



# Risk Control Policy

## Policy

## Preamble

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This Risk Control Policy applies to all portfolios managed by Covéa Finance for the purposes of:

- Identifying the main potential risks to which the portfolios are exposed
- Identifying the main internal monitoring indicators and any action taken to mitigate or eliminate such risks
- Assessing the level of the risks and their impact on invested capital
- Specifying the permanent risk control function; defining its governance, scope and technical and human resources

This policy shall be reviewed annually. However, it may be revised during the year in line with market, regulatory, organisational or operational developments (investment in a new asset class, etc.).

This policy is approved by the Executive Committee before being circulated and duly validated by the Compliance Officers.

The risk control system is based on the following pillars:

- The independence of the risk control function (required in view of the instruments managed)
- Periodic risk committee meetings (held at least 3 times each year) reporting to senior management
- Risk mapping: our main tool for managing the activity

The scope of monitoring covers all Mandates, UCITS and AIFs managed by Covéa Finance.

This policy covers the monitoring of the following categories of financial risks:

- Market risk
- Counterparty risk
- Liquidity risk
- Valuation risk

These risks are monitored at a first level by the investment or research teams.

The control of operational and compliance risks (non-compliance by the AMC with its professional obligations) is carried out by the Internal Control Officers and Compliance Officers.

The Management Company has established risk measurement procedures and techniques to ensure that the positions taken and their contributions to the risk profile of the portfolios are measured using market techniques and on the basis of data deemed to be reliable.

## 1. Market risk

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Market risk is defined as *"the risk of loss for a collective investment scheme or the individual portfolio resulting from a fluctuation in the market value of the positions of its portfolio due to a change in market variables, such as interest rates, exchange rates, stock and commodity prices or a change in the credit quality of an issuer."*

This risk category can be broken down into different sub-risks:

### 1.1 Equity risk

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Equity risk can be defined as the risk of loss resulting from volatility in equity markets. This applies to all assets whose market value is sensitive to changes in share prices (funds or equity and diversified funds of funds, equity trackers (ETFs), structured equity or dividend products, equity derivatives, equity volatility derivatives, convertible bonds, convertible bond funds, equity warrants/rights, unlisted equity funds, etc.).

**Internal risk indicators:** Exposure, Volatility, Betas, Ratios (Sharpe, Information, etc.) and Deltas

**Risk level:** Equity risk is considered to be **HIGH** because the impact on the invested capital may be **significant** (upward or downward).

Except for structured products (subject to conditions), no guarantee is provided for the capital invested in assets exposed to such risks.

Equity risk may be partially hedged via derivatives (reducing exposure), but this remains discretionary and temporary. It notably depends on the managers' expectations, market volatilities and the level of risk of loss that may be borne by the funds or mandates.

Derivatives based on equity volatility, which are classified as complex by the AMF (French Markets Authority), are strictly limited to certain portfolios (diversified AIFs) and are not currently expected to become significant drivers of performance. Finally, structured products based on dividends from equity indices are currently limited to specific allocations within mandates.

Risk on unlisted markets (Private Equity) is monitored through indicators used to measure return – Internal Rate of Return, multiples (DPI, RVPI and TVPI), Private Equity segments (venture capital, development, LBO, etc.) or vintages. A transparent analysis of the funds invested is periodically carried out in order to identify sector and geographic exposure, in addition to distressed holdings.

### 1.2 Interest rate risk

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Interest rate risk can be defined as the risk of loss resulting from the sensitivity of a security to a change in interest rates. This applies to all assets sensitive to variations or volatilities of yield curves (bonds, money market instruments, money market, bond or diversified funds, interest rate derivatives, structured products, convertible bonds, etc.).

**Internal risk indicators:** Exposure, Sensitivity, Convexity, Deltas

**Risk level:** Interest rate risk is considered to be **HIGH** because the impact on the invested capital is significant in light of our overall exposure to this asset class and given the current extremely low levels.

