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Committee of European Securities Regulators (CESR)
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75008 Paris

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AFG response to CESR's consultation paper
Technical advice at level 2 on the format and content of Key Information Document disclosures for UCITS

The Association Française de la Gestion financière (AFG)[1] welcomes CESR's consultation on Technical advice at level 2 on the format and content of Key Information Document disclosures for UCITS. We are very grateful to CESR for having accepted to change the final deadline for responding to this consultation (however, we may have some additional remarks at a later stage if needed, considering the short period of time for consultation).

It is worth noting that our working group dedicated to this matter counts over fifteen French investment management companies and is representative of the industry. It is made of entities that are varied in size (small or large), structure (entrepreneurial or belonging to French or foreign banking or insurance groups) and product range (plain vanilla funds, structured funds or both). The working group appointed by CESR on the subject was smaller and for this reason perhaps less representative.

Given that the French fund industry is the first one in the EU for the financial management of EU funds (wherever they are domiciled in the EU), the following comments are meaningful from a European perspective.

General comments

The objective of the KID is to provide investors with harmonised information that will enable them to compare funds belonging to a same range across all Member States. The disclosure of risk should therefore rely on a single methodology suitable to all funds and applicable in all market conditions – and even to all alternative savings products or contracts as there is a general wish now in the EU to ensure a level playing field in terms of product information across this range of products.

1 The Association Française de la Gestion financière (AFG)[1] represents the France-based investment management industry, both for collective and discretionary individual portfolio managements.

Our members include 409 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing 2300 billion euros in the field of investment management, making in particular the French industry *the leader in Europe in terms of financial management location* for collective investments (with nearly 1300 billion euros managed from France, i.e. 23% of all EU investment funds assets under management), wherever the funds are domiciled in the EU, *and second at worldwide level after the US*. In the field of collective investment, our industry includes – beside UCITS – the employee savings schemes and products such as regulated hedge funds/funds of hedge funds as well as a significant part of private equity funds and real estate funds. AFG is of course an active member of the European Fund and Investment Management Association (EFAMA) and of the European Federation for Retirement Provision (EFRP). AFG is also an active member of the International Investment Funds Association (IIFA).

A synthetic indicator would then appear to be an appealing solution. Unfortunately, no such indicator can be found. Conversely, a narrative approach can be tailored to the reality of the fund strategy. Counter intuitively, a narrative approach could also allow for a better comparability between funds. Indeed, it can be argued that a risk/reward indicator would often be misleading, especially as our workings show that unfortunately no argument is strong enough to promote one methodology over the others:

- Historical volatility has many advantages. However, it appears a poor solution in some cases, and does not suit all funds and all market conditions. CESR itself recognises the weaknesses of this methodology. The current crisis shows, anyway, that it is <u>not</u> a reliable indicator of risk.

- Value at Risk (VaR) can be considered a more appropriate indicator in many cases. However, this measure of risk may sometimes prove too complex and costly to implement.

- More generally, a quantitative approach can not completely guarantee against the risk of manipulation of data.

- In this light, a methodology based on qualitative - rather than quantitative - data presenting the risk relating to the type of assets in the portfolio could be considered as a possible alternative.

Pros and cons for each option appear of equal value and it is impossible for us at this time to choose one methodology over the other.

In addition, synthetic risk/reward indicators would only refer to the past and cannot be predictive for the future – and could therefore be even more misleading.

The compulsory use of a recommended minimum investment period would be, indirectly, more informative for the investor as a complement of the narrative description of risks.

Therefore **<u>it seems unadvisable to replace a narrative approach by a synthetic indicator</u>**. No methodology can be applied to all funds in a satisfactory manner, without taking the risk of misleading investors which will rely on a mere rating in their understanding of the relevant fund – even if the indicator is complemented by some narrative. Conversely, a pure narrative approach would avoid having investors relying on a rating – and, if it would appear as difficult to understand the nature of risks mentioned in the narrative, then investors would abstain from investing more probably than if they face a reassuring single rating.

We are concerned that at the end of the day investors may lose confidence in funds if after a crisis (such as those of 2007 and 2008) it appears that suddenly a well-rated fund suddenly suffers loses and a change of rating.

