

## Chapter 6

# Operating duties and responsibilities

## 6.12 Risk management policy and risk measurement

### Application

6.12.1

**R**

This section applies to:

- (1) an *authorised fund manager* and a *depository* of a *UCITS scheme*; and
- (2) a *UK UCITS management company* providing *collective portfolio management services* for an *EEA UCITS scheme* from a *branch* in another *EEA State* or under the freedom to provide *cross border services*.

6.12.2

**G**

In the *FCA's* view the requirements relating to risk management policy and risk measurement set out in this section are the regulatory responsibility of the *management company's Home State regulator* but to the extent that they constitute *fund application rules*, are also the responsibility of the *UCITS' Home State regulator*. As such, these responsibilities may overlap between the *competent authorities* of the *Home and Host States*. *EEA UCITS management companies* providing *collective portfolio management services* for a *UCITS scheme*, whether from a *branch* in the *United Kingdom* or under the freedom to provide *cross border services*, are therefore advised that they will be expected to comply with the requirements of this section, except for **COLL 6.12.3 R (2)** which, as a notification requirement, is a matter reserved for the rules of the *management company's Home State*.

### Risk management process

6.12.3

**R**

- (1) (a) An *authorised fund manager* of a *UCITS scheme* or a *UK UCITS management company* of an *EEA UCITS scheme* must use a risk management process enabling it to monitor and measure at any time the risk of the *scheme's* positions and their contribution to the overall risk profile of the *scheme*.
- (b) In particular, an *authorised fund manager* of a *UCITS scheme* or a *UK UCITS management company* of an *EEA UCITS scheme* must not solely or mechanically rely on credit ratings issued by credit rating agencies, as defined in article 3(1)(b) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, for assessing the creditworthiness of the *scheme's* assets.
- (2) An *authorised fund manager* (excluding the *EEA UCITS management company* of a *UCITS scheme*) or a *UK UCITS management company* of a *UCITS scheme*

an *EEA UCITS scheme* must regularly notify the following information to the *FCA* and at least on an annual basis:

- (a) a true and fair view of the types of *derivatives* and forward transactions to be used within the *scheme* together with their underlying risks and any relevant quantitative limits; and
- (b) the methods for estimating risks in *derivative* and forward transactions.

[**Note:** article 51(1), first and third paragraphs, of the *UCITS Directive* and article 45(1) of the *UCITS implementing Directive*]

**6.12.3A** R An authorised fund manager or a UK UCITS management company of an *EEA UCITS scheme* subject to ■ COLL 6.12.3R(2) must notify the *FCA* of the information specified in points (a) and (b) of that rule:

- (1) annually, within 30 *business days* of 31 October, with information that is accurate as of 31 October of that year;
- (2) using the form in ■ COLL 6 Annex 2R; and
- (3) by submitting it:
  - (a) online through the appropriate systems accessible from the *FCA's* website; or
  - (b) if the appropriate systems are unavailable, via email to [fundsupervision@fca.org.uk](mailto:fundsupervision@fca.org.uk).

**6.12.3B** G (1) In addition, an authorised fund manager or a UK UCITS management company of an *EEA UCITS scheme* subject to ■ COLL 6.12.3R(2) should submit a notification to the *FCA* if there has been a significant change to the *fund's* risk profile since its last report, by sending the form in ■ COLL 6 Annex 2R, completed as applicable, to [fundsupervision@fca.org.uk](mailto:fundsupervision@fca.org.uk).

- (2) A significant change to the *fund's* risk profile could include, but is not limited to:
  - (a) the first use of *derivatives* for investment purposes, if *derivatives* have previously been used only for *efficient portfolio management*;
  - (b) investment in non-standard *derivatives*, if only standard *derivatives* have been used previously;
  - (c) a change in the type of risk measure used to calculate global exposure (commitment method, relative *VaR* or absolute *VaR*); and
  - (d) where a *VaR* measure is used, a change in the parameters of the calculation.
- (3) Reports of significant changes only need to contain new information for the period since the previous report.

