INVESTMENT MANAGEMENT

P.O. Box 90470, 2509 LL The Hague

Department
Risk Management
Location
Beatrixlaan 15
2595 AK The Hague
The Netherlands

Subject
CESR's technical advice at level 2 on Risk Measurement for the purposes of the calculation of UCITS' global exposure

Date
July 2nd, 2009

Dear Sir, Madam,

Please find herewith our response submitted as working document to your consultation.

Best regards,

Marc Spalburg
Risk Manager

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1	**Do you agree with the proposed approach in relation to the calculation of global exposure?**	
	Agree to carve out counterparty risk from the calculation of global exposure. The text however mentions “global exposure” and “total risk exposure” indiscriminately in relation to the total net value of its portfolio. This leads to confusion and it is therefore suggested to consequently use only one term. It is suggested to name this “economic exposure” (instead of risk exposure) as the intention is to limit every 100€ NAV invested to a maximum of 200€ economic exposure (as the maximum leverage of economic exposure) as can be mimicked with the introduction of FDIs.	
2	**Should the counterparty risk involved in an OTC derivative be considered in the calculation of global exposure?**	
	No. no need as it is being measured, limited and managed in a different way.	
3	**Do you agree with the proposed approach or can you suggest an alternative approach?**	
	FDIs do two things: either they decrease economic exposure (hedging) or they increase economic exposure (investing, even if this entails a linear 1 on 1 look-a-like exposure replication). Therefore all FDIs to be included in the total economic/leverage exposure measure, not only the ones generating incremental exposure (note we disagree we the use of EPM in an economic exposure view, as EPM either increases or decreases economic exposure).	
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?**	
	We agree that when repurchase agreements or securities lending would/could (legally) lead to an effect on the level of leverage these need to be included in the measure of leverage.	
5	**Does option 1 correctly assess the market risk linked to investment in the corresponding instruments, and if so please explain?**	
	Yes, as for both it reflects the maximum potential loss at t=0.	
6	**Does option 2 correctly assess the market risk linked to investment in the corresponding instruments, and if so please explain?**	
	Yes for options, see comment under 5. No for CDS protection buyer, as delta is (as far as we know) not a relevant factor	
7	**Do you have any comments or other suggestions regarding other possible measurement approaches?**	
	The CDS protection buyer total commitment could be précised as the net	

	present value of the sum of the premiums instead of the sum of the premiums. The difference will be negligible in most cases.	
8	**Do you agree with the proposed approach, in particular the inclusion of a non-exhaustive list of financial derivatives?**	
	Yes	
9	**Do you have any alternative suggestions for the conversion method?**	
	Always use maximum potential loss as the fall back if reliable conversions to replicated economic exposures can not be provided	
10	**Are there other types of financial derivative instruments which should be included in the paper?**	
	Inflation linked related derivatives Interest rate options P Notes	
11	**Are you aware of any type of financial derivative instrument where global exposure cannot be calculated using the commitment approach?**	
	Not at this moment	
12	**Do you agree with the approach regarding TRORS and derivatives with cash or an equivalent position?**	
	Yes, as long as structure does not increase/decrease economic exposure (using [embedded] leverage], and for TRORS where the reference to the underlying notional is of the same value (equal and long only underlying)	
13	**Do you agree with the proposed use of the sensitivity approach?**	
	Not sure we understand the proposed description, we do see the intention	
14	**Do you consider that this should be compulsory for these types of derivative or optional for UCITS?**	
	No, either market value or worst potential loss	
15	**Do you agree with the analysis of the sensitivity approach described?**	
	Agree that interest rate instruments with longer maturity show more volatility than short dated instruments in general. This should however be expressed in the change in market value (equivalent economic exposure) as to measure leverage (in relation to the commitment approach). Tough we understand the intention we do not see how the proposed measures translate into the measure of leverage as described.	
16	**What quantitative level would you consider appropriate for the default sensitivity?**	
	The default sensitivity is already catered for in the pricing of the underlying	
17	**Do you have any additional comments or suggestions on this approach?**	
	No, either market value or worst potential loss seem to asses the true economic exposure best	
18	**Do you agree with the proposals regarding netting?**	
	Yes in general	
19	**Do you have any additional comments and/or proposals?**	

	What is meant with ALL in "to demonstrate a strong and negative correlation in ALL market conditions? Correlations tend to go up in crisis instead of down. How is ALL to be proved? Which scenario should be tested and does/did liquidity allow this scenario to be executed in a true crisis?	
20	**Do you consider that hedging as described above should be permitted?**	
	Yes	
21	**Do you consider that the strong correlation requirement should be further clarified by means of a quantitative threshold e.g. 0.9?**	
	Yes, but probably -0.6 would suffice to start with	
22	**Can you suggest a possible threshold e.g. for the minimum correlation between stock baskets? Please justify your answer based on relevant market data.**	
	-0.6, not backed by relevant market data	
23	**Do you agree with this proposal?**	
	Yes	
24	**Do you agree with this definition? Do you have any alternative suggestions?**	
	Yes	
25	**Do you agree with the above approach?**	
	Yes	
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?**	
	Capping and monitoring the daily VaR closely	
27	**Do you agree with the approach outlined in paragraphs 2.3, 2.4 and 2.5?**	
	Yes	
28	**Do you have any comments or suggestions?**	
	To test the validity of the models throughout time and under different market circumstances data used as input should cover both recent volatilities, but also data from a complete multiyear economic cycle. Hence it is suggested to use (1) one set of 1 year of daily data to represent recent market movements and (2) one set of say 12 years of monthly data to span a longer economic cycle	
29	**Do you consider that VaR should be calculated at least daily?**	
	Yes	
30	**What type of criteria should competent authorities take into account in an assessment of the VaR Models?**	
	-historical period considered as input -reliability of forecast when compared to (realized or hypothetical) PnL -comparing VaR method and asset type to determine best fit	
31	**Do you consider that VaR models should be approved by competent authorities?**	
	-Yes, just as trading desk of banks are required to do	
32	**Is the proposed 3-step relative-VaR approach adequate to limit the global exposure of a UCITS?**	
	Yes	
33	**Do you consider that the proposed limitations on the reference portfolio constitute**	

