European Securities and Markets Authority

Response form for the Consultation Paper on the Draft guidelines on stress test scenarios under the MMF Regulation

28 September 2018

European Securities and Markets Authority

Date: 28 September 2018

Responding to this paper

ESMA invites responses to the questions set out throughout its Consultation Paper on the Draft guidelines on stress test scenarios under the MMF Regulation. Responses are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **1 December 2018.**

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

- Insert your responses to the questions in the Consultation Paper in the present response form.

- Please do not remove tags of the type <ESMA_QUESTION_MMFST_1>. Your response to each question has to be framed by the two tags corresponding to the question.

- If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.

- When you have drafted your response, name your response form according to the following convention: ESMA_ MMFST _nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_ MMFST _ABCD_RESPONSEFORM.

  - Upload the form containing your responses, **in Word format**, to ESMA’s website (www.esma.europa.eu under the heading “Your input – Open consultations” → “Consultation on Securitisation Repositories Application Requirements”).

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading Legal Notice.

Who should read this paper?

This document will be of interest to (i) MMF managers and their trade associations, (ii) alternative investment funds and UCITS managers and their trade associations, as well as (iii) institutional and retail investors (and associations of such investors) investing in MMF.

General information about respondent

Name of the company / organisation	AFG
Activity	Investment Services
Are you representing an association?	☒
Country/Region	France

Introduction

Please make your introductory comments below, if any:

<ESMA_COMMENT_MMFST_1>
The Association Française de la Gestion financière (AFG)[1] is grateful for the opportunity given to comment on ESMA's Consultation Paper on the Draft guidelines on stress test scenarios under the MMF Regulation.

A general issue our members wish to raise is about the too granular level of detail and the amount of the stress tests required. It is important to mention that unlike AIFMD stress tests, this MMFR approach to stress tests contains also a calibrated leg which is totally new and somewhat too cumbersome for a first approach. Our members believe that due attention should be paid on this calibrated part so as to choose a limited number of stress tests that are simple to implement, useful and that allow for less need of recalibration or change every year. On these limited calibrated common stress tests, please bear in mind that a calibrated approach needs to specify as much as possible the parameters. For instance, parameters should be opposable and known like external credit ratings for instance.

In general, our members insist on the fact that there is a lack of flexibility for the asset manager to choose a more appropriate (for asset managers) methodology for stress tests. Indeed, the money markets environment is very different from the bonds markets, where transactions and bid/offer data are transparent and available on IT providers' platforms. The consultation document seems to consider that bid/ask spreads are available for money markets instruments which is not the case.

Stress testing should take into consideration the specific features of MMF as an asset class. This is currently not reflected in the proposed stress test scenarios. For example (i) long-term stress tests for MMFs are not meaningful (ii) considering that MMFs are liquid assets for less than 100% of their NAV is unfunded.

AFG would also like to stress that it would be helpful keeping the common standardised reporting stress test simple and avoid any supplement to what the level 1 text requires.

AFG members believe that the idea to look through the assets of the underlying MMF and apply stress tests to those assets seems totally disproportionate and unfeasible given that underlying MMFs have all

[1] The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. 600 management companies are based in France. AFG members manage 3,000 billion euros, making the Paris fund industry a leader in Europe for the financial management of collective investments (with 1,500 billion euros managed from France, i.e. 19% of all EU assets managed in the form of investment funds). In the field of collective investment, our industry includes – beside UCITS – the whole range of AIFs, such as: employee savings schemes, regulated hedge funds/funds of hedge funds, private equity funds, real estate funds and socially responsible investment funds. AFG is an active member of the European Fund and Asset Management Association (EFAMA) and of PensionsEurope. AFG is also an active member of the International Investment Funds Association (IIFA).

conducted the exercise separately. In line with para. 17 of the Consultation, further approaches could be used. We suggest that the manager should also be able to rely on the stress test results conducted by the manager of the underlying MMF (where provided) or use a standard factor.

