
AFME Consultation response**European Commission consultation document****ASSESSING THE ADEQUACY OF MACROPRUDENTIAL POLICIES FOR NON-BANK
FINANCIAL INTERMEDIATION (NBFIs)**22 November 2024

General Comments

Key points:

- Banks should not be a proxy for the supervision of NBFIs
- Regulators should avoid a one-size-fits-all approach for the regulation of NBFIs
- Regulators should distinguish between macro led downturns that have pro-cyclical effects and stresses that originate in the financial sector
- NBFIs have an important role to play in supporting the real economy and distribution of risk and liquidity
- There is already a framework in place for banks to manage their risks from the NBFIs sector embedded in legislation
- If a stress testing framework is developed this should leverage off existing stress testing exercises and bank reporting requirements to avoid new data requirements on banks
- NBFIs conducting activities resulting in equivalent levels of risk as banks should be subject to equivalent regulation.
- Regulatory treatment of Non-Bank Market Makers should reflect their growing position within markets and increased contribution to systemic risk

AFME welcomes the opportunity to provide feedback on the EC consultation on Macroprudential policies for Non-Bank Financial Intermediation (NBFIs). Given that we represent a broad array of European and global participants in the wholesale financial markets, we have prioritised our feedback on this basis and would like to emphasise some key points as part of that feedback.

First, we would emphasize that NBFIs are also part of the European financing landscape and to some extent their growth in certain segments of market activities that were typically preserve of banks is the flipside to increasing levels of post-crisis bank regulation and capital requirements. This is particularly true in the context of the EU Capital Markets Union, where NBFIs provide a source of diversification and alternative funding for the real economy. As such, it is important that macroprudential regulation considers the extent to which risks have migrated from banks to NBFIs and how best to manage these risks. However, the range of products and services provided by NBFIs is vast: many are distinct and entirely dissimilar to conventional banking services and as such the regulatory approach to managing any risks arising from them would likely be different

to that taken for banking risks. Therefore, we believe that the Commission should avoid a one-size-fits all approach to the potential design/ implementation of future macroprudential regulatory initiatives – instead we think the focus should be on identifying and managing the risks arising from specific types of products and services provided by the NBFIs sector, and the specific entities that are providing them.

Second, we would argue against the regulation of the NBFIs sector through the banking sector – i.e. treating banks as proxy supervisors for the NBFIs sector. Instead, we would encourage policymakers and regulators to consider the structure and calibration of banking sector regulation in parallel to their analysis of the NBFIs sector, to help assess whether the current balance of regulation supports financial stability, competition and competitiveness. There is a body of evidence that shows that while the post-crisis regulatory framework has improved risk management within banks, it has also led to the movement of risk from the regulated banking sector to other parts of the financial system¹. In particular, post-crisis leverage constraints have impacted banks' capacity to provide funding or market making services. While the diversification of finance is key, this consultation is a timely opportunity to assess the financial regulatory framework and if financial stability has been advanced as an increased share of financial assets have moved outside of the banking sector and into areas where there is significantly reduced prudential regulation and supervision. This should feed into a broader review of the impact of the prudential framework on the competitiveness of the European banking system, as recommended in Mario Draghi's recent report on the future of European Competitiveness, and the review of the CRR framework that is due by 2028.

This review should also consider the impact of potential reforms versus the lead time required to develop these and secure an appropriate consensus (e.g. at international versus regional/ national level).

Given recent crises and the potential risks associated with the increasing prominence of NBFIs activity, we welcome this review of the existing regulatory framework. We would highlight that even within the wider NBFIs category, there are significant differences in risk profiles and contributions to systemic risk. We consider the categorization of firms within the existing regulatory framework insufficiently granular to appropriately capture these differences and recommend that regulators review how individual NBFIs systemic risk profile contributes to their overall regulatory requirements. While we recognise it might not be appropriate for regulators to approach risks in the NBFIs sector in the same way as the banking sector, we would underline that equivalent risks should be subject to equivalent regulation.

