CNMV BULLETIN: REPORT ON THE SITUATION OF SECURITIES MARKETS AND AN ARTICLE ON THE GENERATION OF SCENARIOS FOR STRESS TESTING OF INVESTMENT FUNDS

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The Spanish National Securities Market Commission (CNMV) has today published its quarterly Bulletin for the second quarter of 2020. This edition includes "The development of national and international financial markets" report and the article entitled "Cuantificación de la incertidumbre sobre los escenarios adversos de liquidez para los fondos de inversión" (Quantification of the uncertainty surrounding adverse liquidity scenarios for investment funds) by Javier Ojea, from the Research and Statistics Department of the Policy and International Affairs Directorate-General of the CNMV.

"The development of national and international financial markets" report details the most relevant trends in financial markets during the second quarter of the year, which was marked by the coronavirus crisis. The share prices of the most important securities markets rose significantly during the second quarter, following the heavy losses recorded in the first quarter, when the initial containment periods and the halt in the economic activity occurred in most economies. The increase in share prices continued until the beginning of June when various international organisations and institutions reported new more negative economic forecasts, worsening the forecasts with regard to both the magnitude of the fall in production and the expected time frame for recovery.

In Spain, the financial market stress indicator continued its upward trend, which began in March, throughout most of the second quarter, and ended slightly down, although its level (0.56) continues to be a high stress level. In the context of the crisis, Spanish securities markets have followed a trend similar to that of other securities markets, although the development of the former has been less favourable. This is partly due to the greater weight in the Spanish index of companies from some sectors which have been particularly affected by the current situation. Thus, the Ibex 35 rose by 6.6% in the second quarter which, together with the 28.9% decline in the first quarter, represents half-yearly losses above 24%. Other European indices rose in the second quarter by at least twice that of the Spanish index (or three-fold in the case of the German index). The performance of sectors with greater importance in the Spanish index (the financial sector – banks – and consumer services – which includes leisure, tourism and catering –), and whose weight reflects the structure of the Spanish economy is, in general, relatively worse than that recorded by other European sectoral indices.

For their part, the performance of debt markets in Spain was similar to that of other European economies with declines in the yields of public debt assets and private fixed-income assets of higher credit quality, as well as in risk premiums. The performance of these markets is still seriously affected by the actions of the ECB. The yield of the 10Y sovereign debt bond dropped to 0.47% at mid-year, the same level as at the beginning of the year. The risk premium stood at 95 b.p. after reaching maximums above 150 b.p. The abundant liquidity and the greater ease to place debt affected the issues of these assets, which rose sharply in the past few months. The total number of issues in the first quarter of 2020 increased by 61% (to 56.554 billion euros) in the case of issues registered with the CNMV. In the case of issues outside Spain, there was a moderate increase of 3.8% (to 46.280 billion euros – up to May –). The largest increases were recorded in issues of promissory notes and mortgage-backed securities.

Stress testing for investment funds

The article entitled "Cuantificación de la incertidumbre sobre los escenarios adversos de liquidez para los fondos de inversión" by Javier Ojea, from the Research and Statistics Department of the Policy and International Affairs Directorate-General of the CNMV offers a statistical approach to generate worst-case but plausible scenarios for the redemption of investment funds. These scenarios are the key elements for liquidity stress testing.

The peak methodology enables creating consistent scenarios for funds with different business models. For the empirical application, a single investment fund database is created combining information from the confidential information statements of the funds and information on the credit quality of their assets. A simulation exercise compares the distribution of the risk measures used to define the redemption scenarios. The results show that the proposed methodology generates narrower confidence intervals for the shock distribution than those obtained on the basis of the current regulatory approach.

Finally, the feedback from stress scenarios obtained from Spanish investment funds in terms of the redemption coverage ratio (RCR) is analysed. The results show that considering not only the point estimate but also a range of potential redemption scenarios enables identifying vulnerable investment funds that would not be identified by observing the point estimate. Spanish investment funds are resilient to redemption shocks with the exception of a few funds which hold a significant percentage of illiquid assets, such as high-yield corporate bonds.

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