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| 1 February 2019 |

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| Response form for the Consultation Paper on the Guidelines on liquidity stress testing in UCITS and AIFs |
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| Date: 1 February 2019 |

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions in Annex I. Comments 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 April 2019.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

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\_LST\_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\_LST\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_LST\_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”).

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?

The main stakeholders to whom these guidelines would apply are managers of UCITS and EU AIFMs as well as EU depositaries overseeing UCITS and EU AIFs. The paper will also be of interest to trade associations, investors and consumer groups relating to UCITS and EU AIFs.

# General information about respondent

|  |  |
| --- | --- |
| Name of the company / organisation | Deutsche Bank |
| Activity | Banking sector |
| Are you representing an association? |  |
| Country/Region | Europe |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_LST\_1>

TYPE YOUR TEXT HERE

<ESMA\_COMMENT\_LST\_1>

1. : What additional costs and benefits would compliance with the proposed Guidelines bring to the stakeholder(s) you represent? Please provide quantitative figures, where available.

<ESMA\_QUESTION\_LST\_1>

Establishing Liquidity Stress Testing (LST) programs across all products that are investment strategy-specific will result in substantial one-off and on-going costs.

More precisely, we expect to have one-off implementation effort (“Change the Bank”) related to the management of data-intensive and analytics aspects of the stress testing (e.g. Investor Concentration, Historical Stress Testing or Reverse Stress Testing) as well as ongoing effort (e.g. Data and Model Validation, hypothetical Scenario generation). While it is difficult to provide explicit estimates are difficult, one can assume that data management related projects could reach a high 6 Digit € Amount for DWS group and will require 1-2 full-time Risk Managers purely dedicated to the activities on an ongoing basis.

While some of the requirements proposed by ESMA are already taken into account in LSTs, as indicated above, others will result in increased costs and may have limited added value for certain types of funds.

This is particularly the case for the following requirements:

* Adapt assumptions regarding investor behavior (estimating both gross and net redemptions in particular for Retail Funds) and asset liquidation (guideline 7): this would generate additional data management costs;
* Conduct reverse stress testing (RSTs) (guideline 8): RSTs would not be appropriate to be implemented all funds with very few exceptions (e.g. MMFs, please refer to our response to Q8);
* Conduct Historical Liquidity Stress Testing (guideline 8): Retrieving historical liquidity parameters and applying them to current funds would generate significant costs in particular for Fixed Income and Alternative Products as market data are scarce ;
* Demonstrate ability to overcome the limitations of third party data (guideline 9): this would require additional resources;
* Cross-reference LSTs with other indicators (guideline 10): this would require the development of additional systems in particular for highly regulated products (like UCITS funds or MMFs required to comply with many investment guidelines;
* Incorporate risk factors to investor type and concentration (guideline 12): data may not be available in particular for Retail Funds.

Therefore, to limit development costs and to balance costs against benefits, we believe these requirements should only be implemented for a subset of the funds managed). Several of the above, in particular RST or Historical Liquidity Stress Testing would result in significant cost across the value chain. Furthermore, parameters, assumptions or expert estimates would need to be validated by an expert and doing so would significantly increase costs.

<ESMA\_QUESTION\_LST\_1>

1. : Do you agree with the scope of these Guidelines? Should certain types of funds be explicitly excluded from these Guidelines? Should MMFs remain in-scope of these Guidelines?

<ESMA\_QUESTION\_LST\_2>

Yes, we agree with the scope of the guidelines, taking into account that more granular requirements under the MMFR should prevail. We believe that certain funds should be excluded from the scope of guidelines. For specific types of funds such as single investors, closed end funds or pension structures, the requirements should only be applied where appropriate, depending on the respective risk profile of the fund.

<ESMA\_QUESTION\_LST\_2>

1. : Is additional clarity required regarding the scope of these Guidelines? Is additional clarity required regarding the meaning of ‘nature, scale and complexity’ of a fund? Are there circumstances in which it would, in your view, be inappropriate for a UCITS to undertake LST?

<ESMA\_QUESTION\_LST\_3>

We believe the scope set out in the Guidelines is clear.

