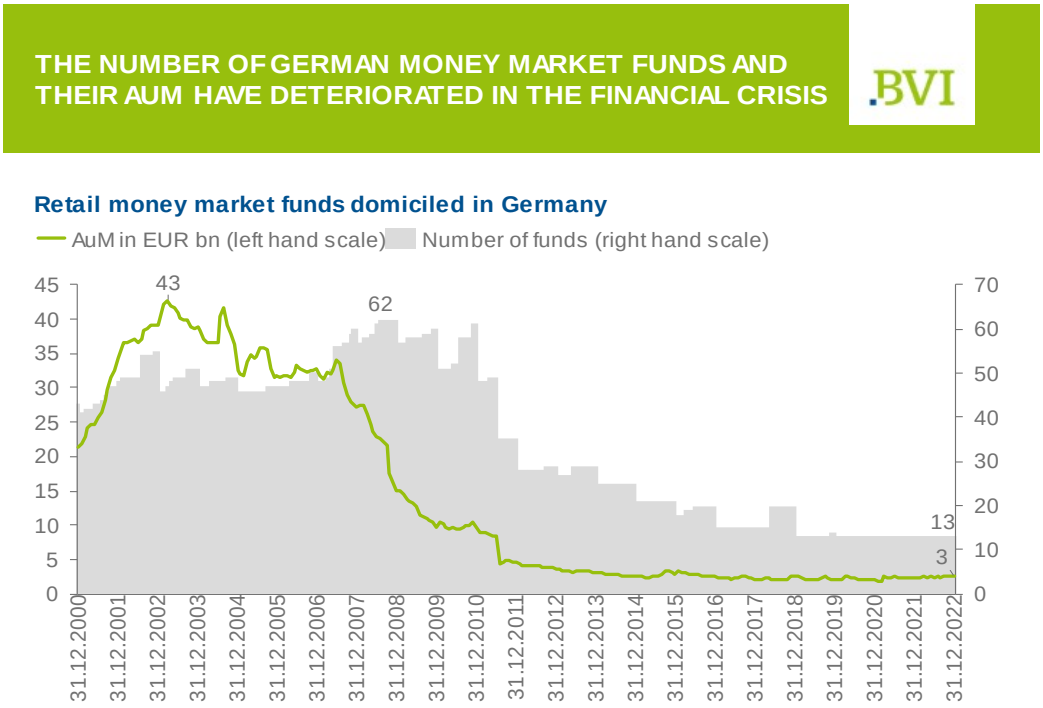
Frankfurt,
28 April 2023

BVI[1] Position on ESMA's Consultation Paper on the review of the methodology included in the Guidelines on stress test scenarios under the MMF Regulation

General Remarks

Our members manage in and outside Germany assets of EUR 34 billion in money market funds, of which EUR 3 billion are issued in Germany, giving it a market share of about 0.2 per cent of the European market. The number of German MMFs and their assets under management (AuM) have deteriorated in the financial crisis 2008.



Even though money market funds are only of minor importance in Germany, ESMA addresses an important and general question with relevance for all investment funds in its consultation paper: Should climate risk scenarios be made mandatory for all investment funds? We see no need for this. Rather, it should be up to the manager to decide whether additional climate risk scenarios are necessary, taking into account the investment strategy, assets and risk profile of the funds (please also see our answer to questions 10 and 11). With regard to the other specific questions on MMF stress tests and to the liquidity and macro scenarios of MMFs, we refer to the answers below.

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 115 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 28%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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Background

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)?

We would like to highlight once again that the imminent jumble of different standards in regulatory reporting and stress tests presents a huge burden for the industry in both operational and financial terms and impedes efficient supervision concerning the analyses of systemic risk within the financial markets. Enhancing consistency of regulatory reporting in terms of content is therefore strongly needed in order to enable the regulators across the board to use the stored data for the purpose of detecting systemic risk and to keep the administrative burden for market participants at a reasonable level.

We continue to strongly decline to specify the calibration figures for the hypothetical changes in liquidity levels that should be similarly used by any MMF manager for reporting purposes. In our view, ESMA itself could conduct this type of stress test itself based on the reported data from the MMFs.

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

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?

No.

Hypothetical changes in the level of liquidity of the assets held in the portfolio of the MMF

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

No. We do not see the need to introduce a new price impact factor as a combination of stress and outflow. For the German MMF market we cannot observe any significant outflows of money market funds in the context of the Covid crisis (as described in chapter 3.1., paragraph 15 of the consultation paper). As described in the following table, net flows have been close to zero even during the COVID-19 crisis.

NET FLOWS HAVE BEEN CLOSE TO ZERO EVEN DURING THE COVID-19 CRISIS

Monthly net flows of retail money market funds domiciled in Germany

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

We refer to our answer to question 2 and reiterate that we reject the introduction of a new factor.

However, if ESMA will maintain such an approach, it should be noted that the impact and value of the calculation logic presented is not yet visible, as the corresponding data such as the thresholds, market footprint and its function are not yet defined. Thus, it is difficult to estimate the actual impact and added value. However, on the basis of the draft, we see the danger of a 'cliff effect' in the introduction of threshold values with possibly high volatility of the results, especially in option 2 'Price impact factor increases with market footprint'. But here, too, the concrete assessment of the impact is still difficult due to the lack of definition of the function calculation.

In our opinion, both options entail unnecessary complexity in the calculation and reporting of the 'asset liquidity risk impact (%)'. Here, the supervisory authority proposes to separately determine the stressed value of the remaining portfolio (stressed NAV) and the part for which a sale is assumed (asset sales) in the future. However, both parts of the portfolio will be multiplied by the same 'VPrice adjusted'. This is also understandable, since in both options the additional 'price impact factor' or 'market footprint discount' is multiplied by the percentage of the asset sets to be sold and thus arithmetically already applied only to the part to be sold.

