Amundi
ASSET MANAGEMENT

Committee of European Securities Regulators (CESR)
11-13, Avenue de Friedland
75008 Paris

Paris, 31st May 2010

AMUNDI INVESTMENT SOLUTIONS RESPONSE TO CESR'S CONSULTATION ON GUIDELINES ON RISK MEASUREMENT AND THE CALCULATION OF GLOBAL EXPOSURE AND COUNTERPARTY RISK FOR UCITS

Amundi Investment Solutions welcomes CESR's consultation on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS.

We support the AFG's response (attached to this letter).

We would like to emphasize especially the questions relating to structured funds (Q56-Q59). As explained in AFG's response, it is very important to make sure that a fair competition exists for structured products and it would not make sense to advantage structured notes over structured funds which, as narrowly defined in the AFG's response, offer much more protections to investors.

We also stress the importance of choosing the Option 2 for the sensitivity approach, as explained in AFG's answers to Q17-Q20.

Sincerely Yours,

(signed)

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EP/AGA/VH- n° 2721_05/Div.

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AFG RESPONSE TO CESR'S CONSULTATION ON GUIDELINES ON RISK MEASUREMENT AND THE CALCULATION OF GLOBAL EXPOSURE AND COUNTERPARTY RISK FOR UCITS

Ref.: CESR/ 10-108

The Association Française de la Gestion financière (AFG)[1] welcomes CESR's consultation on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS.

We want to thank CESR for having submitted such a high quality consultation paper.

Please see our detailed responses below:

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

Yes. AFG members agree with the proposed Level 3 Guidelines for the definition and scope of global exposure.

[1] The Association Française de la Gestion financière (AFG)[1] represents the France-based investment management industry, both for collective and discretionary individual portfolio managements.

Our members include 411 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing 2600 billion euros in the field of investment management, making in particular the French industry the leader in Europe in terms of financial management location for collective investments (with nearly 1600 billion euros managed from France, i.e. 23% of all EU investment funds assets under management), wherever the funds are domiciled in the EU, and second at worldwide level after the US. In the field of collective investment, our industry includes – beside UCITS – the employee savings schemes and products such as regulated hedge funds/funds of hedge funds as well as a significant part of private equity funds and real estate funds. AFG is of course an active member of the European Fund and Asset Management Association (EFAMA) and of the European Federation for Retirement Provision (EFRP). AFG is also an active member of the International Investment Funds Association (IIFA).

2. Do you have any alternative suggestions?

The global exposure is to be monitored on an ongoing basis.

We agree with this provision and would like that level 3 guidelines specify that it is the UCITS' responsibility to monitor the global exposure daily and therefore, since the UCITS is able to verify that the exposure guidelines are complied with on a daily basis, a daily computation obligation as such is not necessarily needed.

3. Do you agree with the proposed conversion methodologies for the different types of financial derivative instrument?

Yes, we agree to the methodology as displayed. Yet, we have one minor remark which consists to propose for better clarity to intercalate in Box 2 point 2 between the two bullets the level 2 provision stated just above by specifying that *"Identify where the use of financial derivative instruments does not generate any incremental exposure for the UCITS and exclude its underlying exposure from the commitment calculation"*.

4. Do you have any alternative suggestions?

The below proposition refers to Conversion methodologies – Standard Derivatives / Swaps heading:

- Interest Rate Swap (IRS) fixed/floating:

Market value or notional value shall be both kept as good alternatives of each other to calculate the exposure especially having in mind cases where for instance IRS are used for duration hedging purposes.

If the DV01 of the IRS of the paying fixed leg matches with the DV01 of the bond, then the resulting netted exposure calculated using the notional value of the bond and the notional value of the interest rate swap would end at zero, else the proportional MtM absolute value corresponding to the DV01 gap shall be accounted for the calculation of the global exposure.

- Currency swap & Currency forward:

We agree that the conversion method should consist in taking the notional value of the currency leg. In the meantime, it shall be clarified that for the needs of adding up the global exposure at the Fund level, the exposure must be translated in the Fund currency (which corresponds to the market value in the Fund currency).

