

***IRELAND – SETTING BEST PRACTICE***

***Managing Derivatives in a UCITS III Fund***  
***1 March 2007***

# Use of Derivatives - Background

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- 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

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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

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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

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## Appropriate Systems and Controls

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

# Use of Derivatives – Risk Management Process

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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

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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

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- Robust Process
- Supervisory Structure
- Independent Framework

# Contact FMConsult

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