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 Association Française de la Gestion financière (AFG*) welcomes ESMA's consultation on draft guidelines on complex debt instruments and structured deposits.

*AFG represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. 600 management companies are based in France. AFG members manage 3,000 billion euros, making the Paris fund industry a leader in Europe for the financial management of collective investments (with 1,500 billion euros managed from France, i.e. 19% of all EU assets managed in the form of investment funds). In the field of collective investment, our industry includes – beside UCITS – the whole range of AIFs, such as: employee savings schemes, regulated hedge funds/funds of hedge funds, private equity funds, real estate funds and socially responsible investment funds. AFG is an active member of the European Fund and Asset Management Association (EFAMA) and of PensionsEurope. AFG is also an active member of the International Investment Funds Association (IIFA).

AFG welcomes positively the draft guidelines that are proposed by ESMA in this consultation. AFG supports the extension to debt instruments and structured deposits of the requirements of MIF applying to "complex products", which represents a move towards a more even playing field.

We would like to insist on the fact that we strongly agree with ESMA's comment that what applies to deposits which are not financial instruments under MIFID art 25 4. (a) (iii) is not to be cross-read in the interpretation of MIFID to financial instruments nor in other pieces of legislation, (§3 of Consultation Paper).

We also appreciate that § 11 further states that the criteria and the classification of securities and deposits as complex or not will only be relevant with regard to art 25 (4) of MIFID II.

AFG would like to take the opportunity of this consultation to provide some general observations even if this consultation focuses on debt instruments and structured deposits. Indeed, this consultation touches on the subject of the complexity of financial instruments. In this context, it should be reminded that complexity is understood under Mifid (Mifid narrowed context) as the difficulty to apprehend/understand the risk and return profile of the product in a given more or less protective wrapper with regards to the framework under which such products may be distributed to retail investors.

The level playing field between products from the perspective of a retail investor's facility of comprehension of the expected/promised output is key. We appreciate that investors should not be sold on an execution-only basis financial instruments whose risk reward profile would be too difficult for them to understand. By contrast, we strongly believe that a fund which uses sophisticated management techniques but whose risk reward profile is easy to understand should not be considered as complex, as it would prohibit investors from accessing products whose objective is in many cases to reduce the risk borne by investors.

We strongly believe that Mifid is not intended to disregard for the execution only regime whole product categories. Indeed, a process of assessing the complexity (within the Mifid concept of facility to understand the risk/return profile) 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.

Regarding Structured UCITS, AFG is fully aware that the risk reward profile of certain structured funds may be less easy to understand than that of other funds. However, unfortunately, Mifid II text does not distinguish between structured UCITS whose structure makes it difficult to understand the risk/return profile and those that on the contrary should not be classified as non-complex products. We feel in this matter there is not enough level playing field in comparison to other products that are not structured as funds and can still be offered within the execution only regime, whilst offering less protection to investors.
< 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>
We agree with the examples of debt instruments that embed a derivative. We understand from the example of inflation-indexed bonds that all indexed bonds (and other debt instruments) will be considered as embedding a derivative and, hence, as complex financial instruments. We would like to stress that floating rate bonds should not be considered as such and suggest that ESMA makes clear the limits of the wording<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>
Our members fear that the definition of embedded derivative proposed in the guidelines be misinterpreted and suggest to amend the last words of the definition by the addition of "*external"* before "variables". Alternatively, ESMA could include in the text of the guidelines a list of examples that would clarify the scope of the definition.
<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>
Yes. However, we believe that the reference to the capacity of an "average retail client" to understand is somewhat subjective. It should be made clearer what we should understand by "unusual or unfamiliar underlying" so as to avoid diverging interpretations among different Member States.
<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>
Yes.
<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>
Yes. We understand the three examples provided are alternative and not cumulative conditions. Maybe ESMA could make this clearer by saying these are each a sufficient condition.
<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>
Yes. However, we believe ESMA should make more explicit the non-cumulative character of the 3 exceptions.
<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>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_COMPLEX_7>