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European Securities and Markets Authority
103 rue de Grenelle
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Date: 30 November 2018

Dear Sirs

RE: ESMA Consultation on Draft Guidelines on Stress Test Scenarios under the MMF Regulation

The Investment Association is delighted to provide input to your consultation.

The Investment Association (The IA) has contributed to the response of the European Fund and Asset Management Association (EFAMA) as a member association. The IA is supporting the EFAMA response to this consultation, and asks ESMA to take this in consideration.

We have provided a summary of our key concerns with the draft guidelines proposed by ESMA, which are generally reflected in the EFAMA response.

Yours faithfully

Peter Capper
Fund & Investment Risk Specialist

ANNEX I

CONSULTATION RESPONSE

ABOUT THE INVESTMENT ASSOCIATION

The Investment Association is the trade body that represents UK investment managers, whose 200 members collectively manage over £5.5 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people’s resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 37% of European assets.

More information can be viewed on our website.

DRAFT GUIDELINES ON STRESS TESTING – KEY CONCERNS

The IA has contributed to, and supports, the EFAMA response to this consultation. We are therefore restricting our comments on the consultation to a few key points, but these should be read and considered alongside the EFAMA response.

- We agree that it is sensible to use the same parameters of tests against assets, where these are relevant. However, the draft guidance proposed is very detailed and highly prescriptive, offering little flexibility to account for specific features of MMFs, treating these as homogenous products when in fact these take different forms, invest in different short term assets, attract different investor bases and therefore are subject to different stresses.

- Timing: The prescriptive approach proposed in the draft guidelines represent a significant change of approach from the principles based approach used in the guidelines issued. Managers of MMFs will therefore need sufficient time to make the significant changes that will be needed to their stress testing processes. Our understanding is that managers of MMFs will not need to perform the stress tests as prescribed in the draft guidelines until at least January 2020, when the reporting to competent authorities are expected to apply, but if there is an expectation that MMF managers need to apply these sooner, they will need to be given a reasonable implementation window in which to do so. Furthermore, we note that article 28(7) will require the guidelines to be updated annually. It would be helpful for ESMA to clarify the timing for implementing the revised guidelines, given that many MMF managers will be undertaking these tests on a quarterly basis for the purposes of reporting to competent authorities These managers will need reasonable implementation times to implement any significant annual revisions to the stress testing guidelines, for example if new guidelines are issued a month before the next reporting window, this will not be enough time for managers of MMFs to implement new requirements.

- Stress parameters should be tailored to the type of MMF. It does not make sense to apply longer-term stress tests to short-term MMFs, which are limited to high quality assets with a legal or residual maturity of less than 397 days, and turn over their portfolios regularly. For example, the exercise to assess "hypothetical movements of the interest rates" yield limited benefit for a short-term MMF, which experiences limited NAV impact and redemption reactions from interest rate changes. Going through the same exercise and calibration process adds cost with limited insight gained. A short-term fund should be subject to less tests or allowed to use a simplified framework.

- It is not clear on what basis the stress testing on hypothetical levels of weekly redemptions, where management companies must assume outflows from 30% of institutional and 15%of retail investors, has been set. This does not distinguish between short term and standard MMFs, and the channels through which they are sold, which are likely to reflect the redemption profiles. It is also increasingly difficult for management companies to know the exact breakdown of their institutional and retail investors due to the increasing use of intermediation – fund registers will typically have a large holdings of nominee companies, which may represent many underlying investors, both retail and institutional. Measures based on historic weekly redemptions are likely to be more meaningful.

- Calibration models or measurements of shock scenarios used in banking (CRD/CRR) or insurance (Solvency II) legislation should not be used as the basis for stress test scenarios of MMFs. These sectors have different risk and business models to MMFs, for example MMFs assets are ring-fenced from those of the management company, they are unleveraged and their asset maturity/liquidity profile is closely aligned with expected holding periods unlike in banking, where maturity transformation is typical.

- We do not believe the suggestion that the manager of an MMF which invests in units of other MMFs should look through to the underlying assets of the investee MMF is necessary of proportionate, given that investment in other MMFs is limited to 10% of the portfolio and those MMFs will themselves be subject to stress testing. We suggest that the manager of the MMF should be able to use the stress test results conducted by the manager of the underlying MMF (where provided) or use a standard factor.

- The draft guidelines should be restricted to those stress tests strictly required under article 28(1) of the MMFR. We do not agree with the proposal for additional scenarios not required by the regulation, such as the simulation of the default of the two main exposures or net redemptions of the two main investors of the MMF. This does not prevent management companies of MMFs performing additional stress tests where they feel it appropriate for their MMF.

Overall, the IA believes that a principles based approach to the stress testing guidance, accompanied by examples, rather than the proposed prescriptive and highly detailed measurements, granular parameters suggested, would provide more flexibility to management companies to tailor stress testing programs to the specific characteristics of their MMFs and thus provide more meaningful results.

The IA notes that ESMA has indicated this may form the basis of its wider work on stress testing by investment managers planned in 2019. While the main categories suggested by ESMA might be suitable as a basis for wider stress testing, MMFs have particular characteristics intended to preserve capital and provide short-term liquidity. The stress test scenarios proposed in the draft guidance are therefore highly unlikely to be suitable for other investment portfolios, including UCITS investing in longer dated corporate bonds and equities.