CESR/08-616

Dear Sirs,

Response by FIL Investments International
Risk Management Principles for UCITS: Consultation Paper

The question of risk is clearly key to the continued health and proper management of UCITS, and having a consistent approach to the supervision of risk by regulators is essential, particularly for a firm such as Fidelity which operates and has funds in several EU jurisdictions.

Our detailed responses are in the attached appendix, but there are a few high level points we would like to make.

Definitions and vocabulary
In the paper the following terms are used: risk management process, risk management, risk management systems, risk management function, risk management policy and risk management tasks. While some of these terms are defined in part (for example the risk management function is characterised as having specific roles in Box 3) they are not always used consistently and at times this leads to confusion as to the extent of CESR's suggestions. It would he helpful if CESR provided some guidance by extending the definitions section.

Similarly, we feel that splitting risk into sometimes arbitrary categories can create a loss of focus. If, as seems sensible, the overall mantra is "identify, measure and limit the risks to which your investors are exposed" that does not need qualification by risk type. For example, "operational risk" can actually become "credit risk" by the time it hits the investor – i.e. whether the culprit can afford to see the investor right. It might be better, particularly for a set of principles, not to attempt any categorisation at the outset.

Devolved v. centralised systems
In some firms risk is managed by processes and responsibilities embedded within the routine business process. Oversight of that management may be located within a separate risk management function, but it might equally well be located in whole or in part in compliance, internal audit or other supervisory and oversight structures. This is recognised to an extent in paragraph 14, but that seems to us to still imply a default to a large centralised function model, whereas the emphasis should be on what works best within the organisation concerned.

Which risks are covered?
In Box 5 CESR states that "The risk management process should assess and address all risks relevant to the UCITS". In Box 10 it states "The risk management policy….should provide…a system of limits concerning the measures to monitor and control the relevant risks". In Box 11 we have "The risk management policy should define procedures that, in the event of breaches to the risk limit system of the UCITS, result in a prompt correction of the portfolio…"

We are concerned that the statements in Boxes 10 and 11 are not consistent with that in Box 5. Not all risks faced by a UCITS are capable of being addressed through a system of limits, though many are. Similarly, some risks are not necessarily mitigated by corrections in the portfolio. In seems that Boxes 10 and 11 are simply concerned with investment risk (and in the case of 10 some aspects of operational risk), but have not been specifically limited in their application. This could result in poor risk management processes being deployed.

Yours faithfully,

Gareth Adams
Executive Director - Regulatory Strategy
FIL Investments International

Section of the document	**Comment**
INTRO AND DEFINITIONS	In the context of the paper it is unclear how the terms for “risk management”; “risk management process”; “investment risk management process” and “risk management functions” are defined and applied. In particular there seems to be an assumption of a centralised risk structure rather than a devolved one, despite CESR stressing the need for coordination between the risk and the business process (paragraph 15). We feel that a more defined approach to the various components of the risk management environment for UCITS would add clarity to the expectations.
PART 1 - SUPERVISION	**Box 1** We have a comment on the “monitoring on an ongoing basis” proposal. We understand this is to be performed by the competent authorities but it would be helpful if CESR could set out some guidance on how it expects this to be accomplished. There is a risk, otherwise, of differing reporting requirements being imposed on UCITS and investment managers. It might be helpful, for example, to suggest that absent significant developments some form of annual review is the baseline standard. Firms could then plan work accordingly to support the competent authorities’ effort.
	Paragraph 5 It would be helpful if the assessment of the risk management process as part of the licensing application could be described/defined further to streamline the proceedings.
	Paragraph 6 It is not clear whether the requirement to assess changes to the risk management process (or should that be risk management policy or risk management function?) applies to the UCITS or to its regulator. If the latter, what is the notification process and approval process with which the UCITS must comply? Further, should the concept of change be confined to material change?
PART 2- GOVERNANCE AND ORGANIZATION OF THE RISK MANAGEMENT PROCESS	**Box 2** In general we understand that a risk policy covers the high level principles of risk management within the organisation and the key governance and functional aspects thereof. It is likely that details will be described in specialist risk manuals and technical documentation as well as operational procedures in individual organisation and procedural manuals to support the overall policy. In that context is it not more equitable to make the Board of Directors responsible for the design, content and implementation of the policy, rather than its many individual components which they are not obliged to approve or review?

