



**STRUCTURED
ASSET MANAGEMENT**

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Paris, the 23th of march 2010

Committee of European Securities Regulators
(CESR)
11-13, Avenue de Friedland
75008 Paris

Object : Response to CESR'S Consultation on guidelines on risk measurement and the global exposure and counterparty risk for Structured Funds also called "fonds à formule"

Dear Sir,

La Banque Postale Structured Asset Management (LBPSAM) is the fifth major Structured Funds Management company in France with more than € 3 Bn of Assets under Management.

The Structured Funds (Fonds à Formule) managed by LBPSAM are relevant investment products distributed by the branches of the French Post Office since more than 18 years to its clients as they provide a full protection of the capital, and at the same time give the opportunity to benefit from a part of potential high return of risky markets

By this letter, we confirm that our responses to the CESR's consultation on guidelines on risk measurement and the global exposure and counterpart risk for structured Funds are fully in line with the proposal of the AFG (Association Française de Gestion). The responses of AFG we have analysed are joined in the appendix of this letter.

Sincerely yours,

The Board of Directors of LBPSAM

Bernard Descreux, Chairman

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APPENDIX

Recall of the questions of the CESR's consultation and the responses proposed by AFG

17. What are the advantages and disadvantages of each methodology?

We understand the sensitivity approach as a complementary method to the classic commitment approach that aims at reaching a more adequate commitment calculation for interest rate derivatives. In this perspective, Option 2 is a more appropriate method than Option 1 as Option 2 better suits with commitment calculation principles.

Indeed, Option 2 is based on the calculation of an underlying asset position that simply translates in "cash terms" the derivative's sensitivity to the underlying's changes in price. This conversion naturally allows for netting under specific and calibrated compensation conditions.

Thus, in our view, Option 2 is in line with the Basel II methodology as both are based on a sensitivity approach. Notwithstanding, it is worth mentioning that there is one major distinction between the two methodologies which accounts for the unmistakable difference in goals. Indeed, the Basel II methodology was designed for the calculation of capital requirements, whereas the sensitivity approach as detailed in Option 2 is redesigned to match with the global exposure calculation under the commitment approach. In our members' view, this makes an undeniable positive feature under Option 2.

In parallel, Option 1 sticks to a larger extent to the Basel II methodology and obtains results consistent with a capital requirements objective. In Box 7, Statement 2 estimates the capital requirement of each debt instrument as in Basel II methodology (see pages 169 and 170 of Annex)¹. It can be interpreted as a VaR estimation and it is not coherent with the commitment approach of part 2 of the CESR document. It would be much better to use directly the general VaR approach in part 3 of the CESR document. Statement 2 is mixing the commitment and the VaR approach and is therefore confusing.

We are not sure to understand how these results convert in the end into a commitment calculation (Box 7, page 20). Indeed, Statement 8 proposes a conversion of the capital requirement (or VaR) into an exposure which has sense for Banks but not for UCITS (see page 12 of Annex). Therefore, our members fail to see how the use of a multiplier (12.5 in the text) is consistent with a commitment calculation approach for the sake of calculating global exposure for UCITS. Moreover, this conversion is not compatible with statement 1 of Box 14 of the general VaR approach (part 3 of the document).

¹ Annex to : *International Convergence of Capital Measurement and Capital Standards A Revised Framework Comprehensive Version*

This document is a compilation of the June 2004 Basel II Framework, the elements of the 1988 Accord that were not revised during the Basel II process, the 1996 Amendment to the Capital Accord to Incorporate Market Risks, and the 2005 paper on the Application of Basel II to Trading Activities and the Treatment of Double Default Effects. No new elements have been introduced in this compilation.

BIS, June 2006

<http://www.bis.org/publ/bcbs128.htm>



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Step 2 in Option 1 allocates instruments to different sensitivity zones. Compared to the maturity buckets proposed in Option 2 that are designed to encompass the main debt issue maturity points:

- Option 1 zones are less stable;
- Option 1 zones are defined based on volatility and correlation assumptions less up-to-date.

18. Which methodology do you consider more appropriate? Please give explanations and indicate whether additional safeguards should be included.

As stated above, our members favour Option 2 which is a steadier and adequate method for the purpose of global exposure calculation under the commitment approach than Option 1.

19. In the last step of Option 1, the total amount is multiplied by 12.5. Do you consider that (i) this takes due account of the sensitivity of the UCITS and (ii) that this is in line with the commitment conversion methodology (e.g. conversion of the derivative into the market value of the equivalent position in the underlying assets)?

(ii) As we have already mentioned in our answer to question 17, our members have remarked that using this multiplier is consistent nor with the commitment conversion method neither with the general VaR approach as clearly this is not a methodology designed to answer the specific needs of global exposure calculation. The resulting figures under Option 1 correspond to risk amounts that are meant to be used to determine the capital required.

(i) Option 1 does take due account of the sensitivity of the UCITS, however this is interesting only as part of the method in order to permit netting and hedging; the goal is not to compute sensitivities but to compute global exposure.

