. As mentioned previously, priority should be given to non-regulated entities and products while most of them are domiciled outside the EU, such as family offices. It is thus important that a global perspective is preserved when considering this topic and the EU does introduce new prescriptive constraints in an isolated manner;

- It is important to distinguish between the impact of regulated NBFIs, including investment funds (MMF, open-ended funds, UCITS,[3] AIF), pension funds and (re)insurers, and the impact of non-regulated or less regulated NBFIs, such as family offices, on the banking sector. The latter poses the most important systemic risks and vulnerabilities in financial markets. This distinction is not properly reflected in the EC Consultation Paper as most questions relate to investment funds (IFs) or other NBFI (insurance, etc.) that are already significantly regulated at the EU level;

- More specifically, it is important to prevent more regulation of NBFIs via banks and their exposures. In this regard, banks already need to comply with the

[2] "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 (link).

[3] For example, the UCITS Directive and the AIFMD already include several rules on liquidity risk management and leverage limitation, through both L1, L2 and L3 provisions. In addition, measures on liquidity management tools (LMTs) (to be applied from 2026 at EU level and already in place in France and Luxembourg) will reinforce the existing framework.

requirements included in the Capital Requirements Regulation (CRR) on Unregulated Financial Sector Entities (*UFSE* - CRR Article 153(2)) and Shadow Banking Entities (*SBE* - CRR Article 394(2). Here, it is important to note the partial conceptual overlap between UFSE, SBE and NBFI. **It would be good if these definitions were aligned within the EU legal framework**;

- Finally, the emergence of new players such as large technology firms ("Big Techs") into financial services (including payment, savings, and credits) should be taken into account from a systemic risks' perspective. These new players pose several risks, potentially systemic (cybersecurity, contagion, concentration risks within multi activity groups). Moreover, the lack of level playing field between "Big Techs" and more traditional institutions could also have implications on financial stability. Additionally, existing regulatory framework does not consider aggregated risks arising from new types of mixed activity group (lack of holistic understanding of the risks they generate through the combination of financial and non-financial activities). In this regard, the European Supervisory Authorities (ESAs) highlighted in a recent report[4] that sharing the same technology infrastructures, including software, data, and customer interfaces, implies operational resilience and cybersecurity risks, which, combined with managing large data pools, may make the group subject to a higher risk of cyber-attacks or operational outages. The report notes that in the event of a successful cyber-attack in large-scale data loss or corruption, reputational risk could lead to a loss of investor or consumer confidence that could result in spillover into the financial system. Similar conclusions are supported by ACPR in a recent study entitled "The Development of Big Techs in the Financial Sector: What Risks, What Regulatory Responses?"[5], as "Big Tech" companies are gradually entering the financial services market bringing new risks to financial stability. The ACPR study highlights the limitations of the existing regulatory framework for such actors and sets out a series of regulatory proposals to allow to regulate inherent risks without stifling the innovation brought by these players.

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?*

1) Yes there are. First, systemic risks or vulnerabilities deriving from NBFI activities can be linked to international interconnectedness (e.g. non-EU NBFI), not only between EU market players.

2) Second, in general, liquidity constraints within market players due to margin calls. In case margin calls in favour of the Credit Counterparty Clearing Houses (CCPs), abrupt market movements can lead to cash outflows and put solvency at risk. The paper provides a comprehensive overview of risks and the overall topic. Besides the discussed margin call topic, which materialises in volatile markets due to variation margin requirements, for instance, CCPs have an inherent pro-cyclical element (risk) as the base initial margin requirements on experienced

[4] Joint-ESAs Report – Report on 2023 stocktaking of BigTech direct financial services provision in the EU, JC 2024 02 - 01/02/2024 (link).
[5] Le développement des big techs dans le secteur financier: quels risques, quelles réponses réglementaires ? | ACPR (link)

market sensitivities, which increases the liquidity stress for clearing members and other market participants.

3) Third, a common source of risk for market participants is the combination of herding behaviours combined with an overreliance on leverage (funded or synthetic) with liquidity risk attached (e.g. margining and/or liability risk).

4) In the context of the growing use of Significant Risk Transfers (SRTs) operations, where allowing banks to transfer some credit risks to other non-bank market participants in order to support their origination capacity is key.

5) As mentioned in the introduction of the EBF Response, new NBFI players such as crypto markets and large technology firms should be considered by the European Commission, given the potential systemic risks they pose to the financial eco-system. It would be important that the designated gatekeepers under the Digital Markets Act (DMA) would have certain conditions/safeguards for accessing data in the context of the Financial Data Access (FiDA) Regulation to avoid asymmetries in the provision of financial services. It also could then "exacerbate" existing asymmetries and risks, notably cyber security risks, and expand potential risk to "new" players with no legal presence in the EU.

