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| 28 September 2018 |

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| Response form for the Consultation Paper on the Draft guidelines on stress test scenarios under the MMF Regulation |
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| 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](http://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](http://www.esma.europa.eu) under the heading [Legal Notice](http://www.esma.europa.eu/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

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| --- | --- |
| Name of the company / organisation | MSCI Inc. |
| Activity | Other Financial service providers |
| Are you representing an association? |  |
| Country/Region | International |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_MMFST\_1>

MSCI appreciates the opportunity to offer these comments to the European Securities and Markets Authority (“ESMA”) in response to the consultation on draft guidelines on stress test scenarios under the MMF Regulation. We support ESMA’s goals to establish guidelines on common reference parameters of the stress test scenarios to be used by MMF managers. We thank ESMA for the opportunity to provide our perspective on the proposed rule.

MSCI is an independent provider of research-driven insights and tools for institutional investors. We have deep expertise in the areas of risk and performance measurement that is based on more than 40 years of academic research, real-world experience and collaboration with our clients.

Our broad product line supports clients’ needs across all major asset classes and provides them with a consistent way of looking at risk and performance from front to middle office. We have a highly flexible business model that enables clients to select the individual products and services they need and integrate them into their own investment processes and methodologies. Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research. We serve 99 of the top 100 largest money managers, according to the most recent P&I ranking.

MSCI is an independent provider with no Asset Management company nor Bank within its corporate structure. MSCI has been actively engaged in research on the subject of liquidity risk management since 2009 and licenses sophisticated liquidity risk analytics to market participants to support both risk management and regulatory compliance activities (e.g., SEC, UCITS, Form PF). MSCI’s views on the subject of liquidity risk is the result of a decade long research on the subject, focused on model innovation and regulatory applicability and they have also been informed by the feedback we have received from the asset managers who utilize our liquidity risk management tools.

<ESMA\_COMMENT\_MMFST \_1>

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

<ESMA\_QUESTION\_MMFST\_1>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_1>

1. : 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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_2>

1. : 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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_3>

1. : 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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_4>

1. : 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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_5>

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

<ESMA\_QUESTION\_MMFST\_6>

The proposed liquidity stress tests focus on the bid-ask spread of the securities held by the MMF, which is a good choice not only because it is widely used in the industry, but also because bid-ask spreads are directly observable in most markets. Direct observability is a key advantage when determining shock sizes: we think that ESMA should simply look at historical data and analyse the behaviour of bid-ask spreads in past crises. For example, the evolution of quoted spreads of Italian government bonds at the end of May 2018 could give a good indication of the shock size to apply to periphery government bonds.

<ESMA\_QUESTION\_MMFST\_6>

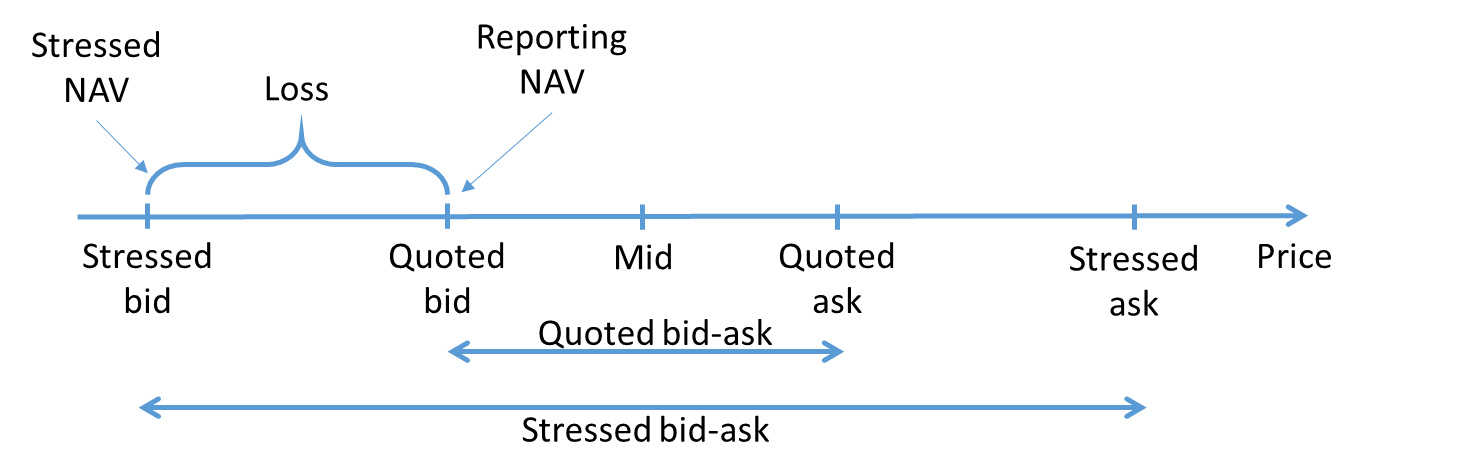
1. : Do you have a preference between the two proposed options: calibrated discount factor on bid prices; Multiple quoted bid-ask spread?

