

Risk-based transparency on non-equity investment products: a quantitative approach



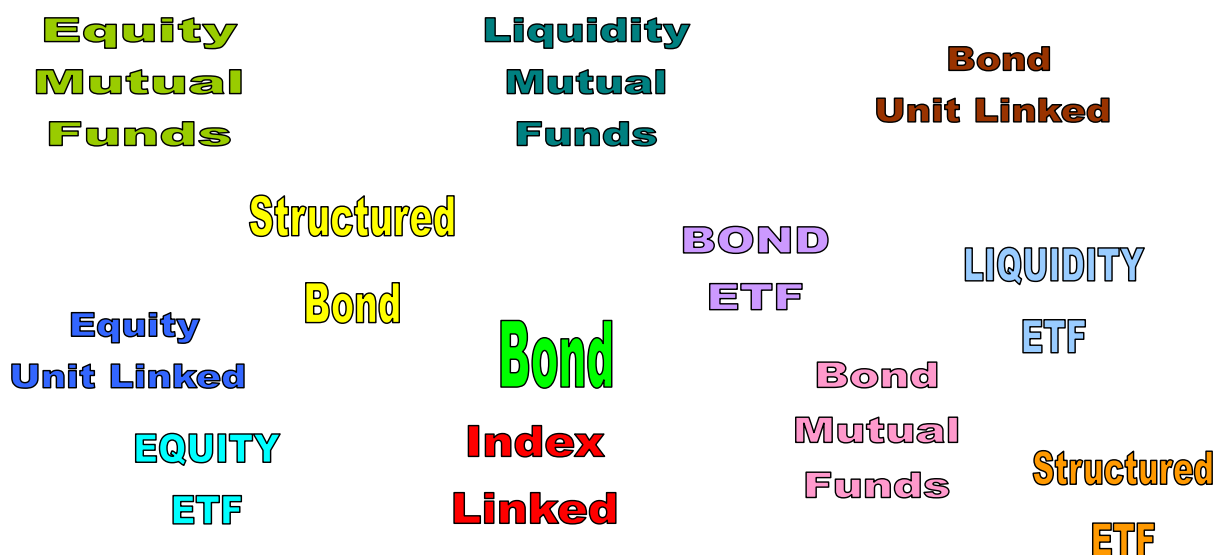
6th Annual SRP.com conference, London, 11-12 February 2009



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Risk-based transparency on non-equity investment products:
 a quantitative approach

The implementation of the disclosure regulation on the risk/reward profile of non-equity investment products should allow the investor, even assisted by a financial advisor, to choose the financial product more suitable to his investment objectives.





The information to be provided to the investor, in a simple, clear and fair way, must allow an assessment of his needs in terms of:



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Time goal: liquidity/investment horizon

INVESTMENT HORIZON



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Time goal: liquidity/investment horizon

INVESTMENT HORIZON

Risk profile: risk limit in terms of downside

RISKS



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Time goal: liquidity/investment horizon