As for IRS above, when used for hedging purposes, notional in the currency leg (of the hedging instrument) could be offset with notional as denominated in the said currency of the hedged instrument; otherwise the proportional MtM absolute value in the fund currency shall be accounted for the calculation of the global exposure.

5. Do you find the numeric examples useful in providing further clarity?

Yes.

6. In particular, do you consider that the use of the market (or notional) value of the underlying reference asset for a credit default swap is appropriate? Do you have any alternative suggestions?

In fact, the use of the market value of the underlying reference asset for a CDS does not always work properly since the underlying reference asset may have a life that is independent from the one of the CDS.

If a UCITS buys a corporate bond for a notional X and hedges it by buying a CDS from the same issuer and for the same notional X, the resulting netted exposure has to be calculated using the notional values of the bond and the one of the CDS, and the resulting exposure shall be equal to zero.

The reasons for using the notional of the CDS in that case rather than the market value of the underlying reference asset are as follows:

The features of the reference obligation of a standard corporate CDS may be different in terms of coupons and/or maturity than the ones of the bond from the same issuer that is hedged. The reference obligation of a CDS is usually used to indicate the seniority of the debt of the issuer but a standard CDS (with IMM dates as of 20 March, 20 June, 20 September, 20 December) can have a maturity date that is different from the one of the Reference Obligation, being itself different from the maturity of the bond to be hedged. That means that taking the price of the underlying reference asset of the CDS to calculate the global exposure in that case would introduce an additional interest rate risk valuation in the global exposure calculation that does not economically exist in the said hedging of the bond.

Also, there is not always a reference obligation associated to a CDS. For example Itraxx Europe main Index CDS 5Y (125 Investment grade entities from 6 sectors) has no reference obligation.

For above reasons, notional value of CDS need to be used as an alternative to the market value of the underlying reference asset, and in particular notional value needs to be used for the purpose of nettings when CDS are bought for hedging a long bond position from the same issuer.

An alternative methodology could be to use the sum of a) the notional value of the CDS and b) the market value of such CDS with the purpose of reconstituting the underlying reference asset that would actually theoretically correspond to the CDS.

7. Do you agree that derivatives which do not result in incremental exposure for the UCITS should be excluded from the global exposure calculation? If you do not agree please explain your answer.

Yes, we agree. This is accurate.

8. Do you consider that the examples provided in the explanatory text properly reflect circumstances which do not result in incremental exposure for the UCITS?

Yes, we consider that the example provided is appropriate.

9. Do you agree with the proposed definitions of netting and hedging?

We agree.

For the avoidance of doubt, nominal values of hedging instruments (such as: IRS in case of duration hedging of a long bond position, CDS in case of credit risk hedging of a long bond position, or currency hedging of any instrument denominated in the currency of such instrument), can be used when the hedging is effective for 100% of the notional of the hedged instrument. Otherwise, the proportional MtM absolute value of the hedging instrument (or the proportional nominal value in respect of CDS, please see above response to question 6) shall be taken into account for calculating the global exposure of the UCITS.

10. Do you agree with the proposed criteria for netting and hedging in order to reduce global exposure?

Yes, we agree.

11. Do you have any alternative suggestions?

No.

12. Do you agree with the examples provided of strategies where netting is possible?

Yes.

13. Do you agree with the examples provided where hedging is possible?

Yes.

14. Do you agree with the examples provided where hedging is not possible?

Yes.

In particular do you agree that so-called beta-hedging strategies may not be taken into account for hedging purposes when calculating global exposure?

Yes, we agree that beta-hedging strategies may not be taken into account for hedging purposes when calculating global exposure.

15. Do you agree with the proposed approach to the treatment of leverage generated through efficient portfolio management techniques?

We would like to indicate that clarification is needed because, following our understanding of the text, there may be an issue with the treatment of repo and reverse repo transactions as mentioned in Box 6 item 4 and in paragraph 23.

A further use of some repo (or reverse-repo) collateral as underlying to a new repo transaction *does not create any new risk as such*. There is no reason to add those securities to the global exposure calculation; only the collateral obtained in that 2nd repo transaction might possibly create risk if reinvested in risky assets, as mentioned in items 1 and 2.