We would also like ESMA to clarify which part of the stress tests are custom and required from the application of the Regulation to the fund and which are implemented for the reporting purposes and with which deadline, bearing in mind for the second part that all companies, including smaller ones, need time and budgets to implement. There should be no requirement to implement the calibrated stress tests before the first reporting period. Only the March 2018 Guidelines on stress tests under the Article 28 are to be implemented once the MMF is authorised under the MMF Regulation. For the sake of clarity, AFG insists on the fact that funds are not managed with the stress test tool and asset management sector does not work on the same basis as the banking sector with pass/fail mindset. Thus, stress tests should continue to be given the place they have in the fund's operation as one tool among others and do not lead to requirements that bear disproportionate implementing costs and deadlines.

i<ESMA_COMMENT_MMFST _1>

Q1 : Do you agree that the impact of market stress should be primarily measured on the NAV?

<ESMA_QUESTION_MMFST_1>
Yes, we fully agree that for all funds the market stress should be primarily measured on the (marked to market) NAV.
Stress scenarios are significant by definition and will hence retrigger a CNAV remarking to market. This remarking must appear in stress results, otherwise it will result in an incorrect perception of risk versus VNAV.

<ESMA_QUESTION_MMFST_1>

Q2 : Do you agree that some assets may not be stressed under all scenarios (in which case the scope of the assets that are subject to the individual stress tests will be clearly defined in the guidelines)? Or should we include additional assumption for those assets (e.g. default by depositary banks in repaying cash holdings)?

<ESMA_QUESTION_MMFST_2>
Yes, we agree that some assets – cash, derivatives or collateralised repos for instance - need not be stressed under all scenarios.
We agree with ESMA that all risk parameters when stressed may not have an impact on these cash positions and therefore on the NAV.
To keep the stress tests framework meaningful, it has to be simple and avoid less necessary or unnecessary stress tests. Indeed, we would like to indicate again that it would be helpful to keep the common standardised reporting stress test simple and avoid any supplement to what the level 1 text requires.
<ESMA_QUESTION_MMFST_2>

Q3 : Do you have views on the way to stress collateral in collateralised transactions (e.g. repos, derivatives)? It may especially involve increased counterparty risk or the need to post additional collateral.

<ESMA_QUESTION_MMFST_3>
The need for collateral stress tests should be reconsidered as our members use high quality government bonds and cash as collateral.
They consider these stress tests would have a totally marginal effect, especially when using high quality government bonds and cash as collateral and only dealing with high quality regulated counterparties. IN addition, Reverse Repo with high quality counterparties have a max 48h call date which limits the liquidity risk.

<ESMA_QUESTION_MMFST_3>

Q4 : Do you agree that the same market stress parameters should be used for all MMFs in order to measure the impact on NAV? Do you have views on the way to take into account the type of fund (short term and standard; CNAV, VNAV and LVNAV) to measure the impact on the fund?

<ESMA_QUESTION_MMFST_4>
Price impacts on assets do not depend on the nature of the fund holding such assets. As such parameters must be the same.
<ESMA_QUESTION_MMFST_4>

Q5 : Do you agree that a consistent approach between the ESAs should be attained? Were appropriate, which risk parameters need to be significantly different?

<ESMA_QUESTION_MMFST_5>
As stated in the consultation paper, the purpose of the stress tests on MM Funds is different from the banking and insurance stress tests (assessing capital adequacy for instance). Therefore, as MM funds take different set of risks, we believe that much simpler stress tests, that do not require same granularity/complexity than other entities such as banks would be appropriate.
We oppose any attempt to copy-paste stress scenarios that are applicable to banks and insurance companies and do not share the idea that applying the same stress to all industries/sectors will give a global and relevant view of a crisis situation. On the contrary, it will blur the view due to overlaps and lack of focus on the relevant risk areas which are specific to each industry.
<ESMA_QUESTION_MMFST_5>

Q6 : Do you have views on which factors are relevant for the determination/calibration of shocks?

