

22 November 2024

European Commission
Directorate-General for Financial Stability, Financial Services, and Capital Markets Union
Attn: Unit E3 – Macroprudential policy
1049 Brussels
Belgium

Re: Targeted Consultation: Assessing the Adequacy of Macroprudential Policies for Non-Bank Financial Intermediation

Dear Sir or Madam,

The Vanguard Group, Inc. (“Vanguard”) appreciates the opportunity to respond to the European Commission’s (“Commission”) targeted consultation aimed at identifying the vulnerabilities and risks of “non-bank financial intermediaries” and assessing the adequacy of macroprudential policies (“Consultation”).¹ As a unique, investor-owned asset manager dedicated to improving outcomes for over fifty million individual investors, Vanguard has a long history of supporting regulatory reforms by US and global policymakers designed to strengthen financial markets and protect investors. For this reason, we believe it is important for regulators, the industry, and investors that a comprehensive kit of regulatory tools exists to ensure markets can function in all scenarios, and that regulators understand the risks and tradeoffs associated with these tools to avoid unintentionally introducing new risks and complexity.

Vanguard’s core purpose is to take a stand for all investors, to treat them fairly, and to give them the best chance for investment success. Vanguard is the second largest provider of index funds in Europe² and since entering the European market in 1998, we have lowered the cost of investing for European consumers³ and encouraged them to adopt straightforward investment principles, including setting appropriate goals, having a balanced portfolio, and maintaining a long-term perspective. Consistent with these investment principles, Vanguard’s EU-domiciled fund range is composed of highly liquid, broadly diversified UCITS mutual funds and exchange-traded funds (“ETFs”).⁴

We share policymakers’ concerns regarding market dynamics in March 2020, and the UK gilt crisis in 2022, and support activities-based evaluations and fact-based measures designed to smooth market functioning in a crisis. The policy analysis and discussion in response to these

¹ Targeted Consultation: Assessing the Adequacy of Macroprudential Policies for Non-Bank Financial Intermediation (“NBFI”) (22 May 2024), available at https://finance.ec.europa.eu/document/download/ddd6c515-3796-4db3-b91d-88a1a64acf07_en?filename=2024-non-bank-financial-intermediation-consultation-document_en.pdf.

² 14.4% market share of the European index fund market (Source: Simfund, June 2024. All funds and ETFs, domiciled in France, Germany, Ireland, Italy, Luxembourg, Netherlands, Switzerland, and UK. Fund of funds excluded; Money Market Funds included).

³ Research by Vanguard has identified that investors have saved approximately £77.4bn in European domiciled funds since 2011 by opting for passive investments over active funds.

⁴ The full range of Vanguard’s EU-based mutual funds and ETFs can be found [here](#). Our full EU fund range is domiciled in Ireland and current assets under management total approximately €300 billion.

episodes has been valuable, and we encourage policymakers to continue to look closely at the primary exacerbating activities of illiquidity and procyclical dynamics. Though the causes are many, and can include monetary policy, regulatory incentives, and fundamental asset repricing given uncertainty—market dynamics can be exacerbated by other factors such as leverage, concentrated investor bases, and illiquid assets.⁵

The ongoing work done to diagnose and remediate identified vulnerabilities is critical but the ambition to expand the macroprudential framework for Europe is a challenge of a higher order. Though macroprudential tools can be helpful, they bring important tradeoffs that should be carefully considered and evaluated before their use. Many macroprudential tools remain novel, largely untested, and can create additional complexity and competitive imbalances. Indeed, many of the successes associated with macroprudential tools has derived, not from their use in setting new standards, but as tools for identifying and highlighting vulnerabilities best addressed by existing primary regulators. A primary regulator has, by far, the most relevant expertise with the sectoral activities under its jurisdiction. It developed and regularly refines the regulatory construct for the respective industry segment and examines and enforces applicable standards using a wide variety of tools tailored to specific purposes or behaviors for the segment. This type of activities-based regulation is more responsive to systemic risks because it can impose important standards and requirements to all relevant entities in a regulated sector, ensuring a level playing field.