Please see hereafter an example:

1. **First reverse repo transaction**: UCITS pays 100, receives stocks for 100 and commits to selling the same stocks for 100 at maturity date.

=> no market risk related to those stocks

2. **Second repo transaction**: UCITS sells stocks for 110, receives cash for 110 and commits to buy same stocks for 110 later-on.

=> no market risk as long as cash is not reinvested (ordinary treatment of repo according to items 1 and 2 of box 6)

3. **Unwind of operations**:

Second repo unwinds via UCITS receiving stocks and paying 110 (no PnL related to stocks MtM).

First repo unwinds via UCITS selling the same stocks for 100 (no PnL either).

=> no PnL even if stock's price has moved.

16. Do you have any alternative suggestions?

As a consequence (see our comment above to question 15), item 4 of box 6 should be deleted as well as last sentences of second and third bullets of §23 page 18.

Another remark from our members is to suggest that the risk free return be based on Eonia and not on Govies rates (as detailed in Box 6 paragraph 23, last bullet point on page 18). Indeed, it is common practice to use Eonia rates for non USD investments.

17. What are the advantages and disadvantages of each methodology?

We understand the sensitivity approach as a complementary method to the classic commitment approach that aims at reaching a more adequate commitment calculation for interest rate derivatives. In this perspective, Option 2 is a more appropriate method than Option 1 as Option 2 better suits with commitment calculation principles.

Indeed, Option 2 is based on the calculation of an underlying asset position that simply translates in "cash terms" the derivative's sensitivity to the underlying's changes in price. This conversion naturally allows for netting under specific and calibrated compensation conditions.

Thus, in our view, Option 2 is in line with the Basel II methodology as both are based on a sensitivity approach. Notwithstanding, it is worth mentioning that there is one major distinction between the two methodologies which accounts for the unmistakable difference in goals. Indeed, the Basel II methodology was designed for the calculation of capital requirements, whereas the sensitivity approach as detailed in Option 2 is redesigned to match with the global exposure calculation under the commitment approach. In our members' view, this makes an undeniable positive feature under Option 2.

In parallel, Option 1 sticks to a larger extent to the Basel II methodology and obtains results consistent with a capital requirements objective. In Box 7, Statement 2 estimates the capital requirement of each debt instrument as in Basel II methodology (see pages 169 and 170 of Annex)[2]. It can be interpreted as a VaR estimation and it is not coherent with the commitment approach of part 2 of the CESR document. It would be much better to use directly the general VaR approach in part 3 of the CESR document. Statement 2 is mixing the commitment and the VaR approach and is therefore confusing.

We are not sure to understand how these results convert in the end into a commitment calculation (Box 7, page 20). Indeed, Statement 8 proposes a conversion of the capital requirement (or VaR) into an exposure which has sense for Banks but not for UCITS (see page 12 of Annex). Therefore, our members fail to see how the use of a multiplier (12.5 in the

[2] Annex to : *International Convergence of Capital Measurement and Capital Standards A Revised Framework Comprehensive Version*
This document is a compilation of the June 2004 Basel II Framework, the elements of the 1988 Accord that were not revised during the Basel II process, the 1996 Amendment to the Capital Accord to Incorporate Market Risks, and the 2005 paper on the Application of Basel II to Trading Activities and the Treatment of Double Default Effects. No new elements have been introduced in this compilation.
BIS, June 2006
http://www.bis.org/publ/bcbs128.htm

text) is consistent with a commitment calculation approach for the sake of calculating global exposure for UCITS. Moreover, this conversion is not compatible with statement 1 of Box 14 of the general VaR approach (part 3 of the document).

Step 2 in Option 1 allocates instruments to different sensitivity zones. Compared to the maturity buckets proposed in Option 2 that are designed to encompass the main debt issue maturity points:

- Option 1 zones are less stable;
- Option 1 zones are defined based on volatility and correlation assumptions less up-to-date.

18. Which methodology do you consider more appropriate? Please give explanations and indicate whether additional safeguards should be included.

As stated above, our members favour Option 2 which is a steadier and adequate method for the purpose of global exposure calculation under the commitment approach than Option 1.