In our opinion, a separate disclosure of the remaining and the sold part of the portfolio would only make sense if the "VPrice adjusted" to be applied to the remaining part were calculated without an additional correction factor and, in return, the part to be sold were calculated with the full application of the new factor. However, since this unnecessarily complicates the calculation, we propose to consider the weighting of the sales within the correction factor as proposed and to leave the calculation of the 'asset liquidity risk impact (%)' unchanged.

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)?
• the threshold in option 2 (e.g. the threshold regarding the individual asset market footprint) above which the cost of liquidating positions may increase?
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?
Q6: Do you have views on any other options which would allow to take into account the interaction between liquidity and redemption pressures?

No. We refer to our answers to questions 2 and 3.

Macro-systemic shocks affecting the economy as a whole

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?

We agree with the assessment that the existing macro scenario for MMFs does not yet specifically capture macroprudential dynamics, i.e., the impact on other market participants and the underlying markets. Both proposed options seem quite plausible and comprehensible. We also agree that the two options are not mutually exclusive and could be conducted in parallel.

However, as recommended by the policy makers[2], it is the task of the authorities to analyse the level of systemic relevance and to consider whether and how to incorporate such potential impact in system-wide stress testing to better understand collective behaviour dynamics as well as the impact on financial markets and on the financial system more generally. Although such system-wide stress testing exercises are still in an exploratory stage, the FSB highlights that over time authorities may provide useful insights that could help inform both regulatory actions and funds' liquidity risk management practices.

Therefore, we agree with ESMA's general approach to keep the methodology simple for the macro systemic shocks affecting the economy as a whole at the current stage. Assuming that the MMFR requires the MMF manager to identify the effect of macro-systemic shocks, it could be helpful that ESMA itself (in consultation with the ESRB) would be required in its guidelines to disclose the outcome of the analyses of the reported results of stress tests to the public with a view on the macro-systemic impact. These figures could be used by the MMF manager for identifying the effect of macro-systemic shocks affecting the economy as a whole. As long as such figures are not existent, it could also be a solution

[2] E.g., FSB recommendations, available under the following link: http://www.fsb.org/wp-content/uploads/FSB-Policy-Recommendations-on-Asset-Management-Structural-Vulnerabilities.pdf.

that such a report is not needed for the time being, or the manager could make a general statement that the MMF as an individual investment fund (because of the size and investment strategy) cannot affect the economy as a whole. We therefore propose that ESMA establishes new guidance under which circumstances such macro shock tests are indeed necessary or where exemptions shall apply.

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;

Any new solution should not oblige the MMF manager to implement new methods. As an alternative to our above proposal (Q7), the existing method should therefore be retained in any case, without the MMF manager having to make any new efforts.

On the new proposals on macro scenarios to be carried out by ESMA, we do not have a conclusive opinion yet. We agree that the macro scenario for MMFs so far does not yet specifically capture macroprudential dynamics, i.e., the impact on other market participants and the underlying markets. ESMA therefore proposes two options on how the reported stress test results could be used to monitor contagion risk from a shock for the EU MMF sector. On this basis, ESMA would then simulate the potential impact on the financial system to identify systemic risks. In general, the two options proposed by ESMA seem appropriate and could both be implemented.

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?

We refer to our answers to questions 7 and 8.

Considerations on the potential climate risk scenario

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.

We support ESMA's approach not to require climate risk scenarios for money market funds due to the short-term nature of their investments.

Also, for other funds investing in assets with a long-term character (e.g., 30-year bonds, alternative assets such as real estate), such climate risk scenarios should not be mandatory. Here, it should be up to the manager to decide whether additional climate risk scenarios should be carried out, taking into account the investment strategy, the assets and the risk profile of the funds. In general, climate risks are basically included in the market prices. In addition, processes for taking sustainability risks into account in funds are already prescribed by law. Regular stress tests and scenario analyses must already be carried out to identify the relevant risks from potential changes in market conditions that could have a negative impact on the fund (including sustainability risks). Unexpected climate events cannot be predicted

and scaled anyway. It must also be taken into account that carrying out climate scenarios over a long-term horizon would represent a new dimension of risk consideration for investment funds, which are not always designed to hold the assets over the long term.

As described by the Financial Stability Board (FSB) in its final report, climate scenario analysis has been the primary tool used to capturing transition risk and physical risk, with a lower proportion of jurisdictions capturing liability risk. However, the FSB also highlights that the use of such tool is generally more common for the banking and insurance sectors and less common for the asset management and pension fund sectors. According to the FSB recommendations, jurisdictions are encouraged to expand the use of climate scenario analysis and stress testing as a tool **for macroprudential purposes**. The design and scope of the analysis should include features to inform a system-wide view.

In this context, we see the EU Commission's mandate to the ESAs to further analyse the resilience of the financial system to climate change shocks on behalf of the EU Commission (cf. letter from European Commission on assessment of the financial system's resilience to stress in the transition to the EU's 2030 goals for the reduction of greenhouse gas emissions). This one-off exercise should go beyond the usual climate stress tests, as a cross-sectoral exercise looking also at contagion and second-round effects, thereby giving a better understanding of the vulnerabilities in the financial system. We therefore suggest waiting for these analyses before making further proposals for micro-prudential purposes based on individual and mandatory climate scenarios per investment fund in this regard.

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

No.

Costs and benefits

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

We refer to our answers to the questions above.