AGA - n° 2794_12/Div.

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

Paris, 17th December 2010

**AFG RESPONSE TO CESR'S CONSULTATION ON CESR'S GUIDELINES ON RISK MEASUREMENT AND THE CALCULATION OF GLOBAL EXPOSURE FOR CERTAIN TYPES OF STRUCTURED UCITS**

*Ref.: CESR/10-1253*

The Association Française de la Gestion financière (AFG)[1] welcomes CESR's consultation on Risk Measurement and the Calculation of Global Exposure for Structured UCITS.

We thank CESR for the opportunity to express the French asset management's opinion on the proposal. Indeed, our industry manages a complete spectrum of asset classes and techniques, including this type of structured UCITS.

These guidelines for certain types of structured funds are clear and precise, perfectly in line with the global guidelines already issued on risk measurement. We thank CESR for having performed such an elaborated work setting clearly the scope in terms of types of UCITS as well as the appropriate process for them to use the commitment method. Our members welcome the availability as an option for UCITS managers of either using this specific approach within the guidelines or the standard methodology.

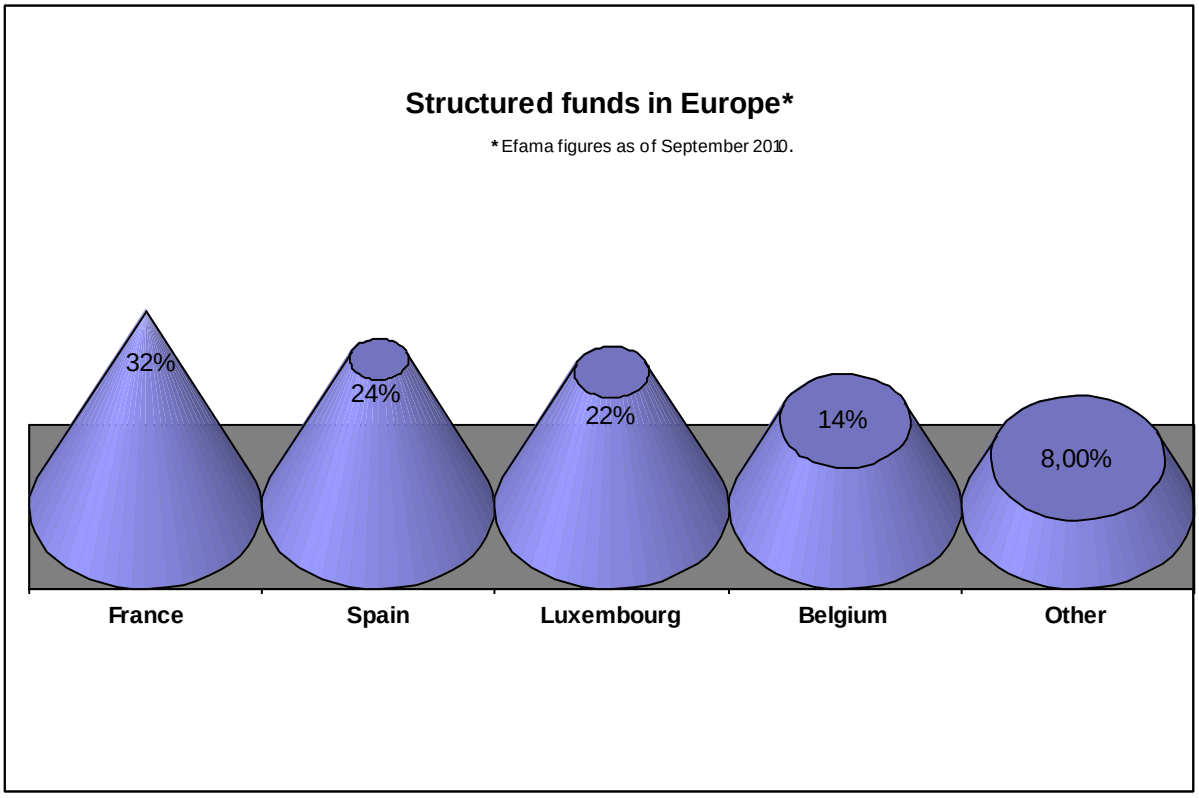
[1] The Association Française de la Gestion financière (AFG)[1] represents the France-based investment management industry, both for collective and discretionary individual portfolio managements.

Our members include 411 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing 2600 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 1600 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 Asset 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).

