

Chapter 7

Market risk

7.7 Position risk requirements for collective investment undertakings

Collective investment undertaking PRR calculation

- 7.7.1** **R** A *firm* must calculate its *CIU PRR* by:
- (1) identifying which *CIU positions* must be included within the scope of the *PRR* calculation (see ■ BIPRU 7.7.2R);
 - (2) identifying which *CIU positions* are to be subject to the *CIU PRR* and which *positions* are to be subject to one of the other *PRR charges*;
 - (3) converting on a daily basis net *positions* into the *firm's base currency* at the prevailing spot exchange rate before their aggregation;
 - (4) calculating an individual *PRR* for each *position* in a *CIU* (see ■ BIPRU 7.7.5R);
 - (5) summing the resulting individual *PRRs*.

Scope of the PRR calculation for collective investment undertakings

- 7.7.2** **R**
- (1) A *firm's PRR* calculation must include all *trading book positions* in *CIUs*.
 - (2) A *firm's CIU PRR* calculation must include all *trading book positions* in *CIUs* unless they are treated under one of the *CIU look through methods* and included in the *PRR* calculations for the relevant underlying investments or subject to an *option PRR*.
 - (3) A *firm's PRR* calculation for *CIUs* must include notional *positions* arising from *trading book positions* in *options* or *warrants* on *collective investment undertakings*.

General rules

- 7.7.3** **R** Unless noted otherwise, no netting is permitted between the underlying investments of a *CIU* and other *positions* held by a *firm* for the purposes of calculating the *PRR charge* for a *position* in a *CIU*.
- 7.7.4** **R** A *firm* may rely on a third party to calculate and report *PRR* capital requirements for *position risk* (*general market risk* and *specific risk*) for *positions* in *CIUs* falling within ■ BIPRU 7.7.9R and ■ BIPRU 7.7.11R, in

accordance with the methods set out in ■ BIPRU 7.7, provided that the correctness of the calculation and the report is adequately ensured.

Calculation of the collective investment undertaking PRR

- 7.7.5** **R** Without prejudice to other provisions in ■ BIPRU 7.7, a *position* in a *CIU* is subject to a *collective investment undertaking PRR* (general market risk and specific risk) of 32%. Without prejudice to provisions in ■ BIPRU 7.5.18R (Foreign currency PRR for *CIUs*) or, if the *firm* has a *VaR model permission*, ■ BIPRU 7.10.44R (Commodity risks and *VaR models*) taken together with ■ BIPRU 7.5.18R, where the modified gold treatment set out in those *rules* is used, a *position* in a *CIU* is subject to a *securities PRR* requirement for position risk (general market risk and specific risk) and a foreign currency PRR of no more than 40%.

Look through methods: General criteria

- 7.7.6** **R** A *firm* may determine the *securities PRR* requirement for *positions* in *CIUs* which meet the criteria set out in ■ BIPRU 7.7.7R, by one of the following methods:

- (1) the *standard CIU look through method* (■ BIPRU 7.7.4R and ■ BIPRU 7.7.7R - ■ BIPRU 7.7.10R); or
- (2) the *modified CIU look through method* (■ BIPRU 7.7.4R, ■ BIPRU 7.7.7R - ■ BIPRU 7.7.8R and ■ BIPRU 7.7.11R - ■ BIPRU 7.7.12R).

- 7.7.7** **R** The general eligibility criteria for using the methods in ■ BIPRU 7.7.4R and ■ BIPRU 7.7.9R - ■ BIPRU 7.7.11R, for *CIUs* issued by *companies* supervised or incorporated within the *UK* are that:

- (1) the *CIU's* prospectus or equivalent document must include:
 - (a) the categories of assets the *CIU* is authorised to invest in;
 - (b) if investment limits apply, the relative limits and the methodologies to calculate them;
 - (c) if leverage is allowed, the maximum level of leverage; and
 - (d) if investment in OTC financial derivatives or repo-style transactions are allowed, a policy to limit counterparty risk arising from these transactions;
- (2) the business of the *CIU* must be reported in half-yearly and annual reports to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period;
- (3) the units/shares of the *CIU* are redeemable in cash, out of the *undertaking's* assets, on a daily basis at the request of the Unitholder;
- (4) investments in the *CIU* must be segregated from the assets of the *CIU* manager; and
- (5) there must be adequate risk assessment, by the investing *firm*, of the *CIU*.