<ESMA_QUESTION_MMFST_6>
Relying on historical data is relevant to set the calibration of shocks, but having these historical data on bid/ask spreads is not so easy to retrieve and implement. A simple shock, by widening all spreads by multiplying them by two for instance can also be accurate and more efficient.
.<ESMA_QUESTION_MMFST_6>

Q7 : Do you have a preference between the two proposed options: calibrated discount factor on bid prices; Multiple quoted bid-ask spread?

<ESMA_QUESTION_MMFST_7>
Our members tend to prefer option 1 – calibrated discount factor

We believe that bid-offer spreads don't necessarily reflect liquidity in the market. Option 2 would require bid-offer to be calibrated at the discretion of each MMF Fund manager, therefore making it harder to achieve homogeneity across all MMF Managers. Another issue with option 2 would be related to Commercial Papers which have no observable bid-offer and for which the regulatory text recommends to use a mark-to-model approach: it would be difficult to apply the multiple bid-offer approach on these instruments.
<ESMA_QUESTION_MMFST_7>

Q8 : What is your view on how to stress underlying assets not mentioned above (i.e. not corporate and government bonds)? In your opinion are there asset classes not mentioned above that should be excluded from a quantitative assessment?

<ESMA_QUESTION_MMFST_8>
AFG members think that quasi-govies should be stressed as govies. We would not stress eonia swaps given their liquidity and sensitivity, same for FX forwards.
.<ESMA_QUESTION_MMFST_8>

Q9 : Do you have any views on the calibration? With reference to Option 2, do you think that the adoption of fixed stress factors for different asset classes is in line with practices? Which elements should be identified and used to define the appropriate stress factor for each asset class?

<ESMA_QUESTION_MMFST_9>
Our members believe the calibration must be uniform across all asset managers. If the option 2 is chosen, the factor should be calibrated using the same breakdown featured in option 1.

Our members don't think it is mandatory to have different factors for different asset class. The bid-ask spread for a corporate bond already includes the asset class liquidity information, so using a unique factor can be entirely relevant.

<ESMA_QUESTION_MMFST_9>

Q10 : Do you think that the volume of an asset held by the fund should be considered for the proposed stress factors (esp. the value of assets held compared with the size of the underlying market)? Do you have any views on the methodology?

<ESMA_QUESTION_MMFST_10>
Yes we think this is a critical factor in the risk management process.
However, our members do not believe that there should be a focus on stressing these factors which are dynamic and evolve continuously. Risk monitoring is a more relevant approach in our members' view.
<ESMA_QUESTION_MMFST_10>

Q11 : Do you have views on which factors are relevant for the determination/calibration of shocks?

<ESMA_QUESTION_MMFST_11>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MMFST_11>

Q12 : Do you have a preference between the two proposed options: spreads multiplied by a factor or ESMA credit spread parameter?

<ESMA_QUESTION_MMFST_12>
Preferred option: stressed credit spreads (option 2). Multiplicative stress should be designed to take into account negative spread to swap.

<ESMA_QUESTION_MMFST_12>

Q13 : Do you see specific issues (e.g. implementation, non-standardisation, or similar) with either of the two options?

<ESMA_QUESTION_MMFST_13>
Our members believe that for consistency reasons across asset managers if the approach of a calibrated stress test is retained, external ratings could be used and ESMA should specify a clear methodology applicable by all MMF Managers (worst, middle, best, average linear, average exponential external rating?). ESMA should also define the approach for non- externally rated issuers. An option on simple credit spread widening (parallel shift) should be available.

We would like to recall that AFG is against, as a principle, the mandatory use of CRA ratings and always against the disproportionate and totally unjustified cost brought the use of several agencies. Only for reporting purposes, it could be envisaged for consistency reasons to use one CRA's ratings. Thus, in any case, we believe that not all credit rating agencies should be mandatory, as it implies a certain amount of fees payable to agencies that are disproportionate to the informative nature of the ratings' use in a stress test and over such a short term horizon of time implied by the MMFs stress tests.
<ESMA_QUESTION_MMFST_13>

Q14 : Do you agree with having an additional credit stress simulating the default of the fund's two main exposures?