Interest rate risk may be partially hedged via derivatives (reducing sensitivity to interest rates through futures or swaps), but this remains discretionary and temporary. It notably depends on the managers' expectations, fixed income market volatility and the level of risk of loss that may be borne by the funds or mandates.

### 1.3 Currency risk

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Currency risk can be defined as the risk of loss resulting from the levels or volatility of exchange rates. This risk concerns all asset classes denominated in a currency other than the euro – the current base currency of our portfolios. We do not have funds or fund units denominated in currencies other than the euro.

**Internal risk indicator:** Exposure, unrealised gains/losses, currency effect on fund performance

**Risk level:** Currency risk is considered to be **HIGH** because the impact on the invested capital may be **significant** (upward or downward).

The risk of loss due to exchange rate fluctuations is not systematically hedged. However, currency hedging agreements (total or partial) to eliminate or mitigate this risk may be put in place. Such hedges remain discretionary and temporary. It notably depends on the managers' expectations, exchange rate volatility and the level of risk of loss that may be borne by the funds or mandates.

### 1.4 Concentration risk

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Concentration risk may be defined as the risk of loss resulting from high exposure to an asset class, activity sector, currency, geographic region, issuer, etc.

**Internal risk indicators:** Exposure (by sector, geographical region, company, issuer, etc.), number of issues, average weightings, weighting standard deviations, main position weightings, etc.

**Risk level:** Concentration risk is considered to be **HIGH** because the impact on invested capital can be **significant** on funds invested in a specific theme (smallcap equities, growth stocks, green funds, convertible bond funds, disruptive technology funds, emerging market funds, real estate funds, high-yield bond funds (speculative securities), credit bond funds, private equity funds, etc.), which can therefore fall more sharply than general purpose funds.

In order to reduce the concentration risk, diversification is a key factor taken into account in the upstream construction of portfolios and in the monitoring of downstream risks.

## 1.5 Credit risk

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Credit risk can be defined as the risk of loss linked to the deterioration in the credit quality of an issuer or the risk of loss associated with (total or partial) issuer default (non-payment of coupons, non-reimbursement of par value, etc.).

**Internal risk indicator:** Ratings of issues or issuers, credit margins against equivalent Sovereign Yields (depending on data availability)

**Risk level:** Credit risk is considered **HIGH** because the impact on the invested capital may be **significant**, particularly in the event of a widening of issuer credit spread, issuer default or non-payment of coupons.

The rating agencies used are S&P, Moody's and Fitch Ratings. The lowest rating of the three agencies is used. An internal rating grid system has also been put in place to produce an independent rating (for a given list of issuers). Any money market or bond instrument not rated by the 3 agencies is given an internal rating.

## 1.6 Commodity risk

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Commodity risk can be defined as the risk of loss relating to volatility in commodity prices. It concerns all instruments sensitive to a change in commodity prices (gold, silver, oil, copper, maize, etc.) and concerns only a few specific portfolios as stated in their prospectuses.

**Internal risk indicator:** Exposure

**Risk level:** Commodity risk is considered to be **VERY HIGH** because the impact on invested capital can be **very significant** (upward or downward) and because this asset class is classified as non-traditional by the AMF.

Treated as complex by the AMF since 2019, this asset class may have a very different trend from traditional markets (equities, fixed income, currencies) and may potentially become a significant driver of performance, even though its weighting remains relatively marginal.

Finally, this asset class exposes portfolios to foreign exchange risk because most commodity contracts are denominated in US dollars (margin calls).

## 2. Liquidity risk

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**Liquidity risk is defined as “the risk of a position in the portfolio not being able to be sold, liquidated or closed at limited cost and within a sufficiently short period of time, thereby jeopardising the ability of the UCITS or the AIF to comply at any time with the investors' issue and redemption requirements or the ability for the AMC to liquidate positions in an individual portfolio under conditions consistent with the contractual obligations resulting from the management mandate.”**

**Indicator used internally:** percentage of the portfolio that can be liquidated in x days, number of days to liquidate x% of the portfolio (liabilities risk), weighting of the least liquid securities, portfolio profile in normal and stressed markets, history of redemptions, held by external unit holders

**Risk level:** Liquidity risk is considered **HIGH** as the impact on the invested capital may be **significant** in the event of market turbulence and the impossibility of selling positions at reasonable prices.