20. Under option 2 the target sensitivity of the UCITS can be longer than the sensitivity of the derivative while the equivalent underlying position is relatively small. This can result in high levels of leverage within the UCITS. Please provide views on the additional safeguards that could be introduced to mitigate this risk.

If the target sensitivity is in line with the investment strategy of the UCITS, the perceived gap between the UCITS target sensitivity and the derivatives' sensitivity is clearly contained.

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?

The calculation of global exposure using an approach

The Structured Funds industry needs a specific treatment for reasons that we will detail later. This industry represents a significant part of the Asset Management industry. In France for example, as of 30 April 2010, there are 756 funds of this kind, narrowly defined, and they manage 66.7 billion Euros of assets, and nearly all of them are UCITS or UCITS-equivalent funds².

Yes we agree with this approach. However, we believe that there is a real risk of abuse of such guidelines. Therefore, it seems to us very important that Structured Funds be defined in a very narrow way, and that the wording uses words and concepts that cannot be interpreted and extended to cover loosely any type of fund. Only a very specific sort of Structured Funds, sometimes named "Formula Funds", cannot fit completely with the standard methodology, but they can fit with some of

² See : http://www.amf-france.org/BIO/BIO_PDFS/EEN_ETAT_ENCOURS/30.04.2010.pdf

it. So the standard methodology should be adapted also as narrowly as possible, only to the extent that this is absolutely necessary and justified.

1. Definition of Structured Funds

The term "Structured Fund" is already too broad, since it often includes many structures, like CPPIs, where there is no compelling reason to adopt a different approach than the standard one. CPPI are funds that have an exposure that is divided between some "risky" assets, for example equities, and "non-risky" assets, for example cash deposits. The only specific characteristics that they have is that they change their allocation between the two types of assets. They can live without any problem with the proposed standard guidelines, that give them the right to be exposed to the risky assets up to a leverage of two, or up to a leverage that respects the VaR requirements.

Structured Funds should be defined for the purpose of these guidelines as purely passively managed funds, in the sense that their return at maturity is purely the result of a mathematical formula that links the return to the value of some underlying securities or indices at certain dates. An investor who would have access to all necessary information on the prices of the relevant securities should be able to determine himself, at maturity of the fund, the redemption price of the fund. The formula has been determined at inception of the fund and cannot be modified by the manager. The manager has therefore no discretion on the final "pay-off" over the life of the fund. This does not preclude the manager of the fund to try to optimize the management of the fund, for example in order to minimize the counterparty risk of the fund, but at any time the manager should be certain, for example through derivatives arrangements, that he can produce the expected pay-off at maturity.

2. Need of an External guarantee

In addition, in order to limit the risks of abuse of the proposed guidelines, we believe that it is essential to make sure that the formula is effectively guaranteed at maturity. For the sake of these guidelines, we should consider as Structured Funds only funds where reaching their promised pay-off at maturity is not only a fiduciary duty of the manager but also a legally binding requirement. We therefore believe that it is important to require that the final predefined payoff be guaranteed by an external entity with enough capital to make a strong, legally binding and enforceable commitment.

3. Proposed definition

We propose to limit the use of these specific guidelines to the funds that respect the following conditions:

- The management objective of the fund is to reach, after a determined period, an amount which is determined by the mechanical application of a pre-determined calculation formula that refers to financial markets indicators or securities; and also possibly to distribute dividends, determined in the same way;
- the achievement of the management objective of the fund is guaranteed by a credit institution, an insurance company, or a MIFID company with enough capital, whose registered office are located in a Member State of the Organization for Economic Co-operation and Development.

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

1. Why cannot Structured Funds completely comply with the standard methodology?

1.1 Structured Funds can respect the standard guidelines at inception

The required standard guidelines, as regards Global Exposure and as regards also Issuer Concentration, are a problem for Structured Funds at inception, but not more than for any UCITS. They can put in place pay-offs (or "Formulas") that comply with the required standard, and indeed most of the classical pay-offs comply with such standards.

Global Exposure is in general not an issue since they tend to have a low leverage, below 1 in general.

Issuer Concentration is also in general manageable, because their pay-off are either based on indices or on a diversified portfolio of securities.

1.2 The problem is that the profile of the fund may, over time, diverge from the standard guidelines.

The problem is that a Structured Fund must be managed in order to provide to investors a pre-determined pay-off at maturity of the fund. They can achieve that, for example, by entering into derivatives transactions that guarantee that the pre-determined pay-off will be reached. The manager of the fund thus does not have much flexibility to follow the guidelines. He is completely constrained to achieve the pre-determined formula that has been promised to investors. He may infringe on the guidelines in a purely passive way.

For example, the pay-off may depend on some conditions related to some specific securities. To cover his pay-off, the manager will enter into barrier options and we know that, if the value of the security is close to the strike of such option and if the maturity is close, the delta of such option can be very important and volatile, and lead to an infringement of the Global Exposure limit (even with a VaR methodology).