Also, as a more general remark, our members don't recommend leaving the two options open for this method. There should be one clear and harmonised methodology.

19. In the last step of Option 1, the total amount is multiplied by 12.5. Do you consider that (i) this takes due account of the sensitivity of the UCITS and (ii) that this is in line with the commitment conversion methodology (e.g. conversion of the derivative into the market value of the equivalent position in the underlying assets)?

(ii) As we have already mentioned in our answer to question 17, our members have remarked that using this multiplier is consistent nor with the commitment conversion method neither with the general VaR approach as clearly this is not a methodology designed to answer the specific needs of global exposure calculation. The resulting figures under Option 1 correspond to risk amounts that are meant to be used to determine the capital required.

(i) Option 1 does take due account of the sensitivity of the UCITS, however this is interesting only as part of the method in order to permit netting and hedging; the goal is not to compute sensitivities but to compute global exposure.

20. Under option 2 the target sensitivity of the UCITS can be longer than the sensitivity of the derivative while the equivalent underlying position is relatively small. This can result in high levels of leverage within the UCITS. Please provide views on the additional safeguards that could be introduced to mitigate this risk.

If the target sensitivity is in line with the investment strategy of the UCITS, the perceived gap between the UCITS target sensitivity and the derivatives' sensitivity is clearly contained.

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

Yes.

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

Yes.

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

Yes.

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

To serve as an example and for more clarity, we would suggest adding that *"for instance, bespoke indices such as a series of zero coupons is eligible as reference portfolio"*.

Also, it should be specified that published benchmarks from data vendors (that are generally accepted) should be all allowed, notwithstanding the first criterion at point 2 in Box 11.

25. Do you have any alternative suggestions?

No.

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

Yes, we agree.

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 do consider them useful.

30. Do you have any alternative suggestions?

No alternative suggestion.

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

Yes, we agree.

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

Yes, we agree.

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

The frequency of the back testing program for monitoring the VaR model is part of a risk management program already in place for those UCITS using the VaR option. We would like to draw attention to the fact that arbitrary fixing the exact frequency is not a relevant measure, as back testing is to be adequately used depending on the market context by the risk management function. Risk management has therefore to be given discretion in monitoring the VaR as it is the UCITS responsibility to ensure appropriate safeguards in relation to the VaR model's use. Otherwise, it may even be dangerous giving the impression that imposed "safeguards" would mechanically lift some of the UCITS responsibility! We therefore suggest leaving the UCITS to decide on the frequency, provided that it shall be at least quarterly.

In the same context, the monitoring of "overshooting" shall remain at the UCITS level and appreciation in terms of adequately measuring the performance of the model in use, without specific figures written as hard limits for a specific back testing period.

34. Do you have any alternative suggestions?

Please see above our response to question 33.

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

Stress testing is done when appropriate at the discretion of the UCITS.

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

As already specified, additional safeguards such as stress tests are done when appropriate at the discretion of the UCITS as part of a responsible and adequate use of the VaR approach.

37. Do you have any alternative suggestions?

Please refer to our answers above.

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

It should be added that: "monitoring on a regular basis the level of leverage *or the maximum exposure (if the VaR method is used)* generated by the UCITS" in Box 21 point 1. Indeed, this rephrasing is needed so as to encompass both global exposure calculation methods.

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

Yes, we agree, however with the exception of the model validation where we think point 3 should be rephrased so as to state clearer that what is needed is an independent party from the portfolio management.

Indeed, if it is the risk management who conceived the model, we fail to see what "independent" and "firm-hierarchy" positioned party could have the capacity/understanding/legitimacy to undergo validation.

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

No, we disagree with Box 22. When the use of VaR is decided, it is precisely the case when leverage is not a relevant concept. This box is contradictory from a methodology point of view and therefore potentially misleading to investors. For instance, hedging may look like increasing the leverage figure, although it is in fact reducing it! Consequently, the provisions contained in Box 22 do not form "additional safeguards" and should be removed.

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

No. We suggest removing statements 2 and 3 of Box 23 (page 41) as in our view these provisions are not consistent with the global methodology as displayed in the paper and would

introduce double counting. The choice of a methodology, commitment or VaR, is performed by the UCITS depending on the relevance of the method.