6) Private credit is a potential building systemic risk, as also highlighted by the International Monetary Fund (IMF).[6]

   In Europe, private credit accounts for a modest 1.6 percent of total corporate credit but has experienced a robust average annual growth rate of 17 percent over the past five years. Given its relatively small yet rapidly expanding footprint, this sector should be monitored carefully. In contrast, North America's private credit market comprises 7 percent of credit to nonfinancial corporations, with an even more accelerated growth rate of 20 percent per year over the same period. The substantial size of the private credit market in North America underscores the need for careful monitoring of this asset class in the EU, as systemic risk or vulnerabilities could be building.

   That being said it is important to note that most private credit activities facilitated in the EU are regulated and subject to regulatory requirements. Risks are therefore fairly contained. It is therefore only macroprudential risks, which must be potentially addressed. Any regulatory and supervisory focus should be proportionate and targeted to the least regulated market (mainly non-EU), when non-regulated NBFIs (different from insurers, asset managers and pensions funds) provide credit outside traditional regulated markets, such as banks and capital markets.

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.*

Our members do not see any significant risks for credit institutions stemming from their exposures to the NBFI sectors. Potential risks, such as counterparty credit risk arising

[6] IMF, Global Financial Stability Report, April 2024, Chapter 2 "The Rise and Risks of Private Credit" (link).

from derivatives and repos, as well as exposures to insurance companies and reinsurers are appropriately mitigated, as follows:

- Credit counterparty risk (CCR) is the first risk that applies to banks active in global markets. Credit Valuation Adjustment (CVA) (to a lesser extent) also applies. Otherwise, credit risk is the risk that applies to exposures in the banking book.

- Losses from closing and liquidation of outstanding transactions after missed margin calls and refinancing risk in a risk-off scenario potential risks are already considered within current prudential measures (for instance, when calculating regulatory exposure at default (EAD), the proposed BSBC Counterparty Credit Risk Guidelines already places a strong emphasis on concentration and illiquidity issues). Therefore, no additional measures are needed from banks to cover these exposures. In case regulators have any concerns about the performance of NBFI exposures, those NBFI entities that are not currently either regulated or supervised should be the focus of any potential measure.

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?*
1 - To a very low extent
2 - To a low extent
3 - To a significant extent
4 - To a high extent
5 - To a very high extent
Don't know / no opinion / not applicable
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 impact of an NBFI failing will be different, depending on the specifics of the case. A distinction should be made between the regulated and the lesser or non-regulated parts of NBFI. Generally speaking, the probability of failure of the regulated part should be smaller.

The majority of financing for the real economy in the EU continues is provided by credit institutions, which are already subject to comprehensive regulation and supervision. The EU NBFIs offering critical functions to the real economy are already heavily regulated (CCP, insurance, etc.). However, we believe that the NBFI definition should be extended to large technology companies (the so-called BigTechs) operating in financial services as they also offer critical functions to the real economy (i.e. payment, savings, and credits etc.). In any case, if concerns arise from a non-regulated NBFI due to the domino effect that can impact other players, a robust regulation should be in place for NBFI players.

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.*

Past failures among NBFI entities - often non-regulated or non-EU-NBFI - have caused systemic stress. Similar events may still occur, even without an intermediary failing, as seen during the spring of 2020 "dash for cash" episode, due to effective regulatory measures developed over recent years that supported financial system resilience.

Within NBFIs, key regulated sectors are:

1. Investment Funds

Current rules align investment strategy, investor type, underlying assets, frequency of subscriptions/redemptions and availability of liquidity management tools. This design ensures IFs can meet liquidity outflows under severe market conditions. In so doing, they rely on liquidity management tools (LMTs). IFs are also required to perform regular liquidity risk stress testing, including the asset and the liability sides.

We believe the greatest potential risk is that non-EU highly leveraged hedge funds no longer have liquid options and that the underlyings are no longer sufficiently valuable. In doubt, this can lead to liquidity-burdening infections of other market participants. European IFs (both UCITS and AIF, open and close-ended) have shown resilience in recent crises. UCITS and AIFMD rules have been recently reviewed, particularly in terms of addressing liquidity risks. These recent changes have not yet come into force, and further developments (Level 2 and 3 laws) are expected. We understand any analysis and modification proposal should come after checking the effectiveness and sufficiency of these recent changes. Moreover, it should be noted that open-ended funds (that may present a greater liquidity risk due to the need to meet redemption requests) are typically incorporated as UCITS, which invest in highly liquid assets (transferable assets and other financial instruments that are sufficiently liquid and diversified) in line with this legislation. It is also the duty of other open-ended AIFs to invest in accordance with their redemption policy. In the case of close-ended funds, the liquidity strategy is adapted to the specific characteristics of the portfolio. It should be noted that the funds are closed to redemptions while invested, and all withdrawals take place at the same time for all investors following the General Partner or Management Company's decision.

