Paris, 22 November 2024

Targeted consultation assessing the adequacy of macroprudential policies for non-bank financial intermediation (NBFI): Paris Europlace NBFI Working Group's response

Paris Europlace brings together more than 600 players in the financial ecosystem — banks, insurance companies, asset managers, intermediaries, fintechs, industrial and commercial companies, consulting firms, law firms, public authorities...: a unique network that brings together all the stakeholders of the Paris financial market to discuss their priorities.

Paris Europlace very much welcomes the European Commission invitation to provide feedback on this NBFI targeted consultation.

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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?

We do not see material other sources of systemic risks other than those identified in the Commission's paper. We acknowledge that the concerns expressed in the consultation paper may be genuine at the international level. Indeed, this consultation is launched in the wake of the work already carried out by the IMF, FSB and IOSCO, also taking into account the concern of central banks in view of the sharp increase in financial assets managed outside of the banking sector, which represents now more than half of total financial assets. However, we believe these concerns are much less relevant as regards the EU, given the wide scope of regulation already in place for all types of financial players.
We would like to make some preliminary remarks:
The FSB's definition of 'NBFIs' blends very different risk profiles and functions (agents, principal), creating a need for clarification and differentiation. The broad categorization of 'NBFI' is indeed unhelpful and unconducive to appropriate policymaking. The 'NBFI' sector is very diverse, encompassing many different types of financial institutions, such as money market funds, venture capitalists, the crypto-ecosystem and even micro-credit organizations. Policymakers' concerns are typically centered around the lack of regulation and supervisory oversight in some areas of the financial sector. As such, a nuanced approach which focuses on the specific concerns is needed. In

this context, we support the views of John Schindler[1], Secretary General of the Financial Stability Board, who recently spoke of the "need to drill down into the gallimaufry of non-bank entities and activities" when looking at the risks of the NBFI sector.

This diversity needs to be taken into consideration as well as the existing micro-prudential frameworks already in place for each type. A one-size-fits-all approach would not be relevant and could have unintended consequences instead of preserving financial stability of the financial system.

Regarding actors, there is also a need to draw a line between entities that are already regulated (banks, insurance companies, asset managers, funds, etc.) and those that are not. Given that the EU regulatory framework already applies to a very wide range of financial entities, including outside the banking sector, non-regulated entities are often being located outside the European Union, while they may operate directly or indirectly in EU financial markets. Accordingly, it should be acknowledged that systemic risks often stem from unregulated activity and there is a need to have a global approach on such matters due the international nature and interconnectedness of financial services.

The existing regulatory elements in place across Europe (as listed in the Annex of the consultation paper) already constitute a strong framework. First, the European insurance sector is already well-regulated and supervised. The extensive prudential framework, Solvency II, provides the sector with a strong regulatory foundation.

- With the Solvency II review, the macroprudential framework for the European insurance industry has already been strengthened, introducing new macroprudential requirements for insurers and new macroprudential powers for supervisors. In addition, the reform of Solvency II includes enhanced powers for supervision of cross border activities. The Insurance Recovery and Resolution Directive (IRRD) is also in the process of being introduced. It will provide further powers for supervisory authorities, and newly created resolution authorities, to protect against systemic risk in the event of a failure of an insurer.
- The insurance sector is also subject to extensive macroprudential oversight through the International Association of Insurance Supervisors (IAIS) Holistic Framework. The Holistic Framework is the key international regulatory tool for the assessment and mitigation of systemic risk in the insurance sector. It is supported by the industry and was endorsed by the Financial Stability Board in December 2022. Through the Holistic Framework, the IAIS has developed one of the most modern approaches to assessing systemic risk.

Another example is the European investment fund sector which is already subject to numerous regulations. Different sectoral frameworks already include micro- and macro-prudential mechanisms that contribute to the overall stability of the EU financial system. In the EU investment fund sector, the UCITS, AIFMD, and MMFR frameworks already limit the build-up of systemic risks and, in combination with the MiFIR and EMIR frameworks, foresee extensive reporting requirements to assist supervisors in carrying out some form of macroprudential oversight. Moreover, the European Commission's consultation document has not convincingly demonstrated the necessity to introduce an additional macroprudential regulatory layer.

Second, the scope of regulation applying to asset managers and funds is very broad. The issue at hand is that the European framework does not apply to unregulated actors operating from outside Europe, which may pose a significant risk. The priority now should be on the coordination between jurisdictions, especially given that the European framework is already more secure than the

[1] Speech by John Schindler, Secretary General of the Financial Stability Board, at the Eurofi Financial Forum 2024 in Budapest (Building bridges: the case for better data and coordination for the non-bank sector - Financial Stability Board (fsb.org))

regulation in other jurisdictions. It should be investigated how this type of coordination, coupled with a true data sharing within the EU, between national and European authorities, across ESAs and between micro-prudential and macro-prudential authorities, can contribute to better identify, assess, monitor and mitigate areas of systemic risks. Accordingly, Paris Europlace suggests that a risk-mapping exercise should be undertaken to address the area of vulnerabilities and reduce the global level of systemic risk.

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.

As mentioned previously, many entities are already highly regulated under the regulatory EU framework. The EU banking regulation has notably introduced robust rules on transparency and counterparty risk management with the CRR. EU investment funds regulation and managers also addresses several types of risks under the UCITS Directive, the AIFMD and the MM Regulation, as liquidity risk management and risk of excessive leverage, through different types of restrictions and transparency requirements. Typically, the Archegos case could not have happened in the EU in view of the existing framework. As a result, banks' exposures to NBFI remain limited, derivatives transactions are largely cleared through CCPs or subject to daily margining. Exposures are stressed as part of the prudential stress tests, and they are monitored very closely by supervisory authorities. Therefore, we consider that the risk for banks stemming from their exposures to non-banks is appropriately mitigated to date.
In that context, it seems more relevant to identify where some vulnerabilities may persist (with the risk mapping exercise mentioned above) and how these should be addressed. It should notably be considered how further coordination between the EU public authorities can be instrumental in this exercise.

Question 3. To what extent could the failure of an NBFI affect the provision of critical functions to the real economy or the financial system that cannot easily be replaced? Please explain in particular to which NBFI sector, part of the financial system and critical function you refer to, and if and how you believe such knock-on effect could be mitigated.

First, it should be reminded that in the EU, contrary to other jurisdictions, a large part of the financing to the real economy, in particular credit to SMEs and households continues to be provided by credit institutions, which are already subject to comprehensive regulation and supervision. The question of a "NBFI" failure cannot be addressed without differentiating the type of "NBFI" entity.
Regulated Funds are subject to strict rules in case of distress, closely supervised by market authorities, and whatever the perspective adopted, we do not see how the failure of an NBFI could generate systematic risk that would endanger the stability of the whole financial system due to the diversified and fragmented structure of these market segments. Even if the size of the whole asset management industry has significantly increased when taken globally, each fund taken individually (or a type of fund) represents a very small proportion of total managed assets. Also, regulated NBFIs have already to comply with a comprehensive set of rules developed to mitigate the different types of risks referred to in the consultation paper. The introduction in the AIFMD of the obligation to select two liquidity management tools (LMTs) for each open-ended fund will further reduce the risk that an investment fund might create a systemic risk as these tools are designed to mitigate any contagion effects. This new framework needs to be fully deployed and assessed before envisaging

any additional policy measures.
As a result, and as mentioned previously, the focus should be on still no or not sufficiently regulated funds or other types of financial entities that are not subject to such safeguards.
Specifically, insurers perform crucial functions for the real economy and financial system. However, there is little systemic risk from a failing insurer, because of the specific insurance business model and the extensive regulatory and supervisory system already established. In addition, most insurance products are characterized by high substitutability between insurance providers.
The concept of critical functions in the insurance sector is typically discussed in the context of the Insurance Recovery and Resolution Directive (IRRD). In its proposals on the IRRD, the European Commission did not elaborate on the concept and has delegated the responsibility of clarifying this concept to EIOPA. Notwithstanding the lack of clarity on what a critical function means in the context of the insurance sector, one of the primary objectives of the IRRD is to ensure the continuity of critical functions. As such, any critical function in the insurance sector should be preserved through the implementation of the IRRD, if an insurer providing these functions does fail.
In the derivatives markets, CCPs have been created in the aftermath of the Global Financial Crisis to precisely avoid that the failure of a financial entity could contaminate other financial entities. And in case a CCP itself would fail, a Recovery and Resolution Regulation has been implemented to addresses the risks that the distress of a CCP itself would pose to financial stability.