In view of the importance of financial markets to the real economy, the Commission, European supervisory authorities (“ESAs”), and national competent authorities (“NCAs”)⁶ will require a credible system-wide analytical framework to more effectively assess, monitor, and address identified vulnerabilities and risks without undue negative impacts. To accomplish this goal, we encourage relevant EU authorities to consider the following:

- (1) To avoid oversimplification and inaccurate assessments, be more specific about institutions and risk types being referred to, rather than relying on one-size-fits-all terms such as “non-bank” when examining a very diverse ecosystem of institutions and activities in the financial sector.
- (2) To benefit from existing expertise and legal frameworks, policymakers should build on existing precedent and rely on microprudential authorities as the primary line of defense against identified risks. Microprudential tools have a long history of success, and relevant EU authorities have expertise with the range of institutions and activities in the EU financial ecosystem.
- (3) To minimize unintentionally introducing additional competitive imbalances and complexity into market dynamics, develop and apply new macroprudential tools *only* when traditional (microprudential) regulation has proven unable to address identified

⁵ For example, as we have recently seen, liquidity risk can present a significant risk to the stability of a bank where a small group of large depositors expect immediate access to their funds at a stable value, and losses on the asset side can trigger runs among these large, uninsured depositors. This risk manifests very differently, if at all, in an unlevered long-term UCITS fund that benefits from constant market repricing, a stable and diverse investor base, and robust liquidity risk management practices.

⁶ We refer to these three sets of institutions as the “*relevant EU authorities*” throughout this letter.

vulnerabilities and risks. This will provide an additional incentive for microprudential authorities to act, if they need one, and ensure a backup if they cannot.

This approach will appropriately build on existing EU expertise regarding various types of institutions, activities, and legal frameworks; reduce subjectivity by promoting a more nuanced and objective approach to identifying potential risks; and provide a mechanism for addressing evolving risks should existing tools prove inadequate.

I. Relevant EU authorities should build on the existing regulatory paradigm to address identified vulnerabilities and risks.

At the highest level, the Consultation identifies illiquid assets, leverage, and interconnectedness as key vulnerabilities and sources of macroprudential risk within the perimeter of the financial sector. We agree and consider that the relevant EU authorities would be best served by seeking to examine these vulnerabilities and potential risks in a precise and granular way. Unfortunately, though the Consultation recognizes that the financial sector includes very diverse business models and markets, it continues to use reductive, one-size-fits-all, terms such as “non-bank financial intermediaries,” “non-bank,” or “non-bank sector” to describe the variety of different institutions operating in the financial ecosystem, ignoring the myriad of unique characteristics and heterogeneity of these institutions, which can include insurance companies, central counterparties, hedge funds, private equity funds, regulated open-end funds, broker-dealers, exchanges, closed-end funds, dark pools, asset management, and many others. Lumping these institutions into a single “non-bank” bucket makes nuanced risk assessment and targeted reforms nearly impossible and presumes that banks and bank regulation represent a higher order of financial institution and risk management against which all others should be compared. Neither of these approaches promotes the depth of analysis, and nuanced and targeted solutioning, necessary to effectively mitigate macroprudential risks in today’s dynamic markets.⁷

Even within the asset management or funds sectors, our area of expertise, individual firms typically manage widely varied product offerings across a range of underlying asset markets, and which serve diverse investor bases and investment objectives. For example, index funds behave differently than active funds, large cap equity funds differ from small cap or emerging markets funds, and non-complex UCITS funds will differ significantly from complex, leveraged inverse alternative investment funds (“AIFs”).

As such, an appropriate analytical framework needs to account for these significant differences. Bucketing an inverse levered bond AIF with a European Stock Index UCITS fund is akin to comparing apples to oranges, and bucketing a European Stock Index UCITS fund with an exchange or dark pool is comparing apples to refrigerators.

We encourage relevant EU authorities to be more specific and open with market participants about their definitions and frameworks for assessing sectors and risks to promote effective

⁷ See Speech by John Schindler, Secretary General of the Financial Stability Board (“FSB”), at the Eurofi Financial Forum 2024 in Budapest, “Building bridges: the case for better data and coordination for the non-bank sector,” 12 September 2024 (discussing that it is time to stop referring to the “non-bank-sector” as if it is monolithic) *available at* <https://www.fsb.org/2024/09/building-bridges-the-case-for-better-data-and-coordination-for-the-non-bank-sector/>. See FSB’s 2022 Global Monitoring Report on Non-Bank Financial Intermediation for an overview of the diverse institutions operating in this ecosystem, *available at* <https://www.fsb.org/uploads/P201222.pdf>.

policies and avoid critical misunderstandings of market dynamics. This dialogue would help to highlight important gaps in understanding, potential opportunities for improved data sharing, and inform the purpose and focus on any future system-wide stress testing.

