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

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**AFG RESPONSE TO CESR'S CONSULTATION ON RISK MEASUREMENT FOR
THE PURPOSES OF THE CALCULATION OF UCITS GLOBAL EXPOSURE**

Ref.: CESR/09-489

Dear all,

The Association Française de la Gestion financière (AFG)¹ welcomes CESR's consultation on Risk Measurement for the purposes of the calculation of UCITS' global exposure.

We want to thank CESR for having submitted this consultation paper within the framework of the technical advice to be rendered on the issue of risk measurement under the provisional mandate given by the European Commission concerning the new UCITS Directive.

We have thoroughly examined this consultation document and we would like to point out the paper's definitely upper quality as well as the high degree of professionalism shown by the document authors.

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 2400 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 1400 billion euros managed from France, i.e. 21% 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).

In our opinion, with the exception of some specific - but very important - points detailed in the comments below, the paper's suggested measures should be preserved as far as possible at level 2 and not 3 so as to allow for a harmonized level of constraint throughout all countries.

All questions left unanswered in this note imply our agreement on the proposed text. Please see below our comments on specific questions:

Answers

Question 2. Should the counterparty risk involved in an OTC derivative be considered in the calculation of global exposure?

Yes, we agree that the counterparty risk involved in an OTC derivative should not be included in the calculation of the global exposure which is thus reduced to its market risk dimension (given that the counterparty risk in OTC derivatives is already limited through specific ratios as of the Article 52(1) of the new UCITS Directive).

Question 4. Do you agree that the incremental exposure/leverage generated through techniques such as repurchase and securities lending transactions should be included in the calculation of global exposure?

Yes, when these instruments generate new market exposure, it should be taken into account. However, most repos would not create additional risk and as such they are to be excluded (as it is the case for derivative instruments in part 1.5). In short, standard repos should be considered as a purchase + a forward sale derivatives, or a sale + a forward purchase derivatives. The combination of the 2 operations does not create any market exposure.

Question 5. Does option 1 correctly assess the market risk linked to investment in the corresponding instruments, and if so please explain?

No. Option 1 measures the maximum potential loss not the global exposure to markets.

Question 6. Does option 2 correctly assess the market risk linked to investment in the corresponding instruments, and if so please explain?

This option is adequate to measure the global market exposure and is also the market practice.

Question 10. Are there other types of financial derivative instruments which should be included in the paper?

Not at this stage.

Question 11. Are you aware of any type of financial derivative instrument where global exposure cannot be calculated using the commitment approach?

Yes, as it is said in the paper, some financial derivative instruments cannot be taken into account using only and always the commitment approach: digital options, barrier options, variance swaps...

Question 14. Do you consider that this should be compulsory for these types of derivative or optional for UCITS?

We think that the sensitivity approach is appropriate for UCITS focused on interest-rate instruments and balanced UCITS, however it should be optional so as to permit the use of VaR following the level of complexity (ex: fixed income arbitrage...).

Question 16. What quantitative level would you consider appropriate for the default sensitivity?

Our view is that each fund should have the responsibility of the risk assessment and therefore be able to set its own corresponding default level. In case the threshold is not already set, we deem appropriate a general default sensitivity level at 10, as consistent with long term bonds.

Question 21. Do you consider that the strong correlation requirement should be further clarified by means of a quantitative threshold e.g. 0.9?

Yes, the requirement may be further clarified by the use of a quantitative threshold as suggested, but also by reducing the commitment in proportion to the correlation coefficient (especially in case of index netting). Also, the Tracking Error notion may be useful to warrant the hedging quality.

Question 23. Do you agree with this proposal?

Yes, as this subject reintroduces a provision that appears already within UCITS III Directive. The specific computing methods should be left to level III.

Question 27. Do you agree with the approach outlined in paragraphs 2.3, 2.4 and 2.5?

Yes, we agree with the approach with the exception of the internal validating function being independent from the building function which is not a very cost-effective measure.

Question 30. What type of criteria should competent authorities take into account in an assessment of the VaR Models?

Rather than concentrate on specific criteria, we would rather have the investment company asked to identify and recognize the models' operational limits.

Question 33. Do you consider that the proposed limitations on the reference portfolio constitute reasonable and adequate safeguards to ensure that the relative VaR method does not result in the UCITS taking excessive risk or leverage?

Yes, we agree to the proposed limitations. However, in the case of a long biased long/short portfolio, it may be appropriate to have the possibility to take a long only reference.

Question 39. Should UCITS using strategies that are potentially highly leveraged under the absolute VaR method be subject to specific marketing provisions, either at the level of the UCITS (minimum initial investment) or during the marketing process?

No they should not. UCITS that follow such strategies should describe these strategies, as required by general regulations concerning the content of the prospectus. There is no reason to add requirements since the global exposure is as well limited using a VaR criteria than using a commitment method.

Question 41. Do you agree with the proposed method for calculating counterparty exposure?

We agree with the proposition, which is at the same time appropriate and simple to implement. This is also the method that is used by some countries, including France. The counterparty risk is calculated following the compensation between the collateral and the OTC derivative's value; it is the potential residual debt of the counterparty as obtained after the compensation.

Question 45. Do you agree with the proposed approach to agree a set of principles in relation to acceptable collateral to reduce counterparty exposure? Do you have alternative suggestions?

The principle should be that collateral can be deducted from counterparty risk. The only requirements should be eligibility and liquidity (especially through the ability of the positions to be easily transferable). However there is no need of any diversification requirement, since collateral is not a primary market risk.

Question 46: Do you consider that rather than following principles based approach specific instruments that can be used as eligible collateral should be identified?

We agree with the proposed principles-based approach. Eligibility principles are already edited by the general regulation and drafting a list may be confusing.

Question 47. Should collateral be UCITS compliant in terms of asset eligibility and diversification?

We agree that collateral should be UCITS compliant in terms of asset eligibility, including the possibility of using assets that are eligible only in the “other assets” ratio of 10%. However, again, the only requirement in terms of the quality of the eligible assets should be a reasonable time to liquidate. Diversification is not required.

Question 48. Do you agree that collateral passed to a derivative counterparty should be included in the either the 5%/10% OTC counterparty limit or the 20% issuer concentration limit?

The collateral should be netted with the counterparty risk. If the balance gives an exposure of the UCITS on the counterparty, this balance is a counterparty risk that is regulated by the 5%/10% OTC counterparty risk as well as by the 20% combined exposure.

If the balance is in favour of the counterparty, this is not a counterparty risk for the UCITS, but a counterparty risk for the UCITS' counterparty.

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Sincerely Yours,

Pierre Bollon