

**CESR's technical advice at level 2 on Risk Measurement  
for the purpose of the calculation of UCITS' global exposure.**

Questions

**1 Calculation of Global Exposure using the Commitment Approach**

1. Do you agree with the proposed approach in relation to the calculation of global exposure?

A: Yes

2. Should the counterparty risk involved in an OTC derivative be considered in the calculation of global exposure?

A: No

3. Do you agree with the proposed approach or can you suggest an alternative approach?

A: Yes

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?

A: Yes

5. Does option 1 correctly assess the market risk linked to investment in the corresponding instruments, and if so please explain?

A: No. This option does not capture the derivative's exposure.

6. Does option 2 correctly assess the market risk linked to investment in the corresponding instruments, and if so please explain?

A: Yes. This option captures the derivative's exposure.

7. Do you have any comments or other suggestions regarding other possible measurement approaches?

A: For financial derivatives with highly volatile or sensible delta (to the pricing model), it should be prescribed to use delta equal to 1.

8. Do you agree with the proposed approach, in particular the inclusion of a non-exhaustive list of financial derivatives?

A: Yes. The list of financial derivatives should be completed with regular update on market practices. However, the decision to use this method should not be subject to the size the investments represent in the UCITS.

9. Do you have any alternative suggestions for the conversion method?

A: For Credit default swap and Total Rate of Return Swap the exposure amount should be the notional amount.

10. Are there other types of financial derivative instruments which should be included in the paper?

A: As much as possible, all financial derivative instruments should be included.

11. Are you aware of any type of financial derivative instrument where global exposure cannot be calculated using the commitment approach?

A: No

12. Do you agree with the approach regarding TRORS and derivatives with cash or an equivalent position?

A: Yes provided that exchanged exposures are in the same currency.

13. Do you agree with the proposed use of the sensitivity approach?

A: No. This approach should not be considered.

14. Do you consider that this should be compulsory for these types of derivative or optional for UCITS?

A: This approach should not be considered.

15. Do you agree with the analysis of the sensitivity approach described?

A: This approach should not be considered.

16. What quantitative level would you consider appropriate for the default sensitivity?

A: This approach should not be considered.

17. Do you have any additional comments or suggestions on this approach?

A: This approach should not be considered.

18. Do you agree with the proposals regarding netting?

A: Yes.

19. Do you have any additional comments and/or proposals?

A: Financial derivative instruments referring to the same underlying asset should be required to have the same sensibility to be netted. For instance, long call and short call with different strikes or maturities should be netted based on their relative delta.

20. Do you consider that hedging as described above should be permitted?

A. Hedging as described should be permitted provided that in addition of statistical tests to demonstrate good correlation between assets, strong economic relation exists between assets.

21. Do you consider that the strong correlation requirement should be further clarified by means of a quantitative threshold e.g. 0.9?

A: Yes. Guidelines to perform the statistical test should also be given.

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.

A: 0.9.

23. Do you agree with this proposal?

A: Yes

## **2 Calculation of Global Exposure using the Value at Risk (VaR) Approach**

24. Do you agree with this definition? Do you have any alternative suggestions?

A: No. The terms relative and absolute should not refer to the measure but to the technique used to control the limit. We should use the terms relative and absolute limit approaches or simply not use these terms.

25. Do you agree with the above approach?

A: No. These are two distinct approaches.

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?

A: None. These are two distinct approaches.

27. Do you agree with the approach outlined in paragraphs 2.3, 2.4 and 2.5?

A: Yes

28. Do you have any comments or suggestions?

A: It should not be permitted to change the input used in the calculation of VaR given the market conditions.

29. Do you consider that VaR should be calculated at least daily?

A: Yes

30. What type of criteria should competent authorities take into account in an assessment of the VaR Models?

A: Results of backtesting, model validation/documentation by the risk management team, data sources and frequency of data update.

31. Do you consider that VaR models should be approved by competent authorities?

A: Yes and authorities should ensure that VaR models are validated by competent risk management team.

32. Is the proposed 3-step relative-VaR approach adequate to limit the global exposure of a UCITS?

A: Yes. The choice of the reference portfolio should be subject to criteria such as the ones of the Global Investment Performance Standards (GIPS®).

33. Do you consider that the proposed limitations on the reference portfolio constitute reasonable and adequate safeguards to ensure that the relative VaR result in the UCITS taking excessive risk or leverage?

A: No answer. The concept of excessive risk or leverage should have been clarified.

34. What additional safeguards (if any) do you consider necessary?

A: No answer.

35. Can the absolute VaR be considered as an appropriate way of measuring global exposure?

A: No. Global exposure does not refer to the concept of VaR which is measuring potential loss.

36. Do you consider that the proposed thresholds are suitable? Can you suggest other thresholds?

A: Lower internal thresholds leading to predefined actions should be set and communicated to the authorities. The legal limits should be communicated to the investors.

37. What are your views on the application of stricter criteria to different types of asset classes e.g. bonds, equities?

A: Stricter criteria should not be based on asset classes but on the risk profile of the UCITS.

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?

A: Yes. Stress tests and CVaR should be communicated to Conducting Persons and Board Members. No additional measure of leverage should be required since leverage is captured by the VaR and the investment restriction.

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?

A: The VaR limit should be specified in the prospectus.

40. Can you suggest alternative safeguards and/or requirements to avoid UCITS engaging in strategies which generate high levels of leverage?

A: Highly competent and independent risk management team should be in charge of setting and monitoring risk limits.

Governance rules should ensure that UCITS's conducting persons and Board members play a larger role by reviewing carefully the risk management reports, challenging the risk figures (VaR, stress testing and back testing results) and keeping up-to-date with recent developments in financial markets and risk management techniques.

### **3 OTC Counterparty Risk Exposure**

41. Do you agree with the proposed method for calculating counterparty exposure?

A: Yes.

42. Can you suggest an alternative method?

A: No.

43. Do you agree with the approach for netting arrangements?

A: Yes if enforceable contracts are in place.

44. Do you consider that additional netting rules should apply?

A: 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?

A: No answer

46. Do you consider that rather than following principles based approach specific instruments that can be used as eligible collateral should be identified?

A: No answer

47. Should collateral be UCITS compliant in terms of asset eligibility and diversification?

A: No answer

48. Do you agree that collateral passed to a derivative counterparty should be included in either the 5%/10% OTC counterparty limit or the 20% issuer concentration limit?

A: No.

49. Do you have any other suggestions as to how such collateral passed should be treated?

A: No.

50. What areas of further work should be carried out with regard to this?

A: No suggestion.

#### **4 Sophisticated/Non-Sophisticated UCITS**

51. Do you agree with the proposal to abandon the use of the term sophisticated and non-sophisticated UCITS?

A: Yes. There is a huge misunderstanding on the marketplace about the terms sophisticated and non sophisticated. The public sometimes thinks about sophisticated funds as systematically riskier than non sophisticated funds.

Absolute return type funds which use the sophisticated approach to take into account hedging effects more efficiently are often less risky (in terms of volatility) than non sophisticated funds investing in highly volatile plain vanilla instruments.

By replacing sophisticated and non sophisticated *funds* by *risk monitoring approaches*, we believe things would get clearer in everybody's mind.

52. If you object to this proposal could you please provide reasons for this view?

A: N/A