2. Pension Funds

Pension funds faced issues due to large margin calls (on the interest rate derivatives and asset swaps they use for asset-liability hedging) from market stress, as seen in the "gilt crisis", when the UK Government market experienced extreme stress during Sep-Oct 2022. After an unexpected rise in yields, pension funds experienced a sudden worsening of their repo and derivative positions and associated increases in collateral and margin requirements, which forced them to sell whatever they could including, more UK government bonds. These selling pressures deteriorated even more the market conditions.

In the EU on the contrary, concerning pension funds, the IORP II Directive establishes uniform standards to ensure the stability of occupational pensions (that represent the largest category and, therefore, those that could potentially have a greater impact), including liquidity risk management. Local legislation (at least, in Spain) also mirrors IORP II for individual pension funds and ensures that liquidity risk is considered. Pension funds (both occupational and individual) are long-term products designed for retirement purposes and invested accordingly. This allows for the management of liquidity needs in an organised manner, as the management company already has the information about potential redemptions. Moreover, for example, as per Spanish law, pension funds are required to invest most of their portfolios in highly liquid assets, including transferable securities and other financial instruments that are sufficiently liquid and diversified.

3. Insurance Companies
The insurance sector is also highly regulated. Solvency II has already been reviewed and macroprudential measures have been included.

4. Other (non-regulated) NBFIs
This is the most important category, as it is the most diverse and opaque group (mostly located outside of the EU). It is difficult to assess liquidity risk given this diversity, but issues of concentration, excessive leverage and liquidity risks have been observed. Moreover, non-regulated NBFIs performing credit intermediation are subject to run risk, due to credit exposures on the asset side combined with high leverage on the liability side and liquidity and maturity mismatches between assets and liabilities. Non-regulated NBFIs have no formal official sector liquidity backstops and are not subject to bank-like prudential standards and supervision. Regulatory focus could address NBFI margining practices for derivatives.

To conclude, we think that authorities and supervisors should seek for more transparency and data sharing across jurisdictions to anticipate and address those risks.

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

Leverage on its own may qualify as "excessive" only if the probability of failure is not properly managed (margin/haircut) and/or the information is not visible to the creditor (e.g. Credit Suisse's turmoil following Archegos' fallout, which was the result of a fundamental failure of management and controls).

In the case of EU's NBFI sectors:

- The AIFMD, MMFR, UCITSD include a wide array of regulatory requirements addressing the use of leverage, including limits on investment concentration and leverage, stress test, transparency requirements with additional disclosure obligations. Accordingly, the excessive leverage topic mainly refers to some funds which are not regulated today and for which adequate regulatory monitoring should be introduced.

In the case of EU banks and prime brokerage activities:

- The current EU framework (CRR, internal risk management policies including due diligence) allow banks to properly manage and address their risks, including for prime brokerage activities which are collateralised by design (e.g. eligible for credit risk mitigation purposes within the CRR framework).
- In addition to the credit risk, market risk requirements, the leverage ratio allows for the assessment of institutions' exposure to the risk of excessive leverage. In accordance with the CRR, institutions have to report to their supervisors all necessary information on the leverage ratio and its components. This information is also disclosed to the market. As far as banks leverage is concerned, if the supervisor (e.g. as part of the SREP exercise) determines that a supervised bank has an elevated risk of excessive leverage, that bank may be subject to a P2R with regard to the leverage ratio, in addition to the 3% requirement.
- Additionally, and as an example, the French law on "separation and regulation of banking activities" requires banks to collateralise their exposures when the leverage is greater than 3. This law applies to all entities within the consolidation

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perimeter of the French entity (including prime brokerage activities). Equivalent legislations also exist in Germany and Belgium.

All of these requirements and constraints allow banks to mitigate properly systemic risk and vulnerabilities stemming from NBFI.

Although hedge funds are leveraged by definition/nature, banks/institutions minimise this type of exposure using collaterals, operating with only those well-rated and those hedge funds with tested models and robust counterparty risk control teams in place.

There are other NBFIs for which information on leverage is not so easily available, as it is the case of private equity. Reinforcing the transparency of those sectors would be very useful.

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

At the moment, trading in crypto assets is not material for banks. Trading in crypto assets, in any case, is a market making activity to provide liquidity to bank’s clients and not to build a proprietary trading book.

In the case of banks, risks, whether coming from crypto assets or other type of assets, are mitigated as a result of being regulated and supervised entities in the areas of capital, liquidity, AML etc. Moreover, even when the safeguards to tackle new emerging risks (i.e., AML) may differ, banks possess the awareness to adapt their risk management practices. In particular, banks operating in the EU are subject to strict capital requirements under the CRR III after July 2024 to tackle the risks associated to their exposure to crypto assets besides being subject to supervision. In this regard, the CRR III differentiates between the different types of crypto assets depending on their risk: while exposures to tokenized traditional assets require the same treatment as the non-tokenised traditional assets (given the similarities in risk), the exposures to stablecoins or cryptocurrencies are applied higher risk weights (RW of 250% and 1250%, respectively) to tackle their higher risks. In addition to this RW treatment, banks are limited in the amount of exposure they can have of the riskiest crypto assets (e.g. cryptocurrencies), which is 1% of their Tier 1 Capital.