Question 4. Where in the NBFI sectors could systemic liquidity risk most likely materialize and how? Which specific transmission channels of liquidity risk would be most relevant for NBFI? Please provide concrete examples.
See our response to the previous question. The priority should be on less or non-regulated entities, including on their effective supervision. Regarding the insurance sector, liquidity risk is rarely problematic because:

- Insurance liabilities are generally illiquid. On most policies, especially non-life policies, claims are not paid out until an insured event occurs. Life products often contain redemption options, but the short-term volatility of policy surrender rates is generally quite low over business and financial cycles. Any risk of mass redemptions is limited by contract features (e.g., limited early redemption options for annuities), cancellation penalties and tax charges or the loss of biometric risk cover, all of which disincentivize policyholders from surrendering policies early. The use of reinsurance also mitigates the risk of mass claims.
- Insurers generally match the duration and liquidity of their assets with that of their liabilities. In addition, insurers have access to a stable flow of cash (pure liquidity) originating from new premiums, maturing assets and investment income. In line with the liquidity risks they face, insurers hold a substantial amount of highly liquid assets. For those insurers that use derivatives, preparedness for margin calls is high (see answer to question 26). Insurers are generally diversified companies and benefit considerably from risk diversification across product lines and time. This limits the extent to which large, unexpected claims can occur and stabilizes aggregate pay-outs. Large single claims usually have a longer, sometimes multi-year, pay-out period and also benefit from reinsurance coverage.

Effective regulatory and supervisory provisions regarding potential liquidity risks are already in place. The heightened significance of liquidity risks has already led to a substantial enhancement in the surveillance of insurers' liquidity risks. For instance, in 2020 EIOPA established a quarterly monitoring exercise regarding the liquidity position and projections of insurers with a potentially vulnerable liquidity profile. Since 2021, a liquidity component has also been included in EIOPA's insurance stress test. Furthermore, the macroprudential reforms to be introduced with the

Solvency II review are specifically aimed at addressing liquidity risk. All insurers, with the exemption of small and non-complex undertakings, will be required to draw up and keep up to date a liquidity risk management plan (LRMP) covering liquidity analysis projecting the incoming and outgoing cash flows in relation to their assets and liabilities. Further, new supervisory powers to address severe liquidity vulnerabilities are introduced, including temporary restrictions of dividend distributions and temporary suspensions of redemption rights of life insurance policyholders.
Regarding the asset management sector, great regulatory work has been achieved over the years both on the UCITS or AIFM directives, through all levels of regulations (Level 1, but also Level 2 and Level 3). Moreover, the deployment of LMTs as mentioned in the response of the previous question will make systemic liquidity risks more remote.

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.

We consider that a wide range of rules are already in place for regulated entities to avoid excessive leverage, with a lot of data available to detect any potential situation where excessive leverage could build up. The priority today is ensuring the capacity to effectively analyze this data and identify what adequate actions should be undertaken when necessary. A review of existing transparency requirements could also help identifying unnecessary data and cases where existing data should be enhanced to be of added value. This also requires data sharing between the various EU public authorities (at both EU and local level) and further coordination to make concerted decisions when stressed market conditions start developing.

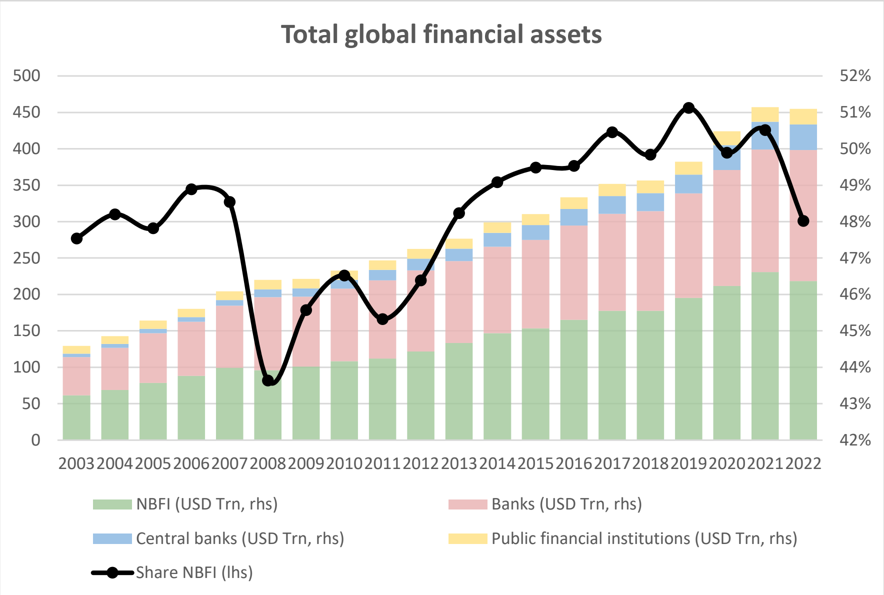
Question 6. Do you observe any systemic risks and vulnerabilities emerging from crypto assets trading and intermediaries in the EU?

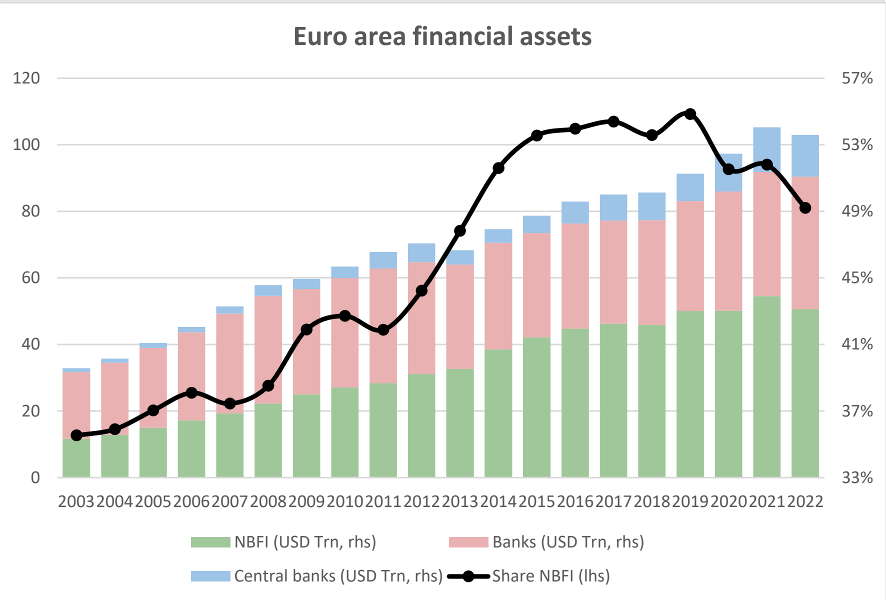
The cryptoassets market has recently experienced significant crises. The risks and vulnerabilities identified concern in particular the following points:
- the interconnection between cryptoassets and the traditional financial sector, with possible transmission of shocks.
- counterparty and liquidity risk, which can lead to runs and volatility that are also transmitted between market segments.
- concentration and over-indebtedness risk (leverage): excessive leverage increases the occurrence and intensity of a potential systemic risk.
- operational risk: human or IT failures, fraud and other manipulations can cause significant losses for end investors.