<ESMA_QUESTION_MMFST_14>
AFG could agree. However, our members do not find this very useful. In addition, for the sake of homogeneity across all MMF Managers, we should have a clear methodology about recovery assumptions (differ-

ent recovery assumptions will lead to different results across MMF managers: they must be the same for all asset managers. If recovery is not to be used it must be explicitly stated in guidance.
<ESMA_QUESTION_MMFST_14>

Q15 : The additional stress simulates the default of the fund two main exposures: when an exposure is collateralised, do you think that additional assumptions on the value of the collateral are necessary (i.e. if the defaulting counterparty is fully collateralised, and the value of the collateral is unchanged, there will be no impact)?

<ESMA_QUESTION_MMFST_15>
AFG considers this additional stress non necessary, as it would have a very marginal effect especially when using high quality government bonds and cash as collateral and dealing with high quality regulated counterparties. Reverse Repo with high quality counterparties have a max 48h call date, which limits liquidity risk.
<ESMA_QUESTION_MMFST_15>

Q16 : Do you think that additional assumptions are needed to calculate the loss given default in the additional scenario?

<ESMA_QUESTION_MMFST_16>
Our members tend to agree. However for the sake of homogeneity across all MMF Managers, we should have a clear methodology about recovery assumptions (different recovery assumptions will lead to different results across MMF managers: they must be the same for all asset managers. If recovery is not to be used it must be explicitly stated in guidance.

<ESMA_QUESTION_MMFST_16>

Q17 : Do you have views on which factors are relevant for the determination/calibration of shocks?

<ESMA_QUESTION_MMFST_17>
Our members do not think it is useful to stress test FX exposure, since MMFs are not allowed to carry open FX positions.
<ESMA_QUESTION_MMFST_17>

Q18 : Do you consider that the parameters used for the 2018 EBA scenario cover all the parameters needed for the purpose of the MMF scenario on interest rates and exchange rates, and the scenario on hypothetical widening or narrowing of spreads among indices to which interest rates of portfolio securities are tied? If not, which parameters should be added?

<ESMA_QUESTION_MMFST_18>

We would like to state again that AFG does not agree as a matter of principle with the idea that ESMA should apply to our industry parameters that have been deemed relevant for banks without further questioning them. AFG would like to recall that asset management is not comparable to banking industry and there is no reason that what is determined for one apply to the other with the same relevance. Capital requirement is not an issue concerning funds.

We nevertheless think these parameters are more than sufficient not to say too complex and granular.

Regarding hypothetical widening or narrowing of spreads among indices to which interest rates of portfolio securities are tied, it's not clear what should be considered, as the market factors mentioned are either interest rates (swap rates and government yields), credit and FX Rates which are already stressed.

<ESMA_QUESTION_MMFST_18>

Q19 : Do you have views on which factors are relevant for the determination/calibration of shocks?

<ESMA_QUESTION_MMFST_19>
AFG recalls that the frequency of the stress tests performed on all factors, encompassing the weekly liquidity of the fund, is to be determined by the asset manager (at least bi-annual) and thus may of course differ from a weekly frequency.
<ESMA_QUESTION_MMFST_19>

Q20 : Do you agree with the proposed approaches: a self-assessment on the maximum size of outflows the fund can face without distorting portfolio allocation; a comparison of stressed outflows with available weekly liquid assets?

<ESMA_QUESTION_MMFST_20>
The two approaches may be somewhat meaningful / understandable. Yet, liquidity differential in a money market fund is less important than in a fund that can go for longer maturity and more diverse risks, rating and seniority wise.

We would like to specify that the bucketing approach is not standard in the asset management. In addition, AFG would like to remind that the MMF Regulation made the structural choice to deal with the issues of liquidity (art. 24 or art. 25) in another manner than a banking bucketing approach.