Interestingly enough, the US SEC considered the possibility of a synthetic indicator one decade ago and finally decided - although they made comprehensive assessments about it - not to set up such an approach; which means that today the summary prospectus in the US, regarding the presentation of risks, is still based on a narrative approach, as the SEC explicitly recognised the limits of quantitative approaches. And the US SEC is known for having a high retail investor protection way of thinking.

Furthermore, in our view the narrative approach could be improved by proposing a glossary of the terms used.

Finally, from a level playing field perspective, within the range of all financial instruments offered to retail investors, UCITS are already today the most transparent vehicle, including in terms of risk disclosure. We do not see why there should be any additional requirements.

<u>Form and presentation of KII</u>

<u>Section 1: Title of document, order of contents and headings</u>

Do you agree with the proposals in Box 1?

Should the information referred to in point 9 of the box be called 'Practical information'?

We agree on CESR's proposals. Furthermore, we would suggest adding an option for management companies to add the name of the promoter in addition to the one of the management company as it is already the case in many Member States. Conversely, we do not see an absolute need for mentioning the name of the group, if any, in relation to the management company as in some cases this notion of "group" might be subject to interpretation (e.g. joint ventures).

Regarding authorisation details, we think that beyond the mere statement of the relevant management company and related authority in the case of use of the management company passport, this statement should be compulsory in any case (even if the management company passport is not used). We think it is a very useful piece of information for investors.

<u>Section 2: Level 2 advice</u>

Do you agree with the proposals in Box 2?

In particular, do you agree that the maximum length of the document and the minimum acceptable point size for type should be prescribed at Level 2?

Are there any other rules that should be prescribed in relation to the appearance of the KID?

AFG believes that a 3 page KID is also needed for funds that wish to show similar share classes on the same document.

We also wish to highlight the need to make good use of white space so that the KID is easily readable. Besides, we agree that the font size should not be less than 8 points.

We agree that the KID should be a tool that consumers can use to compare different funds and that the vocabulary used to present this document should be harmonised throughout the EU. To this end, we believe that a glossary established by CESR – and which can be easily translated in local languages - would be very useful.

<u>Section 3: Publication with other documents</u>

Do you agree with the proposals in Box 3?

Yes.

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<u>Content of KII</u>

<u>Section 4: Objectives and Investment Policy</u>

Do you agree with the proposals in Box 4?
In particular, do you agree that the information shown is comprehensive and provides enough detail to ensure comparability between KIDs?
Are there any other matters that should be addressed at Level 2?

AFG thinks that showing <u>a minimum recommended period is highly valuable to clients</u> in their investment decision making process as it gives an indirect but clear indication of the potential risks for investors. From this perspective, the French long-standing experience has been very positive. Therefore, we believe <u>it should be made compulsory</u>. As a consequence, we would rather show this item within the 'Risk and reward disclosure' section.

On the contrary, we do not feel that the statement that investors may redeem units on demand is essential. In any case, it should be shown in the 'Practical information' section rather than the Objectives and investment' policy section.

One piece of information that we feel should be added to this section is the currency of the fund.

More generally, we agree that the information shown should ensure comparability between KIDs. However, we are concerned that too much detail might confuse the reader and be of the detriment of readability. Contrary to the CESR's question, the aim should not be to give "enough detail" but clear information: too much detail may create confusion.

We will give more detail on the presentation of the objectives and investment policy of structured funds in section 14.

Section 5: Risk and reward disclosure

What are your views on the advantages and disadvantages of each option described above?
Do you agree that Option B (a synthetic risk and reward indicator accompanied by a narrative) should be recommended in CESR's final advice? Respondents are invited to take due account of the methodology set out in Annex 1, as supplemented by the addendum to be published by the end of July, when considering their view on this question.

Do you agree with the proposals for presentation of risk and reward in Box 5A?
Are there any other issues that CESR should consider if it decides to recommend this approach to the disclosure of risk and reward?

AFG is strongly opposed to the compulsory use of a synthetic risk/reward indicator as proposed by CESR, although we are not against the principle of a synthetic risk/reward indicator if a satisfactory one were to be found (we believe that such an indicator should be sufficient in itself and should not need to be accompanied by a complementary text). As we explained in our response to CESR's consultation paper on technical issues relating to KID disclosures for UCITS (May 2009)**,** none of the indicators which might be proposed can meaningfully apprehend all ranges of funds and potential risks. Therefore, a narrative approach appears the best option.