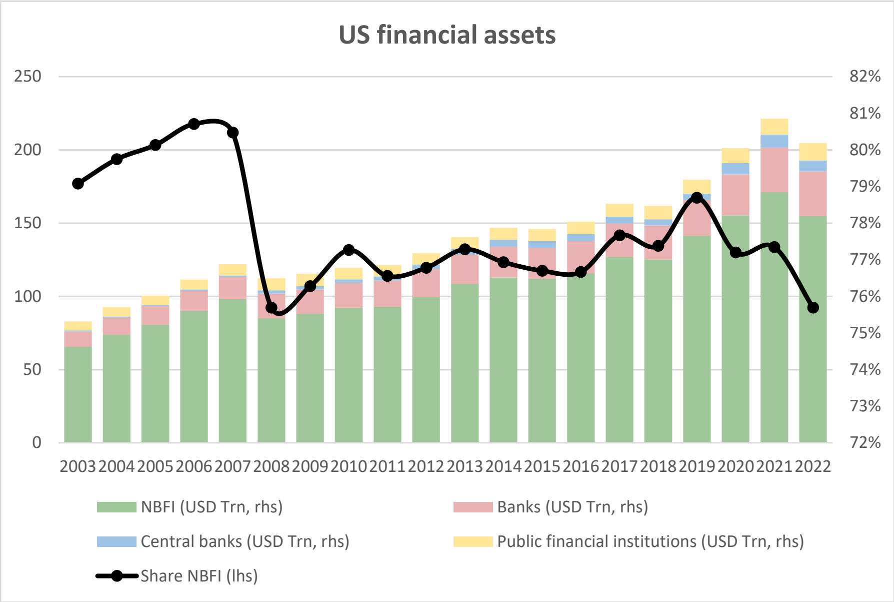
Admittedly, the still limited size of cryptoassets markets does not expose the entire financial system to a real systemic risk, but the provision of financial intermediation services can also be a channel for transmitting or amplifying such a risk.
Today, prudential requirements apply only to banks with regard to their exposures to crypto-assets (December 2022 Basel standards and, in the EU, transitional regime in CRR3), while NBFIs operating on this market do not have comparable constraints.
Such asymmetry of treatment poses a level playing field problem between banks and NBFIs. It also creates a risk of risk transfer to a sector that is unequally regulated and supervised.
Consequently, addressing systemic risk through increased regulation for already regulated players would be a mistake, in our view.

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.

We need to accelerate the ESAP project, support the development of EU-based rating agencies, while widening rating and research toward smaller companies.
We also strongly believe that the success of the CMU relies on the strengthening of financial institutions beyond banks. They are expected to play an increasingly important role in Europe. According to FSB statistics, while assets stagnate globally, NBFIs are experiencing growth in Europe. It is of the utmost importance to ensure that their competitiveness is not endangered by measures that would not be adapted to their own specificities.







Source: FSB

Paris Europlace members would like to highlight the following messages:

- It is key to consider existing banking , insurance and capital markets, as well as macroprudential regulations while recognizing the risks inherent in the system and their procyclical impacts,
- Financial stability is a central issue and must be preserved for the benefit of NBFIs, banks for the Capital Markets Union (CMU), and society at large.
- It seems essential to evaluate the harmonization and generalization of the current regulatory and supervisory framework across the EU and in other jurisdictions before considering additional measures.
- An approach that incorporates competitiveness from the outset is crucial—not just risk control.

All types of NBFIs are essential to the proper financing of the real economy, such as medium and small-sized companies. Regarding large market capitalization companies, it is noteworthy that the French CAC 40 companies are financed in majority by funds, underscoring their pivotal role in the economy.

As regards the private equity sector, it plays a major role in providing access to finance for unlisted SMEs and mid-cap companies. This sector is already subject to specific regulatory provisions for liquidity management and leverage. Most funds are closed-end funds and are reserved for professional investors.

Also, such funds allow investors to diversify their risks, which also strengthens the resilience of the financial system. Through various types of funds, end-users bear certain risks to support financing needs within the economy. We must thus work in priority on the non or less regulated part of the NBFI sector if macroprudential policies are contemplated. Supervision coordination is another key element to be considered, to identify where such unregulated/unsupervised areas persist.

Compared to the US, the stronger reliance on banks for funding, and more generally, the relatively lack of diversity in funding sources for EU businesses is a well-known issue and a key focus of the Capital Markets Union (CMU) project. At European level, there are increasing efforts to reduce bureaucratic hurdles and regulation (e.g. Mario Draghi’s report on the future of European competitiveness).

Besides prudential reforms, measures beyond macroprudential policy are very important as well:

- *Improve prudential rules which are unnecessarily holding back insurers' investments:*

Improvements targeted at improving capital requirements for listed equities are under discussion as part of the Solvency II Review. However, other areas of the review, aimed at reducing excessive overall capital requirements and volatility also have a major impact on the capacity of insurers to invest. It is therefore key that the Level 2 technical details of the Solvency II review are finalized taking into account the impact of the review on the fulfilment of the CMU objectives. Increase insurers' access to SME equity, venture capital, SME debt and infrastructure. There are examples at national level of funds being created, often with the involvement of insurers and governments, containing SME equity and debt, venture capital or infrastructure assets. Such funds provide the scale and access for a wide range of insurers to invest in these asset classes. Actions should be taken to assess where and why such funds have been successful and how their use can be expanded to other EU markets. The potential for multi-national or EU versions of such funds and potential benefits involving financial instruments such as Invest EU should be investigated.

- *Facilitate greater cross-border investment:*

Increase trust and confidence in cross-border investment within the EU, by making progress in the areas of insolvency law and increasing intra-EU investment protection. Harmonizing creditor rights and the legal status and powers of insolvency administrators to trace assets belonging to the insolvency estate would help to ensure that the interests of creditors are appropriately considered and thus contribute to more confidence in a fair liquidation and reorganization process. To increase the intra-EU investment protection a straightforward process for settling or deciding disputes between investors and Member States should be implemented.

Supervisory powers

Question 8. What are pros and cons of giving the competent authority the power to increase liquidity buffer requirements on an individual or collective basis in the event of system-wide financial stability risks? Under which other situation do you believe MMF liquidity buffers should be increased on an individual or collective basis by the competent authority? Please explain.

In France, money markets are key short-term financing markets and money market funds are major investment vehicles. They are all managed as Variable NAV (VNAV) (Variable NAV) funds, and they make the bulk of Euro-denominated MMFs throughout Europe. France is not only a domiciliation and management center for MMFs too, but also an investors' region which helps managers knowing their investors and investors knowing in detail where they place their monies. We would like to recall that French MMFs are mainly held by institutional investors. In terms of the distribution of money market funds within the euro zone, France is by far the leading country with more than 50% market share. French MMF are actively managed and the size of the liquidity buffer is constantly adapted to anticipate the behavior of the investors. These latter are mainly institutional investors. Understanding and anticipating as much as possible investor behavior by a close link with a funds' main MMF unit holders has always been key to French asset managers.