Moreover, at international level, it is also important to note that Basel prudential standards in which the CRR III is inspired, should be implemented in all jurisdictions by January 10, 2026. In addition, markets in the EU are regulated by the Markets in Crypto Assets Regulation (MICA) in the EU and there is an additional package of regulation to prevent and mitigate other risks (AML, third party….) (FATF Travel rule).

However, this is not the case of NBFIs which could operate under MICA's framework, and subject to much higher risks without having any limit when trading, that even being required to have a CASP license, are not subject to the same stringent regulation and supervision than banks are. This asymmetry of treatment not only raises a level playing field problem between banks and NBFIs, more importantly, it leads to a risk of shifting systemic financial risk to the latter.

We consider that the way to tackle these risks is acting on the source of the problem. That means, laying down the necessary additional regulation on NBFIs. Otherwise, the

source of the risk would not be fixed and any other solution, like placing additional requirements on banks, would be counterproductive.

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.*

Macroprudential policies must be designed in a way that they do not stifle innovation or impose undue burdens that could hinder the growth of investment funds and their ability to finance companies. The Capital Markets Union (CMU) - now renamed Savings and Investments Union (SIU) - aims to create a single market for capital across the EU, which can benefit from macroprudential policies if they reduce market fragmentation and ensure a level playing field across Member States and financial products. However, the macroprudential approach should recognise the differences between players: the supervision of investment and pension funds and their management companies must be adequate to its nature and particular risks.

Securitisation, for instance, is one of the best fitted tools for disintermediated funding from NBFIs to the real economy. NBFIs (insurers, asset managers, hedge funds, pension funds, among others) are investors in securitisation market 'cash' or 'synthetic' tranches (senior or mezzanine) issued by corporates or banks. For this reason, for NBFIs, securitisation can be a valuable tool to provide businesses with access to financing, especially Small and Medium Enterprises (SMEs). By facilitating the diversification of funding sources and funding needs, securitisation enhances the allocation of capital, as it can help channel NBFI funds to corporates that require financing, which is especially beneficial for corporates who may not be large enough to tap into capital markets by themselves. The EU has adopted a framework for simple, transparent, and standardised (STS) securitisation, which aims to reduce information asymmetries, enhance investor protection, and ensure high quality and comparability of securitised products. Securitisation is, therefore, an efficient and well-regulated means to provide financing through capital markets for banks and NBFIs alike. Macroprudential policies can help to promote securitisation by creating an overall level playing field when providing credit, promoting the use of transparent and well-regulated markets.

Regrettably, the EU prudential and market regulation has made this funding technique too expensive for both issuers and investors, which has slowed down the EU securitisation market. Data-based risk-adjusted reforms of the different regulations and macroprudential policies applied to securitisation will be proposed by the industry in its response to the ongoing consultation of the European Commission on the revival of securitisation.[7] In fact, securitisation is a perfect example of NBFI funding being unduly refrained by macroprudential policies.

The case of the Netherlands provides the most relevant illustration of the change of NBFI behaviour as a reaction to a change of macroprudential policies. The Netherlands was the largest pool of euro-denominated securitisations, led by bank-originated residential mortgage-backed security (RMBS). The combination of three new regulations has led to a downturn of both supply and demand:

- CRR III (senior tranches no longer in demand from bank treasuries);

[7] EC Targeted Consultation on the functioning of the EU securitisation framework (link).

- Solvency II (senior and mezzanine tranches no longer in demand from insurers); and
- EU Securitisation Regulation in 2019 (introducing unprecedented regulatory due diligence and disclosure requirements).

Additionally, macroprudential policies may support funding opportunities through the capital markets by having a balanced activity-based regulation.
- "Activity": funding and/or risk-taking (many NBFI have off-balance sheet exposure for risk management purposes, regardless of actual funding); and
- "Balanced": having a common focus that applies to the activity, focusing on transparency (as applicable for Securities Financing Transactions (SFT) regulation, Short Selling Regulation, etc.).

Finally regarding insurers, they can be significant providers of funding for companies, underwriting mainly bonds but also equities when placed in the primary markets, but also contributing to a more liquid secondary market. Macroprudential policies should consider this kind of impact when discouraging such exposures through a penalising treatment under Solvency II.

