

FAQ about SSPA's Risk Classification (Value at Risk)

1. Why did SSPA publish a Risk Rating only now?

- We have worked on an easy-to-use risk classification for structured products (STP) for some time now. Relevant criteria such as comprehensibility, extensive STP coverage and optimum stability of method, and quality of results, added to the complexity of the task and the time needed to complete it.

2. Which Risk Figure calculation method does SSPA apply?

- SSPA uses the historic simulation method for the Value at Risk (VaR) calculation. This method is widely applied in the financial industry, since it does not require any model assumptions. The results for structured products are very satisfactory. For more information, please read "The SSPA Risk Figure" backgrounder on the SSPA website: http://www.svsp-verband.ch/download/risikokennzahl/090630_svsp_var_informationen_en.pdf

3. Why does SSPA employ six risk categories?

- Six risk categories make for optimum risk assessment granularity.
- Including a separate category for leverage products avoids most structured products having to be put together in the same class (in Category 5, where most of the products would be included if there were just five categories). This benefits classification clarity.
- Because professional, semi-professional and non-professional investors dispose of different degrees of know-how, we provide differentiated instruments for risk assessment.

4. Why does SSPA you not apply the same category specifications as those of the German Derivatives Association (Deutscher Derivate Verband, DDV)?

- German and Swiss market conditions differ, and it is to be expected that the bandwidths also differ. Since VaR depends on various market conditions, there are different bandwidths.
- Our risk commission monitors category specifications and makes adjustments to the bandwidths for the risk classification. The basis for the bandwidths are benchmarks, whose VaR is also calculated daily. Only considerable changes in the benchmarks' VaR lead to bandwidth adjustment.

- Benchmark-based risk categorization evens out market movements caused by an increase or decrease in volatility of the market overall. The values calculated reflect risk mutations throughout a product's life cycle. Also, this ensures that the interrelationship of product categories in the respective risk categories is taken into account.

5. How do I access SSPA Risk Figures?

- The SSPA risk classification is available free of charge on the SSPA website (www.svsp-verband.ch/riskrating_en). SSPA has developed an intuitive and easy-to-use tool to find the SSPA Risk Figure and SSPA Risk Rating.
- Data vendors, financial portals and issuers may access the information on Swiss Market Feed's (SMF) SIX Exfeed.

6. Why did SSPA choose VaR as Risk Figure and not another indicator?

- VaR is a consistent indicator applicable to all structured products. It is a reliable risk classification measure for structured product clients and their advisors that is readily understood without statistical or financial calculation expertise.
- We consider the Risk Figure an element that reflects long-term changes in market conditions.

7. What is the extent of coverage?

- When the Risk Figure was launched in July 2009, VaR coverage was 85% – considered high then and likely to rise over time.
- SSPA does not aim for full coverage because calculating the VaR of certain products would involve excessive investments of time and effort.
- SSPA provides Risk Figures for all issuers, both Association members and non-members.

8. Why not use expected shortfall or fat tails methods instead of VaR?

- VaR is more widely used and more familiar than the alternative methods to investors who are not Risk Figure experts.
- While banks may prefer the expected-shortfall method because they must back risk with capital to ensure their solvency, investors need a loss-potential indicator. The expected-shortfall method theoretically implies a higher potential loss compared to VaR. In the case of investors who are unlikely to face insolvency in extreme situations and who would not endanger the entire market system, expected-shortfall results would be exaggerated.

9. Why do different models / sources produce different VaR results?

- SSPA bases its Monte Carlo simulation on historic prices. SSPA VaR may vary from the VaR's calculated by other calculators, depending on the model used, such as e.g. logarithmic normal distribution. Because of high volatility in real price history, SSPA calculates higher figures than some issuers.
- Another likely reason for the differences is that SSPA calculates the VaR daily, rather than weekly or once every two weeks, as certain other calculators may do.

10. Why does SSPA not include issuer risk in VaR calculation?

- SSPA accounts for issuer risk – important in the purchase of any structured product – separately namely in the issuer creditworthiness table on the SSPA website (<http://www.svsp-verband.ch/home/bonitaet.aspx?lang=en>).
- In the SSPA VaR calculation, issuer risk is negligible, given ten-day holding periods. What's more, credit spreads do not influence assignment to a given product category.
- Issuer credit spread is important for the calculation of the fair value, while VaR represents a figure for market risk to the investor.

11. Why does SSPA not factor in interest rate changes?

- Given a ten-day horizon, interest rate changes have little impact on a structured product's market risk.

12. Why does SSPA not address components such as sensitivity, volatility and changes in the underlying?

- Most investors look for a clear indication of risks, with emphasis on market risk and issuer risk.
- Structured product VaR for Switzerland is about market risk, pure and simple.
- The publication of credit spreads for issuers on the Swiss market covers issuer risk.
- Most investors consider sensitivity to interest rates, volatility and changes in the underlying of less importance.

13. Does the VaR-method have weaknesses?

- Risk is calculated on a ten-day horizon only.
- SSPA VaR indicates risk with only 99% probability.
- SSPA VaR is based on individual products rather than portfolio risk.

14. Why a ten-day holding period? Why not one day or one year?

- SSPA VaR is calculated daily for each ten-day period, which allows starting from zero. Longer time periods require consideration of trends in the underlying. Such drifts cannot be accurately assessed and would undermine the value of the VaR-method applied.

15. Why 99% probability and not, for instance, 95%?

- Basel II made a 99% confidence interval the standard for banks. We provide investors with the same information that banks have to provide.

16. Why are the risk category threshold values subject to adjustment?

- Specific market risks are not controlled – products move between risk categories when specific risks change.
- We react to changed general market risk as follows:
 1. A given product remains in its risk category because benchmark risk has changed commensurately.
 2. Absolute risk in a given category rises or falls as the risk commission adjusts the VaR risk intervals in the respective category, according to a set rule.

17. When do investors have access to the Risk Figure?

- As a rule, our Risk Rating and Risk Figure are calculated the night before first listing and are available as early as the first day of trading.
- SSPA does not calculate the VaR for products in the initial market phase because indicative termsheets often do not contain all required information. As soon as the issuer provides the final termsheet, a VaR is calculated. If this does not happen before the first day of trading, SSPA calculates the Risk Figure for the second day of trading.

18. Why can't the figures be downloaded daily from the SSPA website?

- SSPA is not a professional market data distributor. Swiss Market Feed's (SMF) SIX Exfeed distributes daily figures on existing channels.
- We lack the infrastructure to provide a machine-readable interface and to respond to user inquiries.

19. Who generates the SSPA Risk Figure and Risk Rating?

- Data used to calculate the Risk Figure are collected and managed by Derivative Partners Research Ltd. The VaR itself is generated by calculation agent Riskmetrics Group.