

The Committee of European Securities Regulators

avenue de Friedland
75008 Paris
France

Wien am 31.5.2010

Stellungnahme: CESR – Risk Management Measurement for UCITS – Consultation Paper

Dear Sirs,

The *Austrian Association of Investment Fund Management Companies* (VÖIG) is the representative association of the Austrian investment fund management companies. VÖIG represents through its members about EUR 140 billion in assets under management managed by around 2200 investment funds. For more information, please visit www.voeig.at.

We want to thank CESR for giving the possibility to consult on the paper „Risk measurement for the purposes of the calculation of UCITS global exposure“ from an Austrian Investment Funds perspective.

Regarding the questions asked by CESR we would like to answer as follows:

Question 1:

Point 2 of BOX 1 seems to be too stringent as UCITS may consider as appropriate advanced risk measurement methodologies only those methodologies on which CESR has published level 3 guidelines. This is in contrast to the global responsibility of the UCITS management to select an appropriate methodology to calculate global exposure. We would appreciate and advise CESR that the application of advanced risk measurement techniques is the sole responsibility of the UCITS management. UCITS management should be allowed to apply other advanced risk management methods like expected shortfall, stress VaR etc without ex ante approbation by CESR. Risk management models could be examined ex post by national regulators in cooperation with CESR.

Question 3-4:

According to point 1, BOX 2, the aim of the conversion methodology for standard derivatives is always the market value of the equivalent position in the underlying asset. This may be replaced by the notional value of the derivative contract where this is more conservative. When studying the examples of the conversion methodology on page 8 and 9 forward contracts and currency futures can only be converted on a notional basis. We think that this procedure does not correspond with the message in

point 1 of BOX 2. Besides we are referring to the CESR consultation paper of 15.6. 2009 „CESRs technical advice at level 2 on Risk Measurement for the purposes of the calculation of UCITS global exposure“ where the conversion methodology was drafted properly. We hope that the conversion formula of the instruments mentioned in the examples can be adapted properly in order to correspond with the message of point 1 of BOX 2.

Regarding the section on the conversion method – standard derivatives - to our mind convertible bonds (page 10) should not contribute to the global exposure because the equity exposure represented can be established via cash transactions. Nevertheless convertible bonds do constitute equity exposure. This equity exposure should be considered in the rule checking process.

For reasons of simplification it should also be possible to convert bond futures with the market price of the index. The cheapest to deliver bond is only of importance when the reference bonds have to be delivered at the end of the maturity of the contract. 99% of the contracts are closed before the end of the maturity of the bond future.

The conversion of Bond Futures should also incorporate the conversion factor, so the formula would be Number of contracts * notional contract size * market price of the ctd reference bond / conversion factor. For Currency Futures also the current future price of the currency should be incorporated, then the formula is Number of contracts * notional contract size * market price of the currency future.

Question 9-14:

Regarding the netting of derivatives/securities we want to stress that covered call writing is a risk reducing management technique which should allow netting of a security and the short call on the same underlying. Point 15 second sentence of the explanatory text could be misinterpreted and should be redrafted.

Furthermore we strongly oppose the strict CESR concept of defining hedging arrangements. Fund management of UCITS is characterised by the general rule to create widespread diversification of the funds assets. Modern portfolio theory stresses that this risk diversification leads to a broad reduction resp. neglectation of the specific risk of held assets. Therefore we cannot follow and accept point 6 of BOX 5 as well as the examples mentioned under the explanatory section (second example of point 20 and 21) where CESR stipulates that general and specific risk (of broadly diversified portfolios) should be linked to the financial derivative instruments. This attitude would be in full contrast to practitioners in the fund management business and would be in contrast to the hedge accounting according to IFRS guidelines where especially macro hedging is fully accepted and supported method.

When referring to question 14 in more detail it is our view that Beta hedging does not reduce Alpha explicitly but nonetheless it can substantially reduce the risk in a fund. Equity markets index futures are the most liquid derivative instruments available and often are used to reduce Beta and Alpha even if the composition of the equity portfolio is not so close to the stock market index, e.g. the S&P 500 is often used for the reduction of Beta of US-equity portfolios although the composition differs but the diversification effects in the portfolios are comparable. According to Explanatory Text Point 21 to Box 5 this would be regarded as the domination of Alpha components and therefore the offset of Beta (market risk) would not be allowed as this is seen as not complying with hedging criteria in Box 5. Another fact is that Point 21 ignores that a Beta-hedge offset the Alpha risk of all those equities that are part the portfolio and the index. The Beta-hedge reduces for this special assets the Alpha risk therefore some of the assets may be fully hedged and this justifies to consider such a hedge of offsetting Beta and Alpha risk.

The new view of CESR would mean an increase in the leverage of existing fund portfolios as certain hedges have to be qualified as increase of leverage instead of risk reduction. Does CESR really want the industry to refuse to hedge their portfolios against possible future losses? We are convinced that the draft on the hedging arrangement has to be redrafted in this point as the level playing field between the funds industry and direct investors would be disturbed.

Please also be aware that the new meaning of hedging arrangements would lead to general problems for existing funds. They have to increase the leverage ceiling of the funds in question in order to stick to the CESR guidelines. But if the increase of the leverage of the funds in question will also be accepted by the national regulator is a big question and concern for the industry.

Please also be aware that derivative indices of certain markets (emerging markets) often are not highly liquid. Therefore fund managers try to compensate and try to find indices which are more liquid

but have a high correlation to the reference index the portfolios are based on. For example Austrian derivative indices (ATX) are not as liquid as for example German comparable indices (DAX), although they are highly correlated. If the alternative hedging via reference indices would not be accepted this leads to very inefficient portfolio management and could be a big disadvantage for investors who have to carry the higher costs.

