

TRANSLATION OF THE REPLY LETTER TO CONSOB CONSULTATION DOCUMENT ON THE DISTRIBUTION OF COMPLEX PRODUCTS TO RETAIL CLIENTS

Honourable
CONSOB
Divisione Intermediari
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Milan, 21 July 2014

COMMENTS ON THE CONSULTATION PAPER RELATING TO THE DISTRIBUTION OF COMPLEX PRODUCTS TO RETAIL CLIENTS PUBLISHED BY CONSOB ON 28 MAY 2014

Honourable Commission,

the undersigned associations, Italian Association for Certificates and Investment Products (*Associazione Italiana Certificati e Prodotti di Investimento* (ACEPI)¹) and The *European Structured Products Association* (EUSIPA), The *Joint Associations Committee on Retail Structured Products* (JAC)², also representing the following associations: *The International Capital Market Association* (ICMA), *The International Swaps and Derivatives Association* (ISDA), *The Association for Financial Markets in Europe* (AFME) and *The British Bankers' Association* (BBA), together with White & Case (Europe) LLP Law Firm, which assisted in the preparation and coordination of these comments, are grateful for the opportunity to participate in the public consultation process relating to the distribution of complex products to retail clients.

In preparing this document we also took into consideration the discussions with the Association of Investment Advisory Firms (*Associazione delle Società per la Consulenza agli Investimenti* (ASSORETI), the Italian Association of Investment Intermediaries (*Associazione Italiana Intermediari Mobiliari* (ASSOSIM), and the Italian Banking Association (*Associazione Bancaria Italiana* (ABI) but these comments substantially reflect the opinion of the undersigned. We hereby submit to your attention our comments on the proposals set forth in the consultation paper that also take into account the needs that our discussions with market operators allowed us to identify.

¹ The issuers associated with ACEPI are: Banca IMI S.p.A., Barclays Bank plc, BNP Paribas, Deutsche Bank AG, Royal Bank of Scotland, Société Générale, and UniCredit Bank AG. The distributors associated with ACEPI are Banca Mediolanum S.p.A. e Poste Italiane S.p.A. Over 90% of the certificates and the investment products offered in Italy are issued by banks associated with ACEPI. ACEPI is a member of EUSIPA – an “umbrella” European association, created in order to promote the interests of the investment products *retail* market – which includes industry associations such as ACEPI, with similar purposes.

² JAC is by multiple associations with an interest in retail products. In the first instance, queries may be addressed to ftaylor@isda.org.

This paper represents the views of members of the JAC with regard to the regulation of retail structured products in the UK and EU. As such, this paper should not be taken to represent views regarding retail structured products in any other jurisdiction.

We are pleased to share with this honourable Commission our thoughts on a regime that is of crucial relevance at a global level and, in particular, in the Italian market as well as our strong concerns about the proposed “concrete guidelines interventions” (“*interventi di indirizzo concreto*”) which, as discussed in this document, we respectfully contend are neither necessary nor justified by the underlying factual and legislative assumptions made by this honourable Commission.

We would like to underline, in this respect, how the intervention of this honourable Commission has resulted in the issuers and intermediaries acting in the Italian market carrying out both a constructive consideration and self-evaluation of the effectiveness of the audit systems, the procedures adopted so far and the extent to which they meet clients’ needs, and a thorough costs/benefits analysis expected to result from the proposed interventions for Italian market players and investors, which has not been analysed in detail in the Consultation Paper. The pursuit of adequate protection standards in favour of retail clients, taking into account current applicable laws and regulations having a European origin, guidelines and orientations of European authorities, approaches adopted in other EU countries, and – last but not least – the specificities of the Italian market is, in fact, a common interest of this honourable Commission and of all market operators.

Therefore, in consideration of the above, we consider it appropriate to open up a debate, according to the modalities considered to be most appropriate, between this honourable Commission and the market participant for the purpose of reaching shared and adequate solutions with reference to the level of services provided to the Italian market in light of the specific needs of such market.

