



# COSI®-NEWSLETTER

Information on collateral secured instruments

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## Everything is getting better - COSI® remains good

Freely adapting the advertising slogan of a Swiss premium mineral water from 2001, COSI® can also be said to represent a Swiss quality brand which has proved able to master turbulent times with its original recipe. The COSI® recipe for success is and remains: the greatest possible degree of investor protection through the standardized and transparent COSI® collateralization mechanism. One core element of the collateralization mechanism is the independent calculation of fair values. These are required to determine the amount of collateral to be pledged on a daily basis. The COSI® service ensures that the fair values used really are *fair* and can't get manipulated. The article on page 8 looks at how the fair values of COSI® products are derived and at their relevance in terms of investor protection.

COSI® quality does pay off - sometimes even in unexpected ways. An example would be the ESMA's decision to tighten the UCITS provisions, as a result of which holding Swiss gold ETF units will no longer be permitted at the end of this year. The resulting gap can (and will) be filled by Delta 1 COSI® products on the price of gold and other precious metals. Further details can be found in the main article on page 3 of this issue. In addition, Stephan Müller, Product Management & Development at Swiss & Global Asset Management AG, will answer questions on the product solution offered by his company in collaboration with Julius Bär Bank in an interview on page 6.

Picking up once again the reference to premium mineral water at the beginning of this introduction, we hope that reading this issue will prove a sparkling and stimulating experience.

Your Scoach team

**COSI® precious metal products - a UCITS-compatible alternative**

Physical gold ETFs are without doubt one of the most successful product innovations in recent years. The slump in the gold price in recent weeks can't deny this fact. However, this success story may now be threatened by a regulatory setback: According to ESMA Opinion 2012/721 dated 20 November 2012, with effect from the end of 2013 UCITS funds will be able to invest only in those non-UCITS funds which correspond to all of the equivalence criteria set out in Article 50(1)(e) of the UCITS IV Directive. Because Switzerland is not part of the EU, its physical gold ETFs sold in the EU do not meet these requirements. On expiry of the implementation deadline at the end of 2013, as set by the ESMA, these ETFs will thus become non-eligible financial instruments for UCITS funds. An outflow of UCITS-linked capital into UCITS-eligible or alternative assets is to be expected. Possible alternatives for the asset management of UCITS funds can be found, among others, in the area of ETCs and structured products.

**UCITS Directive**

UCITS stands for "Undertakings for Collective Investments in Transferable Securities".

The UCITS Directive defines the specific requirements for investment funds and their management companies. Among other things, it focuses on stipulating which assets a UCITS investment fund can invest in (known as *eligible assets*).

The Directive was first published and enacted by the European Council at the end of 1985. The most recently revised version, UCITS IV, is dated from 2009 and remains in force today. It was transposed into national law by the EU states as at July 2011.

According to current practice, UCITS funds can hold up to 10% of their assets in non-UCITS fund units – this is referred to as the "trash bucket". In its Opinion 2012/721 dated 20 November 2012 the ESMA is stopping this practice as at the end of 2013.

With regard to the UCITS provisions, the benefit of structured products is that the look-through approach does not apply to Delta 1 products and that consequently underlying assets that do not in themselves represent UCITS-eligible assets as a direct investment – namely commodities and precious metals - can be used. However, if the structured product includes an option component the diversification criteria stipulated by UCITS must be fulfilled with regard to the counterparty risk.

Of course, uncollateralized structured products as such offer an unsatisfactory alternative to investment funds/ETFs that are classified as segregated assets with regard to investor protection and counterparty risks. This shortcoming can be remedied by the COSI® collateralization mechanism, for example in the form of a euro-denominated COSI® tracker certificate on the gold price incl. quanto exchange rate hedging.

A look at the Scoach table shows that the COSI® segment has a rather sparse selection of 87 precious metal investment products (gold, silver, platinum, palladium and baskets thereof). Moreover, only 20 products are tracker certificates. The biggest share – with 49 products – is accounted for by the yield enhancement products category. Seven of the twenty tracker certificates are based on a basket. Finally, a mere two of the remaining thirteen single underlying products are denominated in euros. One of them is based on the gold price, the other on the silver price.