Please see the sector's figures below:

| **French structured funds that fall under this CESR's consultation scope (called « Formula Funds »)**<br>*Figures as of end September 2010* | |
|---|---|
| AUM | 63,8 Bln |
| % as of French funds AUM | 5,2% |
| Number of funds | 741 |
| Number of firms | 30 |




## ***General Comments***

We have thoroughly examined this consultation document and we would like to thank CESR for the work done in order to deliver a comprehensible and appropriate calculation methodology within the framework of the global exposure method.

We fully support CESR's approach to provide these types of structured UCITS with an appropriate methodology under CESR's risk measurement guidelines and permit the continuation of this market segment by the fund industry, as otherwise the demand would be supplied by less transparent and less protective vehicles for investors (eg structured notes issues under the Prospectus Directive).

- AFG agrees with CESR's approach proposing, within the global exposure method, an adequate calculation methodology for certain types of structured UCITS rather than introducing a separate regime. Splitting the formula by scenarios is an appropriate method that correctly grasps the global exposure in accordance with these UCITS' specificity in terms of scenarios (linked to the structure of the promised payoff).

- We also agree that the perimeter should be precisely delimited to those UCITS which comply with strict criteria in order to maintain the overall coherence of the methodology and ensure adequate investment protection.

- One remark however: all structured UCITS having an equivalent financial set-up and the same payoff should be submitted to an equivalent treatment. Our members bring in supplemental technical insight inspired from practice. Indeed, different technical solutions exist to manage a same type of structured UCITS.

In brief, structures that involve

1. [set –up of a collateralised repo with a counterparty + a performance swap];
2. [an investment portfolio + a performance swap + an external guarantee of the payoff]
3. [an investment portfolio + a total return swap]

are all technical set-ups that comply with the guidelines under the provisions of Box 3 and should be permitted under Case 1.

## ***Please see our detailed responses below:***

**1. Do you agree with the proposed approach for the calculation of global exposure by certain types of structured UCITS which satisfy the criteria in paragraph 2 of Box 29?**

Yes, we agree with the approach proposed in these guidelines.

We thank CESR for the quality and the work done related to the risk measuring of certain types of structured UCITS. We support CESR in its view of specifying an adequate calculation methodology within the global exposure method for these types of structured UCITS (rather than introducing a separate regime).

**2. Do you agree with the proposed criteria for these structured UCITS?**

Yes, we agree with the proposed criteria that delimit the scope in a precise and strict manner. Indeed, the scope for the structured UCITS that choose to use this specific approach has to be limited to those structured UCITS which comply with these strict criteria in order to maintain the overall coherence of the methodology and ensure adequate investment protection.

In our view, the only appropriate manner to further define point 2 (h) of Box 29 is throughout the rule illustrated by examples under paragraph 97. Our members believe that the proposed approach to look through the payoff itself is quite efficient. In practice, it is rather impossible to set any quantitative criteria based on the NAV that would be applicable to the switch from one scenario to another.

**3. Do you agree with the scope of the application of the alternative approach that derives from the criteria and global exposure calculation approach laid down in paragraph 2 of Box 29? If there are any specific criteria which could present difficulties for certain UCITS, could you elaborate on the reasons for your views and describe the types of UCITS concerned?**

We agree in general with the criteria listed in paragraph 2 of Box 29.

Nevertheless, we have one remark, explained in detail under Q11, related to point b) about the assessment of the derivative to be excluded from the calculation of the global exposure under the provisions of Box 3 and Box 4 of the guidelines. Indeed, as in practice there are several equivalent technical solutions to structure a same type of structured UCITS (the one described in Case 1), our point at Q11 is to further specify this structure. Our point is that structured UCITS having an equivalent financial set-up and the same payoff should be submitted to an equivalent treatment.

**4. Can you suggest any alternative criteria?**

Please refer to the question above.

**5. Do you agree with the proposal to limit the maturity of structured UCITS which may apply the provisions of Box 29 to 9 years? Do you have any alternative suggestions?**

We acknowledge the regulators' proposal to limit maturities of structured UCITS which may apply the provisions of Box 29 to 9 years. Taking into account one of the structured fund's typical characteristics - that is the presence of an initial marketing period, the limitation to 9 years is understood ***after the initial marketing period*** (ie after the strike).