Furthermore, without prejudice to the observations expressed in this document regarding the legislative and factual assumptions underlying the envisaged interventions, we highlight that any intervention that this honourable Commission may propose should consider, for the purpose of the potential adhesion of market players to such interventions, the time frame and the cost of the investments required by market players to update their internal systems and that accordingly any such intervention should not become effective as from the beginning of the coming year, since such costs have not been included in the budgets/business plans already approved by such market players for the current year (that, furthermore, may not necessarily coincide with the calendar year).

We remain at your disposal for any clarification or further analysis you should deem necessary and appropriate.

For this purpose, we set out below the reference contacts for this document:

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Sincerely Yours,

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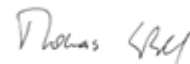


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COMMENTS ON THE CONSULTATION PAPER RELATING THE DISTRIBUTION OF COMPLEX PRODUCTS TO RETAIL CLIENTS PUBLISHED BY CONSOB ON 28 MAY 2014 (THE PAPER)

Introduction

In connection with the proposals set forth by this honourable Commission recommending relating to intermediaries to refrain from distributing products having features of “very high complexity” and introducing further safeguards in addition to those provided for under currently applicable laws and regulations relating to the distribution of products having features of “high complexity” – which, as further explained below, would undoubtedly result in a moratorium in respect of the issue of such products – subject to consultation (the **Interventions**), please find below some general observations, summarised here and described more fully in Section I.

Section II. includes some specific observations in response to the specific questions set forth in the Paper.

Section III. contains some final considerations in light of the analysis carried out herein.

SUMMARY OF COMMENTS AND CRITICALITIES

1. Absence of “pathological” situations in Italy and suitability of the safeguards currently in place

The safeguards referred to in the EU legislation in force appear to be largely adequate and correctly implemented in Italy, as is shown by the absence of overt and/or significant breaches of such legislation identified by this honourable Commission and the very insignificant level in Italy of retail clients’ complaints and consequential litigation. Therefore, there is no evidence justifying or requiring further general protective measures in Italy in addition to the existing ones provided for at both the EU and national levels, and, in particular, the general recommendation to refrain from distributing products of “very high complexity”. It could be, however, appropriate to evaluate the possibility for intermediaries to implement in a more effective fashion the abovementioned safeguards at client disclosure, product due-diligence, advisory service levels and improvement of the (base-level) consulting service on investment matters.

2. Need for coordination with current and future EU laws and regulations and with other competent authorities’ initiatives

The Interventions do not seem to be consistent with (a) the requirements for the exercise of the product intervention powers attributed by the recent regulation No. 600/2014/EU (so called “MiFIR”), (b) the powers currently granted to the competent authorities by the applicable EU legislation (MiFID and the directive implementing the MiFID), and (c) the approach suggested by ESMA in its “MiFID practices for firms selling complex products” opinion of 7 February 2014 and in its “Good practices for product governance arrangements” opinion of 27 March 2014.

3. Need for a peer review and compliance with the prohibition to perform gold plating

This honourable Commission’s intervention does not seem to take into consideration the express prohibition to perform gold plating established at primary level. The distribution of “complex products” is in fact

governed by a maximum harmonisation regime and is, therefore, subject to the abovementioned prohibition to perform gold plating applicable also to “concrete guidelines” initiatives such as the proposed Interventions.

Therefore, the Interventions should be consistent with (a) the initiatives adopted (amongst other reasons, in order to reflect the principles expressed by ESMA in the abovementioned opinions) by other European regulatory authorities, which took action to verify that the procedures adopted by the persons supervised by them were consistent with the protection standards provided for at the European level and (b) the implementing approach followed in the majority of major EU countries, at the same time taking into consideration the characteristics and structural specificities of our financial market, for the purpose of providing an effective level playing field and the harmonisation of supervisory practices.

4. Significant limitations to offer for investors

The Interventions should take into account their possible impact where applied according to the terms set forth in the Paper, in terms of the dramatic reduction in the number of investment opportunities for retail investors who could, in any case, also consider other investment proposals from other markets (also non-EU and, accordingly, often less developed in terms of protection measures adopted) to achieve their goals.

