FINANSTILSYNET

NOTAT

**Finanstilsynet**

6. december 2024
Finanstilsynet

# Denmark's response to European Commission consultation on assessing the adequacy of macroprudential policies for non-bank financial intermediaries (NBFI)

## 1. KEY VULNERABILITIES AND RISKS STEMMING FROM NBFI

***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?*

Denmark welcomes the opportunity to provide input on the European Commission's consultation. We acknowledge the Commission's assessment of the potential risks and vulnerabilities posed by the Non-Bank Financial Intermediaries (NBFIs), as outlined in the consultation document. We recognise the need to better understand the potential risks and vulnerabilities they pose to both the EU as a whole and to Member States.

However, we believe it is crucial to maintain a high threshold for introducing new regulation, as a substantial regulatory framework is already in place. Additional rules may increase complexity and potentially divert businesses and supervisory authorities from focusing on the core risks. Therefore, we emphasize the importance of conducting thorough impact assessments to ensure that any new proposals provide sufficient added value and effectively address significant risks without imposing unnecessary burdens on businesses and National Competent Authorities (NCAs).

If significant risks should be identified, we believe that, as a first step, they could be addressed through gradual and targeted adjustments to existing rules, rather than by imposing new legislation.

***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.*

From a Danish perspective, the primary concern lies in the systemic implications derived from the activities of NBFIs, rather than in direct exposure risks.

NBFIs participate in the market and influence prices and liquidity in many of the same financial markets in which credit institutions operate. This includes the financial markets where credit institutions take positions or seek funding. Furthermore, NBFIs can serve as counterparties in contracts with credit institutions. For example, repo or guaranteed/hedged contracts can mitigate the underlying risk.

Additionally, the business model and financing structure of Danish credit institutions are predominantly simple, relying mainly on deposits and covered bonds. Therefore, the primary concern is not necessarily direct exposures or other dependencies, but rather the potential systemic implications through the financial markets, affecting pricing, volatility, and market liquidity.

***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.*

Insurers play a vital role in providing protection. If an insurance company fails, the repercussions can significantly impact the real economy, leading policyholders to stop activities that require or rely on the insurance coverage until the situation is resolved. The extent of this impact will depend on the availability of alternative insurance options in the market. Consequently, the issue of mitigation raises questions about market concentration. However, we believe this issue will be mitigated when IRRD enters into force.

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

For Danish life insurers and pension funds, systemic liquidity risk is primarily expected to materialize through margin calls on their financial derivatives.

***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.*

We believe it is essential to monitor and address systemic risks related to excessive leverage in NBFIs across the EU. That said, there are currently no indications of excessive leverage building up in the NBFI sector in Denmark.

In 2020, the Danish Financial Supervisory Authority (Danish FSA) conducted an ad-hoc investigation into leverage among Danish life insurers and pension funds. While it was noted that these companies do not measure and consider leverage in a uniform way, the Danish FSA did not identify any excessive build-up of leverage. However, the Danish FSA emphasized the importance of ensuring that the risks arising from the use of leverage should be adequately reflected in risk management practices.

In 2023, the Danish FSA conducted an analysis of hedge funds invested in Danish real estate bonds to assess potential buildup of excessive leverage. The findings indicated that there is currently no current leverage concern. However, the analysis did identify a possibility of systemic risk should excessive leverage be present in this area in the future. Consequently, the Danish FSA will continue to monitor this area closely.

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

The crypto assets markets may still be in the early stages of maturity regarding the criticality of this issue. In Denmark, however, the financial sector has taken a cautious approach to crypto-assets, leading to very limited interlinkages between the financial sector and the crypto-asset markets. With the new EU regulation on markets in crypto-assets (MiCA), the EU aims at enhancing trust and ensuring market integrity as the crypto-asset sector grows. That said, going forward it is also important to maintain focus on the potential of regulatory simplification, such that a future review of MiCA should prioritize enhancing the regulation's effectiveness and efficiency, rather than introducing additional layers of regulation."