Vanguard supports efforts by global policymakers and international standard setters to promote dynamic and resilient markets that work in all scenarios, taking account of local market and regulatory dynamics. When looking at the fund sector, we believe that regulators should follow the data and prioritize elements more likely to exacerbate risk, including leverage, concentrated investor bases, and large quantities of illiquid assets. Since the investment exposure of UCITS funds is largely restricted to liquid, transferable securities and with very limited use of leverage, we expect that in the EU these risks would reside in other parts of the ecosystem. Indeed, regulated open-end funds, such as UCITS, have demonstrated resilience during periods of market stress, thanks to robust regulatory frameworks tailored to local market dynamics governing liquidity management, leverage limits, and concentration controls, which we touch on in the following section.

II. Initial analysis should focus on reviewing and applying existing *microprudential tools*, where necessary, as the primary line of defense to address identified vulnerabilities and risks.

Relevant EU authorities should utilize existing regulation and microprudential tools as a primary line of defense to address identified risks. Microprudential tools have significant advantages over macroprudential tools including long-standing precedent; concentrated expertise; and credible, time-tested processes. Furthermore, these tools have a proven track record and can also demonstrate mitigation of macroprudential risk—something that a number of regulatory bodies have explicitly recognized.⁸

One EU-specific example worth noting is UCITS. The simplicity and rigor of the EU UCITS framework has driven its rapid growth as an investment vehicle and the widespread recognition of UCITS as an appropriate fund vehicle for domestic retail investors. Moreover, EU policymakers have continued to evolve the UCITS rulebook to maintain the integrity and relevance of the regime.⁹ As a result, UCITS funds and their respective asset managers are comprehensively regulated by NCAs, including with respect to liquidity risk management (e.g., defining and maintaining a liquidity profile for each fund, using liquidity management tools to manage flows, and conducting regular liquidity stress testing exercises to ensure that funds can remain resilient even during stressed market conditions); custody and valuation of holdings; conflicts of interest; delegation of key management functions; product rules (e.g., asset eligibility rules, concentration limits, borrowing prohibition, and leverage limits); and several other aspects of their business.

Given these comprehensive requirements, UCITS funds are, and can continue to be, regulated and managed with a myriad of risk considerations in mind, including with the intent to support daily dealing in all market conditions.

⁸ In the Consultation, the Commission states its expectation that new provisions on liquidity risk management in UCITS and AIFMD will be stability enhancing for investment funds. See Consultation at pg. 15.

⁹ See explanatory memorandum by the European Commission which details key evolutions of the UCITS rulebook historically, available at <https://eur-lex.europa.eu/legal-content/EN/LSU/?uri=CELEX:32009L0065>.

For example, the EU has introduced over the years many safeguards to ensure that open-end funds would not contribute to the build-up of systemic risks, and ongoing improvements are routinely made. In particular, the UCITS rulebook was recently revised to introduce an enhanced framework for liquidity risk management, including harmonized definitions and application of liquidity management tools to enhance UCITS funds' ability to manage liquidity risks effectively and mitigate macroprudential risk.¹⁰ These reforms were made by expert regulators, pursuant to traditional microprudential regulatory authority, and taking account of recommendations from important coordinating and macroprudential bodies including the International Organization of Securities Commissions and the Financial Stability Board¹¹.

This is an excellent example of how the process can and should work and we encourage relevant EU authorities to support these reforms and gather data, following their full implementation.

III. Consider developing and applying *new macroprudential tools* in a way that supports and builds on existing microprudential frameworks and serves as a backstop for circumstances when microprudential regulation has proven unable to address identified vulnerabilities and risks.

Macroprudential tools can help but bring with them a host of tradeoffs and unintended consequences, including the potential of raising market or competitive distortions, fostering risk mitigation, and creating a false sense of security for markets and regulators. Though these tools *may* help address gaps in the microprudential framework, they are not a substitute. Where relevant EU authorities decide to supplement existing microprudential tools they should be careful to ensure these toolkits work together. We believe the best way to achieve that goal is for macroprudential tools to serve as a "backstop" to be used only in circumstances where identified risks have not, and cannot, be addressed through traditional microprudential regulation. In this way, relevant EU authorities and markets can continue to benefit from existing frameworks and gain insight from macroprudential perspectives and data, while avoiding creating disjointed regimes and competitive imbalances associated with a parallel regime.

To help support clear guardrails, relevant EU authorities should limit the use of macroprudential tools to circumstances where there is clear evidence of macroprudential risk that cannot be addressed by microprudential authorities and determined by a robust cost/benefit analysis that evaluates the tradeoffs associated with the use of these tools. Given the risk of sudden, subjective and, in some cases, politicized use of these tools, credibility also requires a European system-wide analytical framework that objectively identifies

¹⁰ On 26 March 2024, the revised texts of the UCITS and AIFMD Directives were published in the EU Official Journal.