Assuming that a large part of the foreign UCITS funds are settled in euros, the market potential for UCITS-eligible tracker certificates based on individual precious metals is considerable. This means that an increase in issues in this segment and a substantial inflow of funds can be expected by the end of the year.

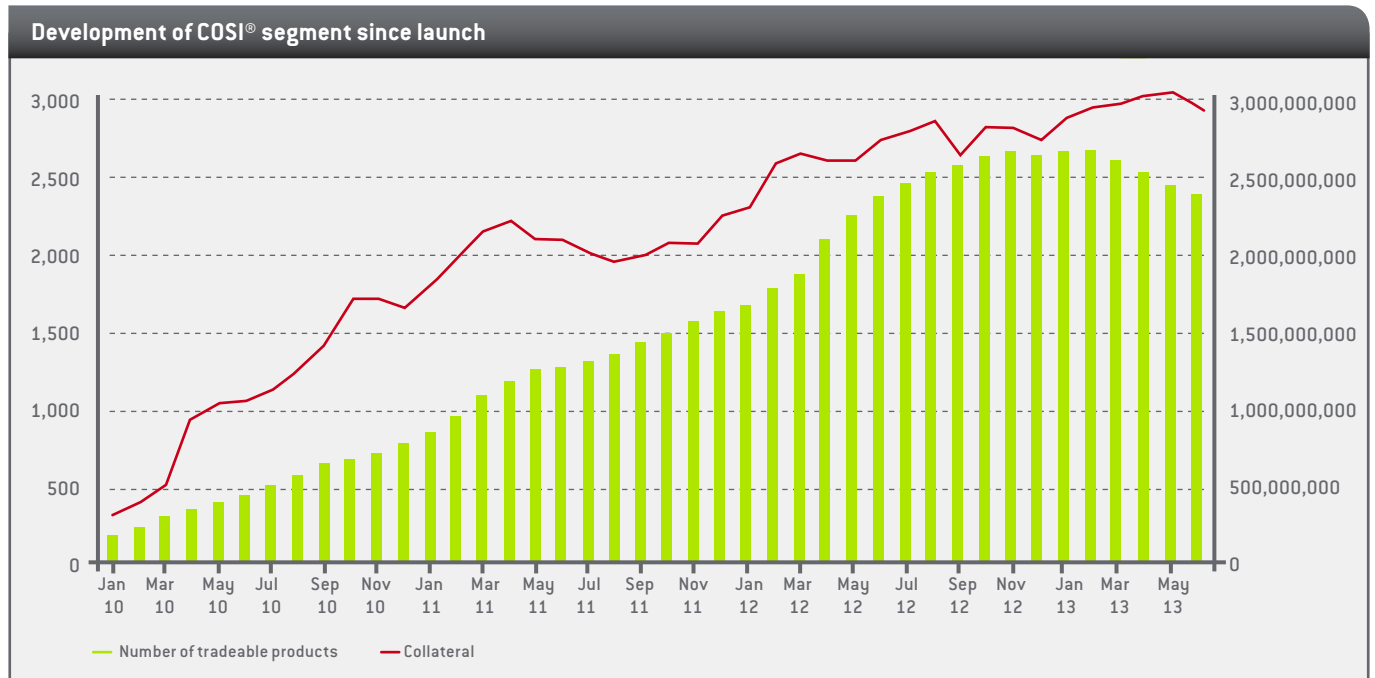
COSI®, ETFs and investment funds (in accordance with CISA) compared							
Name	Legal structure	Collateralization	Term	Market making	Exchange	Valuation frequency	Management of underlying assets
COSI® product	Debt security	Collateralized	Max. 10 years	Single market making	Scoach	Revaluation, usually within seconds	Static or adjusted according to objective criteria
ETF (exchange traded funds)	Collective investment scheme in accordance with CISA	Segregated assets	Open end	Multi market making	SIX Swiss Exchange (ETF segment)	iNAV updated at least every 15 seconds	Usually static
Investment fund	Collective investment scheme in accordance with CISA	Segregated assets	Open end	Single market making	SIX Swiss Exchange (NEW: Sponsored Funds segment), usually off-Exchange	NAV calculated once daily	Active management by fund manager