Depending on the ‘nature, scale and complexity’ of a fund and respective risk profile, we believe it should be left to the discretion of the asset manager to determine which type of stress tests are relevant for specific funds and which might not be appropriate.

Some of the stress tests would not be suitable for certain types of funds (such as Exchange Traded Funds (ETFs) with the ability to redeem in kind) but they could be appropriate for others, depending on an assessment of the Risk Manager.

<ESMA\_QUESTION\_LST\_3>

1. : What are your views on when the Guidelines should become applicable? How much time would managers require to operationalise the requirements of these Guidelines?

<ESMA\_QUESTION\_LST\_4>

Given the wide range of products impacted and the differences in their liquidity profile, an implementation period of at least 18 months would be appropriate (i.e. application at the end of 2020). This takes into account IT budget allocation plans to develop and implement specific requirements.

<ESMA\_QUESTION\_LST\_4>

1. : Do you agree with the proposed approach of setting out a list of Guidelines all funds should follow, and the provision of explanatory considerations to help managers comply with those overarching Guidelines? Do you see merit in including some of the explanatory considerations in the final Guidelines?

<ESMA\_QUESTION\_LST\_5>

We agree with the proposed approach that the 15 guidelines should remain principles-based. ESMA should provide further explanatory guidelines and examples to limit the room for interpretation and divergence between minimum standards implemented across the asset managers.

There should also be room for the asset manager to define internal standards to justify which liquidity stress test scenarios are relevant and applied for which fund ranges / products. There is a limited set of funds where all liquidity stress tests are relevant or where the liquidity risk of the product would require the implementation of the full set of stress tests, especially taking into account alternative strategies.

<ESMA\_QUESTION\_LST\_5>

1. : Do you agree with the proposed Guidelines? What amendments, if any, should ESMA make to its proposed Guidelines?

<ESMA\_QUESTION\_LST\_6>

In general, while we agree with the proposed guidelines we believe that they should

* Leave flexibility for asset managers to tailor stress tests depending on the risk profile and asset type;
* Allow for expert judgement where data is not available;
* Additional examples should be provided and ESMA should indicate which requirements would be mandatory, conditional on compliance with some requirements, or optional.

<ESMA\_QUESTION\_LST\_6>

1. : Do you agree with the proposed explanatory considerations regarding LST of fund assets?

<ESMA\_QUESTION\_LST\_7>

Yes, we believe they are useful if they keep a balance between flexibility and standardisation.

<ESMA\_QUESTION\_LST\_7>

1. : What are your views on the requirement to undertake reverse stress testing, and the use of this tool?

<ESMA\_QUESTION\_LST\_8>

Reverse Stress Testing (RST) can be understood in different ways. They could be either a pure quantitative concept, within which an expected outcome is achieved by variation of a set of underlying parameters. On the other hand, it can be considered as a part of a qualitative assessment within the setup / configuration of a fund, particularly during the configuration of Liquidity Mitigating Techniques (LMTs) implemented for a fund.

Due to the high complexity and the high dependency on data (it is difficult in particular to model data and how funds will react to different scenarios), we believe that quantitative reverse stress tests should only be considered for a very limited set of situations and products (such as for MMFs). The IT costs required to model a reverse stress test with multiple parameters are prohibitively high.

In conclusion, we do not recommend to include RST, as the costs to implement a quantitative procedure with several parameters as well as the limitations due to difficult to model data are not compensated by the benefits generated by the results.

<ESMA\_QUESTION\_LST\_8>

1. : Do you see merit in providing further considerations for managers on the use of data relevant to asset liquidity, particularly in circumstances when data is scarce?

<ESMA\_QUESTION\_LST\_9>

Yes, we believe that data availability and the costs of data should be considered as relevant factors during the setup of the requirements. Therefore, we believe that the following additional considerations should be considered when data is scarce:

1. If no quantitative data from an external data source is available (i.e. no daily trading volume data), expert estimates and/ or modelling of these parameters is required.
2. While we agree that it is important to assess the quality of the information used, one should not require to have an independent validation of the estimate for every expert estimate done. In particular, if the expert can be considered independent from the liquidity management of the fund and no conflict of interest is identified, this expert estimate should be allowed to be used without explicit validation procedure by a second independent expert.