***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.*

The renewed ambition of Member States to support savings and investments, and the integration of financial markets, should be supported by effective macroprudential frameworks for NBFIs.

However, rather than pursuing a complete overhaul of current legislation, we recommend a gradual and targeted refinement of existing regulations. Additionally, we believe that any new measures should be supported by comprehensive impact assessments to ensure that they are necessary and to demonstrate the clear value they provide.

## 3. OVERVIEW OF EXISTING MACROPRUDENTIAL TOOLS AND SUPERVISORY ARCHITECTURE IN EU LEGISLATION

***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 basis by the competent authority? Please explain.*

Liquidity should be managed by individual fund managers, not supervisory authorities. Regulation, including stress tests, should effectively compel managers to set prudential liquidity buffers and manage liquidity effectively and securely. However, competent authorities must retain power to intervene during cases of rare and unforeseen periods of stress – whether market-related, political, or other types of stress – to ensure that market wide risks are also considered.

As for Money Market Funds (MMF's), Denmark currently does not have any MMF's, and therefore, we do not have relevant experience to contribute on this matter.

***Question 9.*** *How can ESMA and ESRB ensure coordination and the proper use of this power and what could be their individual roles? Please provide specific examples or scenarios to support your view.*

The supervisory powers delegated to the competent authorities should be agile and usable, allowing for swift action when necessary.

While ESMA's coordination can be beneficial in this regard, imposing excessive requirements for ex-ante consultation and similar processes might have the opposite effect. From a Danish perspective, it is important that ESMA's role remains primarily one of coordination and, where appropriate, evaluation.

Additionally, ESRB coordination would also be beneficial, supported by ongoing analysis, which already falls within their current mandate. This approach enables them to facilitate, recommend, or advocate for timely action when needed.

Even so, we would like so emphasize that there should not be a shift of significant decision-making powers to ESMA and ESRB in general. ESMA and ESRB already have a wide range of tasks and mandates that they are responsible for, and it is important to maintain focus on these rather than considering potential expansions of their current mandate.

***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*

Denmark currently does not have any MMF's, and as such does not have relevant experience to contribute on this matter.

***Question 11.*** *Do you believe that the proposed enhancements to the stress testing framework listed above are sufficient to identify and mitigate liquidity risks effectively? If not, what specific elements would you suggest including in the strengthened supervision and remediation actions for detecting liquidity risks?*

Denmark currently does not have any MMF's, and as such does not have relevant experience to contribute on this matter.

***Question 12.*** *What are the costs and benefits of introducing an EU-wide stress test on MMFs? Should this stress test focus mainly on liquidity risks?*

Denmark currently does not have any MMF's, and as such does not have relevant experience to contribute on this matter.

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

Denmark currently does not have any MMF's, and as such does not have relevant experience to contribute on this matter.

***Question 14.*** *Can you provide insights and data on how the reverse distribution mechanism has impacted in practice the stability and integrity of MMFs?*

Denmark currently does not have any MMF's, and as such does not have relevant experience to contribute on this matter.

***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.*

Denmark currently does not have any MMF's, and as such does not have relevant experience to contribute on this matter.

***Question 16.*** *How can NCAs better monitor the liquidity profile of OEFs, including redemption frequency and LMTs, in order to detect unmitigated liquidity mismatches during the lifetime of OEFs?*

The recent review of the AIFM and UCITS directives has not yet been implemented into Danish national law (as is generally the case in Member States). Consequently, it is premature to assess whether the revisions to the LMT rules and the associated reporting requirements are sufficient for this purpose. Any potential revision should await concrete experiences, as we must allow time for the effects of already agreed-upon regulations to materialize before proposing new, which can then be evaluated in conjunction with the recently adopted regulatory framework.

***Question 16.*** *[To NCAs/EU bodies] What is the supervisory practice and your experience with monitoring and detecting unmitigated liquidity mismatches during the lifetime of OEFs?*

Based on our experience, it is important to distinguish between UCITS funds (or AIFs investing in only listed assets) with daily or more frequent redemptions, and open-ended AIFs that invest in illiquid assets. In the case of the former, the Danish FSA has primarily identified liquidity mismatches due to inadequate suspension management. This was particularly evident during the COVID 19 pandemic and with Russian assets, where managers tended to suspend redemptions automatically. In both scenarios, proper liquidity management could have mitigated most of these suspensions.

