3.6.4 Back Testing

Box 17

1. UCITS should monitor the accuracy and performance of their model (i.e. prediction capacity of risk estimates), by conducting a back testing program.
2. The back testing process should provide for each business day a comparison of the one-day value-at-risk measure generated by the UCITS model for the UCITS' end-of-day positions to the one-day change of the UCITS' portfolio value by the end of the subsequent business day.

3. UCITS should undertake the back testing program at least on a monthly basis, subject to always performing retroactively the aforesaid comparison for each business day.

4. UCITS should determine and monitor the 'overshootings' on the basis of the aforementioned back testing program. An overshooting is a one-day change in the portfolio's value that exceeds the related one-day value-at-risk measure calculated by the model.

5. If it appears that the back testing results reveal too high a percentage of 'overshootings', the UCITS should review the VaR model and make appropriate adjustments.

6. The UCITS senior management and where applicable the UCITS competent authority should be informed at least on a quarterly basis, if the number of overshootings for each UCITS for the most recent 250 business days exceeds 4 in the case of a 99% confidence interval. This information should contain an analysis and explanation of the sources of 'overshootings' and a statement of what measures if any were taken to improve the accuracy of the model. The competent authority may take measures and apply

Re point 5 and 6 of Back testing above. The VaR model should also be reviewed if there are no "overshoots" at all in a given period. The model can be just as flawed with no exceptions as too many.