Allianz Global Investors Luxembourg S.A.

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Mr. Carlo Comporti

Secretary General
CESR the Committee of European
Securities Regulators
11-13 avenue de Friedland
75008 Paris
FRANCE

Date 31 May 2010
Department Risk / Thomas Nummer
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Subject CESR´s Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS – Allianz Global Investors response on Consultation Paper, Ref.: CESR/10-108

Dear Mr. Comporti,

Allianz Global Investors (AllianzGI) would like to thank CESR for the opportunity to participate in this consultation. Overall we warmly welcome CESR's technical advice to the European Commission focusing on risk measurement for the purposes of calculation of UCITS' Global Exposure as an additional step towards introducing greater supervisory consistency.

AllianzGI Europe with its Management Companies in France, Germany, Italy, Ireland, UK and Luxembourg welcomes the clarification on some technical aspects concerning UCITS risk limitation – in particular the global exposure calculation and details on counterparty risk. Furthermore Allianz Global Investors is of the opinion that the general risk principles issued by CESR in 2009 will also support the aim to harmonise the risk management for a UCITS and will foster a more consistent implementation to become a truly Single Market of regulated investment funds in Europe.

In general, we appreciate CESR's proposals. The enumerated requirements will support the goal having a more uniform understanding of risk measurement methodologies in the UCITS area. To this extent, CESR's proposals are in line on many aspects with some already existing regulations in Europe – e.g. the Luxembourgish regulation issued by the CSSF Circular 07/308 or the German "Derivateverordnung".

Nevertheless, we would like to note that in some areas CESR´s proposals depart from existing standards, and we are of the opinion that not all proposals will bring added value for investors and regulators. Primarily, we would like to draw attention to the following key aspects:

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We request CESR to readjust in particular the following points:

• Box 14:
We agree that for most funds a 20 % absolute VaR limit is acceptable. However, we do not agree with the proposed approach of setting a strict maximum VaR of 20 %. We would like to encourage CESR to implement high principles which allow a case by case approval of the regulator in case a fund needs a higher risk budget. We are of the opinion that existing CSSF guidance as outlined in 07/308 gives on the one hand a clear limit which gives sufficient flexibility for asset manager in setting up adequate absolute risk limits fitting to the risk profile for most of the funds, however, on the other hand it gives – based on clear principles - the opportunity to offer investors a fund with a higher risk budget (funds using a comparable asset as relative limit did show in the past under certain market conditions higher than 20 % VaR. A too strict limitation on the absolute VaR limit might lead asset managers to use inadequate relative VaR limitation). All in all, for most funds a 20 % absolute VaR is deemed sufficient.

• Boxes 23, 24:
We are of the opinion that information about the method used for the calculation of global exposure as well as the level of leverage might be difficult to understand for investors in mutual funds. We worry about some level of confusion, especially as the KID makes use of the SRRI to inform the investor of the level of risk taken by the fund. We believe that one key risk figure should be used in order to inform investors. The KID (SRRI) is more effective and up-to-date than a VaR figure in the prospectus. As the leverage may frequently change over time especially under different market conditions we do not see any added value for investors in giving a rough estimated expectation of leverage and do frequent changes to the prospectus when leverage changes in major dimensions over time within all the other limits given to the fund.

• Box 26:
We are not of the opinion that exposure to a clearing house should be considered as part of the counterparty exposure limit. Exposure to a clearing house must not be considered part of the counterparty exposure.

• CESR´s initial views on specific guidelines for structured UCITS
AllianzGI welcomes the discussion on the global exposure calculation for some structured funds. However, the criteria for defining structured funds - inter alia having a predefined maturity - seems to be too strict. There are also funds with a structured/passive investment approach aiming at generating a clearly described pay-off which do not have a maturity – i.e. the definition of structured funds should be defined more broadly. Furthermore, we believe that funds asking for an alternative calculation method should have a structured investment approach – however, we think that not only passively managed funds should be able to benefit from the possibility to have a different calculation approach. Hence, we kindly ask CESR to define alternative risk measurement principles acceptable for such structured funds.

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All our further comments are listed in the attached appendix.

We fully understand that CESR is asked to consider carefully perceived needs to modernize the legislation regarding Risk Management. In light of the financial crisis we are of the opinion that risk management and in particular the various risk limitations shall not be viewed as single, stand-alone limitations – we rather understand risk management as an overall approach which asks Management Companies to implement adequate measures to assure the protection of the investors. In order to provide best in class risk management expertise across Management Companies in Europe belonging to the same group, we have built up a dedicated risk function within our European Corporate Centre which supports our various European Management Companies inter alia on all risk management related aspects.