Liquidity risk is assessed on both liabilities and assets. Knowledge of liabilities is based on stability, investor type and concentration. On the asset side, risk is measured through a portfolio's ability to liquidate its assets within a defined time frame. This measure varies according to the type of instrument; the methodologies used include:

- For equities: percentage of average trading volume over the last three months
- For fixed income: liquidity score based on the geographical region, type of debt, etc. A liquid amount is associated with each of these scores.

Other methodologies are set out in the Liquidity Stress Test Policy.

It should be noted that certain specific asset classes (small/mid cap equities, private equity funds, loans to social landlords, private placements of fixed-income or structured products, etc.) are, by their very nature, almost illiquid because they are difficult to sell within a short period of time at no cost. These assets are subjected to specific pre-investment analysis by the investment and legal teams. They are also subjected to periodic post-investment monitoring by the managers during meetings with counterparties or management companies and via reports received periodically.

### 3. Counterparty risk

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Counterparty risk is defined as *"the risk of loss for a collective investment scheme or individual portfolio resulting from the fact that the counterparty to a transaction or contract may fail to meet its obligations before the transaction has been settled definitively in the form of a financial flow."*

Post-trade counterparty risk concerns financial contracts traded directly on a regulated or OTC market (futures, forwards, swaps), but also securities using forward financial instruments with a counterparty such as synthetic trackers or specific vehicles in the context of securitisation (SPVs).

**Indicator used internally:** Exposure by counterparty, margin call amounts (and available cash), weighting of margin calls relative to total fund assets, overall risk (leverage), ratings of eligible counterparties

**Risk level:** Counterparty risk is considered **HIGH** as the impact on the invested capital may be **significant** in the event of counterparty default before the final settlement of the contract.

However, this risk is mitigated as applicable by liquidity collateral arrangements (on OTC contracts), deposits requested by clearing houses and daily margin calls (on listed contracts) or by the basket of collateral securities within synthetic trackers.

### 4. Valuation risk

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**Valuation risk may be defined as the risk of loss linked to an incorrect or absent valuation of a financial instrument.** All portfolio management companies must have a method for precisely and independently valuing instruments in its positions.

The valuation of each financial instrument is based on the market prices provided by multiple sources stated in the Covéa Finance Pricing Policy, or by using a valuation based on information provided by the issuer or an independent expert.

Risk Control takes place upstream in the validation phase of the valuation model used, ensuring the consistency of the model and the parameters proposed by the research or management teams.

It also occurs in the event of a valuation discrepancy, i.e. if there is any difference between the value produced using the internal model or the valuations provided by our external service providers (particularly for complex products and OTC financial contracts) and those produced by the counterparties; the instrument is revalued and the source of the discrepancy is established.

The scope of products potentially presenting a valuation risk has been defined using the following criteria:

- Absence of price; or
- A potentially unreliable valuation (which can notably be linked to a contribution from a single counterparty or a complex valuation method).

However, where an instrument has one of the contribution sources stated in the Pricing Policy or at least two independent contributors, its valuation is deemed to be reliable.

Covéa Finance has also implemented an internal valuation process for several instrument categories:

- Negotiable debt securities (following the reform of money market funds in 2019);
- Illiquid instruments traded on Euronext Growth (formerly Alternext);
- Private equity funds for which we may be required to calculate adjusted NAVs;
- Structured products.

The models used internally and external services are reviewed annually by the Risk Control team.

Finally, valuation committee meetings are held periodically, attended by personnel from Front Office, Research, Control and Securities Chain in order to monitor the products identified.