PART 2 - GOVERNANCE AND ORGANIZATION OF THE RISK MANAGEMENT PROCESS	**Box 3** CESR is making an assumption that risk management tasks are carried out by a separate risk management function. This may be true if a risk controlling function consists of investment compliance and investment risk management departments monitoring regulatory limits etc for example. However, it is very common for operational risk management to be built into the trading, settlement and valuation process by way of identifiable risk management processes within the respective departments.
	Paragraph 8 In focusing on the idea of a segregated risk management function CESR runs the risk of creating a focus and responsibility for risk that resides outside the business process itself. This seems sub-optimal and fails to recognise the possibility of a more sensibly devolved model. The references in paragraphs 8 – 12 to the risk management function should more properly be directed at all those areas and resources with a risk responsibility.
	Box 4 We support the proposals on outsourcing and believe they are consistent with the principles set out in MiFID and its implementing Directive, to which reference could perhaps be made. Indeed we would support inclusion of the MiFID criteria here as offering a greater degree of consistency across the EU.

PART 3 - IDENTIFICATION AND MEASUREMENT OF RISKS RELEVANT TO THE UCITS	**Box 5** We agree that the risk management process should assess and address all risks relevant to the UCITS. However, several of the later proposals (including those of Boxes 10 and 11) seem to assume that only certain risk types are covered.
	Box 6 The reference in item 2 to the "concentration and interaction of relevant risks at the portfolio level" does not make sense in respect of certain types of operational risk, while being clearly appropriate for certain types such as market, and counterparty risk. The statement in paragraph 31 seems at odds with the universal obligation of the risk environment set out. It would also assist if there could be a clearer reference to the measurement of liquidity risk. According to CESR proposal, the computation of quantitative risk management measures should cover liquidity risk. Such risk is usually dealt with by monitoring of asset in- and outflows and management of liquidity level in the fund which can be divided amongst several asset classes. As regards employment of further quantitative measures, we feel management companies should be given sufficient flexibility to allow for the differing characteristics of the managed UCITS as well as divergences in their business models, investor profile and so forth.

PART 3 - IDENTIFICATION AND MEASUREMENT OF RISKS RELEVANT TO THE UCITS	**Box 7** We feel it would be helpful for some concept of prioritisation to be introduced. Where models are industry standard and apply to relatively small amounts for a UCITS it seems counter-intuitive to apply the same level of re-testing and reassessment as a proprietary model dealing with material amounts. For example, the requirement to back-test every technique (as per paragraph 33) could be wasteful if applied without thought.
	Box 8 The link between risk measurement and asset valuation is not a straightforward one. While it is reasonable that expertise from risk management should provide appropriate support to the valuation process we would note that the valuation of assets and the measurement of risks are two very distinct processes albeit the models used for each approach are closely aligned. Not least would we point out that in Fair Value Pricing a UCITS is obliged to adopt a "fair value", while from a risk perspective a "worst case scenario" might well be an appropriate approach, dependent upon avowed risk appetite.

PART 4 - MANAGEMENT OF RISKS RELEVANT TO THE UCITS	**Box 10** As noted in the covering letter, the use of limits as envisaged may not work for all areas of relevant risks. The concept of some form of shadow set of limits can make sense, and it is not unreasonable for the Directors to agree measures that are relevant to the risk profiles of particular funds. However, having said that, we feel that "measures" as opposed to "limits" might be a more appropriate term. Managers are bound to manage a UCITS within the limits set by the UCITS legislation and the terms of the fund's own prospectus. Paragraphs 45 and 46 rather imply that what CESR has in mind for such shadow limits are essentially "hard" limits, a perception that is reinforced by Box 11. If a manager is managing UCITS to such "hard" limits they should be expressed within the prospectus to avoid the investor being mislead and any modification to the UCITS limits structure should be processed through amendments to the Directive.
	Paragraph 45 It is not possible to ensure that every transaction is <u>immediately</u> taken into account in the calculation of the corresponding limits without carrying out continual valuations of the UCITS. "Immediately" should be taken to mean with reference to valuation points.
	Box 11 As noted in the covering letter, not all risk limit breaches can be fixed or mitigated by portfolio corrections. This implies this Box applies only to a limited family of risks. It would also help to know what 'prompt' means. We would support a formulation that distinguished between inadvertent and advertent breaches and which required that any correction should be taken with thought given to the best interests of the investor.