Last but not least we would like to ask CESR in its advice also to bear in mind potential indirect consequences of its work to the success of UCITS outside Europe. Using our Luxembourg hub as a platform for the global distribution of our funds we experience in our daily business that the UCITS risk management regulation is of particular interest for all the regulators outside the European Union as well. As we know from our regular discussions with our colleagues, in particular in the Asian region, there is a huge interest in understanding and learning more about the risk management principles given by CESR as well as to understand in detail technical guidelines inter alia concerning the global exposure calculation using a Value at Risk methodology. Even if it is true to have a focus concerning a harmonised regulation assuring a high level of protection for investors in the Single Market, it would make sense to consider that the risk management needs for cross-border distribution is likewise an important aspect which should to be considered carefully in the course of further development of the UCITS risk management system.

Yours sincerely,

Dr. Wolfram Peters

Allianz Global Investors
European Corporate Center

Head of Risk Management

Thomas Nummer

Allianz Global Investors Luxembourg S.A

Head of Risk

Appendix

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Appendix

In this paper AllianzGI presents short answers to the questions raised by CESR in its consultation paper CESR/10-108 and some additional comments, which we hope CESR might find helpful. We have included references to relevant pages and paragraph numbers in CESR's paper.

In case you have questions please get back to Dr. Wolfram Peters (wolfram.peters@allianzgi.de) or Thomas Nummer (thomas.nummer@allianzgi.lu).

1. Definition and scope of Global Exposure

1. Do you agree with the proposed Level 3 Guidelines for the definition and scope of global exposure?

With regard to the intra-day calculations of global exposure we would like to stress that data set more than once a day is associated with high administration efforts. Since the valuation of global exposure (VaR or Commitment Approach) is based on a huge static data set (market prices, volatilities correlations, etc.), it is difficult to update this data set more than once a day. Thus intra-day calculations of global exposure would lead to high costs and to performance issues.

Box 1. Point 4. We propose to add after 'negligible exposure to exotic derivatives the UCITS' the following sentence '*and where it can be assumed that commitment methodology is not adequately capturing the market risk of its portfolio then UCITS*'

2. Do you have any alternative suggestions?

For some structured funds there might be the need to have a tailor made risk management approach to capture the global exposure of a fund adequately. It seems advisable to give the industry and the regulators the possibility to agree for selected funds on internal models which might fit better to limit the global exposure and thus to protect the investors best.
We agree that as standard approaches either the VaR or the Commitment approach should be applied.

Further comments to the internal model for structured funds are given below - see our answers to the questions 56f.

2 Calculation of Global Exposure using the Commitment Approach

n/a

3 Calculation of Global Exposure using the Value at Risk (VaR) Approach

3.1 General Principles and general requirement

21. Do you agree with the general principles outlined for the use of VaR?

Yes, we agree.

3.2 VaR Approaches – Relative VaR and Absolute VaR – The Choice

22. Do you agree with the proposals regarding the choice of the VaR approach?

Yes, we agree.

3.3 Relative VaR approach

23. Do you agree with the proposed approach regarding the use of the relative VaR?

Yes, we agree.

24. Do you agree with the proposed criteria for the reference portfolio?

a. There are other potential exceptions like convertible bond portfolio: reference portfolio should be convertible bond index, even though it comes along with embedded derivatives. Another example is currency hedged fixed income indices.
b. If risk/return changes frequently it is still possible to measure against reference portfolio (e.g. -100 <-> + 100, including neutral exposure).
c. Point 50. not identical: fund may add 100% exposure, have 2 times the risk of ref portfolio.
d. Point 51. 130/30 could have long only ref portfolio.

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e. There is no clear distinction between "derivative-free" and "leverage-free" (see explanatory text pt. 45 and 51 vs. Box 11 Pt.2.1). Basically derivatives should be allowed as part of the comparable asset portfolio as long as (a) they do not cause additional leverage in the comparable asset portfolio (refer to the rules applied for calculating commitment under 2.1.2 and 2.1.3) and (b) help to create a better fit to the risk profile of the fund. Inter alia derivatives should be allowed in order to replicate leverage free and eligible index (for instance commodity indices). Other examples could be: funds that deal significantly with volatility (eg. volatility swaps), credit spreads (eg. CDS), or commodities could have as a benchmark component a volatility index (eg. VIX), a basket of CDS (eg. ITRAXX), or a commodity index (eg. IPD).