Source: Scoach, July 2013

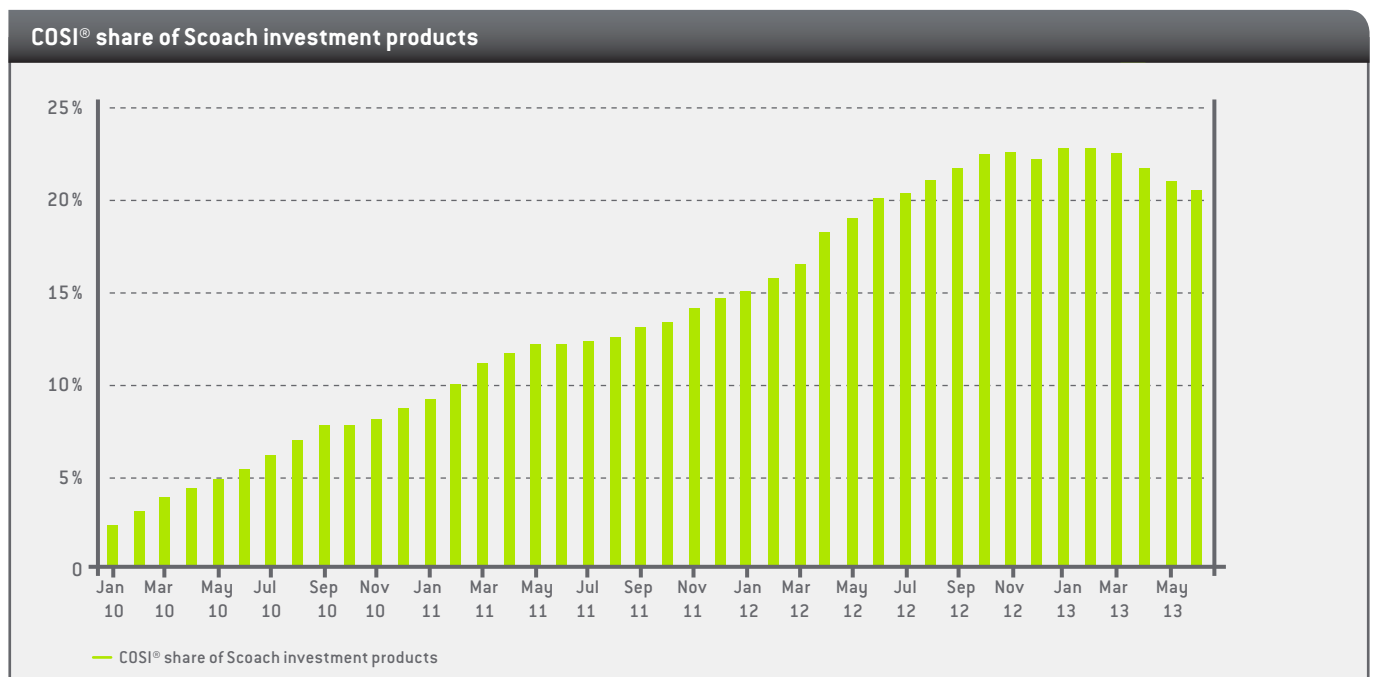
### Development

As at the end of the second quarter of 2013, there were 2,366 tradable collateral-secured products, with the outstanding volume of COSI® products amounting to CHF 2.97 billion. The CHF 1 billion limit was broken for the first time in May 2010, with the

CHF 2 billion mark being passed in March 2011. The CHF 3 billion limit was first exceeded in April 2013. The highest ever daily volume is around CHF 70 million, which was achieved on 13 September 2011.



Source: Scoach, July 2013



Source: Scoach, July 2013



Stephan Müller has headed up fund management in Product Management and Development since November 2007 and specializes in alternative investments and commodities. In the commodities segment he is responsible for the product design and development of the entire chain of added value for physically replicated investment instruments, such as precious and industrial metals. Prior to that, he worked in Product Management and Specialist Management of Basic and Collective Investment Schemes at Zürcher Kantonalbank for seven years, where he played a key role in the development and introduction of the first Swiss precious metal ETFs. He studied law at the University of Zurich and holds a Master of Law degree. He supports the professional development of fund specialists and lectures at the technical colleges of Zurich and Vaduz and at private institutions. Stephan Müller is Chair of the ETF Committee within the Swiss Fund and Asset Management Association.