Liquidity buffers are also adapted according to the market conditions. However, when the market liquidity is largely deteriorated, the MMF can no longer to provide liquidity to its shareholders. At some point of extreme lack of liquidity (frozen markets), the only size of liquidity buffer which is appropriate is 100 % of the Net Asset value. The adequate liquidity ratio that ensures to meet any redemptions at any time is 100% cash when the market is frozen or when no further liquidity can

be created via the selling of assets. The higher the "imposed" calibration, the higher the permanent industry-wide sterilization of investee's monies.
Such an increase of liquidity buffer will uniformize the fund offer to the point that there is less diversity left for investors, but also that may trigger more uniform behaviors in the market, which is the opposite effect to the search of market stability. A collective increase will jeopardize the usefulness of MMFs to finance the economy, will be detrimental to the fund attractiveness, diminish the interest of investors for MMFs comparative to bank deposits, and result in paper squeeze and/or even larger cash amounts held in depositary accounts.
A too high increase in liquidity buffer during market crisis, if publicly disclosed, may trigger uniform behaviors have a procyclical effect, could trigger a "dash for cash" phenomenon , foster by fostering a "first mover advantage" effect which is always detrimental to the remaining investors and consequently put at risk the equal treatment of investors. Increasing collectively the liquidity buffer will inevitably produce a procyclical effect, which is the opposite of the search of market stability.
MMFs are structurally and permanently buyers of short-term debts. Increasing MMF liquidity buffer will limit this key function. Issuers could face difficulties of funding. This will be ultimately detrimental to the short-term funding markets as a whole.
Giving authorities power to increase liquidity buffer may circumvent the investment policy of the MMF and its duty to follow to the requirements disclosed in its fund documentation. Giving authorities power to increase liquidity buffer may also be contradictory with the fact that the primary responsibility for liquidity risk management remains with the manager. Defining a priori what is a liquid asset is particularly difficult and even short-term government bonds that are deemed to be liquid have experienced periods of squeeze, volatility or illiquidity. Before imposing any additional buffer of so called "liquid assets", we should make sure that at any given time, these assets will not become the next source of stress.
Accordingly, we believe that the most efficient solution is to retain for VNAV funds managers to the possibility to individually increase these buffers on a fund-by-fund level above the "minimum regulatory" one as it was the case during previous stress episodes. It is also key to promote and maintain regular exchanges with local NCA especially during crisis periods. Retaining the possibility to individually increase these buffers on a fund-by-fund level above the "minimum regulatory" one, which is already the case and as demonstrated by fund managers during previous stress episodes, is the most efficient solution.
To conclude, VNAV funds have already countercyclical buffers as no automatic trigger is linked to the ratios. MMFR gives also the right to go under the level as long as no new longer-dated investment is done.

Question 9. How can ESMA and ESRB ensure coordination and the proper use of this power and what could be their individual roles? Please provide specific examples or scenarios to support your view.

As we do not agree with the possibility to give additional powers to NCAs, we do not see the need for ESMA and ERSB ensuring coordination on this specific point. Other areas of cooperation should be pursued, in particular as regards data sharing.

Reporting requirements

Question 10. In view of the new UCITS supervisory reporting obligations and improvements to

AIFMD reporting, how could reporting requirements under the MMFR be aligned, simplified and improved to identify stability risks (such as liquidity risks) and to ensure more efficient data sharing?

Stress testing framework

Question 11. Do you believe that the proposed enhancements to the stress testing framework listed above are sufficient to identify and mitigate liquidity risks effectively? If not, what specific elements would you suggest including in the strengthened supervision and remediation actions for detecting liquidity risks?

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? Reverse distribution mechanism

We believe that such stress tests could bring benefits to the MMF industry provided that:

- The reporting requirements are streamlined across jurisdictions.
- The sharing of data is effective across authorities. Currently data collected are underexploited.
- Rules have to be adapted according to the type of MMF: LVNAV, VNAV, etc.
- It should not simply be an additional layer to the existing stress tests, which creates further burden;
- It should be only seen as a risk management tool;
- It should not be used to justify additional investment rules (or constraints on liquidity buffers);
- The results should be disclosed and provide a better understanding of the market and its participants.

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

The reverse distribution mechanism was linked to (or decided during) during a period of negative interest rates. In France, MMFs are VNAV type. Thanks to the Marked to market process applied and their functioning no issue was raised when interest rates went below zero. They did not face problem during that period. Accordingly, no specific mechanism was deemed necessary.

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

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

Liquidity and short-term instruments

Question 15. Should regulatory requirements for MMFs take into account whether the instrument they are investing in is admitted to trading on a trading venue (regulated markets, multilateral trading facilities or organized trading facilities) with some critical level of trading activity? Please explain your answer.

Link between liquidity mismatch and liquidity risks

Question 16. How can NCAs better monitor the liquidity profile of OEFs, including redemption frequency and LMTs, in order to detect unmitigated liquidity mismatches during the lifetime of OEFs?

Many members of Paris Europlace WG emphasize the need for liquidity. NBFIs are vital sources of financing, particularly in capital investments. Their contribution to economic financing cannot be underestimated. The liquidity of these instruments is crucial; any measures that reduce liquidity will diminish their attractiveness and drive investors towards unregulated markets. Accordingly, regulatory measures must ensure that the appropriate level of liquidity is maintained within funds. It means that a focus should be given to the way liquidity can be ensured in the underlying markets. As a matter of fact, if a market becomes completely frozen, no liquidity can be provided by the OEFs which are invested in. The AIFMD includes precise provisions on the management of the liquidity risk of open-ended funds and RTS and guidelines on this matter are under development by ESMA. This new piece of regulation will foster a common understanding of these tools. However, a common set of rules of activation could potentially be counterproductive and dangerous.
By treating similar types of funds equally, liquidity policies could potentially trigger common and simultaneous behaviors which could be detrimental to the global liquidity of the market. Diversity is indeed a key condition. As a matter of fact, each OEF differs from another from an asset and liability perspective. The notion of cohort of funds is illusory, even for funds managed by the same management company. For the purpose of economy of scale, managers favor larger funds to several similar smaller funds, when possible.
While acting in the best interest of the unit/shareholders in the funds they manage, asset management companies also consider financial stability. Indeed, anti-dilution tools that allow the cost of liquidity to be charged to holders who sell, and not to those who remain, are deemed efficient to mitigate the “first mover advantage”. They should be covered with the new releases of UCITS and AIFM directives.
It is also worth mentioning that OEFs did not experience any bankruptcies during the 2020 pandemic crisis in Europe. And it is crucial to note that no cases have initiated LMT activation without dialogue with the NCA. This means that local dialogues can be more effective than global policies. This is how NCA can better monitor unmitigated liquidity mismatch.

Question 16. [To NCAs/EU bodies] What is the supervisory practice and your experience with monitoring and detecting unmitigated liquidity mismatches during the lifetime of OEFs?

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

A broad range of data is used by asset managers to monitor the liquidity risk of their investment funds. Both asset and liability sides must be jointly monitored. On the asset side, marketable volumes are one of the most relevant data monitored in order to have a dynamic view over time of the volumes that can be sold under normal market conditions and under ‘stressed’ conditions.

On the liability side, the fund manager needs to estimate the risk of redemptions to which its fund may be exposed, using the same logic as that adopted for assets, i.e. under normal market conditions and under “stressed” conditions. The most relevant data are those needed to assess the investors behavior and eventually build a redemption curve if the knowledge of the liability structure is sufficiently detailed. The liquidity risk itself is estimated by comparing the analyses carried out on the assets and liabilities sides.
The results of stress tests to be conducted by the asset management company are of course included in this monitoring. Liquidity risk management is also reviewed at the occasion of liquidity risk committees held on a regular basis internally (monthly or quarterly). If necessary, the frequency of these committees is increased, typically in case of stress in the market. Some French professional guides (Link) on the management of liquidity risk provide more detailed examples of relevant data and asset-liability matching indicators.