25. Do you have any alternative suggestions?

We don't have any alternative suggestions.

3.4 Absolute VaR approach

26. Do you agree with this description of absolute VaR?

Yes, we agree.

3.5 Minimum requirements for VaR approach

3.6 VaR approach: Quantitative requirements

3.6.1 Calculation Standards

27. Do you agree with the calculation standards proposed for the VaR approach?

We think this should be left to the discretion of the national supervisory authorities. However, we do not support the proposed approach of setting a maximum VaR of 20%. We would like to encourage CESR to implement high principles which allows a case by case approval of the regulator in case a maximum limit is exceeded.

28. Do you agree with the proposals regarding setting different default parameters and rescaling?

Yes, we agree.

29. Do you consider the examples for the rescaling of parameters are useful in providing further clarity?

Yes, we agree.

30. Do you have any alternative suggestions?

We do not have any alternative suggestions.

3.6.2 Risk Coverage

31. Do you agree with the requirement regarding the risks which should be taken into account in the VaR model?

Event or default risk is an integral part of the VaR calculation (e.g. via credit spreads) so that no clear separation seems to be possible.

3.6.3 Completeness and accuracy of the risk assessment

32. Do you agree with the proposals regarding the completeness and accuracy of the risk management process?

We agree with Box 16 and the explanatory text.

3.6.4 Back Testing

33. Do you agree with the proposals regarding back testing of the VaR model?

Yes, we agree.

34. Do you have any alternative suggestions?

Box 17 point 6 last sentence: it should be up to the UCITS to define the measures to improve the VaR model and take appropriate actions and not to the regulator to change the methodology. However the UCITS/Management Company has to disclose the measures taken to the regulator.

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3.6.5 Stress testing

35. Do you agree with the proposals regarding the VaR stress testing programme?

In general we agree with the approach outlined in the paper. However, the challenge for the asset managers in performing stress tests is to adequately analyse and implement measures for the UCITS, i.e. plausibility test of model as well as direct implications on the investment strategy (e.g. risk reduction).

36. In particular do you agree with the proposed quantitative and qualitative requirements?

Yes, we agree.

37. Do you have any alternative suggestions?

No, in general we agree.

3.7 VaR approach: Qualitative requirements

38. Do you agree with the proposed tasks under the responsibility of the risk management function?

Yes, we agree in general.
However we understand that for the case the global exposure is calculated with a VAR approach there is no additional calculation of the leverage of the UCITS. We think that a VaR approach combined with the cover rules (cf. paragraph 5) would be adequate to limit and thus monitor the global exposure of a fund. An additional monitoring of the leverage using the commitment method is not considered adequate for a UCITS using VAR approach.

39. Do you agree with the requirements regarding model testing and validation?

A review of the risk models should take place on a regular basis. Thus we agree that an independent oversight needs to be established, but we believe that this is already captured sufficiently by internal and external audits. Furthermore, we are of the

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opinion that as long the risk controlling function fulfils all the relevant criteria concerning the independence, the technical model validation should stay within the risk controlling function to avoid costly duplication of work.

3.8 VaR: Additional safeguards and disclosure

3.8.1 Additional safeguards

40. Do you agree with the proposals regarding the monitoring of leverage and the use of other risk measurement methods?

No, we believe with regard to Box 22 paragraph 1 that the VaR approach sufficiently covers the monitoring of leverage in derivatives. In addition CESR should take into consideration that its proposals regarding the monitoring of leverage causes additional administrative burden and will probably not reflect positively on perceived quality of VaR models. It seems also redundant as a high leverage should be captured by VaR or at least within the stress testing programs. We are of the opinion that the cover rules would also be an additional safeguard to prevent the UCITS from an inadequate global exposure.

3.8.2 Disclosure

a) Prospectus

41. Do you agree with the proposals regarding prospectus disclosure?

We do not agree. Information about the method used for the calculation of global exposure as well as the level of leverage might be difficult to understand for investors in mutual funds. We worry about some level of confusion, especially as the KID makes use of the SRRI to inform the investor of the level of risk taken.

42. In particular do you agree that UCITS using VaR to calculate global exposure should disclose the expected level of leverage in the prospectus?

No, we do not agree. The KID (SRRI) is more effective and up-to-date than a VaR figure in the prospectus (ref 41). As the leverage may frequently change over time especially under different market conditions we don't see an added value for investors in giving a rough estimated expectation of leverage and do frequent changes to the prospectus when leverage changes in major dimensions over time.