¹¹ See Anti-dilution Liquidity Management Tools – Guidance for Effective Implementation of the Recommendations for Liquidity Risk Management for Collective Investment Schemes, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD756.pdf>; Revised Policy Recommendations to Address Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds, available at <https://www.fsb.org/2023/12/revised-policy-recommendations-to-address-structural-vulnerabilities-from-liquidity-mismatch-in-open-ended-funds/>; and Letter from Ricardo R. Delfin, Principal, Global Head of Regulatory and Public Policy, Vanguard, to John Schindler, Secretary General, FSB and Damien Shanahan, IOSCO, dated 1 Sept. 2023, available at [https://www.iosco.org/library/pubdocs/739/pdf/Vanguard Group, Inc. \(Vanguard\).pdf](https://www.iosco.org/library/pubdocs/739/pdf/Vanguard%20Group,%20Inc.%20(Vanguard).pdf).

potential residual pockets of risk and sets forth a process for relevant EU authorities, and affected industries, to address or respond. We outline key components of such a framework as follows.

Develop and implement a pan-European strategy to harness relevant supervisory data

A European-wide analytical framework that allows authorities to share existing information and reduces costly and duplicative filings and requests in multiple jurisdictions is a critical, low risk, step toward improving micro- and macroprudential risk. Relevant EU authorities collect significant data for many types of institutions and activities in the capital markets ecosystem, and we believe organizing and sharing this information among authorities will help on several fronts.

- *Closing gaps.* It is vital to address the significant variations in the data available to relevant EU authorities and central banks; as well as how this data is or can be shared. Current data gaps limit the ability of micro- and macroprudential supervisors to identify the potential build-up of risk and calibrate appropriate policy tools. The collection of targeted and comparable supervisory data pursuant to the recent enhancements to the UCITS and AIFMD legislation will be a positive step forward in this regard.¹²
- *Rationalizing.* There is the opportunity and also the pressing need to rationalize and align multiple templates, formats, and data points requested by NCAs.
- *Standardizing.* Use of common, pan-European templates for data reporting by specific types of institutions would be significantly more efficient and effective for relevant EU authorities and for market participants themselves.

Approach system-wide stress testing with a prudent and trialed adoption

We recognize the theoretical potential for system-wide stress testing to help regulators improve their understanding of the behaviors of banks and other specific types of institutions during stressed financial market conditions. However, given the inherent limitations and risks associated with trying to model behavior and interactions in complex systems under unforeseen circumstances (particularly on a pan-EU basis), we urge policymakers to approach adoption of this tool with care.¹³ To assist in that effort, we believe a prudent and trialed adoption consistent with the following principles could help policymakers achieve their objectives, while minimizing unintended consequences:

- *Acknowledge, consistently and repeatedly, the limitations and risks associated with system-wide stress testing to avoid becoming overconfident about its results.* There

¹² The revised UCITS and AIFMD texts require management companies, in respect of each UCITS or AIF they manage, to provide information on the instruments in which the fund is trading; the markets of which it is a member or where it actively trades; and on the exposures and assets of the fund.

¹³ Vanguard is currently participating in the Bank of England's system-wide exploratory scenario ("SWES") exercise. The results of the SWES are likely to provide more insight into the effectiveness of system-wide stress testing and their potential broader adoption. Our experience to date with the SWES has informed our view of the principles that could help to ensure that system-wide stress testing in the EU is effective and efficient.

are a myriad of simplifications and assumptions that go into modeling behavior, even of individual economic actors in relatively routine scenarios. Modeling “system-wide” behavior in an unknown future market scenario is many orders of magnitude more complex—and leverages even more simplifications and assumptions. The output of this exercise *may* be useful in helping authorities form high-level *hypotheses* about potential market behavior or weaknesses, but is highly unlikely, in and of itself, to support sound conclusions: the assumptions are too many and the margin of error too great. Consistent and repeated acknowledgement of these limitations is therefore necessary to avoid slipping into a false confidence over time that can lead to counterproductive regulatory actions based on a necessarily over-simplified model, the results of which will eventually differ meaningfully from the real world.

- *Reduce complexity.* Rather than endeavoring to create a single, highly complex system-wide stress test, policymakers will likely obtain more actionable information by targeting specific tests to specific types of firms, or sectors, with a significant role in the market activities of most relevance to the selected scenario.