5. Inadequacy and partiality of the classification of complex products

The proposed categorisation of complex products, which is instrumental to the adoption of additional protection measures not provided for at the EU level, appears inadequate in many respects as, by definition, it is not based on objective criteria, pre-determined at the EU level, and accordingly, is necessarily based on autonomous and discretionary choices of the national authority, which are not always univocal from a financial point of view.

6. Prejudice for Italian intermediaries subject to the supervision of this honourable Commission

The Interventions should take into account their possible impact on the competitiveness of the Italian market, which consists of Italian issuers and distributors subject to the supervision of this honourable Commission and the Interventions, and also of foreign competitors, who, in comparison, operate both in Italy under a regime of free provision of services and are, accordingly, not subject to the supervision of this honourable Commission and the Interventions, and also in other European markets.

As a result, the proposed recommendations (i) do not possess the “objective” (and per product) effectiveness claimed to be attributed to them in the intentions of the Paper, and (ii) may cause Italian investors to “run” abroad, and may also reduce the ability of the Italian market to attract foreign financial resources.

7. Economic impact for issuers and intermediaries/distributors

The Interventions should take into account their possible systemic and potentially destabilising impact on issuers’ funding and on intermediaries’ revenues which would occur if they were implemented according to the terms proposed in the Paper. The intention to achieve the proposed recommendation, therefore, calls for a more specific, further and careful assessment of costs/benefits (for both market players and investors) expected to result from the proposed measures. This is also the case in respect of compliance costs, which potentially would be shifted onto retail clients, for issuers placing products issued by them and for the

distributors of products issued by third parties, due to the adjustment of the internal control systems and procedures relating to the distribution of complex products in connection with the “advanced advice” service, as envisaged by the Interventions.

SECTION I.

GENERAL REMARKS TO THE INTERVENTIONS

1. Effectiveness of current protection safeguards set out under the EU legislation in force and lack of a factual or other condition identifying the need for further and strengthened protection safeguards by this honourable Commission

The strong retail-oriented outlook of the Italian market induced issuers and intermediaries to pay constant attention, in particular upon implementation, to the fairness and transparency measures provided for by the MiFID regulations vis-à-vis their clients (mainly retail clients). For this purpose, intermediaries made significant efforts in terms of internal reorganisation, management of their operating systems and the financial and other resources and investments dedicated to them.

As proof of the adequacy and effectiveness of the procedures established by intermediaries to comply with the measures and safeguards currently set forth by the applicable laws and regulations and of the same supervisory controls and interventions carried out by CONSOB, it must be emphasised that the Italian market has not been characterised, in recent years, by any impairment or dysfunction capable of affecting the market’s stability and integrity that may justify or suggest the need for intervention by CONSOB, or make it appropriate or necessary in practice in the form of a generalised and preventive recommendation addressed to intermediaries on complex products, such as the one proposed in the Paper.

In particular, and as proof of the absence of an “Italian pathology”, no evidence is apparent of any prejudice caused to retail clients by the distribution of “complex” products with regard to, and not limited to, significant losses, complaints, litigation or an imbalance of retail investors’ portfolios concerning such products³ which would certainly have emerged following the efficient, ongoing and thorough supervisory activity characterising the work of this honourable Commission.

We therefore share what was expressed by ESMA in the “MiFID practices for firms selling complex products” opinion dated 7 February 2014, where it is stated that:

- (i) the set of measures introduced by the MiFiD is deemed sufficient, in the case of correct application and adequate supervision thereon, and the evaluation of the introduction of further measures would become necessary only in the case of non-fulfilment of the compliance standards introduced by MiFiD⁴, and

³ Please see in this respect the “*Statistic Bulletin* of CONSOB dated 4 March 2014. In particular, Table 2.1 (page 19) highlights that in 2012 “derivative securities” in retail client portfolios amounted to €28.7 billion against overall €1,270.4 billion of securities (Government securities, shares, etc.) held with Italian intermediaries versus the performance of investment and asset management services. Also, in the first four months of 2013, such concentration appears substantially in line with the 2012 data.