<ESMA\_QUESTION\_MMFST\_7>

The fundamental difference between the two options is that option 1 implicitly assumes that the bid-ask spread is the same for all assets in an asset group having one discount factor. For example, the loss contribution of any HY corporate bond with maturity less than a year would be 1.482%, regardless of the current bid-ask spread of the issue. Since we see significant differences in the bid-ask spreads of issues in this category, we believe that option 1 is overly simplistic and won’t provide fund managers an incentive to prefer bonds with lower bid-ask spreads.

Option 2, on the other hand recognizes this difference. We think that ESMA should fully take advantage on the observability of bid-ask spreads and let funds recognize the difference between positions falling into the same regulatory group.

We also point out that the current wording of the 37th point of the guidelines overestimates the potential loss due to the stressed bid-ask spread. If the fund’s assets are already valued at the current (unstressed) bid, the additional loss caused by an increased stressed bid-ask spread should be (see also figure below):



<ESMA\_QUESTION\_MMFST\_7>

1. : 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>

We believe that the guidelines should include all transferable securities traded on an active market where sufficient data is available to calibrate the stress factors (this depends on the calibration methodology chosen by ESMA). If the calibration is not possible, an estimated stress factor based on expert judgement would be better than excluding the asset class from stress testing altogether.

On the other hand, we believe that stress testing liquidity for assets other than transferable securities (e.g. repurchase agreements, deposits, etc.) and units or shares of other MMFs would introduce a lot of model risk and would make comparison of stress test results difficult. We suggest to exclude these from the quantitative assessment.

<ESMA\_QUESTION\_MMFST\_8>

1. : 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>

Based on the huge amount of trade and quote data we use every month to calibrate our liquidity model, we believe that a fixed stress factor for each asset group is appropriate and in line with industry practice. In terms of calibration, see our answer to question 6.

<ESMA\_QUESTION\_MMFST\_9>

1. : 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>

We believe that the guidelines should recognize the effect of position size on the increased transaction cost the fund should expect to pay if it’s forced to sell in a stressed market environment. Using the proposed methodology, a small and a multi-billion EUR fund with the same asset composition would report the same liquidity stress test results. In our opinion, ESMA should require fund managers to change the expected liquidity discount / bid-ask stress factor for large position sizes and either let fund managers use their existing liquidity risk management tools or prescribe a very simple methodology for this adjustment. ESMA should find the a balance between being too prescriptive (and increasing model risk by describing a single model to be used by all funds) and too high-level (leaving too much room for interpretation making it hard to compare results reported by different funds). One possible solution could be to leave the methodology to the fund managers this year and formulate a more prescriptive methodology during the next yearly review of the guidelines.

<ESMA\_QUESTION\_MMFST\_10>

1. : 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>

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

<ESMA\_QUESTION\_MMFST\_12>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_12>

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

<ESMA\_QUESTION\_MMFST\_13>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_13>

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

<ESMA\_QUESTION\_MMFST\_14>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_14>

1. : 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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_15>

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

<ESMA\_QUESTION\_MMFST\_16>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_16>

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

<ESMA\_QUESTION\_MMFST\_17>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_17>

1. : 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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_18>

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

<ESMA\_QUESTION\_MMFST\_19>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_19>

1. : 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>

We believe that both approaches make sense and should be included in the final guidelines.

<ESMA\_QUESTION\_MMFST\_20>

1. : 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>

Transaction costs depend on the size of the trade and the time available to execute it. In the definition of the “weekly tradable amount”, ESMA defines the time parameter (one week), but doesn’t mention a limit on transaction cost. Without a cap on costs, almost any amount can be liquidated. On the other side of the Atlantic, the SEC requires funds to bucket their positions based on how long it would take to liquidate a position *without significantly changing the market value*. To a minimum, ESMA should also specify that liquidating the “weekly tradable amount” should not have a large impact on the asset’s value. This provision proved to be too vague in the US and different interpretations of what a significant change is make comparison of the reports of different fund quite difficult. Learning from this experience, we think that ESMA should define the limit on transaction costs explicitly for all of the asset groups already defined in the guidelines.

We strongly agree with ESMA in requiring fund managers to keep the portfolio weights unchanged when determining the weekly tradable amount. Based on our experience with many fund portfolios, however, we suggest to build in some flexibility which allows funds to change the weights by a negligible amount (e.g. 1%). This can prevent a single, small illiquid position become the bottleneck, which often is the case if the weights have to be constant.

<ESMA\_QUESTION\_MMFST\_21>

1. : 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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_22>

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

<ESMA\_QUESTION\_MMFST\_23>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MMFST\_23>

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

<ESMA\_QUESTION\_MMFST\_24>

We believe that it is best practice to simulate outflows from the two largest investors and support ESMA in adding this requirement to the guidelines.

<ESMA\_QUESTION\_MMFST\_24>

1. : 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>

We think that the redemption and general liquidity stress scenarios should be conducted concurrently, since these events tend to happen at the same time. For example, a fund capable of meeting normal redemptions in a stressed market and stressed redemptions in a normal market could still be in trouble in a real liquidity shock, where liquidity evaporates and redemptions increase simultaneously.

<ESMA\_QUESTION\_MMFST\_25>