43. Do you agree with the proposed method of calculating leverage for the purposes of prospectus disclosure?

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We disagree because the proposed method of calculating leverage is not consistent with the commitment approach and does not give a valid estimate of the ‘leverage’ in the portfolio (e.g. Interest Rate Swaps notional amount are not indicative of the inherent leverage of such a position).

As outlined above we do not agree that the leverage should be calculated and published. If CESR expects the industry to do so costs for a UCITS will increase significantly as when using a sophisticated VaR approach a more or less non-sophisticated approach to calculate the leverage is needed, too. VaR in conjunction with stress testing should be adequate.

b) Annual reports

44. Do you agree with the proposals for disclosure in the UCITS annual reports regarding the VaR methodology?

We disagree since the investor should receive consistent information to compare UCITS. This is part of KID discussion. Please refer to questions 41-43.

4 OTC Counterparty Risk Exposure

4.1 Collateral

45. Do you agree with the proposals in Box 25? In particular, do you consider that the proposed criteria for the acceptability of collateral to reduce counterparty exposure are appropriate?

In general AGI agrees with the proposals in Box 25. At a high level, collateral management is the function responsible for reducing counterparty risk in unsecured financial transactions. Collateral is used to provide security against the possibility of payment default by the opposing party in a trade. Examples of transactions involving credit risk include over the counter (OTC) derivative deals (e.g. swaps, swaptions, credit default swaps, CDOs) and business-to-business loans (e.g. repos, total return swaps, money market transactions, term loans, notes, etc.). Collateral of some sort is usually required by the counterparties in these transactions because it mitigates the risk of payment default. Collateral can be in the form of cash, securities (typically high grade government bonds or notes, stocks, etc.).

AGI welcomes CESR’s idea of not imposing an exhaustive list of eligible instruments for collaterals, but rather to define fundamental and high principles for collateral.

We concur with CESR’s liquidity principles as set out in Box 25 that any collateral posted must be sufficiently liquid. We also agree that “stale prices” should not occur. Nevertheless we would like to stress that such occurrence is not always within the control of the UCITS. A liquid instrument may become illiquid at a certain point in time. Thus, rather than impose a prohibition, we recommend introducing an obligation to impose mitigation measures in order to avoid UCITS holding collateral with stale prices.

We would like to encourage CESR to define the correlation between OTC counterparty and collateral. Collateral issuer credit quality, correlation with OTC counterparty and collateral diversification should be considered by the Management Company in a consistent manner. Single guidelines for each of the three dimensions should be avoided.
We fear that the proposed collateral diversification rule might counteract an efficient portfolio management. We would like to stress that collateral solely represents a security that is relevant in the case of counterparty's default. It would be therefore appropriate to provide principles based on the consideration of a combination of the quality of the collateral and of its diversification (very high quality of collateral with few or no diversification requirements and vice versa). This would reflect the consideration of the risk of a concurring default of the counterparty and the collateral issuer. It should be clear that collateral diversification rules should only apply "if" there is an obvious risk.

We have strong reservation regarding the proposal to prohibit UCITS to re-invest collateral. In order to take into consideration the additional risk that UCITS are exposed to, UCITS should be allowed to re-invest cash-collateral received from a counterparty under the condition that the additional market risk is reflected in the Global Exposure calculation (calculation methodology to be defined). In particular, where a UCITS accepts cash collateral, it must be in a position to re-invest the money in order to generate the yield which an OTC counterparty usually expects for cash collateral.

We would like to draw CESR's attention to the fact that in general it is not possible to trace if the collateral is subject to a re-hypothecation by the counterparty.

46. Do you have any alternative suggestions?

AGI deems further clarifications on the role of the depositary/custodian bank in case collaterals are held with the depositary/custodian and in case collateral are held with other parties than the depositary/custodian as useful for the industry.

47. Do you consider that it would be useful to include some examples of minimum haircuts for different asset classes? Do you have a preference on what these haircuts might be?

AGI considers indicative haircuts as very useful for the fund industry. For the valuation of the collateral presenting a significant risk of value fluctuation, UCITS should apply prudent discount rates. In this context it is to be noted that collateral in a currency other than the currency of exposure should also be the subject of an adjustment for risk of currency mismatch.

The definition of haircuts is usually subject to market standards and guidelines and should be therefore left to the UCITS. On the other hand, we would like to encourage CESR to propose high principles for indicative haircuts. In addition, we would welcome if CESR clarifies which levels should be applied to thresholds of collateral and minimum margin calls.

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4.2 Counterparty/issuer Concentration

48. Do you agree that exposure to a clearing house should be considered as part of the counterparty exposure limit? Do you have any alternative suggestions?