⁴ “ESMA is concerned that although the existing MiFID and MiFID Implementing Directive 4 requirements should be sufficient, if correctly applied, supervised and enforced, it appears that compliance standards for the MiFID conduct of business rules (on information to clients, suitability and appropriateness, in particular) may have fallen short in a number of cases”. See item 6 of the “MiFID practices for firms selling complex products” opinion of 7 February 2014.

- (ii) national authorities are invited to adopt “further measures” that would nonetheless consist of an intervention thereof concerning supervision, pursuant to practical indications, on the quality of intermediaries’ “MiFiD practices” in terms of organisation/internal audit, appropriateness, suitability and disclosure.

2. Need for coordination with the current and future relevant EU legislation on the matter (MiFID, and the directive implementing the MiFID and MIFIR) and with the approach suggested by ESMA in its “MiFID practices for firms selling complex products” opinion of 7 February 2014 and in its “Good practices for product governance arrangements” opinion of 27 March 2014

Measures proposed by this honourable Commission (and, in particular, the "additional measures" that seem, in the opinion of this honourable Commission, to represent the actual regulatory content of the Paper⁵), although having been located within the framework of the so-called future product intervention powers attributed by the recent Regulation (EU) No. 600/2014 of the European Parliament and the Council of 15 May 2014 ("MiFIR") to national authorities (powers that however will be applicable after thirty months), in reality significantly differ therefrom.

“Product intervention” powers that national authorities are entitled to exercise pursuant to the MiFIR not yet into force, presuppose, among the other requisites:

- (i) an actual, specific and significant “market failure”,
- (ii) a previous consultation obligation with ESMA, the European Banking Authority (EBA), as well as with the “*competent authority of the other Member States on which the measure could have a relevant impact*”. A general "moratorium" for the Italian market would have an impact on aspects (sound and prudent management – “*sana e prudente gestione*”) that are evidently outside the scope of the responsibilities and entitlements of host countries’ authorities and would entirely fall within the competences of the authorities of the relevant intermediaries’ country of origin. However, we are not aware that such a consultation has taken place in the context of the general initiative now envisaged, with consequent substantial limitation of the fundamental free circulation right within the EU and of the principle of mutual acknowledgement of authorisations,
- (iii) the obligation to avoid any discriminatory effect for other member states (pursuant to article 42, paragraph 2, letter d and e) of the MiFIR).

The initiative of this honourable Commission would, therefore, not only envisage the application of an innovative measure such as that of product intervention but, above all, determine the intervention on products at a general and abstract level and prior to the (current) conduct rules governing the relations between intermediary and client. It would represent, in other words, not only an anticipation of future powers/duties attributed to the supervisory authorities on the markets, but would run counter to the logic that will govern the exercise of such future powers.

The marketing of products having complex characteristics to retail clients is one of the areas in which EU

⁵ Evidence of this is the fact that the specific questions submitted by this honourable Commission to the market as contained at the end of the Paper, refer almost exclusively to matters addressed in the paragraph entitled “*The further measures*”.

legislation and ESMA, the European Securities and Markets Authority, have acted in the most effective way, particularly in light of the ever-increasing distribution of such products, in recent years, to retail clients.

In order to ensure a substantially homogeneous and adequate degree of protection for investors at a European level, which would not be effective differently depending on the country of residence of the investor, or of the issuer's and intermediary's country of origin, in addition to the applicable legislation, the Prospectus Directive on the one hand, and the MiFID and the directive implementing the MiFID on the other hand introduced specific and sophisticated controls, both under a disclosure, transparency and completeness perspective and under a behavioural perspective through the identification of conduct rules applicable to the provision of investment services. These have been adopted in the Italian legal system by taking into account the relevant specific characteristics, the application of which is always scrupulously supervised by this honourable Commission. In the same context of protecting the interests of retail clients, Directive 2014/65/UE (MiFID II) contains several provisions aimed at strengthening such safeguards and instruments, currently under consultation at a European level.

Still with a view to obtaining the maximum harmonisation possible, ESMA has become increasingly active in expressing interpretations and recommendations to be taken into account by national authorities for the purpose of both the adoption of future regulations and for the effectiveness of the Interventions in the protection of investors.