As part of its work, we would recommend that the Commission scope a broader review of the NBFIs sector to inform its policymaking options. In particular, we believe that policymakers/ regulators may need to consider a tailored definition of NBFIs to support more effective future targeted initiatives – particularly to help consider which entities should be in/ out of scope and to help identify how regulatory focus on issues such as leverage may already be supported through existing data. Regarding the NBFIs definition, also considering the recent regulatory updates, it is important to come to a unique classification of the so called shadow banking aggregate, with a direct link to the NBFIs definition (in

¹ In Annex A we have highlighted background academic and regulatory analysis that points to the growth of the NBFIs sector being fuelled by strengthened post-crisis banking regulation reforms (observable by the increasing size of the overall NBFIs sector and the shifting balance of activity within the sector).

order to better classify which exposure is both NBFI and Shadow or whether a specific exposure is NBFI or Shadow).

On data in particular, we would underline that a key priority for policymakers/ regulators should be the identification of data gaps around the NBFI sector, in order to properly inform the design and implementation of policy and regulatory proposals. It is not evident that relevant data is not being reported by regulated firms, but gaps may exist in relation to activities conducted by unregulated entities, non-EU participants or in relation to certain activities, e.g. synthetic leverage.

As part of this work, we would urge the Commission to explore appropriate data sharing arrangements between different regulatory/ national authorities based on existing reporting channels across the banking/ non-banking sectors, rather than seeking to devise new data collection arrangements, and underline that regulatory authorities should make appropriate investments in their data analysis capabilities. Overall, the EU should aim to create a single supervisory data space, in line with the EC supervisory data strategy, to ensure financial institutions do not face duplicated/ overlapping reporting requirements.

We would also recommend that policymakers/ regulators consider the degree of private disclosure that is already being undertaken between counterparties, before considering potential extension of public disclosure arrangements. Considering higher disclosure degrees, especially for funds, in terms of sharing information with markets, investors and lenders, would have a positive impact on the overall regulated financial system which is interconnected with NBFI sector.

KEY VULNERABILITIES AND RISKS STEMMING FROM NBFI

Please consider how the question applies to different NBFI sectors (entities and markets) and specify the NBFI sectors concerned when providing a response. Please also provide quantitative evidence, where possible.

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 believe that the Commission should distinguish between risks/ stresses that originate in the financial sector, versus macro-led downturns that have pro-cyclical impacts in the financial sector. For example, we would classify the 2007/8 GFC (and probably the Archegos episode) as the former, and the 2020 'dash for cash' as macro-led because of the Covid-19 pandemic and the economic policy response.

In this context, we would highlight that some of the strain that money market funds (MMFs) faced in March 2020 was due to a number of factors external to the market, including the increased demand for cash (often called the 'dash for cash') arising from margin calls from cleared and non-cleared contracts and issues in the repo markets which prevented this demand from being met as easily as would be desired.

Hence, there should be a proportionate response to risks that emerge at times of economy-wide stress, which is not wholly related to perceived mismanagement of risk in the sector.

We understand that some of the NBFIs vulnerabilities commonly cited by policymakers relate to activities (leverage, particularly hidden leverage) and entities (there may be some entities that are out of scope of rules). We also note that areas such as private credit have grown significantly in recent years.

As an overview, we would highlight the following aspects that NBFIs play within the broader financial sector and their provision of critical functions to the real economy:

- NBFIs provide wholesale funding across a range of sources (deposits, structured notes and money market funding, securitisation), investment in corporates and banks' bonds, private equity and private debt)
- A key element is the growing role of Significant Risk Transfers (SRTs). This is achieved via the sale of subordinated or junior tranches referencing or collateralised by loan portfolios originated by the bank to third party investors. In doing so, banks transfer the risk of incurring portfolio expected and / or unexpected losses from their balance sheets. In doing so banks allocate capital more effectively by transferring some credit risk inherent in their loan portfolios to investors, distributing risk across different market participants and releasing regulatory capital for reinvestment into financing the real economy.