In order to facilitate a convergence at EU level of the narrative descriptions of the risks attached to funds, we suggest CESR establishes a glossary defining the different main types of risks that could be used by asset management companies (this glossary could be defined in level 3 measures). We agree that only key categories of risks can be identified and described in the KID; therefore, we wish to be able to refer investors to the prospectus for more detail.

In addition, from a level playing field perspective, within the range of all financial instruments offered to retail investors, UCITS are already today the most transparent vehicle, including in terms of risk disclosure. We do not see why there should be any additional requirements.

Furthermore, if CESR and the European institutions were to require a synthetic indicator based on CESR's proposed methodology, they would have to bear the entire responsibility for the future consequences for any misleading information caused by the lack of reliability and quality of this indicator that would flaw investors' decision making process.

Regarding point 3 in box 5A, we think that beyond the prohibition of scale and graphics, there should be no requirement for statistics in relation to the "likelihood" and "potential magnitude" mentioned at letters c) and d).

Do you agree with the proposals for presentation of risk and reward in Box 5B? In particular, is the proposed methodology in Annex 1 capable of delivering the envisaged benefits of a synthetic indicator?
Does the methodology proposed by CESR work for all funds? If not, please provide concrete examples.
Respondents are invited to take account of the methodology set out in Annex 1, as supplemented by the addendum to be published by the end of July, when considering their view on the questions above.
Are there any other issues that CESR should consider if it decides to recommend this approach to the disclosure of risk and reward?

The methodology proposed by CESR is based on historical volatility. However, historical volatility appears a poor solution in some cases, and does not suit all funds and all market conditions. The current crisis shows, anyway, that it is not a reliable indicator of risk: it ignores extreme situations and the most significant risks. Furthermore, as it is based on past performances, historical volatility can be misleading: as such it can not be predictive of future risks, especially of future crisis (e.g. currency risk, political risk, credit risk) – which cannot by definition be weighted. Conversely, pure western equity funds had a very low volatility at the end of 2007 and therefore the mandatory use of a synthetic indicator based on historical volatility would have been misleading for investors at that time.

Indeed, CESR itself recognises the significant weaknesses of this methodology and feels obliged to add a long list of disclaimers highlighting the fact that the meaning of the indicator is very limited. The only advantage of management companies for having a compulsory SRRI would be to put the responsibility of the future failures of SRRI on CESR and the European institutions. But would this be desirable from a political point of view? In case of problem, it will not be possible to hold management companies responsible to the extent they applied CESR's requirements and showed indicators that did not provide investors with adequate information.

Section 6: Charges disclosure

Do you agree with the proposals in Box 6?
In particular, do you agree the table showing charges figures should be in a prescribed format?
Do you agree with the methodology for calculating the ongoing charges figure?

AFG is of the opinion that the presentation proposed by CESR, and in particular the format, is satisfactory. We would recommend the use of a percentage figure based on ex post audited data to disclose charges, in order to allow a better comparability for investors.

We agree with presentations A and B but not on presentation C, as we do not want to mix different kinds of numbers (ex ante estimates and actual figures). Indeed, consistency needs to be ensured throughout the whole KID.

We would like CESR to change the wording of the presentation of the charges as follows:

> "The charges section of the KID should state that the charges an investor pays are used to pay the costs of running the fund, including the costs of marketing and selling. It should also state that charges are applied in deduction of the gross performance to work out the net performance":

Indeed, the charges do not, as such, necessarily reduce the growth of the investment (management fees spent, for example on IT equipment, may ultimately improve the growth performance and are not at the expense of the investor).

We agree with the presentation of the charging structure in a table and with the methodology proposed by CESR for calculating the ongoing charges figure. However, we think it should be made clearer that charges are expressed all taxes included (as usually retail investors think in those terms). Last, we think that this table should be updated once a year.

Do you agree with the proposals in Box 7?
In particular, do you agree that CESR should not prescribe a specific growth rate in the methodology for calculating the illustration of the charges?

