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ESMA CONSULTATION

On the review of the methodology included in the Guidelines on stress test scenarios under the MMF Regulation



AFG



The AFG federates the asset management industry for 60 years, serving investors and the economy. It is the collective voice of its members, the asset management companies, whether they are entrepreneurs or subsidiaries of banking or insurance groups, French or foreigners. In France, the asset management industry comprises 700 management companies, with €4800 billion under management and 85,000 jobs, including 26,000 jobs in management companies.

The AFG commits to the growth of the asset management industry, brings out solutions that benefit all players in its ecosystem and makes the industry shine and develop in France, Europe and beyond, in the interests of all. The AFG is fully invested to the future.

ON THE REVIEW OF THE METHODOLOGY INCLUDED IN THE GUIDELINES ON STRESS TEST SCENARIOS UNDER THE MMF REGULATION

Introduction

The Association Française de la Gestion financière (AFG) 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.

French money market funds represent a very significant share of the French market with more than 300 billion euros at the end of September 2022, i.e. 40% of French UCITS asset under management.

At the European level, with a 21% market share, France is one of the three main centers for the domiciliation and management of money market funds. Most importantly, it is the domicile for most of the money market funds denominated in euros.

Regarding the liquidity management, AFG believes that the current MMF requirements proved to be relevant. During the last crisis, no European MMF suspended during the pandemic and each MMF dealt with its redemptions. In the French market, despite important redemptions, especially in March 2020 (-52.4 bn euros), French VNAV money market funds managed the outflows. Unlike 2008, there was no issue with the portfolio composition, particularly in terms of asset quality; funds were healthy and resilient in their construction and composition.

MMFR played its role. Investors' confidence was maintained: despite the significant net outflows in March, overall inflows in French MMFs over the first 8 months of 2020 amounted to +48.6 bn euros.

AFG' answers

Q1: Do you have comments or suggestions based on your experience of the application of the current Guidelines (including credit, FX, interest rate and redemption scenarios)?

Q1.a: Did you encounter any difficulty or challenge in understanding the requirements of the different stress tests in the current Guidelines?

The current guidelines do not cause any comprehension problems. Globally stress tests requirements are easily understood and were implemented with no major difficulties.

Q1.b: Do you deem that further clarifications are required to ensure that the current Guidelines are being implemented correctly beyond the proposals in the present Consultation Paper? If yes, please specify which parts of the Guidelines are concerned?

Beyond the current proposals, AFG would like to express some comments on the current framework:

- The calibration levels for the liquidity discount factors seem very high. It is worth noting that the corresponding time horizon is not specified. Hence the assessment of the

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changes in the level of liquidity of the assets can not be easily connected with actual movements observed.

- According to the MMF regulation, the entire currency risk exposure has to be hedged. Accordingly, in that context, AFG believes that the stress test scenarios in relation to hypothetical movements of the exchange rates do not make sense.
- AFG would like to remind that the sell of MMF shares is operate through intermediary entities like distributors, account holders, sub custodian banks. Moreover, in France, many MMF are also distributed through employee savings schemes with specific intermediary account holders. In the context of that operational framework, the exact knowledge of the investor's community is not possible. However in the frame of the redemption stress test, AFG believes that a high level of granularity is not necessary to provide reliable results.
- The calibration of the redemption stress tests (outflows from 30% of the retail investor or 40% of the non-retail investors in one week horizon for ex) is much too strong and unrealistic comparing to what has been seen during the covid crisis.

Q2: Do you agree that the price impact of asset sales should be taken into account?

AFG believes that adding the slippage effect on top of the multiplication of the spread bid-ask makes sense. Consequently, AFG do agree that the price impact of asset sales should be taken into account.

Q3: What are your views on the different options? Option 1: Price impact factor increases with volume sold; Option 2: Market impact factor increases with the market footprint of the MMF for each individual instrument it holds in its portfolio.

The 2 approaches seem relatively similar but option 2 seems more complicated to implement from an operational point of view (threshold test).

Q4: Do you have views on

- **the calculation of the size and market depth of the money markets MMFs invest in (eligible money market instruments)?**

Estimating the size and market depth is a difficult exercise for money market instruments. The valuation of this asset class is already a complicated exercise given the lack of reliable and long-lasting data sources. Therefore, modeling market depth, which goes a step further, remains a real challenge. Practically it is more of a qualitative exercise.