SRT investors consist of specialist credit funds, pension funds, multi asset fixed income managers, multilateral development banks and insurers domiciled around the world - some of these organisations would fall within any reasonable NBFI definition. This constitutes an investor base that brings additional capital investment to the wider economy. This not only serves the purpose of broadening and deepening the investor base investing in bank capital but also supports the overarching objectives of Capital Markets Union of broadening and deepening the capital markets. It also attracts new non-EU investors to the EU bank capital market, thereby mitigating the build-up of risk by EU institutional investors. Many are key counterparties and provide liquidity in the derivative market. We would also flag that within the wide NBFI category, non-bank market-makers are playing a greater role in market liquidity:

- Banks' presence in market making has been curtailed by post-crisis regulation and capital requirements, leaving a natural vacuum for non-bank liquidity providers.
- Market making in certain asset classes is now dominated by non-bank liquidity providers (e.g. non-banks in ESMA list of market makers and primary dealers²)
- The majority of these firms are regulated as IFR Class 2 Investment Firms given their performance of the MiFID activity 'Dealing on own account', and do not meet the consolidated asset threshold to be subject to CRR requirements.
- The risk profile and contribution to systemic risk between these types of market makers and other types of Investment firms is very different, and we believe that the level of granularity within existing regulation insufficiently addresses this.

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https://www.esma.europa.eu/sites/default/files/library/list_of_market_makers_and_primary_dealers.pdf

- In light of recent crises, we would highlight the role that market-making plays as an economic function of critical importance and impact on the real economy.
- Non-bank market makers are typically active across multiple markets, and we would highlight that the withdrawal/failure of a firm in one market has the potential to cause instability across all asset classes³.

In addition, we would highlight that a growing sector for banks has instead been the provision of Prime Brokerage to hedge funds:

- This brings increases in related credit, liquidity and interconnected risks.
- Provision of PB acts as a gate way for the bank to provide other services to hedge funds.
- Archegos was a key case study – highlighting the importance of risk management and the sudden build-up of leverage.

In relation to specific markets/ risks we would also cite the following features:

- Parts of the government bond market increasingly depend on NBFIs to function: the weighting of non-banks in secondary market has increased in the wake of balance sheet size prudential constraints on the banks (leverage ratio) and investment in electronic platforms from non-constrained non-banks (as per our general comments, the case can be made that the post-GFC reduced market making capacity from regulated banks has exacerbated market and liquidity risks).
- On systemic risk - all else being equal, the more the crowded the trades with margining involved (be they for speculative or hedging purposes), the more the systemic risk. To note that positions from Archegos were not crowded, unlike for example, basis trades in the US government bonds.
- The asymmetry of margining calibrations (if/when) and/or collateral eligibility (if/when) given risk exposures among market participants will create liquidity risk out of market risk for the sake of mitigating credit risk. There is no silver bullet for taming all three risks at once. As the [Consultation Paper](#) states: “Unexpected margin calls, due to large price shocks or procyclical effects, does thus increase liquidity risk”. To note furthermore, that unlike market and credit risk, liquidity is a risk that cannot be hedged against, and herding behaviour is very difficult to mitigate from a regulatory risk perspective.

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.

We do not observe significant risks from exposures to NBFIs. Banks have various exposures to NBFIs that they manage, in line with their wider approach to counterparty risk management:

- Credit risk in the banking book, for funding purposes:
 - Examples would include bridge financing, warehousing

³ See: IOSCO publishes results of examination of ETF behaviour during COVID-19 induced market stresses - “a subset of ETFs temporarily experienced unusual trading behaviours”; in times of stress, ETFs trade far more frequently than their component bonds; [Bond ETFs suck liquidity out of market in a crisis, academics say \(ft.com\)](#)

- Counterparty credit risk (CCR), even though that specific risk is very much framed through prudential regulation (CRR) and ECB supervision (along the EBA guidelines).
 - Examples of counterparty credit risk include derivatives and repo transactions, exposure to insurance partners and their reinsurers.
- Regulatory risk, stemming from changes in the regulatory environment/constraints that could cause increasing impacts in terms of capital allocation and thus could change strategic decision.
- The CRR 3 framework requires banks to manage exposures to specialised lending, units or shares in a CIU and securitisation positions that can, depending on the entity to which the bank is exposed, be broadly interpreted as NBFI exposures.