We are clearly against this proposal of presenting charges in cash figures. Indeed, we believe that information shown in box 7 is highly misleading and source of many potential misunderstandings for investors. This data is not comparable across different funds, and relies on too many assumptions (the growth rate and time horizon are left up to management companies and depends on the different types of funds – and otherwise if all these parameters were set by CESR, they would not be more meaningful either, as for instance a monetary fund will not have the same growth rate as an equity fund).

However, if CESR were to maintain this summary measure of charge, we suggest that such quantitative examples should be given by distributors – and extended to distributors of all substitute investment products - and not shown in the KID itself.

We do not understand why CESR did not opt for the solution proposed by the expert group to show both gross and performances net of management fees in the graph showing historical performances?

Do you agree with the proposals in Box 8?

AFG agrees with CESR's requirements. But the choice could be more restrictive: from our perspective, setting a cap or maximum on the amount that can be charged would be appropriate.

Box 9 - Do you agree that a variation of 5% of the current figure is appropriate to determine whether a change is material?

We feel that a variation of 5% seems too low and would generate in practice too frequent updates in a year. Therefore we would prefer a variation of 10%. In addition, in case of exceptional non-recurrent expenses, this general rule should not automatically apply.

Do you agree with the proposals in Box 10 – Annual review of charges information?

Regarding the ongoing charges figure, we would rather use ex post figures that have already been audited. In this way, no update would be required when year end figures are released.

Section 7: Past Performance presentation

Box 11 - Do you agree that the above CESR proposals on past performance presentation are sufficient and workable? If not, which alternative approach would you prefer?

AFG believes that the presentation of past performance with a bar chart is sufficient and appropriate.

However, AFG would like CESR to allow the possibility for the management company to present past performance for new funds (less than one year) and for funds that have a lifespan shorter than one year. We believe that it would be useful for investors to have information on how the fund performed since inception. Nevertheless, we believe showing annualised performances for incomplete years would be misleading.

Regarding the disclosure of which charges and fees have been included or excluded from the calculation of past performance, we believe that a note explaining that all fees are taken into account except entry/exit fees would be useful.

Box 12 - Do you agree that the above CESR proposals on past performance calculation are sufficient and workable? If not, which alternative approach would you prefer?

Yes.

Box 13 – Maintaining the past performance record

We are of the opinion that publishing a revised KID no later than 25 business days after 25th December is too tight a deadline in practice. Indeed, updating the information shown in the KIDs could be a very manual process or could be delegated to other entities. Moreover, all KIDs will have to be updated at once, which could create bottlenecks. Therefore, we think that a delay of 50 business days would be more realistic.

Box 14 - Do you agree that the above CESR proposals on material changes are sufficient and workable? If not, which alternative approach would you prefer?

AFG firmly believes that there is a need for harmonised guidelines at CESR level concerning the definition of material changes. Investors should be able to compare funds easily across Member

States. Therefore, we fear that addressing the issue of material changes at national level might lead to inconsistencies among Member States.

Box 15 - Do you agree with this approach? If not, which alternative approach would you prefer?

AFG agrees that the inclusion of a benchmark alongside the fund performance should be allowed. This should be required when a benchmark is identified in the fund's objectives and strategy but left up to the asset managers when it is not. Benchmarks, in any case, should not be required as it would be dangerous and pro-cyclical to force all our industry to be "benchmarked".

We believe that the recommendation rejecting the use of a benchmark as a proxy for non-existent performance data is prudent. As it is impossible to know how the fund would have performed compared to the benchmark during the period in which it did not exist, we are in favour of a cautious approach that does not show the performance of the benchmark in replacement of that of the fund.

Box 16 - Do you agree that the above CESR proposals on the use of 'simulated' data for past performance past performance presentation are sufficient and workable? If not, please suggest alternatives?

AFG believes that track record extensions should also be allowed for funds that change their nationality within the EU and are transferred to another Member State.

Section 8: Practical information

Do you agree with the proposals in Box 17 – Content of "Practical Information" disclosure?

AFG believes that the KID should show information that is relevant to investors. For instance, in cases where share classes are set up on a per country basis, there is no real need for investors in a given country to have details on share classes available in other countries. In the same way, retail investors do not necessarily need to have detailed information on share classes available to institutional investors. This would make the amount of information too large and confusing. Therefore, we suggest rewording the requirement relating to information on other classes as follows:

"A KID shall indicate, if applicable, where investors can obtain information about the other classes of that UCITS".