	reasonable and adequate safeguards to ensure that the relative VaR method does not result in the UCITS taking excessive risk or leverage?	
	Yes	
34	**What additional safeguards (if any) do you consider necessary?**	
	None, if the additional safeguards are disclosed to and tested regularly by the regulator	
35	**Can the absolute VaR be considered as an appropriate way of measuring global exposure?**	
	Yes Although it does not specifically state the amount of leverage (or true economic exposure) taken it shows how the portfolio value can change taking the inherent leverage into account in combination with market movements.	
36	**Do you consider that the proposed thresholds are suitable? Can you suggest other thresholds?**	
	Yes, the 99% VaR, holding period 20 trading days, 20% absolute limit provides sufficient risk budget to exploit many if not most contemporary investment strategies	
37	**What are your views on the application of stricter criteria to difference types of asset classes e.g. bonds, equities?**	
	A case can be made to apply stricter criteria to differentiate acceptable risk levels across the asset types but this should be well defined. Intuitively one would expect tighter limits for bonds over equities but when looking at the details products like emerging bonds may show higher VaR numbers when compared to some equity strategies. It would make sense in any case however to have stricter risk criteria for Money Market products.	
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?**	
	No, not necessarily	
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?**	
	Yes, there can not be enough client information	
40	**Can you suggest alternative safeguards and/or requirements to avoid UCITS engaging in strategies which generate high levels of leverage?**	
	When Fund looses 3 months on a row, risk budget to be cut by 50% (say from index 100 to 50). When fund wins 3 months on a row budget to increase with 50% (from index 50 to 75), and when fund wins 3 months on a row again, another 33% increase restoring the funds initial risk budget	

	(from indexed 75 to 100).	
41	**Do you agree with the proposed method for calculating counterparty exposure?**	
	Daily and independent valuation of OTC's, requiring OTC's traded to be able to closed at any time, having ISDA's in place which provide for netting and daily collateralization in combination with selection criteria on the quality and standing of the counterparty all bring down the resulting current net exposure on the counterparty. As such it could be considered to drop the risk weightings. To completely drop the "add-on" however neglects the potential future mark-to-market exposure which can be incurred due to the rather practical aspects of closing out transactions, replacing them in the market place and the timely receipt of collateral called. An indicative 2 weeks is considered a reliable period to achieve this in reality.	
42	**Can you suggest an alternative method?**	
	In relation to Q41 it is therefore suggested to remain with a 10 days PFE factor which accounts for the frequency of collateral exchange and the general market movement such OTC type of instrument could occur. An average -of say the 5 largest European OTC traders- PFE factors could be employed as a pre-scribed minimum.	
43	**Do you agree with the approach for netting arrangements?**	
	Only if enforceable and legal documentation such as ISDA's are in place.	
44	**Do you consider that additional netting rules should apply?**	
	No	
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?**	
	We agree with agreeing a set of principles in relation to acceptable collateral to reduce counterparty exposure. What should emerge however is that in any case exposures are reduced and that a level playing field is created and respected.	
46	**Do you consider that rather than following principles based approach specific instruments that can be used as eligible collateral should be indentified?**	
	The importance is to create and respect a level playing field when reducing the exposures. As such a principle based approach should suffice. In addition, maybe it is an idea to exclude certain asset types (e.g. hedge funds, ABS, derivatives, etc) instead of appointing specific instruments.	
47	**Should collateral be UCITS compliant in terms of asset eligibility and diversification?**	
	Yes, for client protection and to guard a level playing field.	
48	**Do you agree that collateral passed to a derivative counterparty should be include in the either the 5%/10% OTC counterparty limit or the 20% issuer concentration limit?**	

	If legally a potential loss could incur to the UCITS when such OTC counterparty would default there is a case to include such loss of collateral in the issuer limit. The 20% issuer limit feels more appropriate since it covers both the OTC and max 10% single issuer scenario.	
49	**Do you have any other suggestions as to how such collateral passed should be treated?**	
	Legally ring fencing it in a separate account to both parties.	
50	**What areas of further work should be carried out with regard to this?**	
	The definition of the various possibilities under which such issuer exposures can be netted.	
51	**Do you agree with the proposal to abandon the use of the term sophisticated and non-sophisticated UCITS?**	
	Yes, fully agree.	
52	**If you object to this proposal could you please provide reasons for this view?**	
	The distinction sophisticated / non sophisticated can be abandoned but it may be wise to hold on to the funds being required to conduct both the commitment approach (as to asses leverage and issuer concentrations) and VaR (as to achieve the sophisticated – most risk sensitive/informative-market risk measurement information). From a client perspective it could be argued that clients deserve the best risk management techniques available, regardless whether the fund follows a less or more sophisticated strategy. Clients want their money to be (risk) managed in their best interest and as such deserve the most risk sensitive information available which allows them best to make informed risk return decisions.	