We would underline that both credit and counterparty credit risks are in focus of the current prudential regulatory and supervisory priorities at an EU level (illustrated by the ECB's Counterparty Credit Risk Exploratory scenario exercise, which will be run in parallel to the 2025 stress test, and will be a deep-dive into CCR exposures to NBFIs). Such initiatives will provide useful insights into how these risks are being managed.

The Commission should also take into account the formal review of Credit Suisse's (CS) mismanagement of its exposure to Archegos⁴:

- Fundamental failure of management and controls in CS's Investment Bank and, specifically, in its Prime Services business
- CS was focused on maximizing short-term profits and failed to rein in and, indeed, enabled Archegos's risk-taking.
- CS failed to act on numerous warning signals around Archego's risk to CS.
- Significant deficiencies in CS's Prime Services risk culture; a lack of accountability for risk failures; risk systems that identified acute risks, which were systematically ignored by business and risk personnel; and a cultural unwillingness to engage in challenging discussions or to escalate matters posing grave economic and reputational risk.

Furthermore, while we would query whether macro-prudential frameworks designed with the banking sector in mind are readily applicable to a capital markets/ firm context, we would stress that systemic risks and vulnerabilities should not be addressed through additional constraints on EU banks. Broadly, we would underline that the calibration of macro-prudential policy should not be treated as a supplement to (or substitute for) institutional level requirements. Instead we would emphasize that when assessing the risks within the NBFI sector towards the wider financial system, we believe that regulators should focus in parallel on the appropriate design and calibration of institutional-level regulatory requirements, including individual NBFI market-makers contribution to systemic risk.

We recognise the importance of banks having a holistic view of their exposures to the NBFI sector, in order to manage concentration risk and the resulting contagion that can result in stress. In this regard, we would highlight the work of the BoE on the development of its System Wide Exploratory Scenario exercise (link [here](https://www.bankofengland.co.uk/system-wide-exploratory-scenario-exercise)) and in targeted supervisory engagement with firms e.g. recent on banks risk management capabilities in relation to hedge fund exposures.

⁴ <https://www.credit-suisse.com/about-us/en/reports-research/archegos-info-kit.html>

On specific legislation, we note that the Money Market Fund Regulation specifically prohibits banks from providing sponsor support to MMFs - supposedly to reduce contagion channels. Therefore, safeguards already exist to manage these potential risks (and at least for MMFs, additional safeguards on interconnectedness are not warranted). In fact, we would question whether there should be flexibility to allow banks to provide time-limited support to MMFs during a stress (e.g. to prevent a vulnerability becoming a failure that would have broader impacts), on the proviso that the position was unwound subsequently.

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.

We observe that in key areas such as market trading, there has been a post-crisis migration of market-making activities away from banks and traditional investment firms to NBFIs such as electronic trading firms ([FT article](#) – ‘New titans of Wall Street: How trading firms stole a march on big banks’). However, with increasing market share/ trading concentration being accounted for by such principal electronic trading firms, there may be a need for regulators to focus on operational risk management in the context of potential systems failure and consequent market disruption.

Given the dominance of several non-bank market makers, we would note that disruption and risk stemming from market-making activities would likely lead to the disruption of significant markets with a potential impact on financial stability. Consequently we would suggest that market-making is a critical function on its own merit, and the identification of it as such would address existing gaps within the regulatory framework and address potential vulnerabilities within the NBFi sector.

The Commission should also consider the evidence from the September 2022 crisis in UK gilt markets, driven by the distressed forced selling of gilts by liability-driven investment (LDI) funds that led to an escalating fire-sale market dynamic⁵. One of the key drivers of this situation was the highly leveraged nature of LDI funds, which became a common investment strategy for UK defined-benefit pension schemes. While this was not caused by the failure of an NBFi, it illustrates the potential for vulnerabilities in the NBFi sector to impact critical functions (the UK Gilt Market).