<ESMA\_QUESTION\_LST\_9>

1. : Do you agree with ESMA’s wording regarding the asset liquidation method used in the LST model? How would you describe the asset liquidation method used by you or the managers you represent?

<ESMA\_QUESTION\_LST\_10>

Yes, the asset manager should be given discretion to apply both methods as there is not one correct approach for asset liquidation models. Both methods, whether they are used separately or together, might be considered relevant for one fund. The result of the stress test could be an outcome depending on one or both of the stress tests.

For example, the vertical slicing method (pro-rata) could be used for index tracking funds and funds experiencing high outflows to ensure equal treatment of investors. Meanwhile, the waterfall liquidity method accounts for fulfilling smaller outflows which can be covered mainly by cash holdings or other highly liquid assets.

<ESMA\_QUESTION\_LST\_10>

1. : Do you agree with ESMA’s wording regarding ‘second round effects’? What is your current practice regarding modelling ‘second round effects’?

<ESMA\_QUESTION\_LST\_11>

Generally we agree with the wording. However, taking into account the complexity and difficulty to model second round effects explicitly and separately, we recommend not to incorporate them separately into the LST process. Modelling this will generate additional development costs without adding clear benefits.

<ESMA\_QUESTION\_LST\_11>

1. : What are your views on the considerations on difficult to model parameters, such as price uncertainty? What is your current practice concerning this issue?

<ESMA\_QUESTION\_LST\_12>

There are several factors which are interrelated when it comes to liquidity assessments in particular for illiquid assets such as applying a haircut on the price. Price uncertainty is a factor which is in some way connected to an illiquidity premium (bid-ask spread) as well as to the liquidation period, which is targeted at liquidation. These factors can and should be considered within a liquidity assessment. However, we would not recommend to consider them as separate factors but within the assessment of the parameters, which are already included within the liquidity models.

<ESMA\_QUESTION\_LST\_12>

1. : Do you agree with ESMA’s considerations on LST in funds investing in less liquid assets? What amendments should be made to the proposed wording? Do you think that ESMA should outline additional and/or specific Guidelines to be made in any other fund or asset types, such as ETFs?

<ESMA\_QUESTION\_LST\_13>

In principle, we agree with the considerations, but would like to ask for explanatory examples and clarity on the statement that RST may be a valuable tool in low probability, high impact scenarios. In this direction, please refer to question 8 for detailed comments made for reverse stress testing.

In addition, we believe that a strong focus should be made on a consistent contingency plan to be in place especially for less liquid funds in advance of stressed market events.

For ETFs, we do not believe that specific considerations need to be mentioned here. All characteristics of an ETF as well as the related implications on liquidity risk (e.g. pro-rata constraints) are known by market participants.

<ESMA\_QUESTION\_LST\_13>

1. : Do you agree with the considerations regarding LST on items on the liabilities side of a fund’s balance sheet?

<ESMA\_QUESTION\_LST\_14>

We generally agree with the considerations, in particular to the anticipation of the net flows expected by the asset manager. Still, we believe it is important to leave it up to the asset manager to decide which approach makes sense to analyse potential redemptions. The selection of either a quantitative analysis of the redemptions, observation of the linkage of the fund to redemption behaviour for peer funds or a more customized approach (e.g. for single investor structures) should be left to the discretion of the Asset Manager

.

Additionally, we believe that the “other types of liabilities” mentioned within the section can be considered, but only if these are considered to have a significant impact on the liquidity profile of a fund. For example, for most of the funds using derivatives and the related exchange of collateral / margin, the impact of that portion will typically be much smaller than the effects expected from potential redemptions.

Therefore, we recommend that the asset managers should define within the liquidity profile of the fund whether they expect these factors to have a significant impact on the liquidity profile of the fund – and where it is expected to be less material. Given the outcome of this profiling, the factors should then be omitted to avoid substantial data exercises that do not have relevant / material impact on the liquidity program. The aspects of additional costs due to data collection and IT implementation requirements should also be considered.

<ESMA\_QUESTION\_LST\_14>

1. : Do you agree with the considerations specifying the LST of redemptions and other types of liabilities may need to be considered distinctly, given a fund could potentially limit redemptions but not other sources of liquidity drain?