## **5. Stress testing**

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The Management Company has implemented a global portfolio stress testing process covering two areas:

- Market stress tests
- Liquidity stress tests

These stress tests are designed to measure the impact on the value and structure of portfolios caused by market disruption or market liquidity disruption.

The models used are adapted to the nature, size and complexity of the funds and have been based on the risk factors inherent to each portfolio.

The types of scenarios used are of different categories: historical, hypothetical or a mix of the two. For liquidity stress tests, we also use the so-called reverse scenario.

The indicators used are those commonly monitored as part of our permanent risk control system (loss in market value by security and by portfolio, allocation distortion, sensitivity structure distortion, deterioration of unrealised capital gains, buffers, breakeven points, impact on portfolio liquidation, etc.).

The frequency of these stress tests is adapted to each fund, but is at least quarterly. Models, scenarios and assumptions are reviewed at least annually.

The results of the stress tests are communicated to the management body and, in particular, presented to the Risk Committee, with an action plan in the event of detected vulnerabilities. They are also communicated to the regulator in the context of regulatory reporting (AIFMs, MMFs) and also presented to the Board of Directors of SICAVs (MMFs).

## **6. Risk Committee**

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The main objective of the Risk Committee is to analyse the current exposures of the portfolios under management in accordance with multiple pre-defined analytical criteria (country, region, sector, currency, rating, issuer, maturity category, etc.) and also to explain variations between each committee, in order to report any significant changes.

Once identified, such changes may lead to decisions at the various management committees established in order to anticipate any potential consequences.

It also makes it possible to measure the impact of the selections of the various management committees concerning the market risks present in the portfolios.

Finally, the committee considers the performance and various risk indicators for the portfolios.

## **7. Organisation of the permanent risk control function**

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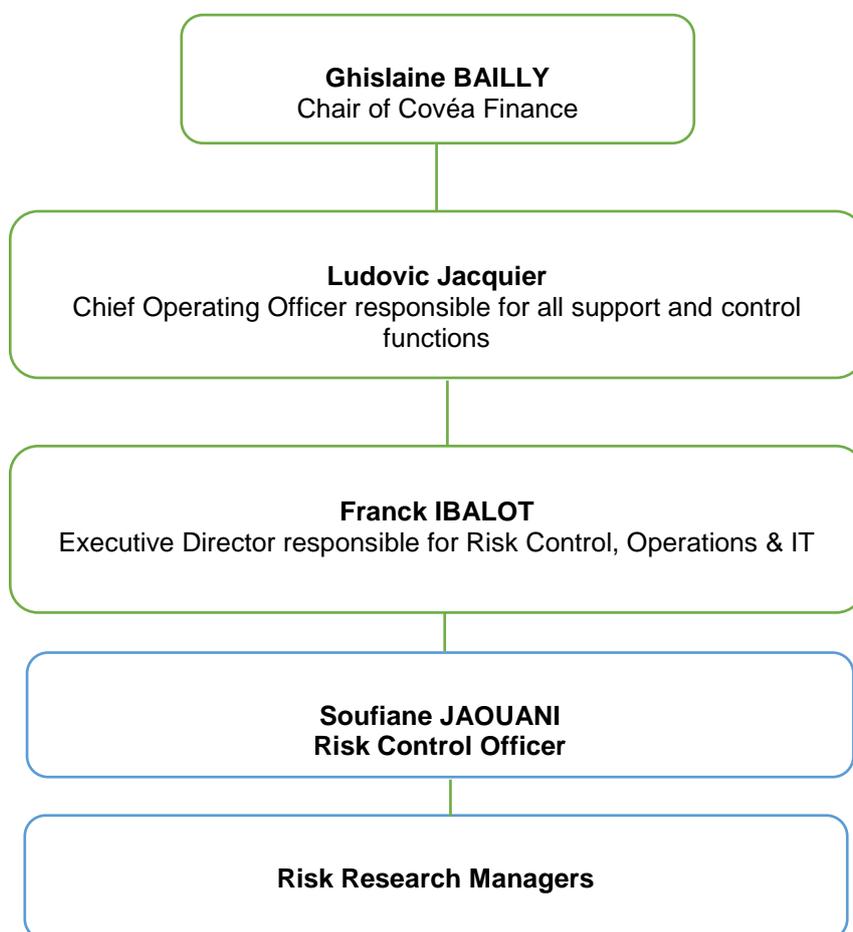
### **7.1 Organisation and scope**