We would also note the concerns raised by officials such as Paul Tucker (former deputy governor of BoE) in relation to the post-crisis strengthening of central clearing functions ([Have regulators created a new type of financial monster?](#)):

- *Clearing houses pose new perils for the global financial system.*
- *A clearing house unable to withstand a member’s default could be a “devastating mechanism for transmitting distress across the financial system”.*

In the case of pension funds, these provide a source of financial security, but also one of the few large-scale vehicles for long-term investment that can usefully be stewarded towards publicly useful asset classes like infrastructure, energy production.

⁵ <https://bankunderground.co.uk/2024/07/26/what-caused-the-ldi-crisis/>

If the Commission were considering some form of resolution regime for NBFIs, we would firmly state that the costs for such a regime should be borne by the relevant NBFI sectors themselves (assuming such a regime is necessary for financial stability reasons and does not have a disproportionate impact on competitiveness/growth).

In general, the major risk we see in the NBFI is related to the exposure to funds which: (i) are not regulated, (ii) might be subject to liquidity distress with the risk of making a domino effect through the banking sector exposed to these funds and (iii) being frequently shareholders of major regulated financial institutions, might trigger governance risk that can cause market turmoil.

Question 4. Where in the NBFI sectors could systemic liquidity risk most likely materialise and how? Which specific transmission channels of liquidity risk would be most relevant for NBFI? Please provide concrete examples.

Banks do not use NBFI liquidity for managing their main/core business. Banks only manage the liquidity of those NBFI clients, providing NBFIs the service to deposit the liquidity generated by the NBFI business.

We would note that where certain markets and activities are dominated by large non-bank liquidity providers, the failure of such firms could cause significant destabilization of the market as a whole. We would urge regulators to consider this when evaluating the robustness of the existing macroprudential framework.

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.

Although hedge funds are leveraged by definition/nature, banks/institutions minimize this type of exposures, using collateral, operating with only well-rated funds and those having in place tested models and robust counterparty risk control teams.

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

At the moment, trading in crypto-assets is not material for banks. Trading in crypto-assets, in any case, is a market making activity to provide liquidity to bank's clients and not to build a proprietary trading book.

In the case of banks, risks, whether coming from crypto assets or other type of assets, are mitigated as a result of being regulated and supervised entities in the areas of capital, liquidity, AML etc. In particular, banks operating in the EU are subject to strict capital requirements under the CRR3 after July 2024 (RWs= 1250%, Group 2 exposure limits, etc.) to tackle the risks associated to their exposure to cryptoassets besides being subject to supervision.

Moreover, at international level, it is also important to note that Basel prudential standards in which the CRR3 is inspired, should be implemented in all jurisdictions by January 10, 2026. In addition, markets in the EU are regulated by MICA in the EU and there is an additional package of regulation to prevent and mitigate other risks (AML, third party....) (FATF Travel rule).

However, this is not the case of NBFIs, that are subject to much higher risks without having any limit when trading, that even being required to have a CASP license, are not subject to the same stringent regulation and supervision than banks are. This asymmetry of treatment not only raises a level playing field problem between banks and NBFIs, more importantly, it leads to a risk of shifting systemic financial risk to the latter.

We consider that the way to tackle these risks is acting on the source of the problem. That means, laying down the necessary additional regulation on NBFIs. Otherwise, the source of the risk would not be fixed and any other solution, like placing additional requirements on banks, would be counterproductive.

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.

Given the importance of funding to the market, it is very important that it is regulated in a consistent way. All players who give the same type of funding should be regulated and supervised under the equivalent rules. Otherwise, exposures will be shifted to unregulated and unsupervised markets.

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?

We think there is merit in reconsidering liquidity buffers from time to time to ensure they are still appropriate (and we note the ECB does this in its recently published Financial Stability Report)⁶; however, we think to do this during a period of market volatility (e.g., COVID period), runs the real risk of exacerbating market dysfunction during a stress. If regulators had the power to intervene during a crisis scenario, investors would closely watch the market and authorities' statements to remain prepared for redemptions in advance of any regulatory response in order to avoid haircuts imposed on them to meet new liquidity buffers. This could worsen a crisis scenario, even in a situation where the relevant authority is not planning to intervene, and its intention is misread by the market. This is the same behaviour witnessed in Q1 2020 as investors redeemed to avoid the potential of fee and gating provisions.