ESMA's opinions are in line with the purpose of the various initiatives adopted at the EU level. Indeed, the approach aimed at strengthening the already strong and adequate measures provided for by EU legislation already in force appears to be shared at the EU level (see, *inter alia*, the works of the European Commission in relation to packaged retail investment products (PRIIPs) and the guidelines issued by ESMA on the suitability rule) and is in line with the latest guidelines issued by the International Organization of Securities Commissions (IOSCO) in the Final Report on "*Regulation of Retail Structured Products*," which invited the regulatory authorities of EU Member States to adopt a regulation toolkit to oversee an adequate level of protection in favour of retail investors.

Please note that IOSCO warns with respect to the "moral hazard risk" that can be incurred by national authorities, such as the one in Belgium, should they try to classify complex products⁶.

Furthermore, IOSCO highlights how all so-called "pre-approval processes" (including those put in place by regulators in their various forms) entail for such regulators the moral hazard risk (and consequent possible failure of the same Interventions), intended as "relief from responsibility" of retail investors who are able to understand the risks underlying an investment, since they would systematically feel relieved from the burden of informing themselves regarding such risks under the assumption that the regulator has in their place assessed and "approved" the product ("*This may lead to less cautious investment behaviour and an increase in the risk of regulatory failure*").

It seems to us that the measures identified at a European level, as interpreted by ESMA and – in compliance with the interpretation guidelines adopted by it – by national authorities, do not show any gaps, shortcomings

⁶ "IOSCO members should be aware of the moral hazard risks involved in becoming more involved in the establishment of standards for products. Similarly, moral hazard could result from a regulatory determination concerning whether a product or product features are 'complex'. See IOSCO "*Regulation of Retail Structured Products*" Final Report December 2013 (page 22).

or insufficient coerciveness. In addition, there are neither breaches nor a large number of litigations concerning the matter under examination that evidence the non-application, or the limited application, by issuers and intermediaries subject to the legislation, or the inadequacy of such legislation, or the inadequacy of the supervision performed by the entities in charge that did not expose relevant breaches nor endemic and systematic pathologies of the Italian market (which is, on the contrary, looked at from abroad as an efficient market capable of protecting its retail clients through the responsible behaviour of issuers and intermediaries and the authority's ongoing supervision).

For the abovementioned reasons and to avoid a national disparity situation at the EU level, the individual authorities are not granted the power to adopt generalised and preventive recommendations aimed at prohibiting the distribution to intermediaries of a particular category of financial products. On the contrary, national authorities are requested to supervise the correct implementation by issuers and intermediaries of the already strong and adequate forms of protection provided by currently applicable EU and national laws and regulations.

It is also advisable to consider the fact that the current applicable legislation is also under discussion at a European level with the aim to create consistency between the protection ensured at primary and secondary market level in terms of disclosure and conduct rules. Therefore, for instance, offers of products falling under one or more of the exceptions to the provisions governing public offers (pursuant to article 100 of the Financial Services Act, with reference to the Italian market) need to be taken into account for the purpose of the Interventions: in particular, under applicable legislation these exemptions fall into the category of a reduced "need of protection" (and as such they do not trigger the requirement of the publication of a prospectus) and as a consequence they should have been considered in the context of the proposed Interventions.

3. Need for coordination with the approach adopted in other EU Member States with reference to the distribution of complex products

The intervention of this honourable Commission does not seem to take into consideration the prohibition to perform gold plating established at a primary level.

Nor it is appropriate to refer to similar choices (which, in any event, are less invasive and generalized) adopted by other countries. In those cases, in fact – and this aspect is of prime importance – initiatives adopted by foreign authorities were entirely supported by legislation.

The reference is, among others, to the initiative of the Belgian authority (FSMA) that, by virtue of an express delegation of powers granted by the legislator, back in 2011, proposed to perform a voluntary moratorium on the distribution of particularly complex products and more recently (with a regulation dated 24 April 2014) banned the distribution to retail clients of very specific categories of financial products, speculative insurance products in particular. The Belgian authority adopted the indicated measures on the basis of a specific delegation of powers implemented through a primary legislative provisions (*i.e.*, law 2 August 2002, as modified by law 2 July 2010, and law 30 July 2013). With respect to all other structured products distributed to retail clients also in Belgium, the legislator and FSMA intervened, in accordance with the Community's initiatives, simply by increasing the pre-contractual information requirements for the purposes of the distribution of such products, and, thus, within the context of the already-existing safeguards in favour of the retail investor.