INVESTMENT HORIZON

Risk profile: risk limit in terms of downside

RISKS

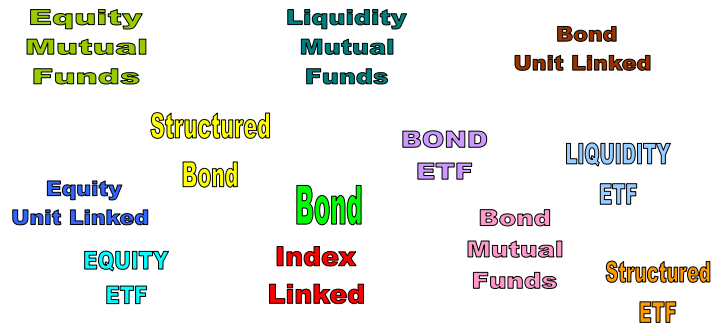
Return goal: desired returns

RETURNS



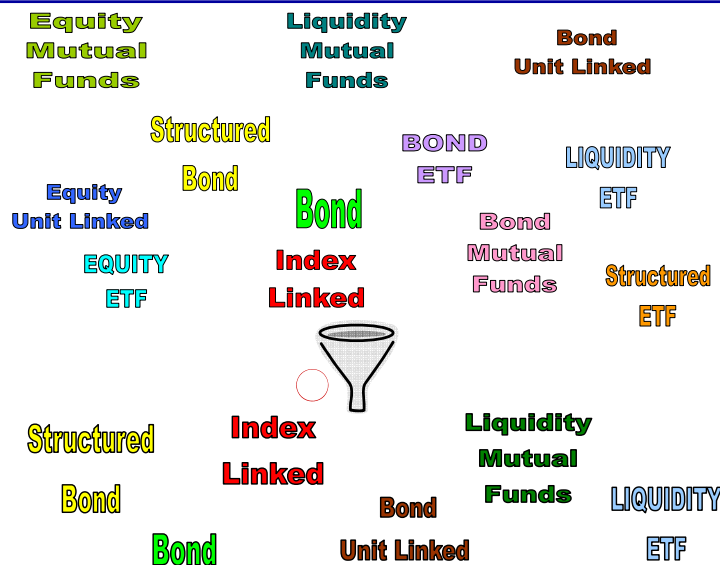
INVESTMENT HORIZON

(less than 3 years)



INVESTMENT HORIZON

(less than 3 years)

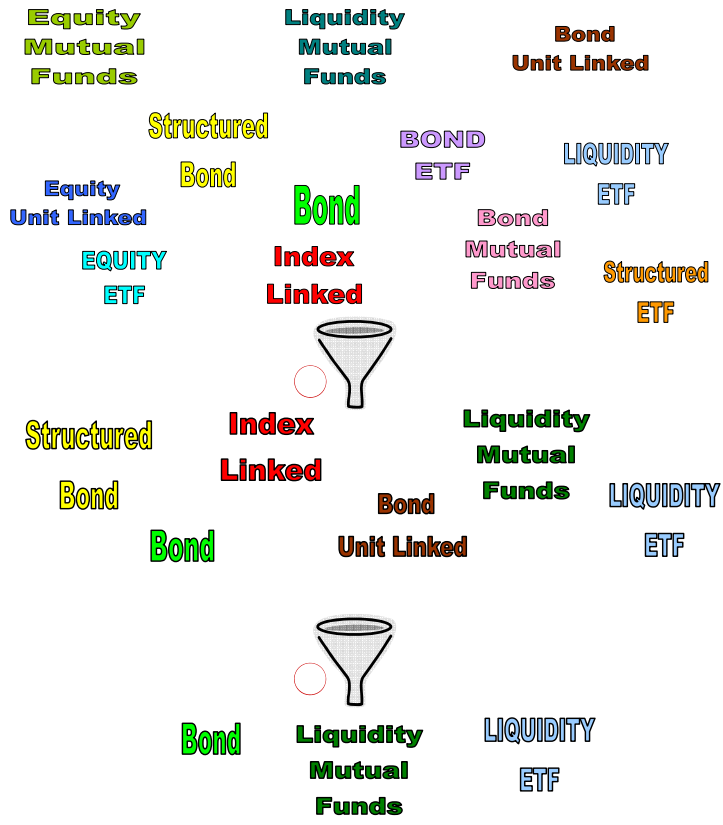


RISKS

(medium-low)



INVESTMENT HORIZON
(less than 3 years)

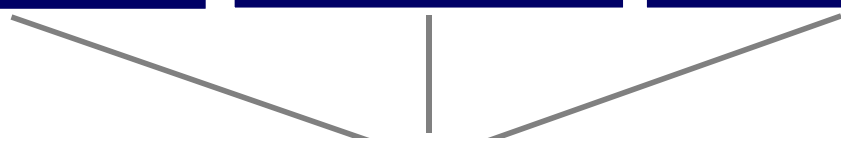


RISKS
(medium-low)

RETURNS
(maximum return)



RETURNS **RISKS** **INVESTMENT HORIZON**



... allow the investor to match his needs with the features of the financial products and to make an informed investment decision



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PREVENT MISBUYING



The key qualitative information is made objective by using a three-pillars approach based on quantitative measures.