We think regulators should prioritise an approach that allows NBFIs to use their liquidity buffers during a stress, to cushion the impact of crystallising financial stability risks rather than seeking to maintain buffers in order to satisfy regulators to the detriment of broader market stability. If regulators were poised to intervene in a crisis, it could cause a "vicious circle" whereby investors redeem as risks begin to appear, worsening a fund's resilience at the worst possible time. As such, any regulatory

⁶ See section 5.3 <https://www.ecb.europa.eu/press/financial-stability-publications/fsr/html/ecb.fsr202411~dd60fc02c3.en.html>

intervention powers should be strictly limited to times of market calm, acting as a counter-cyclical, rather than pro-cyclical, financial stability tool.

If wrongly calibrated, even during times of market calm, liquidity buffers could fundamentally change the nature and attractiveness of the underlying MMF relative to other types of investment funds (e.g., short-term bond funds) or cash and cash substitutes (e.g., bank deposits, government funds where available).

OVERVIEW OF EXISTING MACROPRUDENTIAL TOOLS AND SUPERVISORY ARCHITECTURE IN EU LEGISLATION

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?

One area of incoherence is with respect to UCITS rules where we believe greater alignment would be helpful is in relation to the amount of cash which a UCITS can hold at the depositary versus the amount of cash a MMF can hold at the depositary. Under Article 52 of the UCITS rules a fund can effectively hold 20% of NAV in cash at the depositary. However, Article 17 of MMFR effectively limits the cash held at the depositary to 10% of NAV, regardless of whether the MMF is authorised as a UCITS. This is operationally challenging, particularly around market closures (holidays etc.), does not appear to benefit investors and is not consistent with UCITS.

We would also welcome any technological improvements among regulatory and supervisory authorities that reduce the manual nature of data collection for UCITS and MMFs, especially where such reporting is duplicative between different authorities.

Reverse distribution mechanism

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

The reverse distribution mechanism (RDM) was an operational mechanism used by constant net asset value (CNAV) MMFs to pass along to investors the negative interest arising from investing in Euro denominated securities. RDM was an established and recognised mechanism in Europe prior to MMFR ensuring investors' experience of CNAVs reflected their expectations despite falling interest rates and was very important for processing funds on various sweep platforms. RDM was well understood by investors and the operational processes for implementing it were well established.

The RDM was vital for the functioning of certain MMFs, to prevent them incurring losses in a negative interest rate environment, which would have undermined their attractiveness to investors compared to - for example - parking cash with banks or investing in mixed income funds. In the absence of RDM, it has been necessary to develop alternative mechanisms such as conversion from income bearing shares to accumulating shares in negative yield environments. While these alternatives are helpful to investors, they are not as well understood or established as RDM, are more administratively cumbersome and may cause some technical challenges for intermediaries.

The SEC has also recently introduced RDM as part of its MMF reform package. Given many large financial institutions offer and/or invest in both U.S. and European domiciled MMFs, there is a risk that global investors prefer US funds owing to the lower administrative burden. We believe that any policy that restricts the availability of MMFs needs to be carefully considered, as it can lead to funds being withdrawn and capital being deposited at banks, or in non-EU funds as EUR-denominated funds are generally too small in size to absorb large cash balances. The ban on reverse distribution has restricted the availability of MMFs, increasing pressure on banks' balance sheets, in particular in times of stress, and undermines the objective of the capital markets union which seeks to diversify funding and investments away from banks. This was a point explicitly acknowledged in the Draghi Report, stating "the EU relies excessively on bank financing, which is less well-suited to fund innovative projects and faces several constraints.

For all these reasons, we believe that the EU ban on a reverse distribution mechanism (RDM) by MMFs should be lifted.

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 organised trading facilities) with some critical level of trading activity? Please explain your answer.

We do not see the case for requiring MMFs to trade in instruments admitted onto trading venues with a certain level of trading activity. The market works well as it is.