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In accordance with the provisions of Article 313-53-4 of the AMF Regulations and as explained in Instruction AMF No. 2012-01, *“the permanent risk [control] function shall be hierarchically and functionally independent from operational units.”*

The Risk Control team reports to the Executive Director responsible for Risk Control, Operations & IT, namely Franck IBALOT, who is a member of the Executive Committee.

The organisational structure ensures the independence of the function from the operational units in charge of management. It is downstream of management decisions in both the value chain and risk chain.



The Risk Research Managers monitor risk exposure through the established formal controls and via ad hoc analysis. They regularly produce risk indicators in order to analyse developments. Their role is to measure the effectiveness of management decisions and disseminate their analysis to the members of the Risk Committee.

## 7.2 Attributions and alert system

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In accordance with *the Guide to the organisation of the risk management system within asset management companies* - DOC-2014-06 of the AMF, Risk Control periodically assesses the levels of risks to which collective investments and managed portfolios are exposed.

Risk Control has drawn up a structured overview by type of instrument that establishes linkages between the inherent risks of all types of instruments present in the portfolios.

The risk map was then constructed by portfolio, using the overview by instrument type, ensuring that all the risks inherent to the instruments held as assets are monitored for each portfolio.

This mapping process is the main tool used to monitor risk control. It provides an instant overview of risk exposure levels, via various indicators which have been assigned specific alert thresholds. In the event of thresholds being breached, after analysis alerts are issued to Portfolio Management Department personnel. Management teams then notify us of any comments or the corrective action implemented.

A periodic review (at least annual) of the relevant indicators and alert thresholds is carried out in order to take account of any changes to the fund's investment strategy, any new or lifted constraints during the period, market conditions, regulatory developments, etc.

### 7.3 Oversight

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Monitoring by the Executive Committee of the risk management system via its Risk Committees held in their presence.

Permanent Internal Control also has access to the entire system and performs controls via sampling of the work carried out by Risk Control.