## Interview with Stephan Müller, Product Management & Development at Swiss & Global Asset Management AG

*Mr Müller, what range of services does Swiss & Global Asset Management offer?*

Swiss & Global Asset Management is the exclusive manager of the Julius Bär funds and has established itself as an innovative product designer for active funds and ETFs. In 2008 we launched a global novelty, the first quanto protected gold ETFs, on SIX Swiss Exchange. With 32 precious metal ETFs based on gold, silver, platinum and palladium we now offer the broadest range. In 2012, we launched the first active stock ETFs in Europe on the Frankfurt Stock Market, and this will be followed by industrial metal funds for QI in the second half of 2013.

*How does your collaboration with Julius Bär work in general?*

Julius Bär acts as a custodian bank and trading partner in the segment of precious and industrial metal funds. Valuable and complementary expertise has been developed on both sides thanks to the long-standing and successful collaboration. We are taking active advantage of this expertise as intended by our collaboration between the fund management, custodian bank and trading functions. This interplay forms the basis of our success particularly in the areas of product development and the collaboration with the regulatory authorities.

*You recently issued a number of interesting COSI® products via Julius Bär. How did this come about?*

We took this step in response to the need of our international asset management clients who require collateralized instruments for their portfolio management. Our close collaboration with Julius Bär has also proved to be an ideal fit for the requirements of these clients as we are able to launch COSI® instruments in a timely manner and using tried and tested processes. Here, too, the combined expertise of fund, custodian bank and trading units is the key to success.

*To which investors are these COSI® products suited?*

The COSI® based on precious metals gold, silver, platinum and palladium are tailored to well-qualified investors who use them especially in asset management and for strategy funds.

*Do you plan to offer further product series in collaboration with Julius Bär in the future?*

We are working very closely with Julius Bär as distinct and legally independent partners. If the collaboration generates sustained added value for both partners, it is safe to assume that there is no interest in disrupting a team that is running very smoothly.

***What channels do you use to sell your products?***

This series of COSI® instruments is not concerned with a sales perspective. We work with around 1,000 partners in 30 countries, and our current COSI® series was launched in response to their needs in the area of professional portfolio management.

***What fees do investors incur?***

At the time of issue we take into account a one-off fee totaling 7.5 basis points on the fund's net asset value. Thereafter the investor participates in the fund's price performance at 100%, less an annual fee of around 30 basis points for COSI® collateralization.

***In your opinion, have the regulatory changes in the area of collective investments resulted in further potential for COSI® products?***

Yes, without any doubt! There is very clearly a need for transparent and collateralized instruments. Due to the complex regulations surrounding collective investment schemes and the fact that the authorization procedures are relatively long, COSI® instruments enable us to respond to the requirements of professional asset management in a timely manner.

Thank you for the interview!

### Independent COSI® valuation prevents manipulation

For most structured products involving collateralization solutions the collateralization level is guided solely by the issuer's market price (usually the bid-side closing price on the Exchange). The issuer is able to use market making to influence the collateralization level at will. If in difficult times the issuer quotes a bid price that is too low, collateral is withdrawn from the products. Without an independent valuation, this procedure therefore harbors the risk of insufficient collateral being available in an emergency.

The situation with regard to COSI® is different: Here, market prices (fair values) calculated externally by independent calculation agents are used to determine the value of the collateral to be pledged. Because the value of the structured product is primarily affected by changes in the price of the underlying asset, the issuer is moreover not allowed to issue COSI® products on own structured products as an underlying asset. This ensures that the COSI® product always possesses an appropriate level of collateral and cannot be manipulated unfavorably.

### Determining the amount of collateral

The calculation of fair values is dependent on assumptions such as the expected volatility of the underlying asset. Because of these assumptions, the fair values can easily differ from each other by several percent. This is why two fair values rather than just one are calculated for each COSI® product. Therefore three different valuation prices are employed with regard to COSI®: the issuer's bid price and two independently calculated fair values. If the issuer's bid price is the lowest of the three, an independent price determines the collateral to be provided (see scenario 3). The issuer's bid price is taken into account only if it is higher (see scenarios 1 and 2).