Question 18. [To NCAs/EU bodies] What supervisory actions do you take when unmitigated liquidity mismatches are detected during the lifetime of an OEF?

Question 19. On the basis of the reporting and stress testing information being collected by competent authorities throughout the life of a fund, how can supervisory powers of competent authorities be enhanced to deal with potential inconsistencies or insufficient calibration between the LMTs selected by the manager for a fund or a cohort of funds and their assets and liabilities liquidity profile? How can NCAs ensure that fund managers make adjustments to LMTs if they are unwilling to act? How could coordination be enhanced at the EU level?

If we fully agree with the Commission that the activation of an LMT should remain full responsibility of the manager, we strongly disagree with the Commission’s proposal to empower the NCAs or ESMA to require the AIFM to select a specific LMT for a fund or cohort of funds. The authorities already have a general power of control over the fact that the asset management company is acting in the best interests of its unitholders, and this power is sufficient to enable each NCA to ensure that the asset management company sets up and maintains operational LMTs in line with the level of liquidity proposed by the fund. In any case, rules on LMTs should be adapted to the realities of different fund types, as rules that would not sufficiently be tailored could create risks of paralysis or runs.

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

Question 21. [To asset managers] What difficulties have you encountered in measuring and monitoring liquidity risks and their evolution? Are there enough tools available under the EU regulations to address liquidity mismatches?

In our opinion, there are enough tools available under the EU regulations to address the liquidity risk of open-ended AIFs. The revised AIFMD2 offers a wide and harmonized range of liquidity management tools, from which AIFMs have to choose two. In addition, it allows these managers to put in place any other additional tool they may deem relevant (e.g. soft closures).

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

Stress testing

Question 23. [To NCAs and EU bodies] When monitoring or using results of liquidity stress tests, are you able to timely collect underlying fund data used by managers and the methodology used for the simulation? Are there other aspects that you find very relevant when monitoring the stress tests run by managers?

Question 24. [To NCAs and EU bodies] How do you use information collected from stress tests at fund level for other supervisory purposes and for monitoring systemic risks?

Question 25. [To NCAs and EU bodies] What are the main benefits and costs of introducing a stress test requirement at the asset management company level and how could this be organized?

Other NBFIs

Question 26. What are your views on the preparedness of NBFIs operating in the EU in meeting margin calls, and on the ways to improve preparedness, taking into account existing or recently agreed EU measures aimed at addressing this issue? Please specify the NBFI sector(s) you refer to in your answer?

Regarding the insurance industry, European (re)insurers are well prepared for meeting margin calls. European (re)insurers are subject to the Solvency II prudential regime, which includes liquidity risk management requirements. Furthermore, it provides extensive supervision and reporting. Solvency II restricts the use of derivatives. It is only permitted insofar as derivatives contribute to a reduction of risks or facilitate efficient portfolio management. The use of derivatives for speculative reasons is not permitted. Additionally, the use of derivatives under Solvency II is governed by the prudent person principle which restricts investment to instruments which the insurer can properly identify, measure, monitor, manage, control and report.
Under Solvency II, (re)insurers have to include liquidity risk management and investments, specifically derivatives, in their risk management system. Additionally, if a (re)insurer uses the volatility adjustment or matching adjustment they already required to set up a liquidity plan. These liquidity provisions will be strengthened by extensive new macroprudential requirements, agreed on as part of the Solvency II review aimed at systemic liquidity risk. In particular, insurers will have to draw up and keep up to date a liquidity risk management plan (LRMP) and will also have to develop and keep up to date a set of liquidity risk indicators to identify, monitor and address potential liquidity stress. While the details of the LRMPs and the liquidity risk indicators are still to be determined, European (re)insurers expect that these will be sufficient to address any continued supervisory concerns about liquidity risk management, including the preparedness for margin and collateral calls.

With respect to a further mitigation of potential risks from margin calls, greater transparency from market participants could contribute to improve participants' liquidity preparedness. For example, more transparency around the way Central Counterparty Clearing Houses' (CCPs) collateral requirements are modelled and calculated would allow insurers to anticipate any unexpected surge in collateral needs, helping firms to better identify and contribute to mitigate potential systemic impacts. NBFIs play a key role in promoting growth in their respective economies. The need to hold significant amounts of cash for example to cover margin calls during periods of stress, prevents investment in productive assets. We support further assessment of the feasibility of expanding the type of assets accepted as collateral from cash-only to some types of non-cash. A wider range of accepted collateral would also contribute to strengthen firms' liquidity positions, diminishing systemic risk.

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

Management of liquidity risk is a requirement under Solvency II[2] (Art 44(2) and Art. 132) and at a micro-prudential level, liquidity risk management is already a fundamental part of insurers' wider risk management (see also answer to question 26). Many insurers also regularly report on their liquidity risks to supervisors.
Going forward, the Solvency II review will introduce additional requirements for insurers to prepare liquidity risk management plans. The specifications of the new plans are currently being developed by EIOPA.
At a macroprudential level, European and global supervisors have developed several comprehensive liquidity monitoring tools to identify and quantify liquidity risks arising from the insurance sector. EIOPA has developed EU-wide liquidity stress tests and the IAIS has developed 5 liquidity metrics at a global level which serve as ancillary indicators as part of its Holistic Framework. In particular, EIOPA's 2021 EU-wide stress-testing exercise assessed the financial strength and liquidity of the European insurance sector. The results of this stress test clearly demonstrated that liquidity risk is really not a significant issue for European insurers. This is because it is well managed, being an integral part of insurers' asset and liability management and risk management.
The EIOPA exercise tested a very extreme, 1-in-1000-year scenario. The results showed that:

- Under the base case, insurers had positive liquidity (ie, cash and equivalents) of €80bn ($86bn) AND liquid assets of €2.8trn.
- Under the very extreme stress-test scenario, the positive liquidity position moved to a small negative liquidity position of €10bn, but liquid assets of €2.2trn were still available. The aggregate liquidity coverage ratio after the extreme stress situation was therefore 2 200%

In addition, that liquidity risk in the insurance industry remains moderate under the new interest rate environment was demonstrated in the liquidity risk analysis in EIOPA's Financial Stability Report of Dec. 2023: It presents the results of the liquidity monitoring carried out by EIOPA of 100 selected European insurers identified by the national supervisors on the basis of potential high exposure to liquidity risks. Overall, EIOPA concludes that the aggregate liquidity position of the insurers analyzed does not give cause for concern.

[2] See Article 44 (2) *Risk management* and Article 132 *Prudent Person Principle*

Pension Funds

Question 28. How can current reporting by pension funds be improved to improve the supervision of liquidity risks (e.g. stemming from exposure to LDI funds, other funds or derivatives), while minimizing the reporting burden? What can be done to ensure effective look-through capability and the ability to measure the impact of unexpected margin calls? Please provide examples also for other NBFI sectors.

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

Short-term funding markets

Question 30. What would be the benefits and costs of creating a framework or a label in EU legislation for certain money market instruments (such as commercial papers) to increase transparency and standardization? Should the scope of eligible instruments to such framework/label be aligned with Article 3 of Directive 2007/16/EC60? If not, please suggest what criteria would you consider for identification of eligible instruments.

A global framework or label should bring more transparency and standardization regarding documentation, settlement time, enhanced reporting … We should also assess the benefits and costs from an issuer perspective, notably because the issuers will be called to contribute by financing this label. More transparency should obviously help new issuers to step into CP market. But standardization should not be “pushed” too far because some issuers are looking for flexibility. The NEU CP market, based in Paris, can be seen as a good example of what can be a future EU framework. The NEU CP program was created following the French authorities’ reforms of 2016. It has been sponsored by key players and the Banque de France. This commitment of the French authorities has been an important element to ensure the success of NEU CP.
At the EU level, a similar framework should be also sponsored by the ESA’s or at least the ECB. It must not be an opportunity for an additional layer of regulation, but a framework designed to get better access to information and market data linked to volume and prices. Definitely, MMFs managers need more transparency. Regarding the eligibility criteria, we believe that what matters is that money market instruments remain eligible to MMFs investment universe as MMFs are by far the largest investors.

