

Answers to the

Consultation on CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure for certain types of structured UCITS

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Lyxor Asset Management is an asset management company regulated in France according to the UCITS Directive.

At end of October 2010, we manage approximately 91 bn Euros¹, including 25 bn in Structured and Quantitative funds. Among them, we manage 279 funds that are UCITS or UCITS-like funds and that are Structured Funds according to the definition of this consultation. They represent 18 bn Euros of Asset Under Management.

We welcome very much this consultation and we thank very much CESR for the attention, consultation and efforts that have been put into this work.

We would like to affirm again that Structured Funds are useful for investors and that it is important to continue to allow them to exist under UCITS 4.

a) They are useful for investors

Structured UCITS allow investors to benefit from capital guarantees or guarantees of performances, according to some predetermined market situations. Many investors appreciate to be able to follow a predetermined and transparent strategy. As the recent crisis has shown, another advantage of these funds is that investors tend to hold them until maturity. Structured Funds therefore tend to protect investors from the usual pitfall of investing, which is to sell low, after a market event has already discounted the prices.

b) They already exist as UCITS 3 funds in several countries

There is nothing in UCITS 4 that was not in UCITS 3 and that would trigger a different approach to Structured Funds. These funds already exist under UCITS 3 and, to our knowledge, have not created any specific problems for investors or regulators. We therefore do not see any compelling reason not to continue to allow them.

c) The UCITS framework is more protective of investors than the other legal wrappers.

Structured Funds that will not be able to exist under the UCITS Directive would re-appear under other legal forms, especially Structured Notes or other types of banking products, without all the guarantees that are provided to investors by the UCITS Directive: liquidity at NAV, limitation of counterparty risks, auditing, independent depositary and all the conduct of business rules (conflict of interest, best execution) that have been put in place at level 2 by UCITS 4.

¹ consolidated with our subsidiaries, including Lyxor International Asset Management, which is also a management company regulated in France according to the UCITS Directive.

Answers to CESR questions:

1 Do you agree with the proposed approach for the calculation of global exposure by certain types of structured UCITS which satisfy the criteria in paragraph 2 of Box 29?

Yes we agree with the approach, which is to divide the pay-off of the Funds into scenarios and to apply the Derivatives guidelines to each scenario, as if it were a Fund.

We agree in spite of the fact that the solution proposed by CESR is more restrictive than the existing situation:

- The proposal would not allow some structures that are allowed today. Many existing structures would not be allowed to exist anymore because of the diversification requirements that are required when switching from one scenario to another, as defined by the examples that are in the consultation.
- The proposal would not allow Structured Funds with maturities that are higher than 9 years.
- Structured Funds would have to close after the initial marketing period.

We however recognize the advantages of the proposed solution in terms of coherence of the global regulatory framework for the use of Derivatives by UCITS:

- Modification of the standard guidelines is minimal. The only modification of the standard guidelines that is proposed is the right to divide the fund pay-off into several scenarios and use the commitment approach for each scenario. Apart from this, the standard guidelines are fully applicable. This seems to us the right approach, since it is important to have only one framework for the use of Derivatives by UCITS and to limit the variations from these central guidelines.
- Structured Funds are narrowly defined. The proposal defines Structured Funds in a very precise and restrictive way. Due to this narrow definition, the proposed approach does not open a Pandora Box where such guidelines could be used by all sort of funds, with unintended consequences.

2 Do you agree with the proposed criteria for these structured UCITS?

Yes, we agree with the proposed narrow definition of Structured Funds.

In our view, however, point 2 (h) of Box 29 is not necessary and not possible in practice.

The problem is that it is not possible to determine in practice a pre-determined level of a maximum loss between two scenarios that would be applicable in any market situation. In other words, there will always be a market situation where the switch from one scenario to another would be higher than a pre-determined level.

In order to limit the maximum loss between two scenarios, the only practical approach is to do it through the pay-off itself. This is what CESR is proposing through the diversification rule illustrated by examples under paragraph 97. This diversification rules are, however, in our view not necessary.

- 3 Do you agree with the scope of the application of the alternative approach that derives from the criteria and global exposure calculation approach laid down in paragraph 2 of Box 29? If there are any specific criteria which could present difficulties for certain UCITS, could you elaborate on the reasons for your views and describe the types of UCITS concerned?**

We agree in general with the criteria listed in paragraph 2 of Box 29, except 2(h).

- 4 Can you suggest any alternative criteria?**

Apart from 2(h), the proposed criteria seem appropriate.

- 5 Do you agree with the proposal to limit the maturity of structured UCITS which may apply the provisions of Box 29 to 9 years? Do you have any alternative suggestions?**

We acknowledge the regulators' proposal to limit maturities of structured UCITS to 9 years. Taking into account one of the structured fund's typical characteristics - that is the presence of an initial marketing period, the limitation to 9 years is understood after the initial marketing period (i.e. after the strike).

- 6 Do you agree with the proposal to prohibit these structured UCITS from accepting new subscriptions after the initial offer period?**

Yes.

- 7 Do you agree with the proposed criteria to limit the maximum loss the UCITS can suffer under any individual scenario on any given day? Can you suggest any methods by which this loss can be limited or other safeguards which would deal with the risks posed by barrier-type features as described in Box 29?**

Yes, we agree with the proposed criteria. Indeed, splitting the formula by scenario and calculating the commitment for each scenario limits effectively the maximum loss.

As regards the loss when a switch happens between two scenarios, the problem is that it is not possible to determine in practice a pre-determined level of a maximum loss between two scenarios that would be applicable in any market situation. There will always be a market situation where the switch from one scenario to another would be higher than a pre-determined level.

- 8 Do you agree with the proposals regarding structured UCITS which were authorized before 1 July 2011? Do you have any alternative suggestions?**

Yes we agree.

9 Are the examples provided in paragraph 97 useful in illustrating the diversification requirement?

Yes they are clear and useful.

However, we do not believe that it is necessary to require Structured Funds to respect diversification requirements when they switch from one scenario to another. That would limit the diversity of scenarios and transfer part of the business of Structured Funds to Structured Notes. There was no such constraint until now.

The effect of such constraint would be restrictive. Many Structured UCITS that exist today do not respect such diversification requirements.

10 Can you suggest alternative examples?

No. We think that the examples provided by CESR describe well how the diversification requirements would be applicable.

11 Do you think the examples in paragraph 98 correctly explain how global exposure is calculated in different scenarios?

Yes we believe that the examples correctly explain how the global exposure is calculated in different scenarios.

12 Do you have alternative examples?

No, other examples do not seem necessary.

13 Do you agree with the proposed prospectus disclosure requirements in Box 30?

Yes, we fully agree.

14 Is the terminology used in the guidelines clear? Are there any terms used for which you feel it would be helpful to have a definition?

Yes the terminology is clear and does not need definitions.

We are available to CESR / ESMA and its members to discuss and provide more information. Please contact Alain Dubois, Chairman, Lyxor AM, email: alain.dubois@lyxor.com, tel +33 1 42 13 94 71.