6.12.4

G

- (1) The risk management process in ■ COLL 6.12.3 R should take account of the investment objectives and policy of the *scheme* as stated in the most recent *prospectus*.
- (2) The *depository* of a *UCITS scheme* should take reasonable care to review the appropriateness of the risk management process in line with its duties under ■ COLL 6.6.4 R (General duties of the depository) and ■ COLL 6.6.14 R (Duties of the depository and authorised fund manager: investment and borrowing powers), as appropriate.
- (3) An *authorised fund manager* or a *UK UCITS management company* is expected to demonstrate more sophistication in its risk management process for a *scheme* with a complex risk profile than for one with a simple risk profile. In particular, the risk management process should take account of any characteristic of non-linear dependence in the value of a position to its underlying.
- (4) An *authorised fund manager* or a *UK UCITS management company* should take reasonable care to establish and maintain such systems and controls as are appropriate to its business as required by ■ SYSC 4.1 (General requirements).
- (5) The risk management process should enable the analysis required by ■ COLL 6.12.3 R to be undertaken at least daily or at each *valuation point*, whichever is more frequent.
- (6) An *authorised fund manager* or a *UK UCITS management company* of an *EEA UCITS scheme* should undertake the risk assessment required by ■ COLL 5.2.20R (7)(d) (Permitted transactions (derivatives and forwards)) with the highest care when the counterparty to the *derivative* transaction is an *associate* of the *authorised fund manager*, the *UK UCITS management company* or the credit issuer.

[Note: CESR's *UCITS eligible assets guidelines* with respect to article 8(2)(d) of the *UCITS eligible assets Directive*]

**Risk management policy**

6.12.5

R

- (1) An *authorised fund manager* of a *UCITS scheme* or a *UK UCITS management company* of an *EEA UCITS scheme* must establish, implement and maintain an adequate and documented risk management policy for identifying the risks to which that *scheme* is or might be exposed.
- (2) The risk management policy must comprise such procedures as are necessary to enable the *authorised fund manager* or *UK UCITS management company* to assess the exposure of each *UCITS* it manages to *market risk*, *liquidity risk* and *counterparty risk*, and to all other risks, including *operational risk*, that might be material for that *scheme*.
- (3) The risk management policy must address at least the following elements:
  - (a) the techniques, tools and arrangements that enable the *authorised fund manager* or *UK UCITS management company* to comply with the obligations set out in this section and ■ COLL 5.3 (Derivative exposure);

- (b) the allocation of responsibilities within the *authorised fund manager* or *UK UCITS management company* pertaining to risk management; and
- (c) the terms, contents and frequency of reporting of the risk management function referred to in ■ COLL 6.11.2 R (Permanent risk management function) to the *governing body, senior personnel* and, where appropriate, to the *supervisory function*.

(4) To meet its obligations in (1), (2) and (3) an *authorised fund manager* or a *UK UCITS management company* must take into account the nature, scale and complexity of its business and of the *UCITS* it manages.

[Note: article 38 of the *UCITS implementing Directive*]

**6.12.6** G *UK UCITS management companies* operating *EEA UCITS schemes* are advised that to the extent that the matters referred to in ■ COLL 6.12.5 R (3)(a) are viewed by the *UCITS Home State regulator* as falling under its responsibility, they will be expected to comply with the *UCITS Home State* measures implementing articles 40 and 41 of the *UCITS implementing Directive*.

**Monitoring of risk management policy**

**6.12.7** R (1) An *authorised fund manager* of a *UCITS scheme* or a *UK UCITS management company* of an *EEA UCITS scheme* must assess, monitor and periodically review:

- (a) the adequacy and effectiveness of the risk management policy and of the arrangements, processes and techniques referred to in ■ COLL 6.12.5 R;
- (b) the level of compliance by the *authorised fund manager* or the *UK UCITS management company* with the risk management policy and with those arrangements, processes and techniques referred to in ■ COLL 6.12.5 R; and
- (c) the adequacy and effectiveness of measures taken to address any deficiencies in the performance of the risk management process.

(2) The *authorised fund manager* (excluding an *EEA UCITS management company* of a *UCITS scheme*) or a *UK UCITS management company* of an *EEA UCITS scheme* must notify the *FCA* of any material changes to the risk management process.

