Risk Management

Equities

Comprehensive Management of Risk

Investment management is risk management (RM). While taking a positive approach to risk – it enables us to generate return – we also make a point of being very risk-aware in the cautious sense of the word. The following chart shows our firm's comprehensive view of risk management:

Level	Risk dimension	Responsibility	Approach
Individual stocks	**Economic risk**: Idiosyncratic risk	Individual **fund managers** supported by RM analyses	Buy quality businesses at cheap prices
Portfolio	**Diversification risk / absolute & relative**: Risk cumulation in sectors/countries	**Fund managers, lead manager & risk managers**, supported by Risk Management analyses	Monitor and discuss country & sector allocations resulting from stock selection

Active risk is needed to generate Alpha, but must be taken consciously

Risk Control

- Strong deviations from the market is normal
- Risk analysis with proprietary risk control system Contego:
  - detailed analysis of extent and sources of absolute and relative risk
  - resulting from country, sector and stock specific weightings
  - risk contribution of individual active positions as percentage of total active risk
  - because of bottom-up approach stock selection risk tends to be dominant
- Ex-ante tracking error: indicative range 4-8 % under normal market conditions
- Regular discussion of performance attribution of individual stocks, reviewing the investment case (focus on underperforming stocks) as part of the discretionary investment process
- Monthly reporting to CIO and general management

Market = MSCI EM Europe 10/40

Risk Management – Middle Office

At Raiffeisen Capital Management, two departments separated from the fund management function are monitoring risks, so the review and control functions are organizationally separated from the risk taking units themselves:

The **department Middle Office** is responsible for

- Monitoring of legal, contractual, liquidity and internal investment restrictions,
- Reconciliation and
- Quality monitoring.

<u>Investment restrictions monitoring</u>
In the Middle Office, there is an investment compliance group consisting of 4 people responsible for monitoring the fund management's compliance with legal, contractual, liquidityand internal limits and guidelines. Checks are performed at multiple levels:

- **The first level is the risk taking unit itself**. We use Asset Arena® as Front Office system. In this way the fund manager can immediately see the restrictions on order basis imposed on a fund and take them into account in his/her investment decisions. Asset Arena® is an online system that takes open orders, executions and transactions into account immediately. In this way, the risk of inaccurate or out-of-date information is minimized considerably.
- **The second level of checks is on execution basis**. By entering the execution all restrictions are immediately checked, using SUNGARD™ system Asset Arena®. All trades not compliant with the fund restrictions are blocked. Detailed information about the breach is given to the fund manager and to the dedicated compliance officer. In addition, there are implemented warning constraints for all limits, informing the fund manager and the compliance officer that a limit is reached.

Risk Management – Middle Office

- **The third level of checks is found in the Compliance group in the Middle Office.** On a daily basis, ex-post reviews of all legal and contractual limits based on back office positions, are done to see passive violations due to price changes or subscriptions or redemptions. There is a permanent contact between the Compliance group and the fund managers.

Any violations detected are to be remedied using defined procedures within a set period of time. Active violations must be corrected immediately, while passive violations are generally allowed a 5-day grace period. All violations detected during a one month‟ period are reported to the CIO and the General Management. In addition, our procedures implemented for compliance checks are audited on an annual basis by an external auditor.

In Middle Office, all risk controls are conducted automatically by the SUNGARD™ system Asset Arena®. All data is automatically fed to the system that can show restrictions imposed on a fund, show violations and block an order when a limit is reached, warn when the usage approaches a certain limit, and check restrictions when fund manager entries a trade to avoid active violations, and review the daily passive violations based on back office positions.

Risk Management – Risk Management Department

At Raiffeisen Capital Management, two departments separated from the fund management function are monitoring risks, so the review and control functions are organizationally separated from the risk taking units themselves:

The **department Risk Management** is responsible for

- Definition of the risk profiles and the internal limit system at the portfolio level
- Quantitative risk analysis: ex-ante and ex-post market risk analysis (volatility,
- tracking error and VaR analyses), risk attributions, risk controlling(in cooperation
- with the department Middle Office)
- Performance analysis (GIPS compliance, performance reporting, peergroup
- comparisons, etc)
- Company-wide risk management
- Escalation and resolution of breaches of internal limits
- Internal risk-reporting up to board level

Risk Management – Risk Management Department

<u>Market risk monitoring</u>

The process of the market risk controlling in the department Risk Management comprises three components: analysis, review and documentation.