QUESTIONS 8 TO 19

Question 8. *Pros and cons of giving the competent authority (CA) 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 CA?*

The MMFR already imposes rigorous rules on management between assets and liabilities of the fund through compliance with liquidity ratios (daily and weekly), adapted to the various types of MMFs (CNAV, LVNAV, VNAV). The existing liquidity ratios have proven their resilience during the COVID crisis as no major failure was observed despite tough conditions. The MMF regulation framework also imposes knowledge of investors and understanding of their behaviours, this helps Asset Management companies to prevent mismatch between assets and liabilities.

In addition, it is important to have in mind that any signal sent to the market through intervention of CAs may be negatively interpreted by unit- and shareholders, who could be incentivised to redeem their shares/units. This could result in two major negative impacts:
- It could create "first mover advantage" that is contrary to the fair treatment of the unit/shareholders and would disadvantage the remaining holders in the fund,
- It could generate and accelerate a "panic" event as other unit/shareholders will also ask for redemption. This could cause the systemic risk regulators wish to prevent, hence being counterproductive.

Only individual increases with no public information could be envisaged for a few numbers of entities (knowing that this type of information may be rapidly visible in the market). In addition, increase of cash buffer will result in additional difficulties in liquidity risk management for these funds instead of providing some relief.

The preliminary condition for giving this power is that supervisors have the right data to make this type of decision. It appears that at this stage CAs already receive a huge amount

of information, however, are not in capacity to analyse this properly and/or to share the information they respectively receive between them. As long as such analysis capacity is not effective, it seems difficult to envisage such an option for supervisors.

In case of collective increase, it can be perceived as resulting in decreased performance for MMFs. This could result in investors' decision to use other instruments than MMFs which are less regulated. In that case, market participants would potentially use other instruments/products to hold their cash which are less regulated than MMFs. Accordingly, it would reduce the security provided by the regulatory framework introduced with the MMFR.

For all these reasons, we consider that use of liquidity management tools (LMTs) is much more relevant than power for supervisors to increase the cash buffers. These allow to address the "first mover advantage" by limiting redemptions to only unit/shareholders that really need to get their cash back. With the revision of the AIFMD and UCITS directive, all MMFs will have to select at least one LMT, this will become effective in early 2026 at the latest.

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 examples.*

Today MMFs are supervised at local level rather than at EU level. Asset managers send their reporting and stress testing to their local regulators (with no coordination at EU level) and discuss with them in case of difficulties in the market. It seems that this information is neither shared nor exploited at EU/ESMA level. Accordingly, before looking at coordination between ESMA and the ESRB, it is necessary to assess how further coordination could be introduced between local authorities and ESMA. Indeed, such a move would be beneficial also to avoid competition between local authorities especially in case of stress. Same level playing field across Europe can indeed be helpful.

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?*

It is important to simplify reporting requirements and avoid overlaps. This could be achieved by optimising the flow of information, which would lead to better supervision. All data already reported could be shared between NCAs.

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

Indeed, more precision would be welcome on the methodologies to be used on different fields of the quarterly MMFR regulatory reporting.
Particularly, 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):

- Based on the accounting net asset value (integrating off balance sheet components and based on a trade date positions)
- Based on the front office net asset value (excluding off balance sheet components and based on settlement date positions)

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

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?*

Asset managers already send their stress tests to their local supervisors. At this stage, it does seem that stress tests received from all asset managers are aggregated at EU level by ESMA and so far no feedback have been sent to asset managers on the stress testing exercise they have developed.

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.

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?*

The preliminary phase is to move from a local perspective to an EU-global one. This step is essential to ensure that national supervisors can share their data and provide them through a standardised format to ESMA. If an EU-wide stress test is introduced at EU level, it should not be only an additional layer that creates further burden for asset managers without providing them in return with the added value of such an exercise.

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

This ban resulted in the obligation to replace some LVNAV MMFs by NVAV MMFs. Some of our clients were not in the capacity to go through this type of transformation. So, this move was far from being neutral as we lost some of our clients who have decided to use other instruments.

Question 16. *How can NCAs better monitor the liquidity profile of OEFs, including redemption frequency and Liquidity Management Tools (LMTs)?*

EU investment funds and their management companies are already significantly regulated under the UCITS Directive and the AIFMD. Revision of both directives officially published in March 2024 will enhance the current framework, notably with additional reporting requirements and the obligation for all in-scope investment funds to select at least two liquidity management tools (LMTs) within the list provided in the annexes of the legislative texts. Consultations by ESMA on the RTS about characteristics of these LMTs and on the guidelines to trigger activation of these LMTs aim at ensuring real harmonisation on these LMTS at the European level.

Competent authorities already receive quite extensive information on many features of investment funds, including on their liquidity profile. These reporting can be completed with ad-hoc inspections and regularly reviews when relevant. 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. Work to be launched by ESMA on the review of the AIFMD supervisory reporting and the introduction of a new supervisory reporting for UCITS funds should be a great opportunity to perform a gap analysis between the information currently collected by competent authorities and the one that is still missing for conducting their own analyses of liquidity risks in a proper way, including ex-ante to anticipate some developments in financial markets. As long as this review has not been achieved, it would be premature to add additional requirements which are sufficiently justified by relevant underlying observations.