In line with the approach adopted at the EU level, and reiterated in ESMA's opinions mentioned above, other European regulatory authorities accepted the invitation to pay special attention to this type of product so as to verify that the procedures adopted by the persons supervised by them were in line with the standards expected at the EU level. These authorities provided guidelines aimed at identifying qualitative standards and criteria to be taken into account when implementing the existing information controls and, specifically, when drawing up the promotional and offer documentation relating to complex products⁷.

4. Impact on the investment opportunities of retail clients

The Interventions proposed in the Paper are explicitly aimed at safeguarding and enhancing the typical function of “saving” qualifying as a way of utilising part of the national income for investments in the real economy. The main characteristic of an “investment”, as also resulting from the relevant sectorial rules, is that investors expect to increase the financial resources invested in it in light of the specific risk-return profile; therefore we agree with the statement of this honourable Commission that – in the Italian market – part of the national income is dedicated to investments which have different risk/return profiles.

It is worth noting that the so-called “complex” products, in addition to having capital hedging or protection purposes, often offer advantages in terms of returns and investment diversification. A moratorium, if any, would deprive investors resident in Italy of access to a number of instruments that are utilised by such investors, which allow the pursuit of different investment goals and strategies and are structured to address different market scenarios from time to time (upwards, downwards and lateral). Consequently, this would result in a dramatic reduction in investment opportunities and diversification for retail clients.

Even IOSCO warns national authorities in respect of such interventions and, in particular, in respect of the prejudice that retail investors able to understand “complex products” would suffer, as they “*would be deprived of significant investment opportunities*”⁸.

Empiric evidence proves that certificates, for instance, in Italy, have been able to generate positive performances upon occurrence of the scenarios for which a specific payoff has been designed. In this respect, please find attached the study carried out by ACEPI on the historical performance of all Capital Protected and Bonus certificates (1,406 products) offered in Italy with maturity falling within the 2004-2012 period. The result of this particular survey should easily overcome certain prejudices and results reached by other surveys based on smaller samples (such as the *Economic report* No.1 of 2013 by ESMA “*Retailisation in EU*”, based on an indistinct sample of just 76 “structured products” offered in the entire EU, 10 of which were in Italy), with specific reference to the evidence emerging in respect of the average yields at maturity (as opposed to the underlying yields) and to the consistency between the performances obtained by the certificates and the return profile “promised” and therefore “expected”. In particular, the aforementioned survey highlighted that, in general, in the 2004 – 2012 period, (i) the *Bonus Certificates* return has been equal to that of the underlying upon the occurrence of the barrier event, and higher in event the barrier was

⁷ For example, the French Autorité des Marchés Financiers (AMF) in the documents Position AMF n° 2010-05 (La commercialisation des instruments financiers complexes) of 15 October 2010, as amended on 20 September 2013, and Position AMF n° 2013-13 (Guide pour la rédaction des documents commerciaux dans le cadre de la commercialisation des titres de créance structurés (ivi inclusi i prodotti complessi)), expresses its position with regards to the matter of promotion and distribution activities for complex products and suggests measures aimed at putting in place an even more effective and reinforced protection in favor of retail clients.

⁸ “Retail investors capable of understanding the relevant investment risks will miss relevant investment opportunities”. see IOSCO “*Regulation of Retail Structured Products*” Final Report December 2013 (page 21).

not exceeded (Bonus + 2.07%, Bonus Cap + 17.82%, Easy Express + 23.75%), and (ii) for Capital Protected certificates, in times of market falls, the capital hedging and protection function has been effective. The above confirms that such products are flexible and appropriate instruments under various market conditions that, where appropriately selected and held until maturity, allow – and have until now allowed – retail investors to obtain extra returns compared to the underlying, in the observed periods and cases.