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. Please see above Question 41.

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

No. Please see above Question 41.

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

Yes, we agree.

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?

We would like to clarify that Collateral management is a complex task that forms a specific core competence, a "craftsmanship", where setting the most appropriate and fine-tuned limits is an intrinsic part of the job. It is the UCITS responsibility to best manage collateral.

We therefore don't think that setting hard criteria as proposed would best serve the stated goal of effectively reducing counterparty risk. For instance:

- Liquidity: the liquidity of the collateral could be lower when there is corresponding sufficient haircut linked to the credit quality of the issuer;
- Valuation: valuation of the collateral shall be done with the same frequency as the fund NAV calculation;
- We do not agree with the inclusion of correlation criteria: the monitoring of correlation criteria shall be at the discretion of the management company (ie defining its own tolerance margin in terms of correlation and managing the substitution of collateral at its discretion);
- We do not agree with the diversification criteria, again, the diversification of the collateral shall remain at the discretion of the UCITS;
- Cash collateral could be reinvested in order to pay interest.

46. Do you have any alternative suggestions?

See answer to question 45 above.

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?

No. See answer to question 45 above.

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?

Yes.

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?

Yes.

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?

Yes.

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

We agree that in normal circumstances, the commitment approach should be used in order to calculate the position exposure (page 45/box 26/point 3).

However, as stated in (page 12/statement 8) there are some specific circumstances where it is not possible to use a suitable commitment approach for a particular derivative or derivative structure; for instance, when the delta is very volatile because, for example, the level of a security approaches the strike of a barrier option or because of other circumstances. Therefore, in our view, Level 3 Guidelines should specify that in this case the manager of the fund is able to use an alternative approach. We suggest using also a VaR approach.

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

Yes.

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

No.

54. Do you agree with the proposed definitions?

Yes.

55. Do you consider that CESR should provide other definitions in these guidelines? Do you have any suggestions for other definitions?

We don’t have other suggestions at the moment.

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?

The Structured Funds industry needs a specific treatment for reasons that we will detail later. This industry represents a significant part of the Asset Management industry. In France for example, as of 30 April 2010, there are 756 funds of this kind, narrowly defined, and they

manage 66.7 billion Euros of assets, and nearly all of them are UCITS or UCITS-equivalent funds[3].

Yes we agree with this approach. However, we believe that there is a real risk of abuse of such guidelines. Therefore, it seems to us very important that Structured Funds be defined in a very narrow way, and that the wording uses words and concepts that cannot be interpreted and extended to cover loosely any type of fund. Only a very specific sort of Structured Funds, sometimes named "Formula Funds", cannot fit completely with the standard methodology, but they can fit with some of it. So the standard methodology should be adapted also as narrowly as possible, only to the extent that this is absolutely necessary and justified.

1. Definition of Structured Funds

The term "Structured Fund" is already too broad, since it often includes many structures, like CPPIs, where there is no compelling reason to adopt a different approach than the standard one. CPPI are funds that have an exposure that is divided between some "risky" assets, for example equities, and "non-risky" assets, for example cash deposits. The only specific characteristics that they have is that they change their allocation between the two types of assets. They can live without any problem with the proposed standard guidelines, that give them the right to be exposed to the risky assets up to a leverage of two, or up to a leverage that respects the VaR requirements.

Structured Funds should be defined for the purpose of these guidelines as purely passively managed funds, in the sense that their return at maturity is purely the result of a mathematical formula that links the return to the value of some underlying securities or indices at certain dates. An investor who would have access to all necessary information on the prices of the relevant securities should be able to determine himself, at maturity of the fund, the redemption price of the fund. The formula has been determined at inception of the fund and cannot be modified by the manager. The manager has therefore no discretion on the final "pay-off" over the life of the fund. This does not preclude the manager of the fund to try to optimize the management of the fund, for example in order to minimize the counterparty risk of the fund, but at any time the manager should be certain, for example through derivatives arrangements, that he can produce the expected pay-off at maturity.