Similarly, it is of upmost importance to assess how introduction of LMTs will contribute to enhance the existing framework. Guidelines to be adopted by ESMA by April 2025 should help standardising information reported to competent authorities on the key features of these tools and their activation, which is going into the right direction.

In any case, it is very important to maintain the activation of the LMTs under the responsibility of the asset manager. Activation by competent authorities may send very negative signals to the market and result in totally unintended consequences. In addition, LMTs is the most effective way to address the "first mover advantage" in the investment funds and consequently to maintain the fair treatment of all unit- and shareholders. Thus, this should disincentivise significant outflows only due to a panic effect across the market. Introducing the possibility to impose a similar cash buffer to all OEFs would not have positive mitigating effects on investment funds liquidity risk. Such a cash buffer would first not be consistent with the investment strategy presented by all funds in their prospectus as managers would not be able to disinvest this proportion of the assets according to this policy in some cases. In addition, information about the possibility to trigger such cash buffers would send a negative message to unit- and shareholders as already mentioned. It would feed the panic effect and lead massive outflows which is exactly what we would like to avoid. Finally having such cash buffers would raise question about their calibration and which methodology should be applied.

Another option would consist in introducing liquidity buckets that would be based on the liquidity profile of the assets in a prescriptive way will also not be relevant. It remains quite challenging to assess which asset is liquid or not in the long term as liquidity of one asset can evolve over time and be dependent on several market events and on the investor profiles. In addition, it would be very disruptive to manage a change from one bucket to another, in terms of investment management but also information to be disclosed to investors. It seems much more relevant to apply this type of liquidity analysis when a new investment fund is created and reviewed with the relevant competent authority for its approval.

As a conclusion, it seems much more appropriate to assess how the new enhancements of the existing frameworks will allow to improve the liquidity risk management by asset managers and the information that will be available for competent authorities. In addition, enhancement in the effective analysis of all data collected today should be a key priority for competent authorities being in capacity to identify the missing information on their side and using the information they collect to detect situations where specific attention and closer dialogue with one or some asset managers is needed.

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

A broad range of data is used by asset managers to monitor the liquidity risk of their investment funds. This includes notably "macro data" relating to financial markets as a whole (e.g. interest rates evolutions, main financial indices, level of margin calls by CCPs) and also "micro data" referring to the investment funds themselves as the volumes of inflows and outflows, evolutions on the underlying assets and their pricing, and all elements that can generate some market stress and consequently the activation of some liquidity management tools. 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.

On data that asset managers disclose to competent authorities, asset managers normally establish clear procedures on their risk management policies and communicate these procedures to their competent authorities. These must cover at least the following aspects: controls during the pre-trade phase, controls on the presumption of liquidity for all assets, the control framework all along the life of the investment phase and the governance in place. They also communicate information through their programs of activity and/or Risk Management Process and additional elements that can be required by competent authorities when they conduct audits in one asset management company.

A Common Supervisory Action (CSA) exercise was coordinated by ESMA in 2021 to review to what extent NCAs converge or diverge in the supervision practices of liquidity risk for OEFs. Some NCAs have published detailed reports following this exercise and reported notably on what could be improved in this area. It appeared notably that systematic formalisation of the controls performed should become a good market practice. Another point refers to a lack of granularity on the data produced by the asset management companies.

Question 19. *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?*

As referred to in answers to previous questions, it is important that competent authorities receive quite extensive and regular information on the risk management framework that asset management companies have developed and on the robustness of this framework. Information on the LMTs selected for each fund, on calibration and triggers for the activation of these LMTs should be part of this reporting.

This reporting should notably include information on the NAV for each investment fund and the volumes of subscription and redemption orders received. This information is also quite useful to detect the situations where activation of some LMTs is necessary.

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.

QUESTIONS 26 TO 50

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?*

It should be borne in mind that NBFIs include a wide variety of entities, some of which are unregulated on which the focus should be placed.

With regard to investment funds, both UCITS and AIFs and their management companies are subject to specific requirements regarding the use of derivative instruments and leverage, information, risk management (including the liquidity risk associated with each position). The ESMA guidelines on liquidity stress testing also require margin calls to be taken into account. Therefore, there are sufficient regulatory measures to control the liquidity risk associated with derivative transactions and inherent margin calls for the asset management sector.

We agree that rules on margin calls can create some stress in financial markets as observed over the last years, notably with the LDI crisis in the UK in autumn 2022. Even if this situation was very specific to the UK DB pension fund sector, we consider that the approach adopted by the Central Bank of Ireland to identify major risks, stress test the liquidity of the portfolios for collateral calls against basis points move for different market parameters, with regular reporting to the CBI, makes sense.