Do you agree with the proposals in Box 18?

Yes.

Section 9: Circumstances in which a KID should be revised

Do you agree with the proposals in Box 19?

We believe that, to the extent that there has been no change, there is no need to update the KID in case it is translated into an additional language. It would be misleading for investors to change the date of publication of the KID if the information shown remains unchanged (a mere translation has no impact on the KID).

Again, we wish to highlight the need for a definition at CESR level of the concept of material change (please refer to our comment on box 14).

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Special cases – how KID might be adapted for particular fund structures

Section 10: Umbrella structures

Do you agree with the proposals in Box 20?

We agree that, as long as segregation is not required by a Directive, it will be necessary to mention whether or not the assets and liabilities of each compartment are segregated by law.

Section 11: Share classes

Do you agree with the proposals in Box 21?

Yes.

Section 12: Fund of funds

Do you agree with the proposals in Box 22?

We are of the opinion that a description of the risk factors of a fund of funds as presented in point 2 is only relevant if a narrative approach to the risk reward disclosure is adopted. Indeed, the synthetic risk reward indicator should already capture these risk factors in principle.

Regarding the description of the charges that investors will incur, we believe that taking account of any charges that the UCITS will itself incur as an investor in the underlying collective undertakings will take additional time and that updated KIDs for funds of funds should be required no earlier than 75 business days after the 25th December (this will allow using any updated KIDs published by the underlying funds).

Section 13: Feeder funds

Do you agree with the proposals in Box 23?

We believe that the possibility of showing the past performance of the master UCITS for the years before the feeder operated as a feeder of that master UCITS is inconsistent with the requirements set for the presentation of past performance (please refer to Box 15: the display of a benchmark as a proxy for past performance for years in which the fund did not exist is not permitted).

Indeed, the feeder did not realise the performances of the master during that period of time, and showing the performances of the master could be misleading, especially for existing investors.

Furthermore, we think that the graph showing the performance of the feeder should indicate the date when the feeder started to operate as a feeder of the master (in the same way CESR proposes to treat material changes – please refer to Box 14).

Section 14: Structured funds, capital protected funds and other comparable UCITS

Do you agree with the above CESR proposals on performance scenarios? In particular which option (A or B) should be recommended? If not, please suggest alternatives.

Like the majority of CESR Members, we prefer option A. Option A is closest to the current situation regarding French structured funds. Besides, we agree that the scenarios chosen should be clear, fair and not misleading. However, we believe that the choice of scenarios should be left up to the management company.

We would like to reiterate the arguments against the use of risk neutral models to predict return:

- We believe that option B is based on a methodological flaw i.e. there is a confusion between real probabilities and risk neutral probabilities. Risk neutral models that are used in order to price options are completely inappropriate to give a view of expected returns on any asset, as the real world is not risk-neutral.

- More importantly, the use of risk-natural probabilities would lead to misleading results. For example, a fund that invests 100% of its assets in an equity index would achieve, in a risk-free world, an average return equal to the risk free rate minus the fees and expenses. This return would actually be expected for any fund invested in any type of assets. By definition, no real risk is taken into account and as a consequence investors would only invest in risk-free assets, which have a better expected return - because they have less costs - and no risk.

- Besides, if the risk-neutral world is chosen to evaluate structured funds, it should also be used to evaluate other funds in order to ensure the existence of a level playing field for all funds.

- Furthermore, the only probabilities that make sense for investors are real probabilities, not risk-neutral probabilities. Using historical probabilities is the only objective way of calculating real probabilities. We therefore go back to back-tests, which are the appropriate way to compute probabilities based on historical performances, but that have been discarded by CESR in the Key Information Document. We actually could build in a very objective way probability tables based on past simulations. Such probabilities would be relevant since they would incorporate real market data and real risk taking.

- If CESR wishes to pursue the route of probabilities, CESR should use historical probabilities, based on back-tests.

- Finally, this approach is very hard to implement. If regulators want coherent calculations for all funds, they would have to decide on:
    - models used;
    - more importantly, which parameters are used as Greeks for the simulations: volatility, correlations etc. This may be very arbitrary in practice since those parameters do not have public prices.