- **the threshold in option 2 (e.g. the threshold regarding the individual asset market footprint) above which the cost of liquidating positions may increase?**

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Q5: Do you have views on the price impact factor, i.e. the impact on the price of an asset (in bps) for a given amount of sales under option 1 and 2?

Given the limitations regarding the market data, the assessment of the price impact cannot be accurate enough to provide a sound estimation.

Consequently, even if the proposal makes sense theoretically, it will eventually lead to inconclusive results with regard to the particularity of money market funds.

Q6: Do you have views on any other options which would allow to take into account the interaction between liquidity and redemption pressures?

AFG do agree that considering the interaction between liquidity and redemption pressures make sense. Unfortunately, this link is not easy to model for several reasons:

- When the liabilities become too concentrated the fund manager would increase the liquidity buffer. This is a usual and cautious approach which is inherently part of its role.
- Similarly, managers can anticipate liquidity shocks and/or coming redemptions and build up a buffer of liquidity in advance.

The liquidity buffer management results from the anticipation of the fund manager based on its analysis of the current market conditions and its experience. It is also part of the risk management process.

Consequently, even if the vertical slicing is the general rule that is applied to make sure that shareholders are equally treated, in the reality, there is no automatic link between redemption and market impact assessment since the liquidity buffer could be used first.

Q7: Do you have views on the proposal that ESMA could use the information reported in the macro-systemic shock to assess systemic risk? Do you agree that the two options are not mutually exclusive and could be conducted in parallel?

AFG would like to put an emphasis on the fact that these stress test scenarios are theoretical, and that care must be taken in their interpretations and the conclusions that can be drawn from them.

Assessing systemic risk using data resulting from MMF liquidity stress tests presupposes considering, underlyingly, that these funds play a central role in the triggering of market crises, their acceleration and are also contagion factor for the sector of short-term debt issuers.

We believe it is necessary to recall the positioning of MMFs and their role in this market: it is central but limited.

Concretely, these funds act as interconnection between a short-term financing need and a short-term investment, in a "double-layered" regulatory framework: UCITS or AIFMD + MMFR. Thanks to this intermediary role, they ensure a link that is necessary for the proper functioning of the short-term debt market.

However, this role, although central, is limited. MMFs can only finance issuers if their investors are present. In the event of a "dash for cash" movement, MMFs like any investment fund will pass on to the market, in an orderly fashion, the redemption orders they receive.

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Symmetrically, they can only constitute durably liquid investment vehicles if the markets on which they invest are. As any other investment fund, MMFs are dependent on the well-functioning of underlying markets. Despite the various regulatory measures with which they must comply (liquidity buffer, WAL, etc.), they suffer from the drying up of liquidity, like any other market investor.

Consequently, even if the data collected can be exploited and studied, MMFs are only a “drive belt” and are not the source of liquidity crises and short-term financing problems for issuers. MMFs do not create contagion. On the contrary, they may act as a buffer in a crisis.

A more comprehensive approach including all actors should be contemplated.

Q8: Do you have views on the methodology proposed and especially:

- **the proposal to measure the systemic impact on the money market, using a price impact factor;**
- **the data and calibration;**
- **the approach to assess spillovers to short-term issuers, including the assumption that the short-term funding would not be rolled-over;**

Q9: Do you have views on the proposal to assess spillovers to short-term issuers? Do you have views on the data that could be used to assess short-term funding needs? Do you have views on potential rollover assumptions?

Q10. Do you agree with the approach taken by ESMA of not including a climate scenario in the stress test methodology? And if not, please share views on how climate risks should be taken into account and calibration of parameters.

AFG is agreed with ESMA's position on the inclusion of a climate scenario. This approach, which has been in place for several years in the banking sector, is not relevant for MMFs. In addition, the concrete implementation will certainly be cumbersome and complex.

Stress tests on climate scenario would in theory be interesting to carry out but it would be necessary:

- to rely on data that are available, reliable and consistent;
- to established common methodologies

Unfortunately, the conditions are not met.

It will also be necessary to take into account the exclusion policies currently applied which already reduce the risks and the existing regulatory framework (SFDR, taxonomy) which will evolve further.



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Q11: Do you see any possibility to include other environmental, social and governance issues in a stress test scenario?

Q12: What are your views on the costs and benefits of the 2 options? Option 1: Price impact factor increases with volume sold; Option 2: Market impact factor.

Q13: What are your views on the costs and benefits of the 2 options? Option 1: Systemic impact on the money market; Option 2: Spillovers to short term issuers.



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