We deem, however, that longer formulas will be needed in order to respond to specific needs in terms of longer investment periods (such as for pension and retirement field). Indeed, 8

years length in the insurance field is linked today to fiscal matters, but Solvency II will probably have a heavy impact in terms of requiring longer time periods as well as capital protection. Therefore, we propose in this context and for capital guaranteed funds, to extend of the limit to ***15 years***.

**6. Do you agree with the proposal to prohibit these structured UCITS from accepting new subscriptions after the initial offer period?**

Yes.

**7. Do you agree with the proposed criteria to limit the maximum loss the UCITS can suffer under any individual scenario on any given day? Can you suggest any methods by which this loss can be limited or other safeguards which would deal with the risks posed by barrier-type features as described in Box 29?**

Yes, we agree with the proposed criteria. Indeed, splitting the formula by scenario and calculating the commitment for each scenario limits effectively the maximum loss.

As for barrier type features and the gap between promised payoffs by scenario at maturity, the respect of the diversification requirements make an appropriate safeguard that implicitly sets limits and in this respect, the guidelines provide clear examples illustrating the diversification rule under paragraph 97. Our members believe that the proposed approach to look through the payoff itself is quite efficient. In practice, it is rather impossible to set any quantitative criteria based on the NAV that would be applicable to the switch from one scenario to another.

**8. Do you agree with the proposals regarding structured UCITS which were authorised before 1 July 2011? Do you have any alternative suggestions?**

Yes.

**9. Are the examples provided in paragraph 97 useful in illustrating the diversification requirement?**

Yes.

**10. Can you suggest alternative examples?**

No.

**11. Do you think the examples in paragraph 98 correctly explain how global exposure is calculated in different scenarios?**

We think that the examples and cases provided in the document are correctly explaining how global exposure is calculated in different scenarios.

However, our members would like to specify further the structures described under Case 1 (permitted use of the provisions of Box 3).

Indeed, we would like to point out that there are several structures which all comply with the criteria of Box 3 and which should also be allowed to apply the commitment approach on individual scenario. These structures, for which we will give further detail in this document, are actually used by the French asset management industry, and their features fulfil all the criteria described in point 2 of Box 29.

- In this perspective, we will focus on the structures permitted under Case 1.
- Then, for better clarity, we will describe and illustrate each set-up we have identified under ***Case 1 – permitted use of the provisions of Box 3***.

## I. Focus on the structure presented under Case 1 - permitted use of the provisions of Box 3

- The case of a UCITS invested in a total return swap with a counterparty leads to a calculation of global exposure that complies under the provisions of Box 3 with the global exposure requirements (case 1).

- This box allows excluding a derivative from the calculation of the commitment if three conditions are met:

(a) a performance swap is set up;

(b) the market risk is totally offset through the use of the swap;

(c) no additional risks, optional features, leverage… are added.

- If the structure fulfils these criteria, the performance swap is not taken into account for the calculation of the global exposure.

- We would like to specify that there are several ways to comply with Box 3. Structures that involve

1. [an investment portfolio + a total return swap];

2. [set –up of a fully collateralised repo with a counterparty + a performance swap];

3. [an investment portfolio + a performance swap + an external guarantee of the payoff]

meet the criteria (a) + (b) + (c) of Box 3 mentioned above and constitute equivalent technical set-ups under Case 1 of these guidelines.

## II. We unroll hereafter the example given in the guidelines for the three set-ups we have identified under Case 1 .

**Case 1: The UCITS enters into a performance swap (including fully funded swaps) that complies with all the criteria set out under Box3.**

***1. Set-up of the fund: [an investment portfolio + a total return swap]***

This structure complies with all the criteria of point 2 of Box 29 allowing the UCITS to calculate its global exposure using the commitment approach on individual scenarios.

This set-up is the one already presented in the guidelines (Paragraph 98, Case 1, page 7).

*Technical Description:*

- The UCITS invests in a portfolio of eligible assets.
- The UCITS enters into a total return swap with counterparty. The market risk is totally offset through the use of the swap.

