

**Irish Funds Industry Association's response to CESR's Consultation Paper
"CESR's Guidelines on Risk Measurement and the Calculation of Global
Exposure for certain types of structured UCITS"
CESR/10-1253**

The Irish Funds Industry Association (IFIA) is the industry association for the international investment fund community in Ireland, representing custodians, administrators, managers, transfer agents and professional advisory firms involved in the international fund services industry in Ireland. Given that as of the end of October 2010 there were total Assets under Administration of approximately €1.7 trillion, with 2,879 Irish domiciled UCITS funds, including sub-funds, with a Net Asset Value of €727 billion, all developments in the UCITS arena are of particular interest and relevance to the Irish industry. The IFIA welcomes both the publication of and the opportunity to comment on CESR's consultation paper on Guidelines on Risk Measurement and the Calculation of Global Exposure for certain types of structured UCITS.

The IFIA acknowledge the substantial contribution made by CESR and welcomes CESR's technical advice to the Commission focusing on risk measurement for the purposes of calculation of UCITS' global exposure, we have answered the questions in the consultation paper and included some additional general comments below.

General Comments:

- Point 96, page 5: "... must not actively market their units". Should the industry interpret this as a closure of the subscription possibility, or is it acceptable to not promote the product explicitly with the distributors, on the internet, etc. The strict interpretation may have an impact on the pricing of the derivative counterparties as they know the direction of the trades in the secondary market (i.e. only sells).
- The payoff definition in examples 1 and 2 on page 6 seems to be erroneous because the payout formula is not closed. The first clause "performance of one of the shares" should be replaced by "performance of all of the shares."
- We understand from these 4 examples provided that the 10% rule is envisaged only.
- Page 8-9: The economic difference between Case 2 and Case 3 is very limited, but it makes a very significant difference in applicability of the alternative approach. Definitely in light of the current issues with EU Government paper, the definition of "risk free

assets” becomes very challenging. We agree that having cash invested in non-risk free assets, should lead to an increment of the product’s global exposure, but do not agree that the difference between eligibility and non-eligibility is so digital, given the limited economic difference between both structures. For those that choose to structure products through route 3, this would make this extension of CESR/10-1253 of no use. Also, what if the risk-free asset starts to become non-risk free, no transition mechanism from one to the other calculation is included. Additionally, the demand to invest in a 3-month investment (defined as “risk free”) creates a re-investment risk for the fund. This is also not taken into account in this calculation.

- We think that the difference between “risk free” and “high quality-low risk” is arbitrary and there is a risk this will not be stable in the future. On the other hand, since a total return swap for 100% of the fund is acceptable (Case 1), the fund might be exposed to 100% credit risk to one counterparty (covered by collateral, with much less strict rules). We do not see how this risk can be categorised as lower than the risk of a diversified portfolio of “high quality-low risk” assets.
- As the “global exposures” rules try to look at the total risk or market exposure of a fund, we are of the opinion that funds with a comparable payout formula have to be allowed (or not), no matter what structure is used.

For example: take a 100% equity fund with a call option on top for 20% of notional of the fund. This construction would be perfectly acceptable (commitment approach for 20% notional, multiplied by delta (<1)) whereas a structured fund (structured as Case 3) would not be acceptable. This seems strange since the structured fund in Case 3 gives capital protection (delivered by the low risk diversified portfolio) where the equity fund doesn’t.

Specific Comments - Responses to individual questions, using the question numbers on page 10

1. We welcome that an alternative approach can be used for certain types of structured funds, but we consider the rules to be too restrictive. As stated, the difference between risk-free and low risk is not as digital as described in the document.
2. Yes, we agree with the criteria, except for:
 - e) We think that 9 years is too arbitrary
 - f) Closing a fund after the initial marketing period has an impact for investors in that a uniform market direction is shown towards the counterparties of the fund. Experience has shown that secondary market derivative transactions will become more expensive for the investor/fund.
3. Yes we agree on the scope.
4. No additional criteria necessary.

5. We see the choice of 9 years as too arbitrary, but do not object.
6. We would like to repeat the possible risk on biased pricing by counterparties. We would suggest formulating as “no longer actively marketed” rather than “closed for subscription.”
7. We understand and agree with the rationale on limiting the amplitude of the barrier jumps.
8. Yes we agree.
9. There seem to be errors in examples 1 and 2 (see above). Assuming that the text “performance of one of the shares” should be replaced by “performance of all of the shares” then the examples clarify the cases, at least for the 10% rule. If other diversification rules are envisaged in addition, other examples should be provided.
10. No, we agree with the approach.
11. The approach in Case 2 does not really clarify, and, as stated earlier, we do not see the necessity of a different treatment for Case 2 versus Case 3.
12. No.
13. Yes.
14. A number of criteria suggested in the rules, are not defined well enough, e.g. “high quality”, “low risk”. This leaves room for interpretation and divergence in the execution of the proposed regulation.