European Securities and Markets Authority

Reply form for the Consultation Paper on draft guidelines on complex debt instruments and structured deposits

24 March 2015

European Securities and Markets Authority

Date: 24 March 2015

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper on draft guidelines on complex debt instruments and structured deposits, published on the ESMA website.

Instructions

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type < ESMA_QUESTION_COMPLEX_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

- if they respond to the question stated;
- contain a clear rationale, including on any related costs and benefits; and
- describe any alternatives that ESMA should consider

Naming protocol

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESMA_COMPLEXPRODUCTS_NAMEOFCOMPANY_NAMEOFDOCUMENT.

E.g. if the respondent were XXXX, the name of the reply form would be:

ESMA_COMPLEXPRODUCTS_XXXX_REPLYFORM or

ESMA_COMPLEXPRODUCTS_XXXX_ANNEX1

Deadline

Responses must reach us by **15 June 2015.**

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input/Consultations’.

Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the headings 'Legal notice' and 'Data protection'.

Introduction

Please make your introductory comments below, if any:

< ESMA_COMMENT_COMPLEX_1>

The European Association of Co-operative Banks (EACB)[1] welcomes the opportunity to contribute to the discussion around the correct classification of financial instruments as “complex” or “non-complex” as co-operative banks are amongst the major distributors of a large variety of retail investment products to their clients.

Despite the fact that this consultation concerns debt instruments and structured deposits it falls within a much wider discussion on the complexity of financial instruments and the framework under which such products shall be distributed to retail investors.

With this in mind, we would like to take the opportunity to note that the members of the EACB do not support the ESMA assertion it its final advice to the European Commission on MiFID II and MiFIR (ESMA /2014/1569) that all non-UCITS are to be considered complex products and thus the MiFID II Level-1 Directive categorically bans all non-UCITS funds (i.e. AIFs under AIFMD) from “execution-only” distribution.

ESMA’s interpretation does not take into account the extremely large and diversified universe of AIFs, ranging from complex and leveraged hedge funds to non-complex, non-leveraged retail funds whose investments are regulated and restricted by EU Member States’ laws. In particular, many EU Member States have long-established regulatory frameworks for retail funds that – while not being UCITS – are designed for retail customers and that are subject to detailed rules, over and above the AIFM Directive, and similar to the UCITS Directive (i.e. investment restrictions and diversification requirements).

While we agree that not all AIFs (and other products) can be considered as non-complex, we underline that MiFID II clearly distinguishes between more and less complex financial products, the latter being deemed safe enough to allow distribution through execution-only channels. Even highly-regulated UCITS are separated into “normal” and “structured” UCITS, the latter being considered too complex to be distributed without assessing appropriateness. A similar process of assessing the complexity towards a retail investor should be allowed to distinguish between UCITS-like/retail AIFs (taking into account the particular AIF’s investment strategy and risk profile) that can be distributed execution-only to retail investors and those AIFs that cannot. MiFID II does not categorically intend to disregard whole product categories.

In general, we consider that ESMA should carefully assess the appropriate enlargement of the range of what are complex financial instruments since this affects the products available for retail investors. In

[1] The European Association of Co-operative Banks (EACB) is the voice of the cooperative banks in Europe. It represents, promotes and defends the common interests of its 29 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the cooperative banks’ business model. With 3,700 locally operating banks and 71,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 215 million customers, mainly consumers, retailers and communities. The cooperative banks in Europe represent 56 million members and 850,000 employees and have a total average market share of about 20%.
For further details, please visit www.eacb.coop

particular, we do consider that indexed bonds and inflation-indexed bonds are not too complex to be understood by the clients.

Our responses to a few selected consultation questions are to be found below.

< ESMA_COMMENT_COMPLEX_1>

Question 1: Do you agree with the examples of debt instruments that embed a derivative? If not, which examples do you not agree with, and why not?

<ESMA_QUESTION_COMPLEX_1>
No response at this juncture
<ESMA_QUESTION_COMPLEX_1>

Question 2: Do you agree with the definition of embedded derivative proposed in the Guidelines in Annex IV? If not, why not?

<ESMA_QUESTION_COMPLEX_2>
No response at this juncture
<ESMA_QUESTION_COMPLEX_2>

Question 3: Do you agree with the examples of debt instruments that incorporate a structure making it difficult for the client to understand the risk? If not, which examples and why not?

<ESMA_QUESTION_COMPLEX_3>
We understand ESMA's suggestion that particular attention should be paid to products with unfamiliar and unusual underlying. However, we consider that classifying as complex any "debt instrument denominated in a currency which is not the one of the jurisdiction (or a currency that is pegged to the currency of the jurisdiction) where the investment services are provided" is not reasonable or appropriate.
We suggest to distinguish between EU and non-EU currencies, as otherwise unnecessary barriers between the Eurozone and non-Eurozone members will be created (e.g. investment of a UK retail investor into a German structured bond) and thus further fragment the European single market. We believe that even retail investors in those countries are able to understand that a product currency implies a fluctuation in value. This does not make a product more complex.
Moreover, the proposed ESMA approach could run counter the Commission's current project to reinforce retail investors' participation in the European capital markets with the creation of a Capital Markets Union (CMU).
In addition, in order to achieve a consistent approach between products - even though not the direct subject- matter of the present consultation- we would like to note that there are many UCITS and retail AIF whose units or shares are denominated in EU currencies but whose underlying assets are denominated in other currencies. Indeed, ESMA's recent consultation on eligible UCITS share classes rightly allows currency hedged share classes.
Moreover, both bonds containing an issuer call option and subordinated debt instruments have been presented as embedding a derivative in the draft guidelines. It is difficult to comprehend what the embedded derivative in these instruments would be. Moreover, subordination as such does not make a bond more complex, only riskier.
<ESMA_QUESTION_COMPLEX_3>

Question 4: Do you agree with the definition of a structure making it difficult for the client to understand the risk included in the Guidelines in Annex IV? If not, why not?

<ESMA_QUESTION_COMPLEX_4>
No response at this juncture
<ESMA_QUESTION_COMPLEX_4>

Question 5: Do you agree with the definition of a structure making it difficult for the client to understand the risk of return of structured deposits and with the relevant examples proposed? If not, why not?

<ESMA_QUESTION_COMPLEX_5>

The members of EACB consider that it should be clarified whether the performance of the return depending on the movement of a particular exchange rate (i.e. EUR/RON) is considered to be complex in the following situations:

- i. the return received is dependable on the particular movements of the concerned exchange-rate
- ii. the return is fixed but the capital is exchanged with an (unfavourable) exchange rate in a weaker currency

<ESMA_QUESTION_COMPLEX_5>

Question 6: Do you agree with the definition of a structure making it difficult for the client to understand the cost of exiting a structured deposit before term and with the relevant examples proposed? If not, why not?

<ESMA_QUESTION_COMPLEX_6>
No response at this juncture
<ESMA_QUESTION_COMPLEX_6>

Question 7: Please provide any specific evidence or data that would further inform the analysis of the likely cost and benefit impacts of the guidelines.

<ESMA_QUESTION_COMPLEX_7>
No response at this juncture
<ESMA_QUESTION_COMPLEX_7>