A Structured Fund with a pay-off that is based on a diversified portfolio of securities can also have a problem, over time, of concentration limit. For example, if one security of the Formula goes up very much while the others stagnate, he may be over-exposed to this security.

It is important to note that the other limits, like counterparty risk limits, can perfectly be respected at any time by the manager by appropriate means (collateral, reset of derivatives etc.).

2. At the same time, we believe that the UCITS framework should allow these Structured Funds

As mentioned above, Structured Funds are an important part of the European Asset Management industry, with more than 100 billion Euros under management. We do not see any compelling reason not to allow them.

If no Structured Fund could exist under the UCITS Directive, that would mean that these structures would re-appear under other legal forms, especially Structured Notes or other type of banking products, without all the guaranteed that are provided to investors by the UCITS Directive: liquidity at NAV, limitation of counterparty risks, auditing, independent custodian and all the conduct of business rules (conflict of interest, best execution) that will be implemented at level 2 with UCITS 4.

We believe that investor's protection is overwhelmingly in favor of continuing to allow such Structured Funds.

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

Our comments on the list of criteria provided by CESR:

1. The fund is passively managed and structured to achieve a pre-defined payoff

As mentioned above, we agree on this criteria, provided that the term “passive” means that the manager, at all times, (i) will have to respect the promised payoff, without any right to change it, and (ii) must make sure that he will be able to achieve the required payoff, in practice through derivatives. This should of course not prohibit the manager from his other duties, which are active by nature, like actively managing his relations with derivatives counterparties, actively entering and unwinding derivatives, changing counterparties, managing counterparty risks, managing inflow and outflows etc.

2. The pre-defined payoff is based on a calculation formula relating to the performance of financial instruments or other financial parameters

As mentioned above, we agree on this criteria. We believe that this is the only possible meaning of a “pre-defined payoff”.

3. The fund has a final maturity date not exceeding 9 years

We believe that such safeguard is acceptable, since in practice most of these funds have a maturity that is lower than 10 years. Structured Funds are purchased by investors on the basis that they will hold them until maturity so it makes sense not to extend too much this duration. It seems to us; however, that 9 year is a little bit too short. We would rather propose 15 years.

4. The fund is not open to new subscriptions

We believe that this is not completely necessary. We proposed hereunder an alternative which is to close the fund if and when it is not able to respect the standard risk guidelines.

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

We agree on this. We believe that, since the payoff is predetermined, it should be explained to investors, in a summary way in the KID, and in a more detailed way in the full prospectus.



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6. The final predefined payoff is guaranteed by a credit institution located in the OECD or by entity subject to prudential supervision

We agree. We believe that it is essential to make sure that the formula is effectively guaranteed at maturity. For the sake of these guidelines, we should consider as Structured Funds only funds where reaching their promised pay-off at maturity is not only a fiduciary duty of the manager but also a legally binding requirement. We therefore believe that it is important to require that the final predefined payoff be guaranteed by an external entity with enough capital to make a strong, legally binding and enforceable commitment.

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 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

Structured Funds are sometimes, but not always, capital guaranteed. In fact, they are less and less so, due to the low interest rates level. Their underlyings can be indices or any allocation of securities, in general shares. Their returns may be linked, for example, to the prices reached, at some pre-determined dates, by shares that belong to a pre-determined basket.

It would be very restrictive to limit such funds to capital guaranteed funds. Investors would have a protected downside but at the price of a very limited possible upside, especially if the maturity is limited to 9 years. Very few formulas would therefore make sense and investors would be extremely restricted in their choice. Structured Notes would become the only standard of the market, at the detriment of UCITS, at the very time where the EU commission realizes, in the course of the PRIPs debate, that UCITS are much more regulated and protective of investors than alternative products.

59. Can you suggest any additional criteria?

Yes, we believe that additional safeguards are possible. These safeguards are there in order to make sure that the Structured Products guidelines are used only to the extent that they are necessary. Standard guidelines should be implemented as much as possible.

1. An obligation to respect at any time counterparty risks requirement

Structured Funds can respect these constraints. If any doubt, it should be made clear that they will not have any specific guideline in this respect.

2. An obligation to comply with all the standard guidelines at inception

Structured Funds should be created only the extent that they comply with all the standard guidelines at inception. If they are not able to comply at inception, they should not be created.

3. An obligation to comply with all the standard guidelines as long as the fund is marketed

If at some point the manager sees that the standard guidelines, as regards the commitment approach and as regards the issuer concentration limits, cannot be respected, the fund should close to new subscriptions and stop being marketed.

4. An anti-avoidance rule

It would be prohibited to create a Structured Fund where the formula itself shows that the fund will never be able to respect the standard guidelines during its life.

Example of a fund that should not be allowed: a fund with an indexation on an appropriate number of securities in order to respect proper diversification at inception but that, over time, has an exposition that is reduced automatically to a number of securities that is too limited to allow proper diversification, even if the market conditions were at that time the same as at inception.