On margin calls, review of eligible collateral should also be envisaged. High quality liquid assets, alongside cash, should be permitted to provide some relief in case of high volumes of margin calls.

Finally, to enable NBFI entities to appropriately prepare for margin calls in all scenarios, the key priority should consist in ensuring that CCPs provide sufficient information on their margin models to their users, including simulators and details on models. Market participants should be able to understand and replicate margin models, to adequately predict and prepare for margin calls in times of stress.

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?*

Off the cuff, as a follow up from the point made above (trade-off between market risk (due to market triggers) and margining risk:

- Assess a margining gap in case of market (valuation) stress (e.g. difference of thresholds, of eligible assets)
- Measure the holdings of unencumbered assets (cash and beyond, if/when applicable) eligible for margining
- Stress tests look like the most suited monitoring tool: a practice that is used by most important NBFI.
- Increase transparency in CCP margining practices

Question 29. *What would be the benefits and costs of a regular EU-wide liquidity stress test for pension funds and with what frequency?*

Performing regular stress tests is part of any risk management policy. Benefits depend on the way these stress tests are designed and on the way end-results are exploited. It would be more beneficial to have an EU-wide approach instead of letting NCAs conducting these exercises on a national basis. Otherwise, it would lead to duplication and potentially less valuable outcomes.

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?*

Both UCITS funds and AIFs already produce reporting on potential leverage to their respective NCAs. Then NCAs have the possibility to intervene at individual level or for a group of investments if considered as relevant.

In case of non-public AIFs, some can have unlimited leverage. In the case 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.

In summary, this specific topic is already highly regulated and extensive information is reported to competent authorities. Priority is to ensure that information received is properly exploited and if not, authorities should reflect on how to improve analysis of this information.

(Indeed, these questions are more relevant for pensions funds and insurance products as raised in the following questions in Section 4.2.)

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

Traditionally, the leverage of NBFI has been limited, with the exception of structured finance vehicles, which exhibit a higher ratio.

When narrowing down, the NBFI entity type exposed to leverage risk:

- UCITS and Insurance are not highly leveraged by nature;
- Pension funds: limit to leverage depends on the jurisdiction e.g. the UK gilt crisis led to stricter requirements in the use of leverage for pension funds in the UK;
- Hedge Funds and financial sponsors, tend to have a more systematic recourse to leverage, even if the overall exposures are limited. The question is more on potential pro-cyclical behaviours as, in order to cope with lower returns, usually partially reinvested by investors, hedge funds and financial sponsors tend to increase leverage.

It is also worth reminding though that these activities allowed a risk diversification and represent a limited share of banks' balance sheet and overall commitment. Bank's risk appetite to capital call financing is usually capped to a limited part of balance sheet.

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

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 are the most heavily weighted indicator in the G-SIB assessment grid (20%).

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?*

Regulators already have tools to reconcile positions in leveraged products via derivatives. In the EU, counterparties have to report their exposures within the EMIR reporting framework, allowing regulators to monitor leverage and concentration risks in derivatives markets. Such data includes counterparty identification, notional amounts, valuations and risk metrics, and can already enable regulators to track exposures of all counterparties to a trade, and to build management dashboards that can flag large increases/decreases in positions and exposures. We would urge that regulators to enhance their use of available data rather than imposing additional reporting requirements for firms.

Furthermore, banks would clearly value the opportunity to get a holistic oversight of interconnection via external market data.

The interactive data visualisation tool (Hedge Fund Monitor)[8] launched on July 31st by the Office of Financial Research (OFR) in the USA is an interesting example as it makes aggregated data on hedge fund activities from several sources more accessible. Data are classified in 6 categories (size, leverage, counterparties, liquidity, complexity and risk management) covering potential vulnerabilities identified for this type of NBFIs. To note, as mentioned in the press release, (i) data stems from existing sources (e.g. SEC filings, CFTC reports or FRB survey) and (ii) the monitor does not reveal entity-level confidential information. Preserving confidentiality and reusing already collected data, for instance, in the context of regulatory reporting made to the ESAs are indeed prerequisites, should the development of a similar platform be considered in the EU.

QUESTIONS 52 TO 56

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?*

Risk exposures to NBFIs are regularly monitored on an individual basis as part of the credit risk management process. In addition, risk exposures to NBFIs are monitored at an aggregated level.

Banks are generally linked to the NBFI sectors on both sides of the balance sheet. The deposit-taking business has intensive links with well-regulated pension funds, investment funds, and insurance companies. On the assets side, the NBFIs maintain credit

[8] OFR Unveils New Hedge Fund Monitor for Public Use | Office of Financial Research.

relationships with banks. The banks provide NBFIs with credit loans, whereby the focus is on low-risk transactions. Overall, we consider this risk to be low.