A further likely consequence of this initiative would be the reduced liquidity of the complex products that are currently a part of retail clients' portfolios due to a sharp crunch of the secondary market for such products, with a possible increase of complaints from current holders of the securities who could not easily divest them.

It is important to bear in mind that retail clients' propensity to invest, if not satisfied by the traditional national capital system and by the persons who, also following a logic of, so to speak, subsidiarity, are closer to the needs of their clients, could be satisfied by investment proposals found in other markets (which may also be potentially non-EU, non-retail oriented and less developed, accordingly, in terms of protections provided for), and fall outside the scope of supervision of the Italian Commission, and which investors might also easily access through the Internet (as revealed in the Paper) and through reverse enquiry systems.

5. Critical profiles in the categorisation of products not arising from objective criteria and requirements identified at the EU level

Please note that the Interventions are based on the assumption that complexity and riskiness are synonymous, so that the notion of the complexity of the product has a one-to-one relationship with the lack of comprehensibility of the product as to its functioning and intrinsic risks, along with the increased riskiness of the same product.

As argued by this honourable Commission in the past and also in the Paper, there are products in the market that have a simple structure and are easily understandable as to their pay-out mechanisms, which have a high intrinsic level of risk (such as bonds issued by issuers having a medium-low creditworthiness). Therefore, the assessment of the risk level of products should be carried out on a case-by-case basis, and it does not seem possible to make generalisations in this respect.

In this sense it should be noted that, as opposed to a very wide interpretation at the EU level of the notion of “complex product” such as that contained in the ESMA opinion “*MiFID practices for firms selling complex products*” dated 7 February 2014⁹, the identification at the national level of the specific products subject to the Interventions might, in the presence of other feasible solutions (including from a purely financial and economic perspective), where not based on objective and ‘legislative’ EU criteria, might lead to discretionary and even arbitrary choices, which would therefore be easily subject to various interpretations. For instance, the Interventions make reference to the criterion of riskiness connected with the existence of a certain number of derivative components included in the product, a number that would appear to be identified in a discretionary manner as further analysed below.

It is pointed out that the categorisation of complex products for the purpose of determining their ability to be distributed to retail clients would introduce elements of discrimination between products, in particular

⁹ ESMA highlights that a product “complexity” represents a relative concept that depends upon the risk-return profile and the other characteristics typical of a specific product.

between more or less complex bonds and certificates, on the one hand, and collective investment undertakings and insurance products, on the other hand.

In particular, also in light of the absence of legislative and EU indications in that respect, the criteria on which the categorisations proposed by this honourable Commission in the Paper are based lack clarity and without an intrinsic risk of “possibility for challenge”, which makes it difficult also to understand the distinctions made between the various products included in Lists 1 and List 2.

We believe, generally, that the criteria to be used to measure the degree of complexity of a product must comply at least with the following criteria:

- (i) being unequivocal, objective and non-discretionary: the existence of a discretionary margin would expose intermediaries to significant litigation risks *vis-à-vis* investors, in addition to the supervisory authority¹⁰, and
- (ii) being directly inferable from the offering documentation on the product: for the purpose of putting any market player (be it distributor, adviser or investor) in the position of having direct access to such information, without the need to necessarily have technical competence and sophisticated calculation instruments, typically affordable only by issuers/originators.

Please note, furthermore, that in line with ESMA indications, the qualification of a product as “complex”, as a result of the presence of some of the elements identified as typical of the type, does not determine *per se* the absolute inadequacy of such product for distribution to retail clients, since such a judgement may only be expressed after a case-by-case assessment of the suitability of the specific product. A different approach would not be in line with the opinion expressed at EU level.

Without prejudice to the above, even if one wanted to accept the assumption that complexity and risk are synonymous terms and that purchases “not aware” of the product risk translate into significant losses, it is at the same time necessary to consider – according to the ESMA indications – that such risk will, in fact, be a risk mitigated or voided where such “complex product” offers the possibility of a total or partial protection of the invested capital.