Regarding AIFs with illiquid assets, the Danish FSA mainly encounter open-ended funds intended for retail investors. When a manager applies to market an open-ended AIF to retail investors in Denmark, the liquidity management and valuation methods are areas of focus for the Danish FSA to ensure robust investor protection.

***Question 17.*** *What is the data that you find most relevant when monitoring liquidity risks of OEFs?*

In Denmark, suspensions play an important role in monitoring liquidity of OEF's, but this is done on an ex-post basis. The most relevant data for assessing liquidity risk in OEF from an ex-ante perspective is, however, more challenging to generalize effectively.

***Question 18.*** *[To NCAs/EU bodies] What supervisory actions do you take when unmitigated liquidity mismatches are detected during the lifetime of an OEF?*

According to the Danish FSA, managers must be able to mitigate liquidity mismatches preemptively. If this is not feasible, the fund should be structured as close-ended. Generally, most funds with illiquid assets are ill-suited to operate as open-ended. While liquidity buffers and other liquidity management tools can help mitigate liquidity risks, valuation risks remain present and should be managed whenever possible.

There have been instances where open funds were converted to closed funds by the manager – with the approval of investors – due to their inability to effectively handle liquidity mismatches.

***Question 19.*** *On the basis of the reporting and stress testing information being collected by competent authorities throughout the life of a fund, how can supervisory powers of competent authorities be enhanced to deal with potential inconsistencies or insufficient calibration between the LMTs selected by the manager for a fund or a cohort of funds and their assets and liabilities liquidity profile? How can NCAs ensure that fund managers make adjustments to LMTs if they are unwilling to act? How could coordination be enhanced at the EU level?*

As highlighted in Question 16, the recent review of the AIFM and UCITS directives has not yet been implemented into Danish national law, making it is premature to assess whether the review will leave more to be desired in this regard. Again, we would like to emphasize that any potential revision should await concrete experiences before proposing new measures.

***Question 20.*** *[To asset managers] What measures do you find particularly effective to measure and monitor liquidity risk in stressed market conditions?*

***Question 21.*** *[To asset managers] What difficulties have you encountered in measuring and monitoring liquidity risks and their evolution? Are there enough tools available under the EU regulations to address liquidity mismatches?*

***Question 22.*** *[To asset managers] What are the challenges in calibrating worst-case and stress-case scenarios related to redemptions and margin calls?*

**Question 23.** *[To NCAs and EU bodies] When monitoring or using results of liquidity stress tests, are you able to timely collect underlying fund data used by managers and the methodology used for the simulation? Are there other aspects that you find very relevant when monitoring the stress tests run by managers?*

The Danish FSA receive data from stress tests related to result for alternative funds, but not for UCITS. Additionally, the Danish FSA obtain liquidity profiles for alternative funds, indicating the amount and given timeframe in which they can meet redemptions.

***Question 24.*** *[To NCAs and EU bodies] How do you use information collected from stress tests at fund level for other supervisory purposes and for monitoring systemic risks?*

The data received are mainly used to identify potential liquidity risks, specifically related to the insufficient liquidity for meeting potential redemption within expected timeframes.

***Question 25.*** *[To NCAs and EU bodies] What are the main benefits and costs of introducing a stress test requirement at the asset management company level and how could this be organised?*

Liquidity stress testing is best conducted at the fund level to handle liquidity risks related to each individual fund. Therefore, we believe that introducing additional requirements at the company level may increase regulatory burdens without delivering significant added value at this time.

