CESR

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	BSBV 64/2009 Dr. Rudorfer/Ob	3137	13th July 2009

CESR - Risk Management Measurement for UCITS

The Bank and Insurance Division of the Austrian Federal Economic Chamber, representing the entire Austrian Banking Industry, would like to comment on the paper „Risk measurement for the purposes of the calculation of UCITS global exposure" as follows:

Generally speaking we appreciate that CESR follows the principle of the recommendation of the EU-Commission of 27th April 2004 (2004/383/EC) that UCITS funds can apply either the smplified risk management approach (commitment approach) or the sophisticated risk management approach (VaR). It is in the duty of the senior management to decide which risk management approach is best suited fort the inidividual UCITS fund managed.

Regarding the questions asked by CESR we would like to answer as follows:

I) Commitment Approach

1. **Do you agree with the proposed approach in relation to the calculation of global exposure?**

2. **Should the counterparty risk involved in an OTC derivative be considered in the calculation of global exposure**

We agree with the concept presented by CESR in relation to he calculation of global exposure and think that counterparty risk involved in an OTC derivative is not considered in the calculation of global exposure. Global exposure should only comprise marktet risk. Market risk is divided into the systematic an unsystematic risk. The inclusion of counterparty risk would lead to double counting of risk which cannot be justified.

3. **Do you agree with the proposed approach or can you suggest an alternative approach?**

4. **Do you agree that the incremental exposure/leverage generated through techniques such as repurchase and securities lending transactions should be included in the calculation of global exposure?**

Referring to the example mentioned in the text (generation of leverage through the reinvestment of collateral) we can agree with CESRs view.

5. **Does option 1 correctly assess the market risk linked to investment in the corresponding instruments, and if so please explain?**

6. **Does option 2 correctly assess the market risk linked to investment in the corresponding instruments, and if so please explain?**

7. **Do you have any comments or other suggestions regarding other possible measurement approaches?**

Option 2 should is the preferable option and should be the proper risk measurement method.

The delta adjusted methode to measure the risk exposure is a generally accepted approach and reflects at best the actually risk exposure. Option 1 has the main disadvantage, that the market value could be extremly low in comparison with the actually risk because of the leverage.

8. **Do you agree with the proposed approach, in particular the inclusion of a non-exhaustive list of financial derivatives?**

9. **Do you have any alternative suggestions for the conversion method?**

10. **Are there other types of financial derivative instruments which should be included in the paper?**

11. **Are you aware of any type of financial derivative instrument where global exposure cannot be calculated using the commitment approach?**

12. **Do you agree with the approach regarding TRORS and derivatives with cash or an equivalent position?**

A list of examples how to convert certain derivative instruments into their underlyings is helpful to achieve a common risk management standard for the risk measurement of UCITS in the EU.

We have combined our answers to point 1.4 and 1.5 of the consultation paper as both topics seem to be interconnected. We agree with CESRs view in point 1.5 that total return swaps which do not provide incremental exposure or leverage will not have to be taken into account in the commitment approach calculation process, as a total return swap only exchanges the performance of the portfolio held by the UCITS into the performance of the portfolio held by the counterparty.

We only think that the same principles applied to total return swaps in point 1.5. should also be applicable when answering the question of proper conversion of forward Fx and swaps contracts mentioned in point 1.4.. When the forward FX or the swap contract do not subject the UCITS to the market risk of the asset held and when it does not include leverage clauses or additional risks as compared to a pure holding oft he reference financial asset, the contract should not be taken into consideration for the purpose of the calculation of the total commitment.
A clarification of the conversion formula in point 1.4 concerning forward FX and swaps engagements seems to be necessary in order to avoid inconsistancies

13. Do you agree with the proposed use of the sensitivity approach?

14. Do you consider that this should be compulsory for these types of derivative or optional for UCITS?

Austrian funds currently do not apply the sensitivity approach, but from our point it could be a proper extension of risk measurement tools. We therefore think that the sensitivity approach should only be optional for UCITS funds.

18. Do you agree with the proposals regarding netting?

19. Do you have any additional comments and/or proposals?

20. Do you consider that hedging as described above should be permitted?

21. Do you consider that the strong correlation requirement should be further clarified by means of a quantitative threshold e.g. 0.9?

22. Can you suggest a possible threshold e.g. for the minimum correlation

We support the general comments delivered by CESR on the netting of cash instruments with derivative instruments and the netting of derivative instruments. What we do not understand is the intention when differing between the netting of cash and derivative instruments held by simple structured funds and the netting of cash and derivative instruments when implementing special investment and hedging strategies. In the latter case netting of derivatives should not be allowed according to CESRs view. We would like to receive some more clarification on this issue.

To our mind the last sentence of point 1.7.1 is not complete. Concerning risk management of funds of funds netting of derivatives held by sub-funds with derivatives held by the funds of funds should be possible. We think the term „directly“ (..derivative instruments and assets held directly by UCITS..) could be deleted.

Furthermore we do not think that the strong correlation requirement should be clarified further as this process is agreed in the risk management departement on an individual base in coordination with the auditor of the fund.

II) VaR Approach

25. Do you agree with the above approach?

26. What additional safeguards (if any) are necessary for UCITS which use VaR to calculate global exposure to ensure consistency with the total exposure limit of 200% of NAV?