[Note: article 39(1) and 39(2) of the *UCITS implementing Directive*]

**6.12.8** G *UK UCITS management companies* are advised that when they applied for *authorisation* from the *FCA* under the *Act*, their ability to comply with the requirements in ■ COLL 6.12.7 R would have been assessed by the *FCA* as an aspect of their fitness and properness in determining whether the *threshold conditions* set out in Schedule 6 (Threshold conditions) of the *Act* were met. *Firms* are further advised that their compliance with these requirements is subject to review by the *FCA* on an ongoing basis in determining whether they continue to meet the *threshold conditions*.

[Note: article 39(3) of the *UCITS implementing Directive*]

**Measurement and management of risk**

6.12.9

**R**

- (1) An *authorised fund manager* of a *UCITS* scheme or a *UK UCITS management company* of an *EEA UCITS* scheme must adopt adequate and effective arrangements, processes and techniques in order to:
  - (a) measure and manage at any time the risks to which that *UCITS* is or might be exposed; and
  - (b) ensure compliance with limits concerning global exposure and *counterparty risk*, in accordance with ■ COLL 5.2.11B R (Counterparty risk and issuer concentration) and ■ COLL 5.3 (Derivative exposure).
- (2) For the purposes of (1), the *authorised fund manager* or a *UK UCITS management company* must take the following actions for each *UCITS* it manages:
  - (a) put in place such risk measurement arrangements, processes and techniques as are necessary to ensure that the risks of positions taken and their contribution to the overall risk profile are accurately measured on the basis of sound and reliable data and that the risk measurement arrangements, processes and techniques are adequately documented;
  - (b) conduct, where appropriate, periodic back-tests in order to review the validity of risk measurement arrangements which include model-based forecasts and estimates;
  - (c) conduct, where appropriate, periodic stress tests and scenario analyses to address risks arising from potential changes in market conditions that might adversely impact the *UCITS*;
  - (d) establish, implement and maintain a *risk limit system* for each *UCITS*;
  - (e) ensure that the current level of risk complies with that *risk limit system*; and
  - (f) establish, implement and maintain adequate procedures that, in the event of actual or anticipated breaches to that *risk limit system*, result in timely remedial actions in the best interests of *unitholders*.
- (3) The arrangements, processes and techniques referred to in (1) should be proportionate in view of the nature, scale and complexity of the business of the *authorised fund manager* or the *UK UCITS management company* and the *UCITS* it manages and be consistent with the *UCITS'* risk profile.

[Note: articles 40(1) and 40(2) of the *UCITS implementing Directive*]

6.12.10

**G**

*UK UCITS management companies* operating *EEA UCITS* schemes are advised that to the extent that the matters referred to in ■ COLL 6.12.9R (1)(b) are viewed by the *UCITS Home State regulator* as falling under its responsibility, they will be expected to comply with the *UCITS Home State* measures implementing articles 41 and 43 of the *UCITS implementing Directive*.

6.12.11

**R**

- (1) An *authorised fund manager* or a *UK UCITS management company* of an *EEA UCITS* scheme must employ an appropriate *liquidity risk*

management process in order to ensure that each *UCITS* it manages is able to comply at any time with ■ COLL 6.2.16 R (Sale and redemption) or the equivalent *UCITS Home State* measures implementing article 84(1) of the *UCITS Directive*.

- (2) Where appropriate, the *authorised fund manager* or *UK UCITS management company* must conduct stress tests to enable it to assess the *liquidity risk* of the *UCITS* under exceptional circumstances.

[Note: article 40(3) of the *UCITS implementing Directive*]

**6.12.12** R An *authorised fund manager* or a *UK UCITS management company* of an *EEA UCITS scheme* must ensure that, for each *UCITS* it manages, the liquidity profile of the investments of the *scheme* is appropriate to the *redemption* policy laid down in the *instrument constituting the fund* or the *prospectus*.

[Note: article 40(4) of the *UCITS implementing Directive*]

**CESR guidelines: Risk management principles for UCITS**

**6.12.13** G *Authorised fund managers* are advised that CESR issued guidelines prior to the revision of the *UCITS Directive* in 2009 which, to the extent they remain compatible with the *rules* and other *guidance* in *COLL*, should be complied with in applying the *rules* in this section. These guidelines are available at:

Guidelines - Risk management principles for UCITS (CESR/09-178)

[https://www.esma.europa.eu/sites/default/files/library/2015/11/09\\_178.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/09_178.pdf)