The analysis is based on risk metrics to quantify portfolio risk. In addition to ex-ante risk calculation (indicative range of active risk 4-8 % under normal market conditions), risk attribution also shows a breakdown of the overall risk on defined risk sources:

- Detailed analysis of extent and sources of absolute and relative risk resulting from country sector and stock specific weightings
- Risk contribution of individual active positions as percentage of total active risk
- Due to our bottom-up approach, stock selection risk tends to be dominant

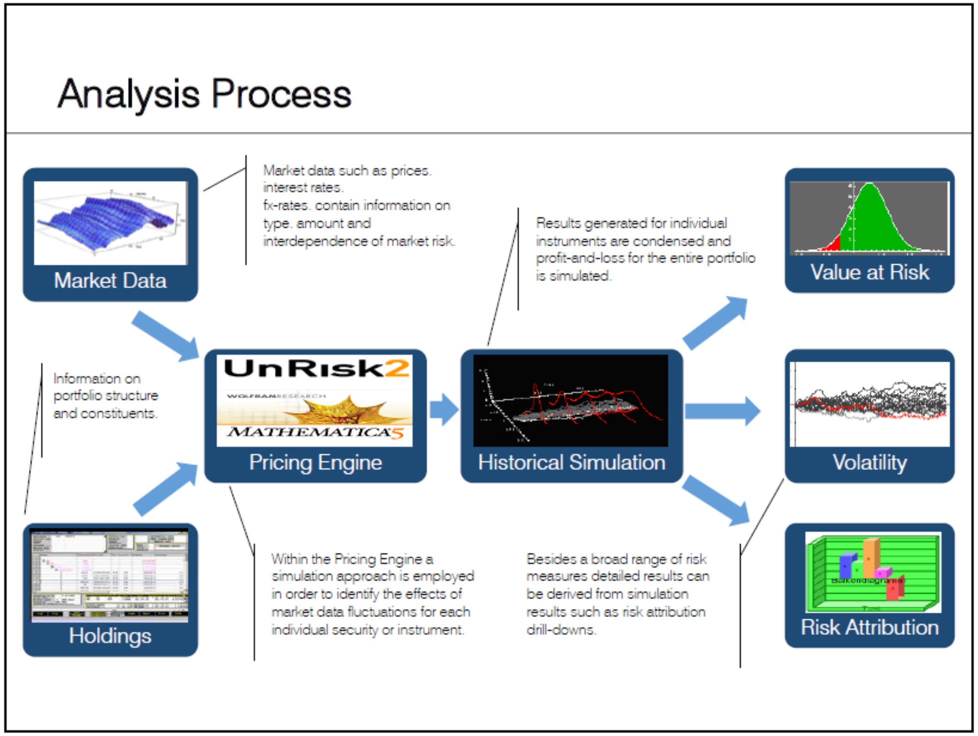
This step ensures that the responsible risk managers always have a comprehensive insight into the extent, type and composition of the portfolio risk.

As part of the review process, the risk ratios calculated for each fund in the analysis phase will be analyzed against the existing system limits. The findings are presented and discussed with the CIO and general management on a monthly basis, where the deviations from investment strategies are identified and discussed with the responsible fund managers.

In the final documentation it will be ensured that all limit violations, the fund managers' comments and the actions taken, are available for later reference. The risk report will be presented monthly as a part of the monthly management-board-level reporting.

Risk Management – Risk Management Department

Our portfolios and their respective markets are covered within the market risk system CONTEGO. CONTEGO is a proprietary development of the department risk management and based on an ex-ante historical simulation and a full valuation approach incorporating the UNRISK® pricing engine. Various depths of analysis are available, including fundamental ex-ante statistics (such as Value at Risk and Volatility), back-testing and stress testing up to detailed sensitivity and risk attribution analysis.



Raiffeisen Capital Management

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