1st

Table of probabilistic performance scenarios

2nd

Synthetic Risk Indicator

Risk Classes

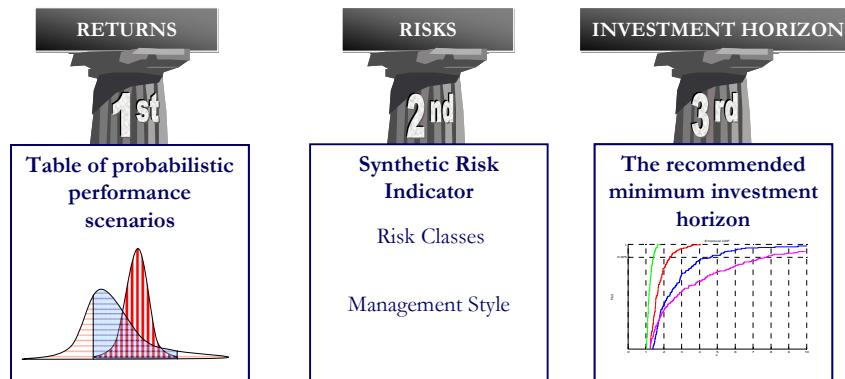
Management Style

3rd

The recommended minimum investment horizon



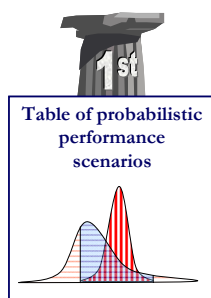
Identification and representation of risk-reward by a three-pillars approach



The three-pillars approach must be implemented via the proprietary models of risk management used by the industry, according to the general principles specified in the transparency regulation.



Identification and representation of risk-reward by a three-pillars approach



Performance Risk
w.r.t. the risk-free asset
under
the risk-neutral probability measure



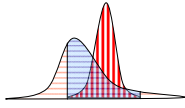
... illustrates the unbundling of the price of the financial products at the time of subscription and provides clear and concise information about the possible outcomes and costs.



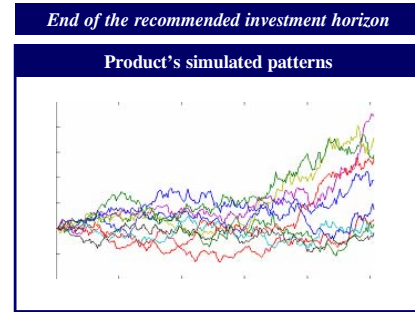
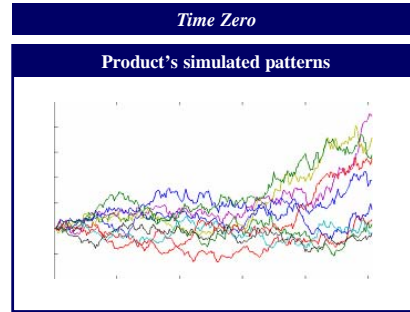
Identification and representation of risk-reward by a three-pillars approach



Table of probabilistic performance scenarios



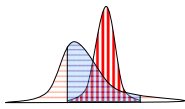
Connection between the risk-neutral price at time zero and at the end of recommended minimum investment horizon



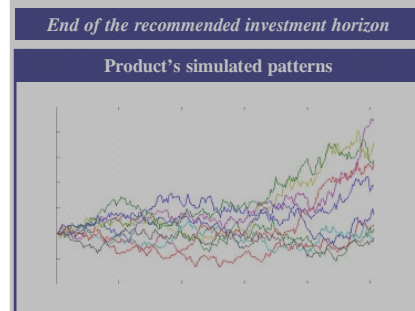
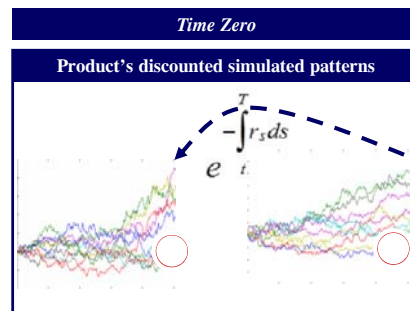
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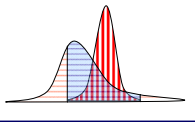