We agree with CESRs view. We think that both the relative VaR approach and the absolute VaR are possible risk measurement methods for UCITS funds. CESR should stick to the opinion that UCITS funds which apply the VaR approach may generate higher levels of leverage than that which would be allowed were the same positions measured using the commitment approach.

27. Do you agree with the approach outlined in paragraphs 2.3, 2.4 and 2.5?

28. Do you have any comments or suggestions?

29. Do you consider that VaR should be calculated at least daily?

30. What type of criteria should competent authorities take into account in an assessment of the VaR Models?

31. Do you consider that VaR models should be approved by competent authorities?

As there have been discussions on the national and EU level how to calculate absolute VaR VÖIG strongly supports the view of CESR where it is said that the absolute VaR is calculated on a portfolio basis and the calculation is not restricted to the derivate instruments held by the UCITS (point 2.5. second paragraph says that all cash and derivative instruments in the portfolio should be taken into account; point 2.8. first paragraph mentions the calculation of VaR of the UCITS funds).
We would appreciate if CESR could further clarify this view regarding the calculation of the absolute VaR.
We do not think that competent authorities should be obliged to approve VaR models, especially on an ex-ante base. From our view competent authorities should focus more on the risk management processes implemented by the management company than approving risk management models. The senior risk management is obliged to check the risk models on an ongoing base and adapt risk management models if they are not able to cope with the model requirements (backtesting). This process should be surveyed by the competent authorities.

35. Can the absolute VaR be considered as an appropriate way of measuring global exposure?

36. Do you consider that the proposed thresholds are suitable? Can you suggest other thresholds?

37. What are your views on the application of stricter criteria to difference types of asset classes e.g. bonds, equities?

We support the view of CESR that the absolute VaR is a proper risk management method for UCITS funds. Absolute VaR measures the potential loss of UCITS funds and should be easily explainable to the public.

We do not understand that a maximum absolut VaR-limit of 20% of the UCITS net asset is proposed. We think that this ceiling will avoid offering certain funds products to the public (certain ermerging markets products etc) and will cause damage to the European funds industry. Please be aware that the Eurostoxx 50 in November 2008 has reached the absolute VaR level of 20%. Furthermore we do not understand the proposal of a holding period of 20 days, as we thought that a ten day period is the typical holding period as for example required to compute capital requirements under the European Capital Adequacy Directive (CAD).
The Austrian funds industry has agreed with the national competent authorities a maximum absolut VaR ceiling of 30% of the NAV of the funds for a holding period of ten days. We think that this ceiling would be a better limit for offering a wide enough range of investment funds products to the public.
We also would like to ask what will happen to already existing funds which have a higher absolute VaR ceiling than 20% if the European Commission sticks to the 20% absolute VaR ceiling. If the 20% absolute VaR ceiling on an EU-level cannot be avoided, we strongly propose a grandfathering rule for UCITS funds which already have been been launched and can surpass the 20% absolute VaR ceiling.

The scalation on page 16 is based on the delta-normal approach and cannot be applied to other VaR models, but other VaR models should also be possible.

Globally speaking we think that any definition of an absolute VaR ceiling for individual funds should be laid down by the senior management of the management company. To our mind it is not necessary to lay down absolute VaR-limits on the EU-level.

38. Do you consider the proposed safeguards, such as the use of appropriate additional risk management methods (stress-testing, CVaR) and the disclosure of the level of leverage, are sufficient safeguards when the absolute VaR method is used in the context of arbitrage strategies or complex financial instruments?

39. Should UCITS using strategies that are potentially highly leveraged under the absolute VaR method be subject to specific marketing provisions, either at the level of the UCITS (minimum initial investment) or during the marketing process?

We think that the UCITS brand is a key investments product in the EU for retail investors. Therefore one should take care of the UCITS brand and should not split up UCITS funds into different resp. two different sets of marketing products (for example creating a new UCITS fund product with minimum initial investment). Additional information in the prospectus on the leverage and the maximum VaR should be sufficient to fulfil the information duties required by the UCITS Directive resp. the MIFID Directive.

45. Do you agree with the proposed approach to agree a set of principles in relation to acceptable collateral to reduce counterparty exposure? Do you have alternative suggestions?

46.Do you consider that rather than following principles based approach specific instruments that can be used as eligible collateral should be indentified?

47. Should collateral be UCITS compliant in terms of asset eligibility and diversification?

We think that a principle based approach as proposed by CESR is the proper way for structuring the theme complex collateral as regards caluculation of counterparty risk. We do not think that collateral should be UCITS compliant as it is not the intention of the funds that collateral becomes an investment underlying for UCITS funds. Collateral is received as cash equivalent and must be sufficiently liquid in order to be sold immediately.

51. Do you agree with the proposal to abandon the use of the term sophisticated and non-sophisticated UCITS?

Yes.
In our view the VaR approach is just one of many ways to measure something out of a specific view. VaR does not, as any other methodology, calculate the whole risk and could only give an indication of a potential loss. But it is by far not clear, that the VaR approach is the best approach in any situation. VaR is only a little bit more complicated, than other methods.

52. If you object to this proposal could you please provide reasons for this view?

We do agree with the proposal by CESR to abandon the use oft he term sophisticated and non-sophisticated UCITS for risk measurement purposes. The wide range of criteria which could be used for arguing in favor of applying a sophisticated or simplified risk measurement approach have not worked very well in practice.

We hope that our remarks will find agreement of CESR. Many thanks for giving the opportunity to consult on the CESR paper.

Yours sincerely,

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