### 7.4 IT system and tools

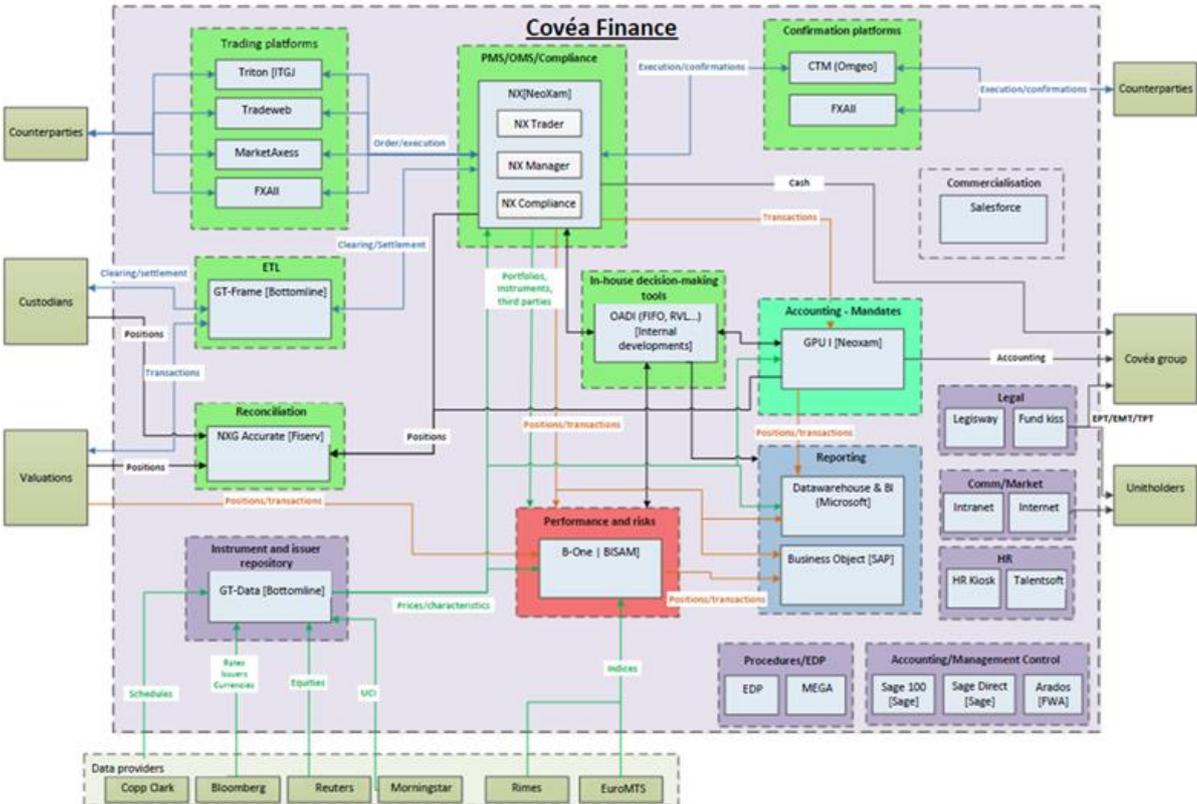
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Risk Control uses the following risk measurement and monitoring tools:

- **B-One** (FACTSET): Performance and risk measurement and attribution tool.
- **NX Portfolio Management System** (NEOXAM): Position and transaction tool.
- **Business Objects** (SAP): Reporting tool.
- **Applications developed internally**

Risk management procedures are documented in the internal MEGA procedure system.

The tools are fed by various sources of data deemed to be reliable and are part of the following overall information system:



The market data used is derived from recognised contributors: Bloomberg, Thomson-Reuters, MorningStar, Six Telekurs, Markit, Rimes.

Daily data quality controls and their integration within the IT system are carried out by the Market Data Reporting team and Support & Maintenance team.

## REFERENCES

- General Regulations of the AMF
- French Monetary and Financial Code - Article L. 533-10-1
- AMF Instruction 2014-06 -- Guide to organisation of the risk management system within asset management companies.
- Vadémécum AFG 2013-03 -- Organisation of risk control
- AMF Instruction 2012-01 -- Organisation of the UCITS or OPCI management activity and the portfolio management investment service on behalf of third parties in terms of risk management.
- AMF Instruction - Risk management and internal control systems.
- AMF Instruction 2011-15 -- Methods for calculating the overall risk of UCITS and AIFs.
- AMF Instruction 2008-06 -- SGP and ISP organisation in terms of the valuation of financial instruments.
- DOC-2012-19 - Position - AMF Recommendation - Guide to the development of the activity programme of asset management companies and self-managed collective investment schemes

## Appendix: MEGA Procedures

The procedures enabling Risk Control to measure market, liquidity and counterparty risk exposure are modelled in the internal MEGA tool:

- Controlling risks
  - Defining risk categories
  - Defining risk indicators by category
  - Monitoring risk indicators
  - Level 1 alert processing
  - Level 2 alert processing
  
- Managing valuations
  - Monitoring complex product valuations
  - Controlling structured product valuations
  - Verifying complex product counter-valuations
  
- Managing the Risk Committee
  - Preparing Risk Committee material
  - Holding Risk Committee meetings
  
- Managing market stress tests
  - Defining post-stress test action plans
  - Defining test scenarios and assumptions
  - Defining risk types by portfolio
  
- Managing liquidity stress tests
  - Defining post-liquidity test action plans
  - Defining liquidity profiles by portfolio
  - Defining liquidity test scenarios and assumptions

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