In case of stressed markets conditions, it should be clarified that portfolio managers will in practice distort their portfolios to an extent acceptable by the intended overall risk-reward profile of the fund.

However for consistency reasons, if distortion must be controlled in the stress, it has to be specified what is considered an asset class, as the maximum size of outflows the fund can face in one week is highly dependent on it (different clustering could lead to significantly different results). It is of utmost importance that all asset managers use the same approach to define asset classes to avoid any arbitrage.

Weekly Liquidity stress test:

Regarding CQS, if the approach of a calibrated stress test is retained, guidance should be provided (only for the reporting purpose and in the case a calibrated and uniform stress test is required, one rating agency free of access could be used and the methodology to retain should be specified (best, middle , worst, average linear, average exponential?) in order to ensure consistency across MMF managers.

We would like to recall that AFG is against, as a principle, the mandatory use of CRA ratings and always against the disproportionate and totally unjustified cost brought the use of several agencies. Only for reporting purposes, it could be envisaged for consistency reasons to use one CRA's ratings. Thus, in any case, we believe that not all credit rating agencies should be mandatory, as it implies a certain amount of fees payable to agencies that are disproportionate to the informative nature of the ratings' use in a stress test and over such a short term horizon of time implied by the MMFs stress tests.

<ESMA_QUESTION_MMFST_20>

Q21 : Reverse stress test: do you have views on how to assess the capacity to comply with the weekly liquid assets requirements specified in Article 24(1)?

<ESMA_QUESTION_MMFST_21>
The approach seems highly complex and our members doubt on the usefulness of such a stress test, which in addition is not required by the MMF Regulation. In addition, as the reverse stress test requires

not to distort the portfolio, as long as the MMF Fund complies with weekly liquid assets requirements specified in Article 24(1) before the stress, it should also comply afterwards. A simple comparison between the weekly liquid assets and the potential weekly outflows is more than enough.

<ESMA_QUESTION_MMFST_21>

Q22 : Do you think there should be differentiated outflows assumptions for retail and institutional investors (e.g. higher outflows from institutional investors).

<ESMA_QUESTION_MMFST_22>
It is general knowledge that retail and institutional investors will have different behaviours, therefore it is necessary to differentiate the levels of outflows and acknowledge higher outflows for institutional investors. Members consider that the 15 and 30% ratios for redemptions over a week is terribly demanding, since historical data do not confirm those levels. We believe past statistics can justify different metrics
.<ESMA_QUESTION_MMFST_22>

Q23 : Do you have views on the weights that should be attributed to weekly liquid assets?

<ESMA_QUESTION_MMFST_23>
We would have expected Shares in MMF Funds to have a weight of 100% considering their nature. There is no valid reason to consider for MMFs authorised under the MMF Regulation a weight less than 100%.
<ESMA_QUESTION_MMFST_23>

Q24 : Do you agree with the additional stress test scenario simulating outflows from the two main investors?

<ESMA_QUESTION_MMFST_24>
Largest investors will be institutional, stressed assumption used above points at a figure of 30% from a stress test standpoint. If this figure were kept the proposed additional stress test doesn't seem necessary at all.
<ESMA_QUESTION_MMFST_24>

Q25 : Do you agree that for the first update of the guidelines MMF managers could be asked to combine the impact of the different risk scenarios, including the liquidity shock?

<ESMA_QUESTION_MMFST_25>
Implementation of stresses is already challenging given the fact we do not have all detailed guidance that will be decided after this consultation. We deem it is more reasonable to postpone this exercise.

Moreover, other reported stress results already implicitly carry this information or at least can give a very close proxy. We also think that market stress test and liquidity stress tests should be treated separately and independently.

It should be added that in any case combining different risk scenarios and liquidity shock in sequence is very difficult to implement. Adding impacts is more appropriate.

<ESMA_QUESTION_MMFST_25>