2. Need of an External guarantee

In addition, in order to limit the risks of abuse of the proposed guidelines, we believe that it is essential to make sure that the formula is effectively guaranteed at maturity. For the sake of these guidelines, we should consider as Structured Funds only funds where reaching their promised pay-off at maturity is not only a fiduciary duty of the manager but also a legally binding requirement. We therefore believe that it is important to require that the final predefined payoff be guaranteed by an external entity with enough capital to make a strong, legally binding and enforceable commitment.

3. Proposed definition

We propose to limit the use of these specific guidelines to the funds that respect the following conditions:

- The management objective of the fund is to reach, after a determined period, an amount which is determined by the mechanical application of a pre-determined calculation

[3] See : http://www.amf-france.org/BIO/BIO_PDFS/EEN_ETAT_ENCOURS/30.04.2010.pdf

formula that refers to financial markets indicators or securities; and also possibly to distribute dividends, determined in the same way;

- the achievement of the management objective of the fund is guaranteed by a credit institution, an insurance company, or a MIFID company with enough capital, whose registered office are located in a Member State of the Organization for Economic Co-operation and Development.

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

1. Why cannot Structured Funds completely comply with the standard methodology?

1.1 Structured Funds can respect the standard guidelines at inception

The required standard guidelines, as regards Global Exposure and as regards also Issuer Concentration, are a problem for Structured Funds at inception, but not more than for any UCITS. They can put in place pay-offs (or "Formulas") that comply with the required standard, and indeed most of the classical pay-offs comply with such standards.

Global Exposure is in general not an issue since they tend to have a low leverage, below 1 in general.

Issuer Concentration is also in general manageable, because their pay-off are either based on indices or on a diversified portfolio of securities.

1.2 The problem is that the profile of the fund may, over time, diverge from the standard guidelines.

The problem is that a Structured Fund must be managed in order to provide to investors a pre-determined pay-off at maturity of the fund. They can achieve that, for example, by entering into derivatives transactions that guarantee that the pre-determined pay-off will be reached. The manager of the fund thus does not have much flexibility to follow the guidelines. He is completely constrained to achieve the pre-determined formula that has been promised to investors. He may infringe on the guidelines in a purely passive way.

For example, the pay-off may depend on some conditions related to some specific securities. To cover his pay-off, the manager will enter into barrier options and we know that, if the value of the security is close to the strike of such option and if the maturity is close, the delta of such option can be very important and volatile, and lead to an infringement of the Global Exposure limit (even with a VaR methodology).

A Structured Fund with a pay-off that is based on a diversified portfolio of securities can also have a problem, over time, of concentration limit. For example, if one security of the Formula goes up very much while the others stagnate, he may be over-exposed to this security.

It is important to note that the other limits, like counterparty risk limits, can perfectly be respected at any time by the manager by appropriate means (collateral, reset of derivatives etc.).

2. ***At the same time, we believe that the UCITS framework should allow these Structured Funds***

As mentioned above, Structured Funds are an important part of the European Asset Management industry, with more than 100 billion Euros under management. We do not see any compelling reason not to allow them.

If no Structured Fund could exist under the UCITS Directive, that would mean that these structures would re-appear under other legal forms, especially Structured Notes or other type of banking products, without all the guaranteed that are provided to investors by the UCITS Directive: liquidity at NAV, limitation of counterparty risks, auditing, independent custodian and all the conduct of business rules (conflict of interest, best execution) that will be implemented at level 2 with UCITS 4.

We believe that investor's protection is overwhelmingly in favor of continuing to allow such Structured Funds.

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

Our comments on the list of criteria provided by CESR:

1. ***The fund is passively managed and structured to achieve a pre-defined payoff***

As mentioned above, we agree on this criteria, provided that the term "passive" means that the manager, at all times, (i) will have to respect the promised payoff, without any right to change it, and (ii) must make sure that he will be able to achieve the required payoff, in practice through derivatives. This should of course not prohibit the manager from his other duties, which are active by nature, like actively managing his relations with derivatives counterparties, actively entering and unwinding derivatives, changing counterparties, managing counterparty risks, managing inflow and outflows etc.