*Illustrative example*

The following example illustrates how a UCITS which has the structure described above can use the procedure outlined in Box 29 to calculate its global exposure.

| ***Example*** | |
|---|---|
| Maturity | 5 years |
| Pay-off | The payoff at maturity is equal to the investor's initial investment plus 120% of the positive performance of the Eurostoxx 50 index.<br>At maturity:<br>Scenario 1 - If the performance of the Eurostoxx 50 index is positive (e.g. +30%) then the payoff is equal to the initial investment (e.g. €1,000 plus 120% of the performance of Eurostoxx 50 index (€1,000*120%*30% = €1,360<br>Scenario 2 - If the performance of the Eurostoxx index is negative then the payoff is equal to the initial investment i.e. €1,000 |
| | |

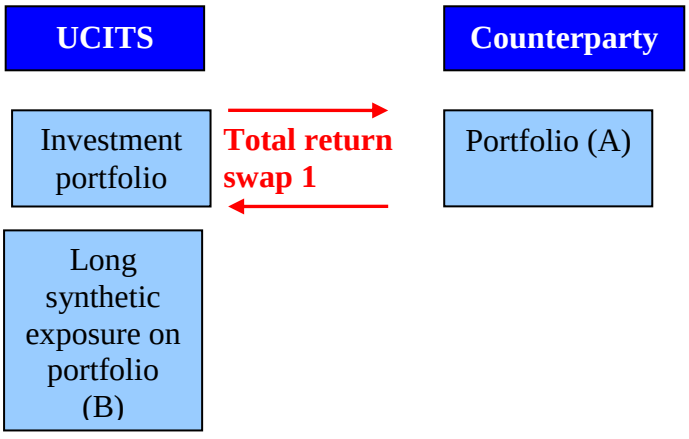
| | |
|---|---|
| Split by scenario | The alternative scenarios into which the UCITS can be broken down are the following:<br><br>Scenario 1: the payoff is equal to the initial investment plus 120% of the performance of the Eurostoxx 50 index (if the performance of the Eurostoxx 50 index is positive)<br><br>Scenario 2: the payoff is equal to the initial investment (if the performance of the Eurostoxx 50 index is negative). |

In **scenario 1**, the UCITS can be seen as a combination of:

a) An investment portfolio,

b) A total return swap which exchanges the total return of the fund investment portfolio for a portfolio (A) which offers 100% of the initial NAV and 100% of the performance of Eurostoxx 50,

c) A long synthetic exposure on a portfolio (B) which offers synthetic exposure on 20% of the performance of Eurostoxx 50.




Since the combination of (a) and (b) fulfils the criteria of Box 3 of the Guidelines, the total return swap is not taken into account for the calculation of global exposure.

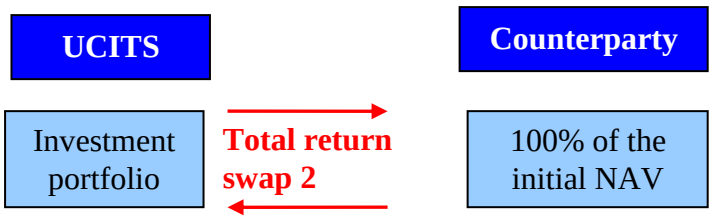
The long synthetic exposure on portfolio (B) is taken into account for the calculation of global exposure. Its commitment is equal to the market value of the underlying; that is 20% of the Eurostoxx 50 index.

Since the payoff under scenario 1 is equal to the initial investment plus 120% of the Eurostoxx 50, this leads to a global exposure of 0.2 for scenario 1.

In **scenario 2**, the UCITS can be seen as a combination of:

a) An investment portfolio,

b) A total return swap which exchanges the performance of that investment portfolio for 100% of the initial investment.




Since the combination of (a) and (b) fulfils the criteria of Box 3, the total return swap is not taken into account for the calculation of global exposure. This leads to a global exposure of 0 for scenario 2.

***2. Set-up of the fund: [set –up of a collateralised repo[2] with a counterparty + a performance swap];***

This structure complies with all the criteria of point 2 of Box 29 allowing the UCITS to calculate its global exposure using the commitment approach on individual scenarios.

*Technical Description:*

- The UCITS enters into a fully collateralised repo agreement with a counterparty and receives in collateral a portfolio of eligible assets. The value of the portfolio is equal to the value of the cash invested.
- The UCITS money market return received for the repo agreement (in exchange of the *total return* of the collateral assets) is exchanged via a performance swap with the promised payoff. It results that the total return of the collateral assets is exchanged with the promised payoff and the market risk of the swapped assets is totally offset.