Other NBFIs and markets

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.

We recognise that there are only a small number of vehicles – both MMFs and banks – that are able to accept substantial cash balances from large institutions and investors. We do not believe that there is a viable alternative to that arrangement, as vehicles of sufficient scale are necessarily limited in number.

Measures intended to broaden the availability of vehicles that can be used for short-term capital management are welcome. We would distinguish this from measures to restrict access to existing providers of short-term funding, which would be counter-productive in increasing the availability of funding for the real economy and worsen any existing concentration risks, by reducing the number or variety of such funds.

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)?

We do not oppose the possibility for a wider range of market participants trading on a regulated venue, though we would have concerns about any regulatory requirements to trade on a regulated venue – as it could have the opposite effect of restricting short-term funding market making.

MONITORING INTERCONNECTEDNESS

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?

We have previously referenced examples under our response to Q3.

We believe that the Commission should focus on the intersection of growing NBFI dominance in areas such as market trading with the incidence of crowded trades, and the consequent risks in terms of liquidity shortages and spikes in volatility.

Many banks have investment management, or other NBFI-type entity, arms that sit within their group. These intra-group exposures are already comprehensively regulated and monitored through the prudential framework applicable to banks, while also being supplemented in certain areas (such as the MMFR that restricts sponsor support from banks to MMFs).

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?

In case a deeper monitoring is expected for NBFIs, a specific stress test for NBFI should be developed. In this situation, an EU system-wide stress test of NBFIs would be helpful but should be done in a way that does not lead to another stress test of banks. Any aspect of the stress test which relies on bank data should be integrated as part of the existing bank stress testing framework. In addition, the data burden should be pooled across the NBFI sector rather than the onus being on banks to provide data for the exercise.

Furthermore, it should be noted that credit institutions already have in place mitigant procedures for these exposures as well as robust regulation in force, and banks should not be the channel to monitor NBFI activities. The aim should be to understand how NBFIs respond to a stress, rather than seeking to identify interconnectedness.

Taking account of the useful guidance on how to undertake such an exercise could be drawn from the BoE System-Wide Exploratory Scenario (SWES) exercise⁷. This is providing the BoE with new information about the behaviours of NBFIs and banks during stressed financial market conditions. It is also providing information about how those behaviours might interact to amplify shocks to UK financial markets that are core to UK financial stability (i.e. UK gilts). Participants include banks and NBFIs (including insurers, CCPs, funds managed by asset managers, hedge funds, and pension funds).

However, we note that the BoE SWES is constructed around dynamic institutional behaviour in the context of specific scenarios focused on core UK gilt markets – therefore it would be necessary for EU policymakers and regulators to clearly prioritise key markets and key NBFIs/ behaviours they would

⁷ <https://www.bankofengland.co.uk/financial-stability/boe-system-wide-exploratory-scenario-exercise>

wish to focus on when considering the design of a system-wide framework (particularly given the relatively more complex institutional and policy framework that applies in the EU).

We have previously remarked that in relation to data, the priority for EU policymakers and regulators should be:

- identification of data gaps around the NBFIs sector
- exploration of appropriate data sharing arrangements between different regulatory/ national authorities based on existing reporting channels across the banking/ non-banking sectors
- avoidance of new data collection requirements on banks – instead banking supervisors should have access to relevant market transaction data
- appropriate investment in their data analysis capabilities

On maximising existing data sources, by way of example:

- most 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 reporting⁸. If used and shared appropriately among EU regulators and supervisors, this would enable a better understanding and limit the reporting burden on market participants.
- in the EU Total Return Swaps (TRS) are within the scope of Securities Financing Transaction (SFT) Regulation (SFTR) – therefore the opacity around the exposures of a family office such as Archegos in March 2021 could not have happened in the EU. On leverage, the case of so called “hidden leverage” might be considered as mitigated in the EU as many reporting requirements have been set in place over the last decade (e.g. AIFMD/ Annex 4 on counterparty reporting).
- In relation to AIFMD reporting requirements, firms already report on leverage in terms of overall fund positions and by principal counterparty under Annex 4.