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<u>Other issues</u>

<u>Section 15: Medium and timing of delivery, including use of a durable medium</u>

Do you agree with the proposals in box 25? If not, what alternative approach would you suggest?

Yes.

<u>Section 16: Other possible level 3 work</u>

Do you agree with the approach to transitional provisions set out above?
Are there any other topics, relating to KII or use of a durable medium, not addressed by this consultation, for which CESR might undertake work on developing Level 3 guidelines?

AFG believes that no replacement of the existing Simplified Prospectus (“SP”) by the future KID should be required for funds that can no longer be sold and that transitional measures are needed for existing funds. We are of the opinion that the implementation of the KID should be progressive, in order to avoid any bottlenecks. We suggest first producing a KID for all new funds, and then gradually replacing SPs by KIDs for existing funds. We should learn lessons from the French experience of replacing the French “notice” by the Simplified Prospectus that was a burdensome, lengthy and costly (a Deloitte study mandated at that time by AFG concluded that the cost was more than 50 million euros for French management companies) process. In any case, we are opposed to implementing the KID before the first semester in 2011.

ADDENDUM

In the case of structured funds, AFG deplores that CESR prohibits the use of back-testing in the KID. We believe prospective scenarios would not be as beneficial to investors, as prospective scenarios rely on unpredictable data, which could prove misleading. Conversely, back testing uses actual data.

AFG believes that CESR should not reject as such the use of back-testing:

- We think a table could be used that shows the results to investors clearly. For instance, it could show how the fund would have behaved in different scenarios (favourable, unfavourable, average conditions).

- More importantly, back-testing relies on actual data, which would be consistent with the rest of the information provided in the KID. Conversely, relying on hypothetical data could be misleading.

- Finally, in order to make the back test reliable, regulators should set strict and precise rules in this matter. For example, when back testing is used, the French regulator approves the back testing methodology at the same time as the fund itself. This experience has proven quite satisfactory.

Questions 1-3 – Volatility "buckets"

First of all, we remind CESR that we are opposed to a mandatory SRRI in general. Second, the setting up of volatility buckets might be arbitrary to some extent even though CESR tries to solve this issue. Third, there would probably be an update issue for the volatility buckets in case of changing market conditions such as financial crisis.

None of the suggested solutions is satisfactory, as we oppose to the SRRI approach as long as no method is applicable to all funds without the risk of misleading investors. In any case, the worst would be Option B in Box 2, as it would be more difficult to segregate between the whole range of fixed-income funds. In case of Option A, an additional 7th risk class would be interesting in order to get 10/15 for class 5, 15/25 for class 6 and 25/over 25 for class 7. It would ensure a more meaningful segregation between equity funds and balanced funds.

For benchmarked funds, in any case it would be important to be allowed to disclose the tracking error or the volatility scale of the benchmark along with the one of the fund itself.

As a general principle, although we oppose to the SRRI approach because of all its drawbacks and potential dangers of misleading investors, we think that for volatility the longest observation period would be preferable (e.g. 5 years), in order to take the highest number of situations into account – in particular the recent impacts of the crisis – and to limit the changes from one class to another over time .

Question 4 – Migration rules

AFG does not think that migration rules are desirable.

Question 7 – Computing SRRI for structured funds

We agree on the principle where VAR at maturity is calculated and then an "equivalent" volatility is inferred by a log-normal model. However, we believe that it is not appropriate to take the maximum of the volatility that comes from the 1-year VAR and volatility that comes from the VAR at maturity. We should only calculate an equivalent volatility that comes from the VAR at maturity and use this volatility to classify the fund according to the risk scale.

The reasons why this seems to us not appropriate are the following:

- <u>The consultation recognizes that “most investors in structured funds tend to hold their investment until maturity”. This is very true and the consequence should be that the risk/reward indicator is calculated on that basis.</u>

  The only reason why the consultation proposes to use also the 1-year VAR is that investors are allowed to redeem before maturity. This should be seen as an added flexibility for investor, but no sensible investor will ever invest in a structured fund having in mind that he will exit before maturity. Therefore, it does not make sense to base a risk/reward indicator on a behaviour that, itself, does not make sense.