***Question 26.*** *What are your views on the preparedness of NBFIs operating in the EU in meeting margin calls, and on the ways to improve preparedness, taking into account existing or recently agreed EU measures aimed at addressing this issue? Please specify the NBFI sector(s) you refer to in your answer?*

EMIR3 will facilitate further transparency for clients by providing insight into how their margins are calculated for cleared derivatives, thereby providing a better foundation for clients from all NBFI sectors to better plan their own liquidity needs in different market situations. Measures, such as these, which ensures the availability of relevant information necessary for prudent liquidity management, serve as natural starting point and are prerequisite for fostering the liquidity preparedness of NBFIs.

At the same time, it is important to acknowledge that NBFIs face greater limitations in sourcing liquidity compared to credit institutions, making them less equipped to manage stresses in cleared markets. This warrants a cautious approach to the mandatory propagation of NBFI clearing, given that mandatory clearing could introduce liquidity risks, potentially leading NBFIs not subject to prudential supervision to adopt more limited hedging strategy for their business and market risks. EMIR's hedging exemption, which addresses this issue for non-financial counterparties, is therefore critical to maintain.

Even in light of the removal of the clearing exemption for pension scheme arrangements, Danish life insurers and pension funds are considered well-prepared to meet margin calls. However, this remains an area requiring attention and close monitoring in the future, particularly to ensure an adequate number of repo counterparties. The Danish FSA most recently assessed this issue in 2022. For more information you may follow the link (only available in Danish): https://www.finanstilsynet.dk/nyheder-og-presse/nyheder-og-pressemeddelelser/2022/dec/notatpenslikviditet_011222.

***Question 27.*** *What are relevant risk metrics or tools that can be used to effectively monitor liquidity and margin preparedness across all NBFI entity types? Please provide examples specifying the sector you refer to.*

From a Danish perspective, there is currently no concrete proposal for a specific metric that can effectively accomplish this task.

However, it is noted that the liquidity management of a company can be dependent on a variety of aspects, including both its physical business (e.g. energy production) and its position in financial instruments (e.g. hedging of production), which are of critical importance.

Given this complexity, establishing any 'indirect' metrics to monitor the liquidity situation of NBFIs appears to be a very difficult task. A more practical approach may be to focus on creating healthy incentives for companies to prioritize their own liquidity management, while ensuring they have access to the necessary information, such as margin calculation methodologies. As an example, the Danish FSA has used ad hoc liquidity stress testing of interest rates to assess the liquidity and margin call preparedness of Danish life insurers and pensions funds.

In this regard, we consider it important to keep in mind that applying a one-size-fits-all approach across very different NBFI types may be challenging, as it may not be appropriate to impose the same regulatory obligations on all of them.

***Question 28.*** *How can current reporting by pension funds be improved to improve the supervision of liquidity risks (e.g. stemming from exposure to LDI funds, other funds or derivatives), while minimising the reporting burden? What can be done to ensure effective look-through capability and the ability to measure the impact of unexpected margin calls? Please provide examples also for other NBFI sectors.*

As Danish life insurers and lateral pension funds are regulated under Solvency II, effective look-through is, from a Danish perspective, generally constrained by the fact that look-through is not required for the final 20 pct. of an undertaking's total assets.

At this stage, we do not see a clear path to improving reporting processes without adding to the regulatory burden, particularly in areas where the benefits are uncertain.

***Question 29.*** *What would be the benefits and costs of a regular EU-wide liquidity stress test for pension funds and with what frequency? What should be the role of EU authorities in the preparation and execution of such liquidity stress tests?*

In Denmark, life insurers and lateral pension funds (27 undertakings with a total balance sheet of approximately 425 billion EUR) are regulated under Solvency II, where liquidity stress testing is already part of the regular EU-wide stress testing conducted by EIOPA.

Danish company pension funds (18 undertakings with a total balance sheet below 9 billion EUR) are regulated under IORP, with liquidity stress testing set to be included in the 2025 version of the EU-wide stress testing performed by EIOPA.

Given the new requirements for liquidity risk management in the Solvency II Reviews, as well as the ongoing work in relation to liquidity risk management under the IORP Review, we do not see a need for additional EU-wide liquidity stress testing for pension funds.