Question 31. Would the presence of a wider range of issuers (notably smaller issuers) to fund themselves on this market, and therefore diversify their funding sources, be beneficial or detrimental to financial stability?

In the past few years, financial regulation has led to industry concentration. Money Market Funds (MMF) regulations have encouraged more in-house credit analysis, with solely large money market funds hosting large analysts teams. In addition, internal risk policies (and a constant need for cost control) have encouraged in-house analysts to cover only the few largest NEU CP issuers, solving by

this way their issue of concentration ratio on small NEU CP programs.
As a result, the number of issuers and the volume of issues have plateaued and the risk that smaller issuers might turn away from the NEU CP market if they do not find enough investors has drastically increased in the recent 2 years. It is detrimental to the well-functioning of financial markets as the NEU CP program is an extraordinary funding tool for a wide range of issuers, with lots of market data and statistics thanks to the work of the Banque de France. It is also a means to finance the real economy and offers financing diversification opportunities to corporates of a variety of size.
We believe it is essential to preserve and push further the opening up the NEU CP market to as wide and diversified a range of issuers as possible. Giving access to a wide range of issuers can foster the financial stability. Diversity and granularity disperse risk.

Question 32. What are your views on why euro-denominated commercial papers are in large part issued in the 'EUR-CP' commercial paper market outside the EU? What risks do you identify? Please provide quantitative and qualitative evidence, if possible.

Question 33. What could be done to improve the liquidity of secondary markets in commercial papers and certificates of deposits?

Question 34. Considering market practice today, is the maturity threshold for 'money market instruments' (up to 397 days) in the Eligible Asset Directive 2007/16 sufficiently calibrated for these short-term funding markets?

This maturity threshold is sufficiently calibrated for the short-term funding markets.

Question 35. Do you think there is a risk with the high concentration of this market in a few investors (MMF and banks)? Please elaborate.

Question 36. How could secondary markets in these money market instruments attract liquidity and a more diverse investor base, while relying less on banks buying back papers they have helped to place?

Question 37. What are the benefits and costs of introducing an obligation to trade on trading venues (regulated markets, multilateral trading facilities and organized trading facilities) for such instruments?

The costs will be much higher than the benefits. For an MMF manager perspective, there will be additional costs linked to the connection with theses trading platforms along with reconciliation issues. Some issuers need flexibility. The standardization of the instruments will not favor the market. Such measure could be considered if the structure of STFMs looked like equity markets. This is absolutely not the case. While a given issuer generally has only one equity instrument traded on the stock market, with a one-off primary issue (when listed, through IPOs), the same issuer may have plenty of short-term instruments issued on the STFMs, as frequently, for some of them, as every day. Consequently, standards of trading prevailing on the equity market cannot be transposed into the STFMs, as their respective instruments cannot be compared on both numbers and frequency of issuance standpoints. Mandating participants of STFMs to trade through a given channel rather than another will impair its their liquidity rather than improve it.

Question 38. Can the possibility to trade on a regulated venue increase the chances of secondary market activities in a systemic event, for instance by acting as a safety valve for funds that need to trade these assets before maturity (especially when facing strong redemption pressures, like for MMFs)?

Commodities markets

Question 39. How would you assess the level of preparedness of commodity derivatives market participants in terms of meeting short-term liquidity needs or requests for collateral to meet margins? Please rank from 1 to 5 (lowest to highest) the level of preparedness for the following participants by sector: insurance companies, UCITS funds, AIFs, commercial undertakings, investment firms, pension funds.

Question 40. In light of the potential risk of contagion from spot markets or off-exchange energy trading to futures markets, do you think that spot market participants should also meet a more comprehensive set of trading rules for market participation and risk management? Please elaborate on your response.

Question 41. How can it be ensured that the functioning of underlying spot energy markets and off-exchange energy trading activity does not lead to the transmission of risks to financial markets?

Other markets

Question 42. To what extent do you see emerging liquidity risks or market functioning issues that can affect liquidity in other markets? Can you provide concrete examples?

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?

At the EU level, UCITS funds and AIFs are significantly regulated on the leverage they can take. UCITS funds have a (synthetic) leverage cap of 100% and AIFMs have to demonstrate that the leverage limits for each AIF they manage are reasonable and that they comply with those limits at all times. Both UCITS funds and AIFs already produce reporting on potential leverage to their respective NCAs, there is also related disclosure requirements to end investors. Then NCAs have the possibility to intervene at individual level or for a group of investments if considered as relevant, according to Article 25 under the AIFMD. 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.

Question 44. What are, in your view, the benefits and costs of using yield buffers61 for Liability-Driven funds, such as it was done in Ireland and Luxembourg, to address leverage?

Question 45. While on average EU OEFs are not highly leveraged, are there, to your knowledge, pockets of excessive leverage in the OEF sector that are not sufficiently addressed? Please elaborate with concrete examples.

We do not consider there to be a risk of pockets of excessive leverage that could not be addressed with the existing framework mentioned above.

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

The UCITS directive authorizes the investment in funds established in third countries provided that foreign funds are subject to an equivalent supervision and (art 50 e (ii)): "the level of protection for unit-holders in the other collective investment undertakings is equivalent to that provided for unit-holders in a UCITS, and in particular that the rules on asset segregation, borrowing, lending, and uncovered sales of transferable securities and money market instruments are equivalent to the requirements of this Directive". Consequently, no leveraged strategy can be invested by funds under the UCITS directive.
Regarding AIFs, rules are less strict and leverage is possible. However, in the case the leverage is above 300%, more detailed reporting on the leverage and on any change in this leverage is requested. However, this type of highly leveraged funds is quite limited inside in the EU. Even if a highly leveraged strategy is indirectly invested (through a fund), the maximum loss is limited to the money invested only.
For a better detection of leverage strategy, some specific stakeholders should be targeted: the custodian banks of the funds implementing a leverage strategy through bank overdraft, its auditors, the lender or the derivatives counterparty or the leverage provider.

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

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

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

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 criterion is the most heavily weighted indicator in the G-SIB assessment grid (20%).
Similarly, the existing framework for EU investment funds has already introduced robust rules to address such concerns with quite extensive transparency requirements. The priority should be on assessing how this information is effectively analyzed and how coordination between public institutions, including on data sharing, can be enhanced to make the most of this information.

Question 49. [To NCAs and EU bodies:] Are you able to timely identify (financial and synthetic) leverage pockets of other NBFIs (such as pension funds, insurance companies and so on), especially when they are taken via third parties or complex derivative transactions? Please elaborate on how this timely detection of leverage could be obtained?

Question 50. How can it be ensured that competent authorities can effectively reconcile positions in leveraged products (such as derivatives) taken via various legal entities (e.g. other funds or funds of funds) to the ultimate beneficiary?

The "Interconnectedness" between NBFIs and between banks and NBFIs is already closely monitored by bank supervisors. It is also an important criteria in the calculation of banks G-SIB score, translating directly into a capital buffer. Most of data about derivatives, risk exposures and counterparties, although complex and not readily functional, is currently available to EU regulators and supervisors either through trade repositories or supervisory/regulatory reporting. If used and shared appropriately among EU regulators and supervisors, this would enable a better understanding and limit the reporting burden on market participants.
There is an interesting initiative in the US that could also be useful for the benefit of all market participants in Europe as well. The interactive data visualization tool (Hedge Fund Monitor) launched on July 31st 2024 by the US Office of Financial Research (OFR) 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.
Ultimately, we recommend that regulators and supervisors should enhance cooperation among relevant authorities across jurisdictions (including in the EU), and invest into data analysis capacities.