*Illustrative example*

The following example illustrates how a UCITS which has the structure described above can use the procedure outlined in Box 29 to calculate its global exposure.

| ***Example*** | |
|---|---|
| Maturity | 5 years |
| Pay-off | The payoff at maturity is equal to the investor's initial investment plus 120% of the positive performance of the Eurostoxx 50 index.<br>At maturity:<br>Scenario 1 - If the performance of the Eurostoxx 50 index is positive (e.g. +30%) then the payoff is equal to the initial investment (e.g. €1,000 plus 120% of the performance of Eurostoxx 50 index (€1,000*120%*30% = |

[2] The repo structure detailed here is a "Reverse repo".

| | |
|---|---|
| | €1,360<br>Scenario 2 - If the performance of the Eurostoxx index is negative then the payoff is equal to the initial investment i.e. €1,000 |
| | |
| Split by scenario | The alternative scenarios into which the UCITS can be broken down are the following:<br><br>Scenario 1: the payoff is equal to the initial investment plus 120% of the performance of the Eurostoxx 50 index (if the performance of the Eurostoxx 50 index is positive)<br><br>Scenario 2: the payoff is equal to the initial investment (if the performance of the Eurostoxx 50 index is negative). |

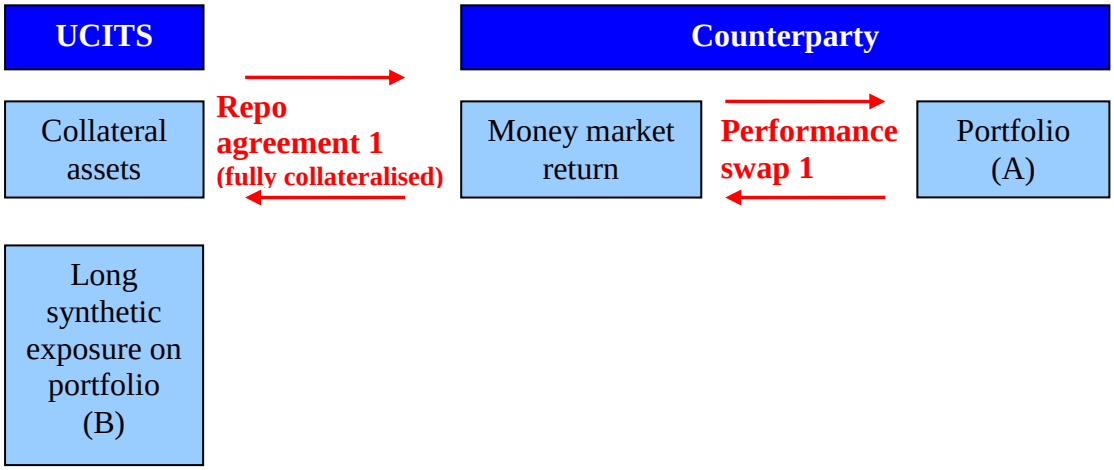
In **scenario 1**, the UCITS can be seen as a combination of:

a) A portfolio of assets held in the UCITS as collateral of the repo,

b) The repo agreement which exchanges the ***total return of the collateral assets*** for a money market return,

c) A performance swap which exchanges the money market return ***for a portfolio (A)*** which offers 100% of the initial NAV and 100% of the performance of Eurostoxx 50,

d) A long synthetic exposure on a portfolio (B) which offers synthetic exposure on 20% of the performance of Eurostoxx 50.




The combination of (b) and (c) results in an exchange of the ***total return of the assets held in the UCITS for a portfolio (A)*** which offers 100% of the initial NAV and 100% of the performance of Eurostoxx 50.

The market risk is totally offset and no additional risks are added by the use of the derivative. Therefore, the combination of (b) and (c) detailed above meet the criteria (b) and (c) of Box 3 of the Guidelines.

Since the combination of (a), (b) and (c) detailed above fulfils all the criteria of Box 3 of the Guidelines, the derivative is not taken into account for the calculation of global exposure.

The long synthetic exposure on portfolio (B) is taken into account for the calculation of global exposure. Its commitment is equal to the market value of the underlying; that is 20% of the Eurostoxx 50 index.