  We believe that it would be more appropriate to add a specific disclaimer of the kind that is already requested by the French regulator in simplified prospectuses of French structured funds: “The fund XYZ is built on the basis of an investment on the whole life of the fund. It is therefore highly recommended to purchase shares of such funds only if your intention is to keep them until maturity of the fund. If you sell such shares early (…)”.

  Indeed, the text of the consultation proposes to add a “specific disclaimer to indicate, where appropriate and relevant, that the fund might have a different (lower or higher) level of risk if the investment is held until maturity or, conversely, redeemed before that date”. Since the consultation proposes to take the highest risk of the two, the disclaimer would only have to say that the effective risk will always be lower than the risk mentioned by the synthetic indicator. This is very curious. Normally, a disclaimer is used to mention a potential additional risk in case of a specific event. Here the synthetic indicator would artificially increase the measure of risks, and then propose a disclaimer that the risk will always be lower!

- <u>The computation of 1-year VAR would be a quantitative nightmare.</u>

  The computation of VAR at maturity is not based on model, but only on running the formula of the fund on past data. This is therefore heavy but not difficult to implement. There is only a requirement to calculate 260 x 5 = 1300 values of the formula according to past data during 5 years. This is heavy but manageable.

  Calculating the 1-year VAR, as shown by the consultation, is much more difficult. It would imply calculating 1300 prices of the fund according to past data. Each price to be calculated would be a full pricing exercise and would have to be reproduced 1300 times.

  We believe that no asset manager has currently the systems to do such calculations every year on each structured fund. New computing chains would have to be built and the cost for the industry may be quite significant. And all this added work would be required only to calculate data that, in fact, are not relevant to investors, and require a disclaimer to mention that the real risks may be lower!

- <u>Using only VAR at maturity would not create any advantage for Structured Funds.</u>

  The formula that is used to compute the equivalent volatility takes fully into account the duration of the VAR. In other words, if the distribution of a fund is log-normal, the application of the method of Box 4 would produce an equivalent volatility equal to the historical volatility, whatever the maturity used for the calculation may be. There would be no advantage for a fund to be a structured fund, which would require finding a way to penalize them.

Question 8 – Use of VR as an (intermediate) instrument for the measurement of volatility

Yes we agree with the approach proposed by CESR, provided that only VAR at maturity is used (please refer to our answer to question 7).

Question 9 – Can the proposed solution accommodate the features of all types of structured funds?

AFG believes that the proposed methodology is not appropriate if the fund is based on baskets.

Question 10 – Computation of VaR-based volatility of structured funds over a holding period of one year

As explained above in our answer to question 7, we do not agree that a 1-year VAR should be calculated.

Question 11 – Computation of VaR-based volatility of structured funds at maturity

We agree on the method proposed by CESR.

Question 12 – Delta approach

AFG agrees with CESR's decision not to promote further the adoption of the delta representation approach for the computation of volatility of structured funds, as this methodology does not take into account the investment horizon and is also model dependent.

Question 13 – CESR's proposal

We do not think that CESR's current proposal represents an improvement with respect to the delta representation approach. Indeed, the use at the same time of the 1-year VAR and the VAR at maturity would give some irrational results. The delta approach is too simple because it does not take into account the horizon of the fund, but at least it has some logic. The mix of VAR is even worse.

Question 14 – Use of Monte Carlo simulations

Monte Carlo simulations are risk neutral simulations. They do not make sense in the real world. Only simulations based on past performances, as proposed by CESR, can give a real view of the risks. Also, Monte Carlo simulations would introduce a discrepancy between Structured Funds and other funds, where the SRRI is computed based on historical volatility. They would also be very difficult to compute. They would be also model and parameter dependent and would therefore introduce some degree of discretion by the asset manager.

Question 15: How to avoid significant differences in the outcome of simulations across management companies?

Only 1-year VAR is a problem in this respect. VAR at maturity is an objective data, which would not depend on models, and therefore not depend on the asset manager. On the contrary, 1-year VAR can be calculated only using pricing models and pricing parameters. Models are not identical among asset managers; many pricing parameters, like correlations, do not have public prices and would therefore be very dependent on the asset manager.

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Sincerely Yours,

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