2. ***The pre-defined payoff is based on a calculation formula relating to the performance of financial instruments or other financial parameters***

As mentioned above, we agree on this criteria. We believe that this is the only possible meaning of a "pre-defined payoff".

3. ***The fund has a final maturity date not exceeding 9 years***

We believe that such safeguard is acceptable, since in practice most of these funds have a maturity that is lower than 10 years Structured Funds are purchased by investors on the basis that they will hold them until maturity so it makes sense not to extend too much this duration. It seems to us; however, that 9 year is a little bit too short. We would rather propose 15 years.

4. The fund is not open to new subscriptions

We believe that this is not completely necessary. We proposed hereunder an alternative which is to close the fund if and when it is not able to respect the standard risk guidelines.

5. The prospectus contains full disclosure regarding the investment policy, underlying exposures and pay-off formulas. It should also contain information on leverage levels and the specific risks associated with investing in such a fund.

We agree on this. We believe that, since the payoff is predetermined, it should be explained to investors, in a summary way in the KID, and in a more detailed way in the full prospectus.

6. The final predefined payoff is guaranteed by a credit institution located in the OECD or by entity subject to prudential supervision

We agree. We believe that it is essential to make sure that the formula is effectively guaranteed at maturity. For the sake of these guidelines, we should consider as Structured Funds only funds where reaching their promised pay-off at maturity is not only a fiduciary duty of the manager but also a legally binding requirement. We therefore believe that it is important to require that the final predefined payoff be guaranteed by an external entity with enough capital to make a strong, legally binding and enforceable commitment.

7. Investors capital on maturity is guaranteed by a credit institution located in the OECD or by an entity subject to prudential supervision; or capital protection on maturity is obtained through investments in deposits, debt securities of high quality such as debt securities issued by an entity subject to prudential supervision and registered in a Member State of the EEA or debt securities issued or guaranteed by a Member State of the EEA

Structured Funds are sometimes, but not always, capital guaranteed. In fact, they are less and less so, due to the low interest rates level. Their underlyings can be indices or any allocation of securities, in general shares. Their returns may be linked, for example, to the prices reached, at some pre-determined dates, by shares that belong to a pre-determined basket.

It would be very restrictive to limit such funds to capital guaranteed funds. Investors would have a protected downside but at the price of a very limited possible upside, especially if the maturity is limited to 9 years. Very few formulas would therefore make sense and investors would be extremely restricted in their choice. Structured Notes would become the only standard of the market, at the detriment of UCITS, at the very time where the EU commission realizes, in the course of the PRIPs debate, that UCITS are much more regulated and protective of investors than alternative products.

59. Can you suggest any additional criteria?

Yes, we believe that additional safeguards are possible. These safeguards are there in order to make sure that the Structured Products guidelines are used only to the extent that they are necessary. Standard guidelines should be implemented as much as possible.

1. An obligation to respect at any time counterparty risks requirement

Structured Funds can respect these constraints. If any doubt, it should be made clear that they will not have any specific guideline in this respect.

2. An obligation to comply with all the standard guidelines at inception

Structured Funds should be created only the extent that they comply with all the standard guidelines at inception. If they are not able to comply at inception, they should not be created.

3. An obligation to comply with all the standard guidelines as long as the fund is marketed

If at some point the manager sees that the standard guidelines, as regards the commitment approach and as regards the issuer concentration limits, cannot be respected, the fund should close to new subscriptions and stop being marketed.

4. An anti-avoidance rule

It would be prohibited to create a Structured Fund where the formula itself shows that the fund will never be able to respect the standard guidelines during its life.

Example of a fund that should not be allowed: a fund with an indexation on an appropriate number of securities in order to respect proper diversification at inception but that, over time, has an exposition that is reduced automatically to a number of securities that is too limited to allow proper diversification, even if the market conditions were at that time the same as at inception.

If you need any further information, please don't hesitate to contact myself at +33 1 44 94 94 29 (p.bollon@afg.asso.fr) or Eric Pagniez, at +33 1 44 94 94 06 (e.pagniez@afg.asso.fr) or Adina Gurau Audibert, at +33 1 44 94 94 31 (a.gurau.audibert@afg.asso.fr).

Sincerely Yours,

(signed)

Pierre Bollon