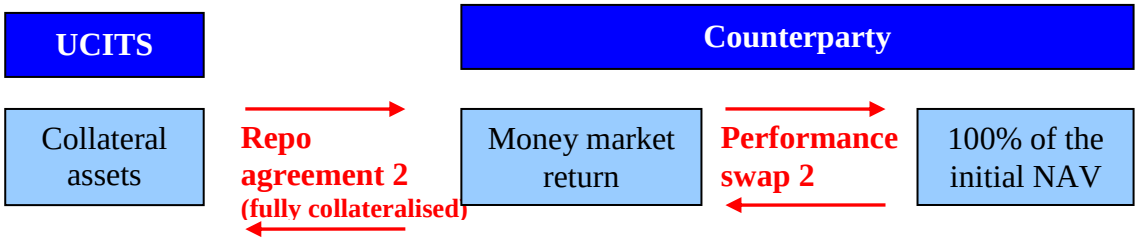
Since the payoff under scenario 1 is equal to the initial investment plus 120% of the Eurostoxx 50, this leads to a global exposure of 0.2 for scenario 1.

In **scenario 2**, the UCITS can be seen as a combination of:

a) A portfolio of assets held in the UCITS as collateral of the repo,

b) The repo agreement which exchanges the ***performance of the collateral assets*** for a money market return,

c) A performance swap which exchanges the money market return ***for 100% of the initial investment.***




The market risk is totally offset and no additional risks are added by the use of the derivative. Therefore, the combination of (b) and (c) detailed above meet the criteria (b) and (c) of Box 3 of the Guidelines.

Since the combination of (a), (b) and (c) detailed above fulfils all the criteria of Box 3 of the Guidelines, the derivative is not taken into account for the calculation of global exposure. This leads to a global exposure of 0 for scenario 2.

***3. Set-up of the fund: [an investment portfolio + a performance swap + an external guarantee of the payoff]***

This structure complies with all the criteria of point 2 of Box 29 allowing the UCITS to calculate its global exposure using the commitment approach on individual scenarios.

*Technical Description:*

- The UCITS invests in a portfolio of eligible assets.
- The UCITS enters into a performance swap with counterparty and the payoff benefits from an external guarantee. The resulting structure totally offsets the market risk of the swapped assets.

*Illustrative example*

The following example illustrates how a UCITS which has the structure described above can use the procedure outlined in Box 29 to calculate its global exposure.

| ***Example*** | |
|---|---|
| Maturity | 5 years |
| Pay-off | The payoff at maturity is equal to the investor's initial investment plus 120% of the positive performance of the Eurostoxx 50 index.<br>At maturity:<br>Scenario 1 - If the performance of the Eurostoxx 50 index is positive (e.g. +30%) then the payoff is equal to the initial investment (e.g. €1,000 plus 120% of the performance of Eurostoxx 50 index (€1,000*120%*30% = €1,360<br>Scenario 2 - If the performance of the Eurostoxx index is negative then the payoff is equal to the initial investment i.e. €1,000 |
| | |
| Split by scenario | The alternative scenarios into which the UCITS can be broken down are the following:<br><br>Scenario 1: the payoff is equal to the initial investment plus 120% of the performance of the Eurostoxx 50 index (if the performance of the Eurostoxx 50 index is positive)<br><br>Scenario 2: the payoff is equal to the initial investment (if the performance of the Eurostoxx 50 index is negative). |

In **scenario 1**, the UCITS can be seen as a combination of:

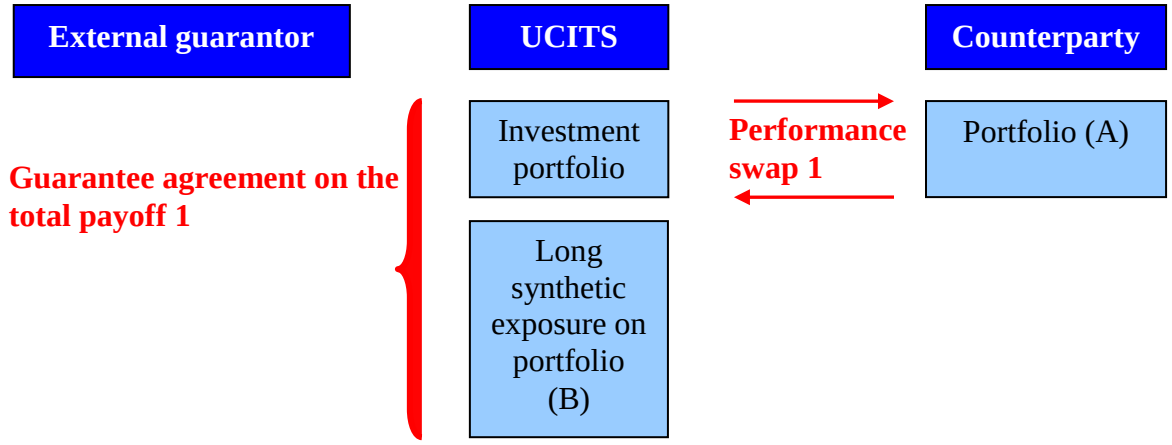
a) An investment portfolio,

b) A ***performance swap*** which exchanges the performance of the fund investment ***portfolio for a portfolio (A)*** which offers 100% of the initial NAV and 100% of the performance of Eurostoxx 50,

c) A long synthetic exposure on a portfolio (B) which offers synthetic exposure on 20% of the performance of Eurostoxx 50,

d) ***An external[3] guarantee on the total payoff made of (A)*** and (B).