- 7.7.8 **R** Third country *CIUs* are eligible if the requirements in ■ BIPRU 7.7.7R (1) - ■ BIPRU 7.7.7R (5) are met.

Standard CIU look through method: General

- 7.7.9 **R**
- (1) Where a *firm* is aware of the underlying investments of the *CIU* on a daily basis the *firm* may look through to those underlying investments in order to calculate the *securities PRR* for *position risk* (*general market risk* and *specific risk*) for those *positions* in accordance with the methods set out in the *securities PRR* requirements or, if the *firm* has a *VaR model permission*, in accordance with the methods set out in ■ BIPRU 7.10 (Use of a Value at Risk Model).
 - (2) Under this approach, *positions* in *CIUs* must be treated as *positions* in the underlying investments of the *CIU*. Netting is permitted between *positions* in the underlying investments of the *CIU* and other *positions* held by the *firm*, as long as the *firm* holds a sufficient quantity of units to allow for redemption/creation in exchange for the underlying investments.

Standard CIU look through method: Index or basket funds

- 7.7.10 **R**
- (1) A *firm* may calculate the *securities PRR* for *position risk* (*general market risk* and *specific risk*) for *positions* in *CIUs* in accordance with the methods set out in the *securities PRR* requirements or, if the *firm* has a *VaR model permission*, in accordance with the methods set out in ■ BIPRU 7.10 (Use of a Value at Risk Model), to assumed *positions* representing those necessary to replicate the composition and performance of the externally generated index or fixed basket of *equities* or *debt securities* referred to in (a), subject to the following conditions:
 - (a) the purpose of the *CIU's* mandate is to replicate the composition and performance of an externally generated index or fixed basket of *equities* or *debt securities*; and
 - (b) a minimum correlation of 0.9 between daily price movements of the *CIU* and the index or basket of *equities* or *debt securities* it tracks can be clearly established over a minimum period of six months.
 - (2) Correlation as referred to in (1)(b) means the correlation coefficient between daily returns on the *CIU* and the index or basket of *equities* or *debt securities* it tracks.

CIU modified look through method

- 7.7.11 **R**
- Where a *firm* is not aware of the underlying investments of the *CIU* on a daily basis, the *firm* may calculate the *securities PRR* for *position risk* (*general market risk* and *specific risk*) in accordance with the methods set out in the *securities PRR* requirements, subject to the following conditions:
- (1) it must be assumed that the *CIU* first invests to the maximum extent allowed under its mandate in the asset classes attracting the highest *securities PRR* for *position risk* (*general market risk* and *specific risk*), and then continues making investments in descending order until the maximum total investment limit is reached;

- (2) the *firm* must take account of the maximum indirect exposure that it could achieve by taking leveraged *positions* through the *CIU* when calculating its *securities PRR* for *position* risk, by proportionally increasing the *position* in the *CIU* up to the maximum exposure to the underlying investment items resulting from the investment mandate; and
- (3) should the *securities PRR* for *position* risk (*general market risk* and *specific risk*) under this approach exceed that set out in ■ BIPRU 7.7.5R, the *PRR charge* must be capped at that level.

7.7.12 **R** For the purpose of ■ BIPRU 7.7.11R (1) the *position* in the *CIU* must be treated as a direct holding in the assumed *position*.

CAD 1 models and VaR models

7.7.13 **G** Where ■ BIPRU 7.7 permits a *firm* to calculate the *PRR charge* for a *position* in a *CIU* using the *rules* in ■ BIPRU 7 relating to the underlying investment, a *firm* that has:

- (1) a *CAD 1 model waiver* that covers *positions* in *CIUs* may use the *rules* as modified by that *waiver*; and
- (2) a *VaR model permission* that covers *positions* in *CIUs* may use its *VaR model*.

Options on a CIU

7.7.14 **G** An *option* on a *CIU* should be treated in accordance with ■ BIPRU 7.6.35R to ■ BIPRU 7.6.37G (Options on a CIU).