Question 17:

The advantage of both methodologies is that they allow netting and hedging without checking individually the criteria set out in Box 5 as this is accepted under duration hedging. It seems that Option 2 does not allow considering underlying positions in the buckets (only equivalent underlying asset position of each interest rate derivative) which is hard to understand as this would mean that Option 2 does not allow duration hedging for bonds in a portfolio (only hedging between interest derivative positions). Therefore like in Option 1 each debt instrument should be taken into account.

It should also be possible to apply a simple volume/duration approach for calculating the commitment for bond portfolios. According to the duration each interest rate instrument should be allocated to duration buckets (interest rate derivatives according to the Conversion Methodologies of Box 2, bonds with market values), this will be done for derivatives and bond positions, to match the derivatives position with the bond positions and to take the remaining derivative position and 40% of the matched position of each bucket to calculate the amount for the commitment approach. No hedging between zones would be allowed. This approach has obviously stricter netting and hedging definitions than the sensitivity approach.

Question 24:

We agree that a long/short strategy (e.g. 30/130) should not have a long only benchmark. However we want to point out that an exposure control strategy that sometimes holds long positions and sometimes holds short positions should be able to have a long only benchmark. For the avoidance of doubt, a trend following strategy on the EuroStoxx50 index which is in most cases 100% long and in some periods 100% short should be allowed to have the long only EuroStoxx50 index as benchmark, since it is the intention of the strategy to outperform this index.

Question 27-30:

According to the Austrian regulator the calculation standard for the VaR currently is a holding period of 10 days. This is in contrast to the CESR draft guidelines where a holding period of 20 days is stipulated. We are of the opinion that the meaning of VaR decreases with the length of the holding period (when applying the 250 day effective observation period on the 20day holding period you have only 12 returns available for calculation of the VaR). Rescaling of the VaR to the particular holding period and/or confidence interval to our mind is not the best methodology which should be applied to calculate VaR. We therefore would appreciate and advise a holding period of 10 days and a confidence interval of 99%.

As already mentioned in the first CESR consultation on Risk measurement of 15.6. 2009 we strongly disagree with CESR proposing the implementation of a maximum absolute VaR limit. VÖIG strongly supports the view of CESR that the absolute VaR is a proper risk management method for UCITS funds. Absolute VaR measures the potential loss of UCITS funds and should be easily explainable to the public. We do not understand that CESR proposes a maximum absolute VaR-limit of 20% of the UCITS net asset value. We think that this ceiling will avoid offering certain funds products to the public (certain emerging markets products etc) and will cause damage to the European funds industry. Please be aware that the Eurostoxx 50 in November 2008 has reached the absolute VaR level of 20%.

Besides the Austrian funds industry currently has agreed with the national competent authorities a maximum absolute VaR ceiling of 30% of the NAV of the funds for a holding period of ten days. We think that this ceiling would be a better limit for offering a wide enough range of investment funds products to the public.

The proposed absolute VaR limit of 20% cannot be justified when comparing it to the relative VaR concept. If you have for example a relative VaR fund with a reference portfolio of 15% VaR the relative

VaR of the fund in question should not be higher than 30%. Funds which apply the absolute VaR cannot surpass the 20% VaR limit. To our mind there is a high inconsistency between possible relative VaR ceilings and the absolute VaR limit of 20%.

We also would like to ask what will happen to already existing funds having a higher absolute VaR ceiling than 20% if the European Commission sticks to the 20% absolute VaR ceiling. If the 20% absolute VaR ceiling on an EU-level cannot be avoided, we strongly propose a grandfathering rule for UCITS funds which already have been launched and can surpass the 20% absolute VaR ceiling.

Question 33:

We do not agree with point 6 of BOX 17 where it is stated the national regulator has to be informed when the number of overshootings for each UCITS for the most recent 250 business days exceeds 4 in the case of a 99% confidence interval. The overshootings have to be a lot higher than 4 in order to question the whole model and simultaneously to have the national regulator be informed.

Question 41:

We generally do agree with CESRs proposal on the disclosure requirements but want to point out that point 1 of BOX 1 and point 3 of BOX 23 concerning calculation of leverage is inconsistent (conversion methodology is the market value or the notional value). It should be adapted. The message of point 2 (disclosure of expected level of leverage and the possibility of higher leverage levels in the prospectus) is questionable and to our mind not a key disclosure parameter required by investors.

Question 56-59:

We do not understand CESRs draft regarding the special treatment of a special type of structured funds (guaranteed funds) concerning the required risk management methodologies. To our mind all structured funds (guaranteed funds), irrespective if they are managed passively or actively (as for example by a CPPI model) should be treated equal.

General Concern of the industry:

As already stated above there is a big concern that CESRs draft guidelines will lead to massive changes in the day to day risk management of funds portfolios if they are not redrafted (non acceptance of macro hedge). Please be aware that for example ex-post changes in the leverage limit of already existing funds as a result of CESRs view on the conversion method applicable could lead to problems for the industry as well as the national regulators, as these bodies have to accept ex post changes of the funds prospectuses and fund regulations etc. The same applies to already existing funds where the absolute VaR limit exceeds the proposed 20% maximum limit.

If CESP really sticks to the current proposal we urgently want to point out that existing funds have to be granted grandfathering rules in order to allow a smooth transformation of the new guidelines. Otherwise trust of investors could be heavily distorted if a lot of funds prospectuses and fund regulations have to be changed ex post.

Kind regards