Commodities markets

Question 51. What role do concentrated intraday positions have in triggering high volatility and heightening risks of liquidity dry-ups? Please justify your response and suggest how the regulatory framework and the functioning of these markets could be further improved?

Monitoring interconnectedness is crucial in our view.

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?

Interconnectedness with the NBFIs sector exists since banks can potentially act as a source of leverage or as liquidity providers to NBFI, as illustrated with the example of the failure of Archegos Capital Management. However, strengthening the prudential regulation of banks to better control NBFI activities is counterproductive. To conclude, banks should not act as gatekeepers for NBFIs. Key point is about how such exposures are monitored and properly mitigated:

o Financing of NBFIs through loans and repos

o Due to tightening of bank lending standards, NAV loans from banks can however lack the liquidity and flexibility of terms that investment managers want or need. NAV finance can also be provided by non-banks like NAV funds, active in the growing private credit market as in the private equity market. NAV lending increases leverage in the fund and – would the fund have to be wound up - investors would be paid out after NAV lenders, which are higher up in the capital structure.
The volumes of NAV financing are small at this stage, but are expected to rise.

o Investors' financing by banks of investment in SRT tranches – through repo's with recourse to SRT funds or through NAV finance - is not excessively leveraged, i.e. that the haircuts and maximum LTV are properly calibrated based on expected and unexpected economic losses on the underlying loan pools per asset classes, to ensure that credit risk is truly transferred.

o Unfunded credit risk transfers between banks and NBFIs - like synthetic securitisation or credit insurance - are reducing systemic risk by spreading credit risk between the systemic banking sector and less systemic insurance and investment sectors.

o Insurance and investment funds are generally long term buy-and-hold investors in bank-originated risks. They are protected by the strictly regulated and supervised bank loan origination and monitoring framework, and by the retention requirements imposed by the Securitisation requirement (for STS and non-STS transactions). In addition they are subject to (largely redundant) due diligence requirements.

o Bank-originated credit positions are a very small proportion of insurance investment portfolios and credit funds, within a portfolio allocation strategy which explicitly considers risk/return and concentration factors (dedicated credit funds may be more vulnerable to systemic risks: cf. recent IMF report on private credit)

o These exposures provide diversification and yield that benefit to asset owners. In times of stress, they are built to be less vulnerable, thanks to the first loss protection, than direct exposure to equivalent loan portfolios.

o These exposures are (excessively) conservatively capitalized in Solvency2 for insurance companies

o In Europe, the private SRT market has grown gradually since the early 2000 based on a principle of long-term partnership between banks, investors and insurers, with a close monitoring by supervisory authorities and central banks. The risk sharing activity is very healthy and mature, and was not affected by credit downturns in the last two decades.

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?

We are supportive to this proposal. We consider that main benefit would be the data that this exercise would provide and the specific interconnectedness between the various market participants. It would also enable better understand the behaviors of the various players in time of stress, results should be much more instructive than some theoretical assumptions not supported by relevant data so far. The design of such an exercise would be key in view of the implication it will require from participants. Existing challenges, such the lack of data in some cases (i.e. non-regulated NBFI that should be part of the stress test), selection of right scenarios, fragmented nature of EU markets, need to be properly addressed before any effective launch. It would also make sense to make the most of similar exercises already conducted in other jurisdictions (mainly in the UK). Lastly it is essential that results of this stress testing are shared with the participants.

Indeed, to identify and measure the potential sources of systemic risk, and transmission channels of systemic shocks, a stress test of risk transfers across the whole financial system would be a major undertaking, requiring deep collaboration across ESAs and NCAs. First, it should be reminded that stress tests are already regularly performed "in silos" for banks, investment funds and insurance companies. In the case of banks, the regular EU-wide stress tests include specific stresses to be applied by banks on their exposure to their main financial counterparties (including general downgrade of financial and non-financial counterparts, and a sudden default of the main 2 financial counterparts). Second, transversal approaches to stress tests affecting the whole financial system are currently being developed at international levels: at the IMF, in the context of FSAP and in the UK "System-wide Exploratory Scenario". While these exercises are still at early stage, the EU may want to leverage on those experiences and draw the lessons of initial findings:

- A focus on a specific asset class and its "value chain" as done in the UK may prove to be a pragmatic approach, especially targeting the sovereign debt market. Such an approach reduces considerably the data challenge compared to a full market approach, given the high transparency and high data frequency in the sovereign bond market.
- Such an approach would need to cover the whole value chain, including digital trading platforms, high-frequency trading, CCPs, etc.
- Beyond the data collection needed to build a baseline, the development of relevant scenario(s) would have to be carefully approached, including realistic behavioral changes of various types of market participants, based on experience from recent episodes of stress. For example, those scenarios would need to include : freeze in secondary market by market makers (and related regulatory and risk appetite drivers), changes in collateral eligibility and haircuts, and reaction functions of market participants, etc.
- Understanding changes in behaviors and flows of credit risk to the real economy would be a much more difficult exercise, as it would require mapping and collection of horizontal data on issuing banks' risk profile, applicable regulations, protected asset classes, structure of risk mitigating transactions, direct but also indirect protection providers and their financing providers, concentration and capacity of ultimate risk owners. Moreover, because credit risk transfers are by nature cross-border and executed between banks and counterparts based within and outside the EU, a stress test limited to the EU zone would not be meaningful to test the robustness of interconnections in credit risk transfers.

We believe system-wide stress tests, such as the Bank of England's System-Wide Exploratory Scenario (SWES), can be a good way of assessing dynamics in core markets. Through feedback loops, results of system-wide stress tests can also enhance risk managers' own stress test modelling.

Finally, it is important to recognise that better supervision is not limited to stress testing and new data provision – there is a real need to improve sharing of existing data reporting among NCAs. As we outline in response to the questions below on supervision, policymakers should seek to develop standardised reporting templates to reduce the administrative burden for cross-border firms operating in Europe.

Because of the additional insights they allow, cross-sectoral stress tests can be a useful tool in macroprudential monitoring and are already used by supervisors. With respect to the design of these stress tests – as with stress testing in general – it is crucial to balance the costs and the benefits of the exercise, and in particular take the already existing data and analyses and the burdens on financial institutions and supervisors fully into account.

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.

The answer to this question is obviously 'yes'. The sharing of information should not be limited to stress test exercises, but should also be the rule as regards day-to-day monitoring.

The principle of data sharing among financial supervisors should be introduced at the core of the governance of those institutions, possibly at the occasion of the next ESA review. It would also probably require a fundamental change in the governance of ESRB, currently perceived as bank centric given its position within the ECB. In order to have the legitimacy to review financial stability issues across the whole financial sector, it should be established at EU level and with a balanced governance of banking and non-banking regulators, including as well representatives of economic policy at EU and member states levels, reflecting the governance of national macroprudential authorities such as the French HCSF, as well as the governance of the FSB where both Treasuries and central banks are represented.

Authorities should explore new ways to overcome impediments to sharing data across EU and other jurisdictions, to be able to effectively monitor the build-up of leveraged and concentrated positions, amplification channels, sources of vulnerabilities (see response for question 50). This would require a more streamlined and comprehensive data sharing/data analysis strategy between EU supervisors and the various NCAs in EU Member States; using existing data (and therefore refrain from imposing additional reporting requirements to regulated NBFI or banks). The ultimate objective should be a better understanding of existing interconnectedness between banks and NBFIs, and how this should be addressed in case of market stress. It should also be used to avoid unnecessary duplication of reporting requirements and lead to a single format and unified timeline of reporting across NCAs and for securities regulators and central banks when applicable.