Phased approaches work as well. The SWES benefited from being designed to be run in two rounds: an information-gathering phase and a scenario phase. This allowed the exercise to evolve based on the findings of the first round, and the system-wide dynamics the Bank of England observed by aggregating responses from, and examining interlinkages between, participating firms. During the SWES the Bank of England was able to ask specific clarifications on participating firms’ initial submissions, while participants were able to consider how their initial proposed actions would change in light of information shared with them by the Bank of England during the SWES.

- *Be careful not to over-index to the last crisis.* There is a real risk in macroprudential policymaking to regulate “using the rear-view mirror” and try to replay the last crisis. There is little benefit from a system-wide stress testing scenario that replicates previous crises, as these are the least likely to happen again, and regulators and specific types of institutions will already have evidence of the implications of these previous events. Instead, policymakers should endeavor to assess, over time, a range of severe, but plausible hypothetical events and seek to determine if there are overlapping findings or consistent “weak spots” among them. These overlapping findings or consistent “weak spots” should then be used to develop *hypotheses* for meaningful analysis.
- *Appreciate the time and resource demands involved.* System-wide stress testing can be burdensome for both regulators and institutions and should be appropriately scoped in line with the potential risk and the costs and benefits involved. Given their limitations and burdens, they should be used infrequently, only when needed, and carefully crafted to ensure the benefits truly exceed the costs.

- *Work together to give, and get, feedback.* Regulators and market participants can all benefit from active involvement in the design, information-gathering, and execution of targeted system-wide stress testing:
 - Early and active engagement will enable policymakers to benefit from insights from market participants about the value of their scenario and modeling assumptions for risk management purposes.
 - The quality and robustness of stress test contributions will be enhanced by policymakers providing timely and considered participation guidance to market participants.

To incentivize participation, at the end of the process policymakers should provide participants with more nuanced industry, and firm-specific, feedback so firms can benefit from the process and benefit from any best practices.

- *Provide broad market transparency regarding the scenario and lessons learned, but protect the confidentiality of firm-level data.* Policymakers should publish details of the stress test scenario used and industry-level conclusions to ensure there is wide appreciation of how the proposed scenario might impact specific types of institutions while keeping firm-level data confidential (e.g., under a secure information classification and only available to regulatory staff working on the specific exercise). Published materials should not provide information on named firms, nor provide commercially sensitive information (including aggregate statistics that would enable an expert in the field to “back out” an individual firm’s sensitive information).
- *Take targeted regulatory action (after due process) if identified risks have been fully analyzed and considered and cannot be addressed by existing microprudential tools.* Where a system-wide stress test supports a hypothesis regarding risk, it is essential that the hypothesis be shared with affected institutions and regulatory action and resources be prioritized to more thoroughly assess that hypothesis. This is the most efficient way to bring key stakeholders together, pressure test the hypothesis, and promote rapid risk mitigation where it exists.

If authorities determine microprudential tools cannot address the underlying risk, authorities might consider macroprudential tools. In light of the risks and tradeoffs involved in the deployment of macroprudential tools, we encourage regulators to tread carefully and focus any regulatory action on the identified, consistent “weak spots” in the financial system so as to avoid complicating the existing regulatory framework, creating new competitive imbalances, and unintentionally undermining the critical microprudential regime.

IV. Conclusion

Vanguard appreciates the opportunity to engage in this Consultation process and hope our observations and recommendations are useful. Though many macroprudential tools may assist in identifying key risks and promoting effective mitigation, they also present risks and tradeoffs in their own right. To maximize the benefits—and mitigate the risks—we encourage policymakers to:

- (1) Be more targeted and specific when assessing the broad diversity of institutions and activities in the capital markets ecosystem;
- (2) Build on the existing activities-based microprudential framework whenever possible to benefit from existing precedent and expertise, reduce complexity, and avoid competitive imbalances; and
- (3) Consider developing and applying new macroprudential tools in a way that supports and builds on existing microprudential frameworks and serves as a backstop for circumstances when microprudential regulation has proven unable to address identified vulnerabilities and risks.

We believe this combination of actions will significantly improve the Commission's ability to identify and address emerging risks.

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If you have any questions or would like to discuss our views further, please contact Richard Withers, Head of International Public Policy, at richard.withers@vanguard.co.uk.

Sincerely,

/s/ Ricardo R. Delfin

Ricardo R. Delfin
Principal, Global Head of Regulatory and Public Policy
The Vanguard Group, Inc.