[3] The final predefined payoff is guaranteed by an external entity with enough capital to make a strong, legally binding and enforceable commitment.




The guarantee agreement (d) is a supplemental element in the structure that totally offsets the market risk of the swapped assets held in the UCITS portfolio so that the UCITS performance does not depend on the performance of the swapped assets. Also, no additional risks, leverage or optional features are added compared to a direct holding of the reference assets. Thus, the combination of the guarantee agreement (d) element with the performance swap (b) element meets the criteria (b) and (c) of Box 3 of the Guidelines.

Since the combination of (a), (b) and (d) detailed above fulfils all the criteria of Box 3 of the Guidelines, the derivative is not taken into account for the calculation of global exposure.

The long synthetic exposure on portfolio (B) is taken into account for the calculation of global exposure. Its commitment is equal to the market value of the underlying; that is 20% of the Eurostoxx 50 index.

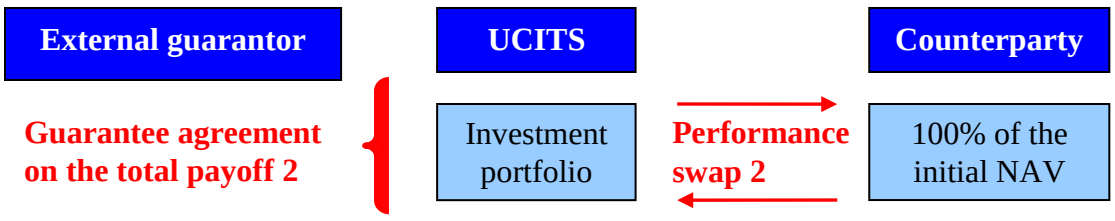
Since the payoff under scenario 1 is equal to the initial investment plus 120% of the Eurostoxx 50, this leads to a global exposure of 0.2 for scenario 1.

In **scenario 2,** the UCITS can be seen as a combination of:

a) An investment portfolio,

b) A performance swap which exchanges the performance of that investment portfolio for 100% of the initial investment.

c) An external guarantee on the total payoff.




The guarantee agreement (c) is a supplemental element in the structure that totally offsets the market risk of the investment portfolio so that the UCITS performance does not depend on the performance of the swapped assets. Also, no additional risks, leverage or optional features are

added compared to a direct holding of the reference assets. Thus, the combination of the guarantee agreement (c) with the performance swap (b) meets the criteria (b) and (c) of Box 3 of the Guidelines.