Provided that the clearing house complies with the following three conditions, we understand that all transactions on derivative financial instruments executed on a market could be excluded from the calculation of the use of counterparty risk limitations:
- backing by an appropriate completion guarantee;
- daily valuation of the market values of the positions on derivative financial instruments; and
- making margin calls at least once a day.

AGI expects that the introduction of Central Clearinghouses, as planned by global regulators in the case of CDS, will meet the above-mentioned criteria.

49. Do you agree that margin passed to a broker which is not protected by client money rules should be included in the counterparty exposure limit? Do you have any alternative suggestions?

No further comments.

50. Do you agree that exposures to a counterparty generated through stock-lending or repurchase agreements should be included in the OTC counterparty exposure limit? Do you have any alternative suggestions?

AGI agrees with the approach proposed by CESR - although the wording of the UCITS directive solely refers to "risk exposure to OTC counterparty in an OTC derivative transaction…".. AGI understands that there is no clear legal basis for this approach.

51. Do you agree that a UCITS position exposure should be calculated using the commitment approach?

No further comments.

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5 Cover rules for transactions in Financial Derivative Instruments

52. Do you agree with the proposed cover rules for financial derivative instruments?

Yes, we agree with the proposed cover rules for financial derivative instruments. As mentioned under 3.8.1 we would see cover rules as an additional safeguard to the VaR approach – for a fund using a commitment approach we are of the opinion that this is inherently included and thus no separate cover rule needs to be applied.

53. Do you think there should be further restrictions on the assets held by the UCITS as cover?

No, there should be no further restrictions; however, the UCITS should perform an appropriate assessment regarding the liquidity level of the assets held in order to ensure that they can be converted into cash on very short notice at a price corresponding closely to the current valuation of the financial asset on its market.

6 Glossary of Terms

54. Do you agree with the proposed definitions?
55. Do you consider that CESR should provide other definitions in these guidelines? Do you have any suggestions for other definitions?

We agree with CESR's proposed definitions. One remark for "Specific market risk": default risk may be added here.

CESR's initial views on specific guidelines for structured UCITS

56. Do you consider that these types of structured UCITS should calculate global exposure using an approach which differs from the standard VaR and commitment methodologies?

We welcome the discussion on the global exposure calculation for some structured funds. However the criteria for defining structured funds - inter alia having a predefined maturity- seem to be too strict. There are also funds with a structured/passive investment approach aiming to generate a clearly described pay-off which does not have a maturity – i.e. the definition of structured funds should be defined more broadly.

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We agree that such funds asking for an alternative calculation method should have a structured investment approach which – however, we think that not only passively managed funds should able to benefit from the possibility to have a different calculation approach.
We kindly ask CESR to define alternative risk measurement principles acceptable for such structured funds.

57. If you agree that a different commitment calculation should be permitted, please provide a rationale for this approach.

The approach is sufficient to avoid that NAV becomes negative in such structured funds.
The rationale of max loss approach would be the special features of these products (e.g. known pay-off, defined maturities and passively managed with no changes in the life-time of the fund).
As a general comment, we are fine with all the criteria as specified but believe that they only focus the approach on a subset of structured funds with passive investment strategies.

We kindly ask CESR to define further alternative risk measurement principles acceptable for actively managed structured funds.

58. Please indicate which of the above criteria would provide sufficient safeguards for investors in UCITS which apply this approach

We do not agree with the too strict criteria since this will limit the possibility to have beside the VaR/commitment approach another approach to calculate the global exposure to just a very limited range of funds.

The limitation of the fund maturity date to 9 years is not appropriate as a general investor safeguard. Such limitation should be considered on a case-by-case basis depending on the exact structure of the fund and disclosed to the investors. See our general comment above.

59. Can you suggest any additional criteria?

No – we think it might be good to analyze the possibility to give derogation to the standard approaches further.
For structured funds it should be contemplate if global exposure is an adequate way to limit the risk. In certain market situations it is possible for structured funds that the VaR is higher than twice VaR of the benchmark. In this case there is no chance to reduce the risk without changing the payoff function of the fund. But the payoff function is stated in the prospectus and hence in our opinion this limit breach should not cause any transaction which distorts the payoff function. The most important thing regarding the risk of structured funds is to keep the payoff function, because this is the amount the investor expects to achieve, and to ensure that the NAV could not be less 0. In our opinion sufficient and appropriate safeguards for this are the coverage rules and the limitation of counterparty and concentration risk. Compliance of the payoff function should be monitored regularly, too.