***Question 30.*** *What would be the benefits and costs of creating a framework or a label in EU legislation for certain money market instruments (such as commercial papers) to increase transparency and standardisation? Should the scope of eligible instruments to such framework/label be aligned with Article 3 of Directive 2007/16/EC1? If not, please suggest what criteria would you consider for identification of eligible instruments.*

Increasing liquidity for money market instruments, such as commercial papers, presents certain challenges. However, it is likely that enhanced transparency and standardization of documentation will be essential in addressing this issue. A less opaque market can attract more participants in the secondary market as it reduces asymmetric information.

We also refer to our response to Question 36.

***Question 31.*** *Would the presence of a wider range of issuers (notably smaller issuers) to fund themselves on this market, and therefore diversify their funding sources, be beneficial or detrimental to financial stability?*

Denmark has no comments.

***Question 32.*** *What are your views on why euro-denominated commercial papers are in large part issued in the 'EUR-CP' commercial paper market outside the EU? What risks do you identify? Please provide quantitative and qualitative evidence, if possible.*

Denmark has no comments.

***Question 33.*** *What could be done to improve the liquidity of secondary markets in commercial papers and certificates of deposits?*

Denmark has no comments.

***Question 34.*** *Considering market practice today, is the maturity threshold for 'money market instruments' (up to 397 days) in the Eligible Asset Directive 2007/16 sufficiently calibrated for these short-term funding markets?*

Denmark has no comments.

***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.*

Denmark has no comments.

***Question 36.*** *How could secondary markets in these money market instruments attract liquidity and a more diverse investor base, while relying less on banks buying back papers they have helped to place?*

While increasing liquidity for instruments such as commercial papers appear challenging, a crucial prerequisite is the enhancing transparency and standardization of documentation. A more transparent market can attract more participants to the secondary market as it reduces information asymmetry, which often leads to an increased reliance on dealers.

Additionally, it is important to highlight that one of the risks arising from illiquid secondary markets for these instruments is the liquidity mismatch between MMFs and the underlying instruments. This risk in question, however, is already mitigated in the existing MMF regulation. Any consideration of introducing new regulations must carefully evaluate whether the benefits outweigh the costs, ensuring that the added value justifies the need for further regulatory measures.

***Question 37.*** *What are the benefits and costs of introducing an obligation to trade on trading venues (regulated markets, multilateral trading facilities and organised trading facilities) for such instruments?*

Benefits:

- Reduced reliance on dealers
- Standardization of contracts and documentation
- Increased market monitoring
- Increased transparency.

Costs:

- Dealers may be sensitive towards increased transparency, potentially leading to a reduction in their positions and risk-taking activities.

***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)?*

In a systemic event, it is essential to have active buyers in the market. Investors in commercial papers and alike typically include large institutes, such as MMFs and pension funds. These institutions can act as buyers during systemic event through an intermediary. However, there are concerns regarding whether the demand for these assets will increase with the possibility of regulated market trading.

***Question 39.*** *How would you assess the level of preparedness of commodity derivatives market participants in terms of meeting short-term liquidity needs or requests for collateral to meet margins? Please rank from 1 to 5 (lowest to highest) the level of preparedness for the following participants by sector: insurance companies, UCITS funds, AIFs, commercial undertakings, investment firms, pension funds.*

Denmark has no comments.

***Question 40.*** *In light of the potential risk of contagion from spot markets or off-exchange energy trading to futures markets, do you think that spot market participants should also meet a more comprehensive set of trading rules for market participation and risk management? Please elaborate on your response.*

As of now, Denmark does not have any commodities exchanges, which limits the availability of relevant experiences or specific insights to share on this matter. However, we would like to emphasize the importance of conducting thorough impact assessments to ensure that any new rules deliver sufficient added value relative to the burdens they may impose.

***Question 41.*** *How can it be ensured that the functioning of underlying spot energy markets and off-exchange energy trading activity does not lead to the transmission of risks to financial markets?*

As of now, Denmark does not have any commodities exchanges, which limits the availability of relevant experiences or specific insights to share on this matter.