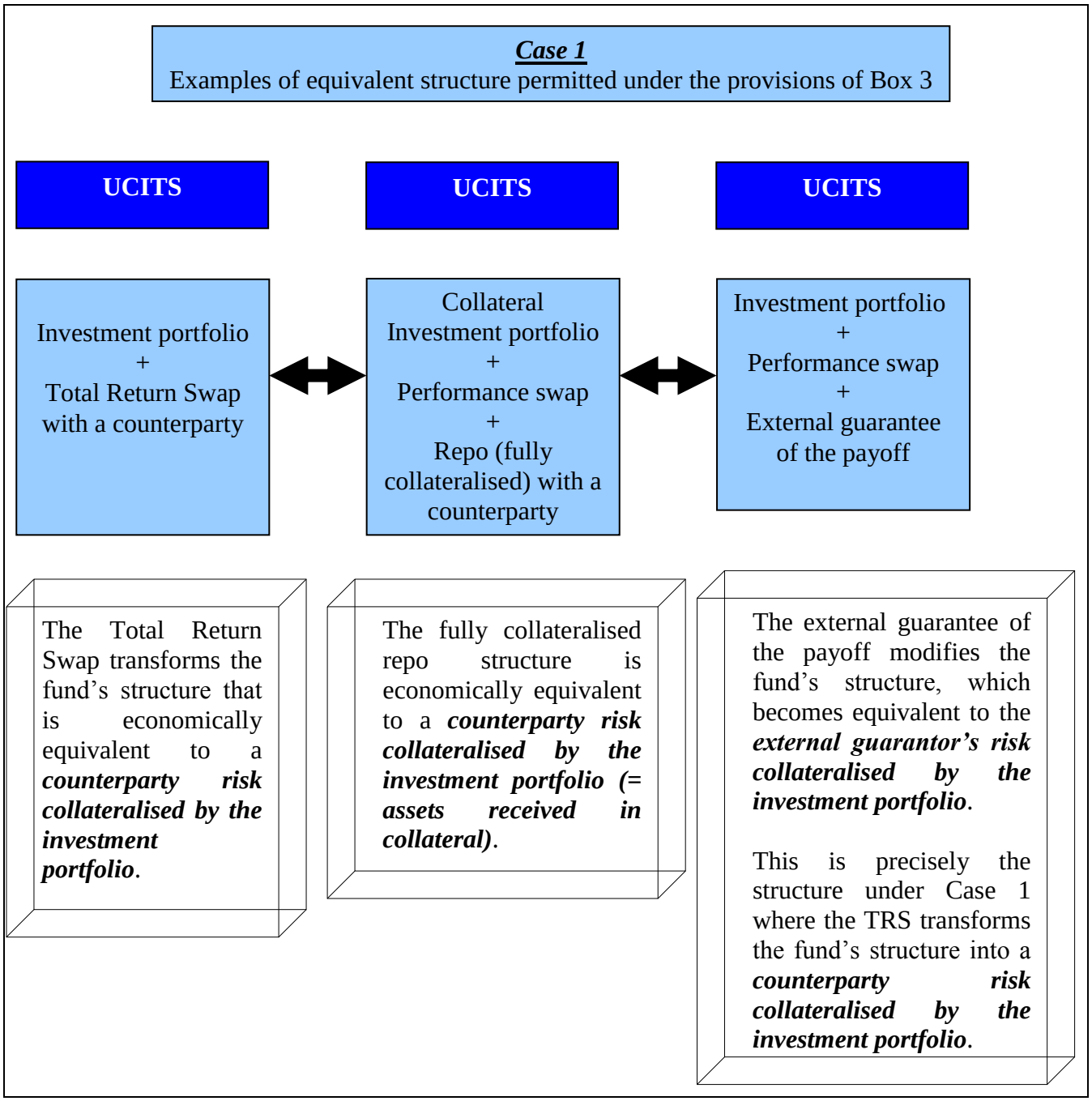
Since the combination of (a), (b) and (c) detailed above fulfils all the criteria of Box 3 of the Guidelines, the derivative is not taken into account for the calculation of global exposure. This leads to a global exposure of 0 for scenario 2.

- To summarise, the three examples described above:

1. [an investment portfolio + a total return swap].
2. [set –up of a fully collateralised repo with a counterparty + a performance swap];
3. [an investment portfolio + a performance swap + an external guarantee of the payoff]

are all technical practices that implement an equivalent structure that fulfils all the criteria of Box 3 and therefore the performance swap is not taken into account for the calculation of the global exposure. These 3 examples illustrate the structure depicted under Case 1 (***Case 1 – permitted use of the provisions of Box 3***.)

All three set-ups we have detailed are actually used in the French asset management industry. The second and third set-ups presented above would represent about two thirds of the French industry.




**12. Do you have alternative examples?**

No.

**13. Do you agree with the proposed prospectus disclosure requirements in Box 30?**

Yes, we fully agree. Disclosures are a determinant element.

**14. Is the terminology used in the guidelines clear? Are there any terms used for which you feel it would be helpful to have a definition?**

These guidelines for certain types of structured UCITS are clear and precise, perfectly in line with the global guidelines already issued on risk measurement. We thank CESR for having performed such an elaborated work to clearly set the scope in terms of types of funds as well as the appropriate process for them to use the commitment method.

If you need any further information, please don't hesitate to contact Eric Pagniez, at +33.1.44.94.94.06 (e.pagniez@afg.asso.fr) or Adina Gurau Audibert, at +33.1.44.94.94.31 (a.gurau.audibert@afg.asso.fr) or myself at +33.1.44.94.94.29 (p.bollon@afg.asso.fr).

Sincerely Yours,

(signed)

Pierre Bollon