

IRELAND – SETTING BEST PRACTICE

Managing Derivatives in a UCITS III Fund
1 March 2007

Use of Derivatives - Background



- Flexibility
- Product Directive
 - Article 21 (2) – no divergence from investment objective
 - Article 21 (3) – global exposure
 - Article 21 (1) – employ a risk management process
 - Article 24a – disclosure of volatility

Use of Derivatives – Practical Implications

The Manager must construct a formal risk management process that is appropriate to the complexity and sophistication of derivatives used within the scheme.

Use of Derivatives – Practical Implications

Extended powers offer a more flexible approach

- New Investment Strategies/Funds
- Market Exposure
- Saving of Costs – transaction taxes, custody fees
- Use of SWAPS – Guaranteed/Protected Funds

Use of Derivatives – Appropriate Systems and Controls

Appropriate Systems and Controls

- Supervisory Structure
- Independent Framework of internal controls
- Process for approving

Use of Derivatives – Risk Management Process

Establish and Approve an Effective Policy and Appropriate Supervisory Structure

- Committee
- Responsibility
- Internal Audit
- External Audit
- Remuneration
- Notification

Use of Derivatives – Independent Framework of Internal Controls

An independent framework of internal controls is necessary to ensure an effective and controlled use of derivatives within the fund

- Strategy – subject to rigorous prior assessment and approval
- Report to Committee
 - Investment Strategies
 - Intended
 - Limitations
 - Appetite for Risk
 - Regulatory Constraints
 - Monitoring Positions
 - Depositary

Use of Derivatives – Ten Point Plan

1. Competence
2. Appropriateness
3. Responsibility
4. Segregation
5. Process
6. Monitoring
7. Limit Setting
8. Independent Price Verification
9. Stress Testing
10. Reporting

Use of Derivatives – Conclusion

- Robust Process
- Supervisory Structure
- Independent Framework

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