<ESMA\_QUESTION\_LST\_15>

Yes but we think the Asset Manager should have discretion to decide how these factors should be included in the assessment, as these factors are only relevant in specific circumstances and should than be tailored to the relevant setup and risk profile. Additional liabilities would only have a material impact on redemptions for a limited subset of funds which we manage hence it would not be sensible to factor them for all funds.

<ESMA\_QUESTION\_LST\_15>

1. : Do you agree with the requirement to reverse stress test items on the liabilities side of the fund balance sheet?

<ESMA\_QUESTION\_LST\_16>

For RST please consider the comments made in question 8 especially taking into account the significant costs involved to assess the different factors specific to each fund.

<ESMA\_QUESTION\_LST\_16>

1. : Do you agree with the requirement to incorporate investor behaviour considerations into the LST model ‘where appropriate’? Are there cases which you believe it would not be appropriate, and should these be detailed in these Guidelines?

<ESMA\_QUESTION\_LST\_17>

We believe that the consideration of investor’s behaviour can make sense, but can create significant challenges to aggregate and manage investor information. Due to the diverse distribution setups existing within the market and the lack of data exchange standards between intermediaries, asset manager and transfer agents, incorporating investor behaviour considerations within the liquidity risk models will require significant implementation and data maintenance costs.

Therefore, we believe that these requirements can only be implemented if legal frameworks allow the exchange in a standardized way, where at least investor Meta data/ information support the analysis. If no such standard is being developed on the transfer agent side, the cost generated within the market will be significant and will not outweigh the benefits of increased transparency of investor behaviour.

<ESMA\_QUESTION\_LST\_17>

1. : What do you think about ESMA’s Guideline stating that managers should combine LST results on both sides of the balance sheet?

<ESMA\_QUESTION\_LST\_18>

We generally agree with the approach as well as the considerations to combine LST on both sides of the balance sheet, as the combination is the only possibility to provide a full and transparent overview of the liquidity in normal and stressed market conditions.

<ESMA\_QUESTION\_LST\_18>

1. : What are your views on ESMA’s Guideline that aggregated LST should be undertaken where deemed appropriate by the manager?

<ESMA\_QUESTION\_LST\_19>

We see limited benefit in aggregating LST results across funds, as this would impose significant additional effort on the liquidity risk program and might not be relevant considering the various diverse and uncorrelated structures of products as well as investors behind these products. Aggregation should only be considered if several very similar products are managed within the same market by one asset manager.

<ESMA\_QUESTION\_LST\_19>

1. : What is your experience of performing aggregated LST and how useful are the results?

<ESMA\_QUESTION\_LST\_20>

We have very limited experience in the usage of aggregated stress testing, with the exception of the simulation of the default of a counterparty to securities lending transactions across all funds managed on the platform.

<ESMA\_QUESTION\_LST\_20>

1. : What are your views on ESMA’s considerations concerning the use of LST during a fund’s lifecycle?

<ESMA\_QUESTION\_LST\_21>

We do not believe it is reasonable to perform quantitative analysis based on an explicit model portfolio pre-launch. Based on our view, it is important to consider relevant factors like target size of the product, asset profile within the fund and/or expected investor structure. Given these factors, the right set of liquidity mitigation techniques as well as product configuration (notice period, redemption frequency, lock-up period, open vs. closed ended) should be defined.

<ESMA\_QUESTION\_LST\_21>

1. : What is your experience of the use of LST in determining appropriate investments of a fund?

<ESMA\_QUESTION\_LST\_22>

In our experience, LST only provides a limited value to determine if an investment is appropriate for a fund.

Usually, the investment policy, the legal fund structure as well as the investor profile is known pre-launch of the fund and the factors are considered appropriately by the Portfolio Manager.

<ESMA\_QUESTION\_LST\_22>

1. : In your view, has ESMA omitted any key uses of LST?

<ESMA\_QUESTION\_LST\_23>

No, all relevant situations have been mentioned. We still believe that LST is not useful in each of the mentioned situations. For example, in times of stressed liquidity, it is important that all LMTs are in place already and that in these scenarios all liquidity management procedures required are functional.