***Question 42.*** *To what extent do you see emerging liquidity risks or market functioning issues that can affect liquidity in other markets? Can you provide concrete examples?*

As a general comment, liquidity risks can arise from many sources – often unexpected. Therefore, the goal should be to incentivize companies to prioritize their own liquidity management, while ensuring adequate transparence, such as providing access to the necessary information, including methodologies for margin calculation.

## 4. EXCESSIVE LEVERAGE

***Question 43.*** *What are other tools than those currently available under EU legislation which could be used to contain systemic risks generated by potential pockets of excessive leverage in OEFs?*

As for now, Denmark does not have any suggestions. The Danish FSA have not yet used the current tools for addressing systemic risk, such as Article 25 in the AIFM, and therefore have not yet encountered any lack of tools.

***Question 44.*** *What are, in your view, the benefits and costs of using yield buffers for Liability-Driven funds, such as it was done in Ireland and Luxembourg, to address leverage?*

Denmark has not yet assessed this.

***Question 45.*** *While on average EU OEFs are not highly leveraged, are there, to your knowledge, pockets of excessive leverage in the OEF sector that are not sufficiently addressed? Please elaborate with concrete examples.*

From a Danish perspective, an assessment has not yet been conducted to determine whether there was excessive leverage in hedge funds investing in Danish mortgage bonds, nor whether this, combined with procyclical behavior of the managers, should be addressed by a macroprudential tool – as this was not deemed to be the case.

***Question 46.*** *How can leverage through certain investment strategies (e.g. when funds invest in other funds based in third countries) be better detected?*

The easiest yet challenging method to detect this type of leverage is to require a look-through approach when calculating the total leverage. This could be done by calculating both direct and indirect leverage. However, this approach may prove to be difficult to implement in practice.

***Question 47.*** *Are you aware of any NBFI sector entities with particularly high leverage in the EU that could raise systemic risk concerns?*

Denmark has no comments.

***Question 48.*** *Do stakeholders have views on macroprudential tools to deal with leverage of NBFIs that are not currently included in EU legislation?*

Denmark has no comments.

***Question 49.*** *[To NCAs and EU bodies:] Are you able to timely identify (financial and synthetic) leverage pockets of other NBFIs (such as pension funds, insurance companies and so on),* *especially when they are taken via third parties or complex derivative transactions? Please elaborate on how this timely detection of leverage could be obtained.*

For life insurers and pension funds, defining leverage is neither straightforward nor uniform. Consequently, the timely identification of potential leverage issues within these institutions relies on a combination of qualitative and quantitative supervision. From a Danish perspective, increasing or improving data reporting may not necessarily be the best and only way forward, especially considering the associated burdens.

***Question 50.*** *How can it be ensured that competent authorities can effectively reconcile positions in leveraged products (such as derivatives) taken via various legal entities (e.g. other funds or funds of funds) to the ultimate beneficiary?*

Denmark has no comments.

***Question 51.*** *What role do concentrated intraday positions have in triggering high volatility and heightening risks of liquidity dry-ups? Please justify your response and suggest how the regulatory framework and the functioning of these markets could be further improved?*

As of now, there are no commodities exchanges in Denmark. Therefore, there is currently no relevant experience or special insights to share on this matter.

## 5. 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?*

A number of AIFs in the covered bond markets use bank credit lines to leverage large investments in covered bonds. These funds seek to benefit from the spread between a covered bond and the cost of a repo line. While interest rate risk is typically hedged using swaps, these funds remain vulnerable to the risk of sudden increases in the OAS-spread. Such movements could trigger margin calls by banks, particularly if bond prices decline sharply, and the leverage employed by these funds could amplify the potential fire sales of assets. Should these AIFs fail to meet their margin calls, it could result in credit losses for the banking sector, but this risk should already be taken care of in the banking regulation. In Denmark, we have observed that trading patterns of leveraged AIFs are somewhat pro-cyclical, tending to sell assets when bond prices are falling. However, we have no evidence to suggest that leveraged AIFs were forced to sell off covered bonds during crises times, such as in March 2020 or the first half of 2022.