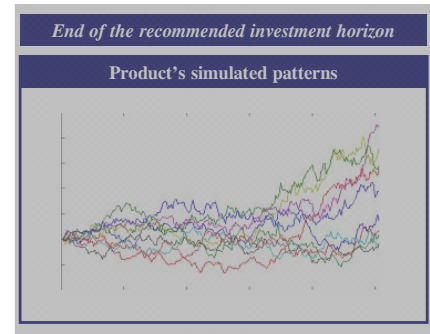
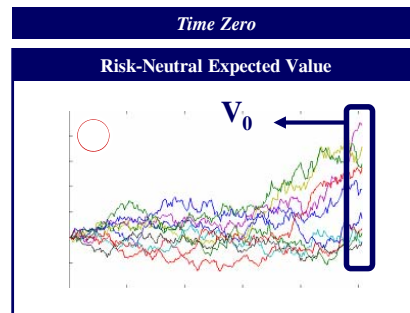
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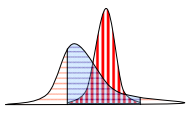
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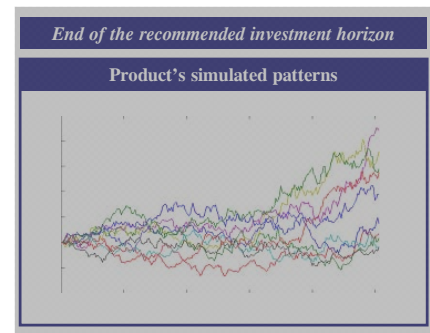


Connection between the risk-neutral price at time zero and at the end of recommended minimum investment horizon

Time Zero

Financial investment table

(A) Invested Capital
(B) Costs
(C) = (A) + (B) Notional Capital

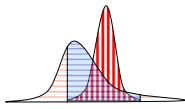




Identification and representation of risk-reward by a three-pillars approach



Table of probabilistic performance scenarios



Unbundling of the financial investment at time zero

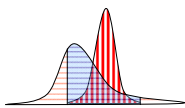
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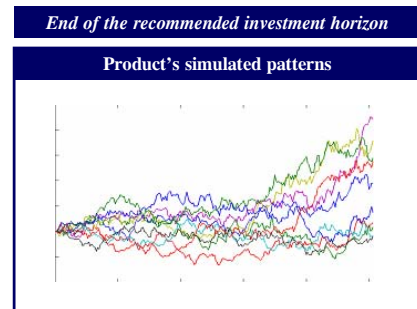


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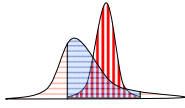




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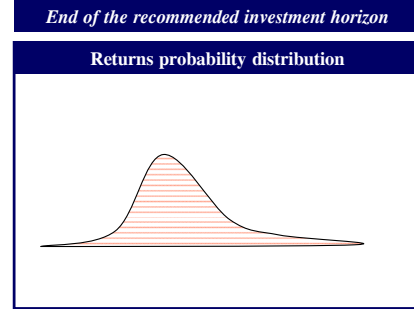


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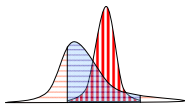
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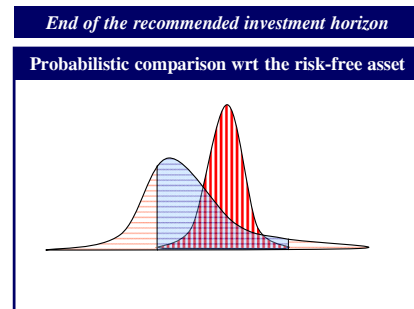