<ESMA\_QUESTION\_LST\_23>

1. : Do you agree with ESMA’s Guideline that LST should be undertaken in all cases annually, but that it is recommended to undertake it at least quarterly, unless a different frequency can be justified? What is the range of frequency of LST applied on funds managed by stakeholder(s) you represent?

<ESMA\_QUESTION\_LST\_24>

We agree with annual reviews of the LST activity. However, we do not believe that this should be repeated more often than that as the results are typically rather stable and the quality of the results is not increased through a high frequent repetition of the activity. Depending on the liquidity assessment, the frequency of undertaking LST should be appropriate to the risk profile.

<ESMA\_QUESTION\_LST\_24>

1. : Should ESMA provide more prescriptive Guidelines on the circumstances which can justify a more/less frequent employment of LST?

<ESMA\_QUESTION\_LST\_25>

No, we believe this should be defined by the asset manager within its internal procedures.

<ESMA\_QUESTION\_LST\_25>

1. : Do you agree that LST should be employed outside its scheduled frequency (ad-hoc) where justified by an emerging/imminent risk to fund liquidity?

<ESMA\_QUESTION\_LST\_26>

We believe in case of stressed liquidity events, most procedures are already in place and the ordinary or adhoc liquidity stress testing program might not useful as the intention of the ordinary programs focus on pre-assessing potential drawbacks instead of retrospectively providing feedback. Therefore the use of adhoc LST is not recommended and such a program should only be put in place ex-ante.

<ESMA\_QUESTION\_LST\_26>

1. : What are your views on the governance requirements regarding LST?

<ESMA\_QUESTION\_LST\_27>

We agree but would like to include the comment made in response to Question 9, where there should not be a requirement for independent validation for every expert estimate.

In cases where expert estimates are required, it should be sufficient to have only one independent expert on the asset class being involved in the assessment. As long as it can be validated that no conflict of interest is being identified for the expert selected, this estimate should not be required to be validated by a separate expert.

<ESMA\_QUESTION\_LST\_27>

1. : Should more information be included in the UCITS RMP and AIF RMP?

<ESMA\_QUESTION\_LST\_28>

No.

<ESMA\_QUESTION\_LST\_28>

1. : Do you have any views on how managers which delegate portfolio management can undertake robust LST, independently of the portfolio manager, particularly when the manager does not face the market?

<ESMA\_QUESTION\_LST\_29>

We believe that several options in terms of roles and responsibilities exist to setup a LST framework. We believe that data provided by external parties (asset class experts / market data providers) or internal functions (independent functions such as trading departments) can be included into the program. In cases where these sources of information or expertise are not available, the risk management function should have sufficient expertise to assess the appropriateness of the figures and factors used within the LST program.

<ESMA\_QUESTION\_LST\_29>

1. : Do you agree with the proposed Guideline for depositaries on carrying out their duties regarding LST?

<ESMA\_QUESTION\_LST\_30>

Yes

<ESMA\_QUESTION\_LST\_30>

1. : In your experience do depositaries review the UCITS RMP and AIF RMP as a matter of course?

<ESMA\_QUESTION\_LST\_31>

Depositaries review the overall structure and assess the existence of various components of the risk management policy. Some depositaries request further details on the procedures in place, to perform assessments similar to that of an internal or external auditor. Generally, there is no uniform standard for due diligence activities of the depositary on the asset manager.

<ESMA\_QUESTION\_LST\_31>

1. : Do you see merit in ESMA publishing further guidance on the reporting of results of liquidity stress tests? If so, in your view how should ESMA require that results be reported?

<ESMA\_QUESTION\_LST\_32>

Yes. Unlike AIFMD reporting, which has now been harmonised across Europe, UCITS reporting in general varies significantly between Member States, which goes against the intent of harmonisation of the directive. ESMA should provide further guidance to establish a uniform European standard on reporting activities.

Even if this standard differs for different asset classes or fund structures (e.g. UCITS vs. Illiquid AIFs), it would be beneficial for the industry to define a European standard to avoid multiple implementation projects within the different countries. This simplifies and reduces the effort for service providers and asset managers and will allow ESMA to compare the results on a European level.

<ESMA\_QUESTION\_LST\_32>