Another example of risk interconnectedness is found in energy infrastructure investments, such as wind farms and solar farms, which is increasingly being structured as AIFs. These assets are inherently long-term and thus come with traditional risks, such as incorrect value assessment and liquidity mismatch. While such funds are typically targeted at institutional investors, there is a growing trend of marketing them to retail and semi-professional investors. Due to the complexity in valuing these assets, there is a risk that retail investors may buy or exit the funds at 'incorrect' prices. Furthermore, these funds often have complex structures with multiple layers of legal entities, raising doubts about the true nature of the underlying asset. The risks associated with these funds are comparable to those of real estate funds, although the market has less experience with energy infrastructure investments. The risk to banks arises because these funds are generally financed through bank lending and are often highly leveraged, with leverage ratios of 4-5 times the investors' equity.

Finally, there is the case of unregulated energy traders (in terms of MiFID). These entities share many characteristics with investment firms but face uncertainty in terms of national supervision and regulation. Due to their leveraged position in derivate markets, they present potential counterparty risk to the financial system.

***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?*

We are skeptical towards EU system-wide stress test across NBFI and banking sectors. Even if the stress test are carried out successfully, there is a risk that the results might not be entirely accurate or useful. Additionally, the costs of conducting a comprehensive EU-wide stress test are considerable, given the complexity of such an exercise and the vast amount of resources it would require.

Current reporting and data-sharing arrangements, such as those under EMIR and SFTR, already provide data. ESMA should be able to map the risk exposures of banks' risk exposures in derivative markets, whereas EBA should have the necessary oversight of bank loan exposures, among other areas MiFIR-data could also be integrated. Entities are commonly identified by LEI, which would be key for the stress test. However, even if banks' and NBFIs risk exposures are consolidated using this data, it would still pose a challenge to identify the true level of risk since. This is because many derivate exposures are related to hedging activities.

***Question 54.*** *Is there a need for arrangements between NBFI 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.*

Without further details about the specific design of the stress test, it would be premature to provide a definitive answer to this question. However, if the intention is for both NBFI and bank supervisors to collaborate on an EU-wide ex-ante stress test, it would be logical that data sharing is both timely and comprehensive. The extent of this requirement may also depend on the frequency of the stress test.

***Question 55.*** *What governance principles already laid out in existing system-wide exercises in the EU, such as the one-off Fit-for-55 climate risk scenario analysis or the CCP stress tests conducted by ESMA, could be adopted in such system-wide stress test scenario?*

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| Denmark has no comments. |

***Question 56.*** *[To NBFIs and banks:] In your risk management practices, do you run stress tests at group level, and do you monitor the level of interconnectedness with (other) NBFIs (within and beyond your own sector, e.g. portfolio overlaps)?*

## 6. SUPERVISORY COORDINATION AND CONSISTENCY AT EU LEVEL

***Question 57.*** *How can we ensure a more coordinated and effective macroprudential supervision of NBFIs and markets? How could the role of EU bodies (including ESAs, ESRB, ESAs Joint Committee) be enhanced, if at all? Please explain.*

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| The ESRB will probably serve as the natural starting point for coordination, given its current systemic and macroprudential mandate, which is already reflected in its ongoing analysis production. Macroprudential issues with actual or potential systemic impact on credit institutions and the financial markets are addressed in this forum, including topics related to NBFIs (which are already being covered). Therefore, there does not appear to be an immediate need for further initiatives at this time.<br><br>However, if new macroprudential regulation are introduced for NBFIs, the respective ESAs would likely have a role similar to their role in the banking sector today. Once again, we would like to emphasize that the ESAs already have a broad range of tasks and mandates. We believe it is important to maintain focus on these rather than considering expansions of their mandate. |

***Question 58.*** *How could the currently available coordination mechanisms for the implementation of macroprudential measures for OEFs by NCAs or ESAs (such as leverage restrictions or powers to suspend redemption on financial stability grounds) be improved?*

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| While the Danish FSA has not yet used the coordination mechanism, the current perspective is that the process, as seen in the example with Ireland, has been positive. |