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

Question 56. [To NBFIs and banks] In your risk management practices, do you run stress tests at group level, and do you monitor the level of interconnectedness with (other) NBFIs (within and beyond your own sector; e.g. portfolio overlaps)?

The answer is yes. These stress tests are conducted on a regular basis and with a holistic approach. Comprehensive and detailed testing methodologies have been developed internally in this respect. If « interconnectedness » means exposure to non-banking institutions, of course banking groups measure their exposure to non-banks across their whole business portfolios (including insurance, as required by the Conglomerate directive).

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.

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

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

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

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

Sector-specific regulators are knowledgeable about their areas, while the FSB ’s global approach may add unnecessary layers. Central bank tools are designed for macroeconomic measures, but the mandates of National Competent Authorities (NCAs) are frequently overlooked. Whatever initiative is designed to enhance a more coordinated supervision, it should prioritize measures that do not undermine competitiveness and should not come at an additional cost to European actors. Indeed, any macroprudential policy should analyze risks in a precise and aggregated manner according to the principle of “burden reduction: report only one”.

Enhanced coordination mechanism (implementation and adoption of NMMs)

Question 58. How could the currently available coordination mechanisms for the implementation of macroprudential measures for OEFs by NCAs or ESAs (such as leverage restrictions or powers to suspend redemption on financial stability grounds) be improved?

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 do not consider that the introduction of an ECM would be the most efficient way for improving coordination mechanisms between supervisors. We are more supportive to the greater role that could be given to ESMA for both data sharing via the creation of a single reporting data, and for further coordination in the reporting requirements. This should result in less complexity and in removing unnecessary duplication in the data to be reported according to the various existing policies. At the same time, strong expertise and deep knowledge of NCAs should be preserved as they ensure proximity and reactivity when needed. Ultimately, NCAs are best-positioned to identify and address any risks related to market stability and investor protection thanks to their knowledge of national specificities, diversity of products and complexity in some cases.

Question 60. How can ESMA and the ESRB ensure that appropriate National Macroprudential Measures (NMMs) are also adopted in other relevant EU countries for the same (or similar) fund, if needed?

See our responses to the previous questions.

Question 61. Are there other ways of seeking coordination on macroprudential measures and possibly of reciprocation? What could this system look like? Please provide concrete examples/scenarios and explain if it could apply to all NBFI sectors or only for a specific one.

Supervisory powers of EU bodies

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

We do not consider that size is a relevant metric for asset managers. It has been observed that reduced (not to say no) supervision of smaller entities for banks can lead to critical situations (as in the US with the failure of the SVB). In addition, and most importantly, risk management in case of asset management activities is to be considered at the fund level and not at the asset manager / management company level. Having an entity-level approach makes non-sense due to the diversity of investment funds managed. Lastly an asset manage / management company as such cannot become insolvent as it mainly manages the assets of its clients and not its own assets (or in very small proportion).
At the same time, 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 4 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. This would not interfere with the role of each NCA while enabling more coordination in the actions that could be identified and then implemented.
In our view, evolving towards a more integrated supervision would suppose some conditions to be met before:

- Extending the ESMA's remit to include direct supervisory powers over all market participants will deliver the expected benefits it has a better exposure to market realities. Interim steps

should therefore be envisaged to deepen dialogue between the ESMA – at all levels – and market participants, in order to build positive, trust-based relationships with pan-European stakeholders;
- In order to progress towards a single, harmonised set of rules, ultimately enforced by a single supervisory authority, the phasing-out of national exemptions and domestic gold-plating of EU regulations has to be ensured;
- Adding a layer of supervision could increase costs, complexity and red tape. Thus, the short-term target should not be a centralised supervision but, at least, an integrated supervisory mechanism leveraging both NCAs and ESMA expertise.

Some policymakers have suggested an "opt-in" scenario as an interim step. In such a case, firms would have the right to opt for centralized supervision by the ESMA, with a view to facilitating and harmonizing the supervision of their various subsidiaries or undertakings across the EU. Granted, this opt-in framework could be limited to a number of voluntary Member States as part of a "reinforced cooperation", as it seems unlikely to achieve unanimity among 27 Member States on this ambitious project. However, such an opt-in framework could create additional, complex implementation issues with NCAs. It could lead to different regulatory outcomes between opt-in firms and firms remaining under domestic supervision. This gap could even reinforce fragmentation and complexity around financial regulation. Instead, the next European Commission should focus on a few pragmatic steps towards more integrated supervision, which could include the establishment of a single set of convergent European rules and provision of the possibility for groups operating in more than one country to operate fully on a consolidated basis, i.e. allowing them to organize their functions as if they were a single legal entity. This also include the possibility to give more powers to the group, i.e. lead, supervisor, in the form of a clear mandate for consolidated institutions and for facilitating cross-border business, working closely with the ESMA. Of course, this implies recognizing the concept of an "EU group", as regards the asset management industry for instance.

Question 63. What powers would be necessary for EU bodies to properly supervise large asset management companies in terms of flexibility and ability to react fast? Please provide concrete examples and justifications.

As mentioned previously, large asset managers should not be supervised in a different manner. No additional powers should be given to EU institutions, it is key that asset managers / management companies keep discretion and flexibility on selecting and activating any mechanism at their disposal in case of market stress (and under normal conditions as well).
When required, close dialogue between the asset manager/ management company is the key priority instead of activating some tools in an automated and/or prescriptive way. Coordination between NCAs as mentioned previously should also be more efficient than such powers. In case of cross-border asset managers, designation of a lead supervision (as mentioned previously) could also contribute to an enhanced supervision approach.

Question 64. What are the benefits and costs of having targeted coordinated direct intervention powers to manage a crisis of large asset management companies? What could such intervention powers look like (e.g. similar to those in Article 24 of EMIR)?

See our responses to the previous questions.

Question 65. What are the pros and cons of extending the use of the Enhanced Coordination Mechanism (ECM) described under section 6.1 to other NBFI sectors?

ESAs and ESRB's powers during emergency situations

Question 66. What are the benefits and costs of gradually giving ESAs greater intervention powers to be triggered by systemic events, such as the possibility to introduce EU-wide trade halts or direct power to collect data from regulated entities? Please justify your answer and provide examples of powers that could be given to the ESAs during a systemic crisis.

We consider that giving "coordination" powers is more adequate than "intervention" powers. It makes sense that further data sharing and concertation would be of strong added value to manage critical situations. However activating some mechanisms or imposing them in a prescriptive way could have unintended consequences in contradiction with the purpose of preserving the financial stability.
Specifically, article 18 of the EIOPA regulation already provides EIOPA with power to perform a facilitating and coordinating role in the event of adverse developments which may jeopardize financial stability. At this stage, no evidence has been put forward of the need to extend these powers or of any potential benefits that would arise from the extension of these powers.

Integrated supervision for commodities markets

Question 67. What are the benefits and costs of a more integrated system of supervision for commodities markets where the financial markets supervisor bears responsibility for both the financial and physical infrastructure of the commodity futures exchange, including the system of rules and contractual terms of the exchange that regulate both futures and (cash/physical) forward contracts?

International coordination

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

We consider that the existing regulatory framework in the EU is already quite extensive and properly designed to address sources of systemic risks that could stem from EU regulated entities. So any elements of the FSB programme that would apply to EU regulated NBFI are not necessary.
Focus must be in priority on non-regulated NBFI and how improving supervisory coordination and convergence. Data sharing is essential to achieve this target and more broadly, coordinated approaches between supervisors in any relevant situations should be at the core of future actions.