### Calculation of fair values

Structured products usually combine classic financial instruments such as bonds with options. If possible, a structured product is split into its individual components for the purposes of valuation. Each product component is then valued individually and the total is shown as the fair value. If the product cannot be split, numerical approximation methods such as a Monte Carlo simulation are used to determine the fair value.

SIX provides the calculation agents electronically with the static input parameters, such as the size of the barrier level for barrier reverse convertibles. The products' dynamic parameters, such as the volatility of the underlying asset of a product, are usually calculated by the calculation agent on the basis of the options available on the market or, like the market prices of the underlying assets, obtained from data vendors. The calculation agent then uses the static and dynamic input parameters to calculate an updated fair value on a daily basis. This fair value is transmitted to SIX and taken into account when determining the amount of collateral, which ensures that the investor can be certain that their COSI® product is always adequately collateralized.

Scenario no. 1	Scenario no. 2	Scenario no. 3
Issuer bid price	Fair Value II	Fair Value II
Fair Value I	Issuer bid price	Fair Value I
Fair Value II	Fair Value I	Issuer bid price

Source: Scoach, July 2013



Top-Produkte					
Kategorie	Symbol	SSPA category	Underlying	ISIN Number	Total turnover in CHF
Capital protection	EFHLS	Capital protection with participation	n/a	CH0113520123	5,729,910
	EFHAM	Capital protection with coupon	ABB / CS / Nestlé / Roche GS	CH0110622609	4,257,631
	EFHSX	Capital protection with coupon	Novartis / Swisscom / Syngenta / Zurich	CH0115890706	3,955,991
	EFGFCI	Capital protection with participation	SMI Index	CH0205167015	2,356,585
	EFIIW	Capital protection with coupon	Nestlé / Roche GS / Swisscom / Zurich	CH0119126677	2,003,143
Yield enhancement	EFGEQJ	Express certificate	BP / Centrica / DS Smith / GlaxoSmithKline / ...	CH0204548744	9,113,370
	EFHXU	Express certificate	EURO STOXX 50 PR Index	CH0117081320	8,901,646
	EFGFFL	Express certificate	EURO STOXX 50 PR Index	CH0205168054	7,669,394
	EFGFFM	Express certificate	EURO STOXX 50 PR Index	CH0205168062	7,669,394
	EFGCUB	Reverse convertible	EURO STOXX 50 PR Index	CH0194433980	7,461,044
Participation	EFGFGM	Tracker certificate	EFG Swiss Fund Basket (EFGFGM)	CH0205168468	51,267,009
	EFGBPL	Participation diverse	S&P 500 Index	CH0133271459	9,740,255
	EFGFYV	Participation diverse	Banco Santander / Deutsche Bank / Société Générale	CH0210575988	4,819,101
	JFKWZ	Tracker certificate	JB Japan Export Basket (JFTIZ)	CH0202302326	4,605,509
	EFGDMB	Participation diverse	EFG Insurance Basket (EFGDMB)	CH0190891298	4,493,373
Certificates with reference entities	VFRGA	Reference entity certificate	CHF 3M LIBOR	CH0141505302	6,215,120
	VUSXK	Reference entity certificate	EURO STOXX 50 PR Index	CH0141504024	4,449,662
	VUDXK	Reference entity certificate	DAX Index	CH0141504032	4,295,823
	VFNLK	Reference entity certificate	CHF 3M LIBOR	CH0141506458	3,367,893
	VFRAC	Reference entity certificate	CHF 3M LIBOR	CH0141504545	2,581,000
Leverage products	EFGBNK	Mini-Future	n/a	CH0184262290	7,425,026
	EFGBNG	Mini-Future	n/a	CH0184262266	5,662,062
	EFGBNL	Mini-Future	n/a	CH0184262308	1,659,038
	EFGBNM	Mini-Future	n/a	CH0184262316	1,092,287
	EFGFUQ	Mini-Future	n/a	CH0198382126	1,056,000

Source: Scoach, July 2013

## COSI® in a nutshell

SVSP category	Number of tradeable products
Capital protection	191
Yield enhancement	1,614
Participation	298
Certificates with reference entities	228
Leverage products	35
Number of issuers	7
Outstanding volume	CHF 2.97 Mrd

Source: Scoach, July 2013

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