KBC Asset Management NV
Havenlaan 2, Brussels, Belgium

KBC Asset Management NV's position on the consultation paper, "CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS"

Question 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, but the type described in Box 4 is too strictly defined: "cash" in the first condition should be extended to money market instruments, deposits, and high-quality debt instruments.

Question 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?

Yes. We prefer the approach described under 4(b) on p. 51, because the investor has assumed the risks involved in the strategy described in the prospectus and the KII. During the life of the fund, the most relevant risk is not achieving the pre-defined payout by not observing the following portfolio management guidelines:

- swap contract(s) and prospectus must correspond with each other;
- deviations between the notional of commitments towards the investors and the notional amount of the swap contract must be subject to tight spreads;
- interest flows generated by the investments must be in line primarily with the interest flows that are to be ceded to the counterparties of the swap.
- the issuer and/or counterparty risks of the investments must meet certain criteria.

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

We are in favour of the approach described under 4(b) on p. 51 and not any type of commitment approach, because the investment strategy is elaborated on beforehand and the investor knows from the start which market parameters will influence the payout and in what way. The pre-defined output for customers is a core element in the product proposition (and especially with capital protected funds) and is transparent.

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

<u>(1) The fund is passively managed and structured to achieve a pre-defined payoff; and</u>

The interpretation of CESR is too strict: this would mean "that the portfolio composition is selected at the launch of the fund and remains in place until maturity, with no changes allowed over the life of the fund." It should be possible to rebalance the assets due to redemptions, risk-speading limits, prospectus requirements, internal risk framework, market trends. We propose the following definition: "the management of the fund portfolio is aimed exclusivily at achieving a pre-defined payoff".
We also propose that the payoff must be achieved on a pre-defined date and would add the following to the definition: "the management of the fund portfolio is aimed exclusivily at achieving (a) pre-defined payoff(s) on (a) pre-defined date(s); and"

<u>(2) The pre-defined payoff is based on a calculation formula relating to the performance of financial instruments or other financial parameters; and</u>

OK

(3) The fund has a final maturity date not exceeding 9 years; and
We don't see the sense of having a maximum maturity. What matters is that the maturity is fixed. We propose the following: "The fund has a final maturity date."

(4) The fund is not open to new subscriptions; and

This condition seems superfluous to us. A fund can be organised in such a way that subscriptions are possible without harming the existing investors. Moreover, if there are only redemptions, the counterparty of the swap could be tempted to price the option rather low. It is also worth mentioning that the portfolio is rebalanced upon the net movement of subscriptions and redemptions.
However, new subscriptions can be subject to considerable downward commitments. If the estimation of CESR is that this is not opportune, new subscriptions should be not be allowed.

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

OK
We would put "and" after point (5), because point (6) also looks important to us.

(6) The final pre-defined payoff is guaranteed by a credit institution located in the OECD or by entity subject to prudential supervision; or

We don't understand this so clearly. If the meaning is that the fund cannot be its own counterparty, we agree. It is essential that the pre-defined payoff be guaranteed by one or more derivatives agreements. If the fund were to be its own counterparty, it would have to engage in the necessary hedging operations to achieve the "pre-defined payoff" and to assume the relevant market risk: that cannot be the intention. Thus, the fund should conclude swap agreements with one or more counterparties. We would re-word this point as follows: "The final pre-defined payoff must be based on one or more OTC derivative agreements."

(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 guarantee is not a constituent of the concept: we propose that it should be deleted.

(8) 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.

Capital protection is not a constituent of the concept: we propose that it should be deleted.
However, Capital protection could be seen as a precaucionary measure, because it leads to a decrease of the commitment of a structured fund. If CESR tends do keep the "commitment" and/or "VaR" approach, then we strongly suggest to follow the 4b) approach of page 51 at least for capital protected funds (which then would receive an alternative approach). If necessary without allowing secondary subscriptions.
We are in favour or a more diversified set of debt instruments to invest in (for capital protection) : broader than "registered in a Member State of the EEA or debt securities issued or guaranteed by a Member State". Always with prudent risk management, good diversification and under prudential supervision of countries with equivalent supervision to this in the EEA.

Question 59. Can you suggest any additional criteria?

No.

KBC AM / Compliance / Wim Van Haute