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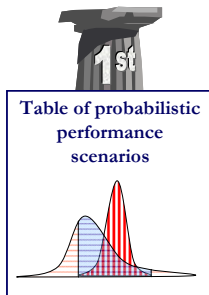
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Identification and representation of risk-reward by a three-pillars approach



Connection between the risk-neutral price at time zero and at the end of recommended minimum investment horizon

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End of the recommended investment horizon		
Table of probabilistic performance scenarios		
EVENTS	PROBABILITY	MEDIAN RETURN
The performance is <u>negative</u>	%	€
The performance is <u>positive but lower</u> than risk-free asset	%	€
The performance is <u>positive and in line</u> with risk-free asset	%	€
The performance is <u>positive and higher</u> than risk-free asset	%	€



Identification and representation of risk-reward by a three-pillars approach

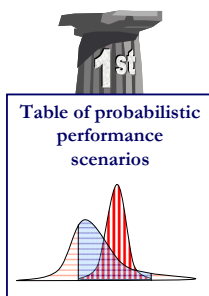


Table of probabilistic performance scenarios

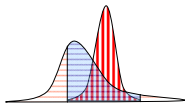
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Identification and representation of risk-reward by a three-pillars approach



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1:1 Relationship



Identification and representation of risk-reward by a three-pillars approach



Synthetic Risk Indicator

Risk Classes

Management Style

Synthetic Risk Indicator

... provides a description, on a qualitative scale, of the risk level of the financial products based on volatility measures.

... represents in an explicit way the riskiness of the product embedded in the probabilistic performance scenarios of the first pillar.



Identification and representation of risk-reward by a three-pillars approach



Synthetic Risk Indicator
Risk Classes
Management Style

Synthetic Risk Indicator

The model has to take in account the following steps ...

Time evolution of the
Volatility



Mapping of the
Qualitative Risk Classes
into corresponding
Volatility Intervals



Identification and representation of risk-reward by a three-pillars approach



Synthetic Risk Indicator
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Synthetic Risk Indicator

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Mapping of the
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Benchmark Products

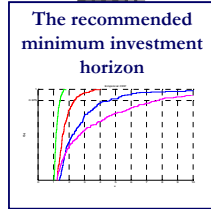
Time evolution of the
“intensity” of the
Management
Style



Mapping of each
Volatility Interval
into corresponding
Intervals of a suitable
Volatility Measure for every
Management Style



Identification and representation of risk-reward by a three-pillars approach

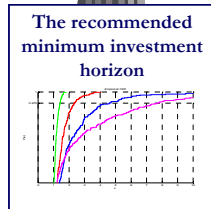


The recommended minimum investment horizon

Investment period which can be deemed appropriate having regard to the risk-reward profile and to the costs of the product



Identification and representation of risk-reward by a three-pillars approach



The recommended minimum investment horizon

The recommended minimum investment horizon crucially depends on types of financial products...

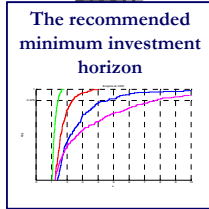
Risk Target
Products

Performance
Target
Products

Benchmark
Products



Identification and representation of risk-reward by a three-pillars approach



The recommended minimum investment horizon

... for performance target products and for guaranteed products the recommended minimum investment horizon is inherent to their financial engineering, as:



Identification and representation of risk-reward by a three-pillars approach



The recommended minimum investment horizon

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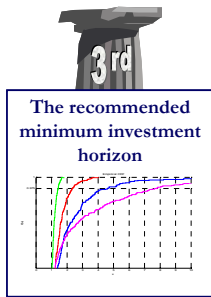
the recommended minimum investment horizon is



the period of validity (or the time to maturity) of their target/guarantee mechanisms



Identification and representation of risk-reward by a three-pillars approach



The recommended minimum investment horizon

... for risk target products or benchmark products is calculated as the break-even time of the financial investment, i.e. the time needed to recover the initial charges and to offset the ongoing costs at least once, from a probabilistic perspective.



CONSOB

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