Some of our members monitor their exposure to the shadow banking sector on a monthly basis with a set group limit following the RTS definition and EBA guidelines. They also monitor their financing and deposits activities closely. We currently do not see a spillover effect on banks and NBFIs in the EU. Besides, financial institutions already have mitigant procedures in place for these exposures, and there is robust regulation in force. In any case, banks should not be the channel to monitor NBFI activities.

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?*

As mentioned in the European Commission's Consultation Paper, a similar UK-wide stress test between NBFIs and banks has been carried out. The final results are still being analysed and are expected to be published towards the end of this year. In our view, we consider it critical that the banks have fulfilled a large number of data requirements and that the test is mainly aimed at already regulated NBFI entities. Besides, banks already run various internal stress tests for management purposes where counterparties are stressed.

If a regular EU system-wide stress test were be proposed, it would be extremely important to consult the industry on its intended terms, scope, purpose and rules. In such a scenario, the views of market participants (asset managers, insurers, banks, etc.) will contribute to think thoroughly about how such a stress test should be set up to ensure that the conclusions are valid and useful.

Some of the key topics that should be addressed and discussed include (1) the difficulties of finding all the (hidden) links between banks and the NBFI sectors, (2) the hypothetical limited benefits of such EU-wide stress test having in mind the disproportionate costly efforts involved, (3) the variation of data quality and availability within the NBFI sectors, and (4) the challenges of comparability of data from NFBIs and banks, which may be difficult to combine due to the different business models, investor structures and regulatory frameworks.

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.*

There is a need to regulate and supervise the non-regulated and unsupervised players. Any arrangements between NBFI supervisors and bank supervisors would benefit supervisors considering the final output would be enriched. However, it should be noted that to the extent that banks already carry out exercises, it is key to avoid overburden banks with duplicating/additional information requirements.

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?*

We believe that the governance chosen for Fit-for-55 is interesting as it involves all relevant supervisors, covering banking, insurance and asset management. However, it is probably too early to opine on the merits of the approach as the exercise is not closed.

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)?*

One of the core tasks of banks is risk management. Like other risks, relationships with the NBFI sectors are comprehensively analysed and regularly monitored. Both credit and liquidity risks are closely monitored in the NBFI portfolio. The banks use the internal liquidity test to manage liquidity risks. As part of the LCR stress test, the links to NBFIs are also stressed, and various scenarios, such as an economic downturn or an external shock such as a coronavirus pandemic, are analysed to develop the liquidity situation. Liquidity stress tests are carried out at group and individual institution levels. The stress test is applied at the portfolio level.

We also run stress tests on our NBFIs exposures following established EU RTS and current EBA guidelines. We already have limits to reduce risk (CRR requirements on interconnected clients), if any counterpart falls under the shadow banking of the EBA definition, it is included in the stress test.

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.*

Greater coordination between supervisors could be facilitated by ensuring that there is this a focus on improving data sharing between the various EU bodies.

The immediate issues to address are:
1. Effective data sharing between EU bodies of the data that is already received would facilitate EU bodies to identify and mitigate any potential vulnerabilities.
2. Identification of 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. Removal of any unnecessary reporting of data which has no added value and/or that cannot be effectively exploited by EU bodies.

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?*

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?*

We are supportive of enhancing the efficiency of the current supervisory framework through greater facilitation of supervisory coordination. However, we do not consider that this is best achieved through the introduction of an ECM led by ESMA and the ESRB.

We suggest instead to focus on how ESMA could facilitate data sharing between the NCA and the ESAs and how this could lead to a streamlining of existing requirements by NCAs. This could be achieved via the creation of a single regulatory reporting data hub, where NCAs and ESAs have access to relevant data sets, and on an aggregated basis where required, on the data which is already being collected via the different reporting requirements. Especially given the recent AIFM and UCITS Directives reviews which enhanced reporting requirements (including the requirement for ESMA to develop new reporting templates), it is a timely opportunity to upgrade Europe's data collection infrastructure and sharing mechanisms. This single data hub mechanism has also been proposed by several key EU NCAs. This should also allow to remove existing differences between requirements by NCAs, leading to duplication of obligations that have to be enforced in different ways at national level while referring to the same EU rules.

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 are concerned that the question as drafted assumes that the size of the asset management company is related, or in any way proportionate, to the size of the market risk they may pose. Size is not an appropriate risk metric, or an indicator of potential future liquidity shocks such as from margin or collateral calls. Applying different rules to entities depending on size would create an unlevel playing field and risks regulatory arbitrage.

Accordingly, supervision should be applied consistently across all management companies and not be determined by size.

Nonetheless, we consider that the notion of "group" should be introduced in the case of asset managers with cross-border activities. The concept of "lead supervisor" as presented by four NCAs in April 2024 could facilitate the coordination of supervision for these type of asset managers and avoid that similar requirements have to be enforced in different ways from one jurisdiction to another.