***Question 59.*** *What are the benefits and costs of introducing an Enhanced Coordination Mechanism (ECM), as described above, for macroprudential measures adopted by NCAs?*

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| The proposed mechanism has the potential to enhance supervisory convergence. However, depending on its design, there is a possibility that it could slow down the process of addressing systemic risks and create pressure on NCAs, potentially affecting their ability to take necessary supervisory actions, and vice versa. An introduction of an ECM should only be explored if there is clear added value. |

***Question 60.*** *How can ESMA and the ESRB ensure that appropriate National Macroprudential Measures (NMMs) are also adopted in other relevant EU countries for the same (or similar) fund, if needed?*

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| The decision to adopt a NMMs from another EU country should ultimately rest with the NCAs in the relevant Member States. |

***Question 61.*** *Are there other ways of seeking coordination on macroprudential measures and possibly of reciprocation? What could this system look like? Please provide concrete examples/scenarios and explain if it could apply to all NBFI sectors or only for a specific one.*

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| Denmark does not have any specific proposals, but we remain open to exploring potential ideas if they have a clear added value. |

***Question 62.*** *What are the benefits and costs of improving supervisory coordination over large (to be defined) asset management companies to address systemic risk and coordination issues among national supervisors? What could be ESMA's role in ensuring coordination and guidance, including with daily supervision at fund level?*

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| The effectiveness of this approach will depend on the specific design and implementation of the supervisory framework. Once again, we would like to emphasize the importance of conducting thorough impact assessments to ensure that any new proposals deliver sufficient added value relative to the administrative burdens they may impose on businesses and NCA's. We believe, therefore, that it is essential to maintain a high threshold for introducing new regulation. |

***Question 63.*** *What powers would be necessary for EU bodies to properly supervise large asset management companies in terms of flexibility and ability to react fast? Please provide concrete examples and justifications.*

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| Denmark has no comments. |

***Question 64.*** *What are the benefits and costs of having targeted coordinated direct intervention powers to manage a crisis of large asset management companies? What could such intervention powers look like (e.g. similar to those in Article 24 of EMIR)?*

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| We understand that Article 24 of EMIR (once EMIR 3 comes into effect) will grant ESMA the authority to coordinate the responses of competent authorities in situations where cross-border markets may be affected and to generally facilitate information exchange. However, we do not interpret Article 24 as conferring 'hard powers' to ESMA that would enable it to override the national authorities' jurisdiction over their respective CCPs. |

***Question 65.*** *What are the pros and cons of extending the use of the Enhanced Coordination Mechanism (ECM) described under section 6.1 to other NBFI sectors?*

Denmark has no comments.

***Question 66.*** *What are the benefits and costs of gradually giving ESAs greater intervention powers to be triggered by systemic events, such as the possibility to introduce EU-wide trade halts or direct power to collect data from regulated entities? Please justify your answer and provide examples of powers that could be given to the ESAs during a systemic crisis.*

Denmark has no comments.

***Question 67.*** *What are the benefits and costs of a more integrated system of supervision for commodities markets where the financial markets supervisor bears responsibility for both the financial and physical infrastructure of the commodity futures exchange, including the system of rules and contractual terms of the exchange that regulate both futures and (cash/physical) forward contracts?*

The theoretical benefits of centralizing the supervision of spot and derivative markets could include the potential for more coherent surveillance across these spots and markets, given the correlated nature of these. However, such coherence might also be achieved through a more formalized sharing of transaction data.

On the other hand, a centralized approach may risk diminishing the expertise related to the specificities of individual commodity markets. Financial supervisors may not be as familiar with the complexities of the underlying spot markets, which can be influenced by specific dynamics and regulations. Moreover, such sectoral regulations could be enforced by other “non-financial” authorities, which may provide them with a deeper and more native understanding of the spot markets.

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

Choosing between the various elements of the FSB programme is challenging, as each component is important and often interdependent, making future predictions difficult. The significance of these element can also change over time, further complicating the prioritization process. However, if to choose, Denmark would like to emphasize the importance of margining practices and non-bank leverage.