Question 54. Is there a need for arrangements between NBFIs 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.

We have provided feedback on data arrangements under Q53.

Any arrangements between NBFIs supervisors and bank supervisors would provide benefits for supervisors considering the final output would be enriched. However, it should be noted that to the extent that exercises are already carried out by banks, it is key to avoid overburdening banks with duplicating/ additional information requirements.

SUPERVISORY COORDINATION AND CONSISTENCY AT EU LEVEL

International coordination

⁸ <https://www.isda.org/2023/10/10/hidden-in-plain-sight-derivatives-exposures-regulatory-transparency-and-trade-repositories/>

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

We believe that the Commission should reference the FSB's NBFI monitoring framework to support a common definition of NBFI among policymakers/ regulators/ industry. One key problem is that different bodies approach the definition of NBFIs in different ways, depending on their policy/ regulatory objectives. We think that the FSB's narrow definition would be a good starting point to discuss how to harmonise definitions.

We also think that is important that policymakers and regulators approach the proposals to be presented in the FSB's imminent consultation on NBFI leverage policy (planned for December 2024) in a proportionate manner. For example, we note that the FSB DG Martin Maloney recently spoke against the implementation of a cross-market cap, instead preferencing a bespoke approach⁹.

More broadly, we would underline the need for international consistency between the large financial centres to enable firms to implement coherently and to minimise any possible competitiveness impacts on the EU. We would also recommend that the EU continue engaging through regulatory fora such as FSB and IOSCO to agree a consistent approach.

⁹ <https://www.risk.net/markets/7960107/fsb-exec-dismisses-leverage-cap-proposals-for-nbfis>

ANNEX A – background academic/ regulatory analysis on post crisis banking regulation and the growth of the NBFI sector.

- a. FSB Review of post GFC reforms - “The analysis finds substantial growth in total assets of NBFIs after the TBTF reforms. Between 2011 and 2018, banks’ share in the assets of the financial system has been decreasing while the share of NBFIs has been increasing worldwide, in advanced economies and in emerging markets alike”. <https://www.fsb.org/uploads/P010421-1.pdf>
- b. Line in a paper by Claudia Buch – “recent evidence shows that tighter regulation of banks affects the market shares of non-banks and shows that risks potentially migrate to other parts of the financial system”. https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr1091.pdf
- c. A study by the Deutsche Bundesbank² in 2023 established that following an increase in capital requirements for banks in 2011, NBFIs were able to increase their lending exposure to real economy firms 2.2 percentage points per quarter faster than banks. [Effects of bank capital requirements on lending by banks and non-bank financial institutions \(bundesbank.de\)](https://www.bundesbank.de/~/media/Bankensystem/Studien/2023/Effects_of_bank_capital_requirements_on_lending_by_banks_and_non-bank_financial_institutions.pdf)
- d. Academic Paper on macroprudential policies - “We find that a net tightening of domestic macroprudential policies causes the share of domestic NBFI assets in total financial assets to increase, driven by both an increase in NBFI assets and a decrease in bank assets”. <https://www.ijcb.org/journal/ijcb23q5a5.pdf>
- e. ECB presentation on impact of the leverage ratio on bond fund liquidity establishes that the LR contributes to market vulnerability - [White background title slide \(newyorkfed.org\)](https://www.newyorkfed.org/presentations/2023/03/23-03-2023-ecb-presentation-on-impact-of-the-leverage-ratio-on-bond-fund-liquidity)
- f. Bank of England data shows that almost all the GBP 400bn increase in net borrowing by UK businesses since the GFC came from non-banks - [A journey of 1000 miles begins with a single step: filling gaps in the central bank liquidity toolkit - speech by Andrew Hauser | Bank of England](https://www.bankofengland.co.uk/speeches/2023/03/23-03-2023-boe-speech-by-andrew-hauser-on-the-impact-of-the-leverage-ratio-on-bond-fund-liquidity)

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AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

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Contact details:

Constance Usherwood (AFME)

Managing Director, Capital and Risk Management

Constance.usherwood@afme.eu

Direct: +44 (0)20 3828 2719