In acknowledging the observation expressed by this honourable Commission¹¹ as regards the absence of a two-way correlation between a product’s financial structure and risk, we share the principle so expressed, *i.e.*, that the two aspects (namely the financial structure and the risk) are not generally linked by a two way correlation. However, it is equally true that such aspects are not entirely independent from one another and, with reference to capital protection, the risk deriving from the possibility for clients not being able to understand the features of the product or from the “not aware” purchases phenomenon will, substantially, be a risk with a very different size depending on whether the product exposes the investor to loss of the entire capital, or a portion thereof, or does not expose the investor to the risk of loss of the capital invested at all.

With respect to the specific identification and definition of products of “very high complexity” (List 1) and

¹⁰ In fact, with respect to litigation by investors, where a lawsuit relates to very technical matters (*e.g.*, number of derivative components embedded in a product) an expert would be required to be appointed during the proceedings by the relevant court in order to decide the issue and, as a consequence, intermediaries would be exposed to an unpredictable outcome of such lawsuit.

¹¹ See note 8 of the Paper.

products of “high complexity” (List 2) please note the following:

(A) Number of “derivative components” criterion

We do not believe that the number of derivative components embedded in the product (regardless of the arbitrary identification of the “number” of derivative components that makes the product more or less complex/risky – without considering the type of derivative components) is a criterion complying with the requirements of uniqueness, objectivity and questionability/of being non-discretionary, at least for the following reasons:

- (1) There is no official classification of derivative components: financial practice, which is in continuous evolution, recognises vanilla derivatives, strategies, exotic derivatives, stripes of derivatives, etc., and the same product can correctly be broken down in different ways (and, more importantly, into a different number of derivative components) depending on the choices made; the same notion of “elementary derivative component” continues to evolve over time; and
- (2) the number of derivative components embedded in the product criterion appears not to be appropriate for measuring complexity or risk. In this respect, it is worth noting the use by intermediaries of parameters to allow them to measure the risk for investors – such as ISR – allowing the calculation of risk on the basis of objective and pre-set criteria such as complexity, liquidity and risk.

(B) “Higher than 2 leverage” (with reference to List 1) or “higher than 1 leverage” (with reference to List 2) criterion *(regardless of the arbitrary identification of the same leverage “ratio” that, regardless of the type of product, makes the latter more or less complex/risky)*

With reference to the leverage underlying such product categories, we believe that such criteria can be subject to a number of interpretations and are therefore misleading, as well as not in line with the indications recently expressed by the supervisory authority in the identification of products with leverage higher than that indicated in the Paper for the purpose of the admission to trading venues (that may therefore lead to, for the above mentioned reasons, a rise in future litigation regarding such products’ features).

It is clear that the leverage intended as a positive factor in the performance of the underlying (so called “asymmetrical leverage”) entails advantages for the investor without exposing him/her to the risk of losing the capital invested.

We refer to the abovementioned under this paragraph 5; we also believe that it is not possible to disregard the assessment of the potential “complexity” of a product given the actual impact that such complexity may have on the riskiness thereof.

(C) Criterion relating to the “credit linked (exposed to credit risk of third parties)”

Products that can abstractly be classified within such category are heterogeneous among themselves, both from a financial and a legal perspective.

The exposure to the credit risk of third parties may be achieved both with different modalities (physical or synthetic) and, to different extents, with consequential heterogeneity of the risk level for the investor.

Furthermore, products providing for the protection, even the total protection, of the capital invested, also

theoretically qualifying as credit-linked products as identified by this honourable Commission, exist on the market, *i.e.* they expose the investor in various ways to the credit risk of entities other than the issuer and regardless of how this risk functions within the products (for instance, as underlying, equity, debt, etc.). In this regard we avoid making any considerations regarding the inherent exposure to sovereign risk of the country of the issuer (or of the intermediary with which an investor's funds are deposited) that would not be increased by specifying such country as the "reference entity"; indeed we would submit that an increase of the product's return linked to the sovereign risk would be "evident" and specifically "remunerated".

In light of such diversity and of the considerations set out above in respect of the need to consider the actual risk for investors, it appears very arbitrary to bring all credit-linked products within a single category and consider them complex, and therefore risky, under any circumstance.

6. Competitive disadvantage for Italian issuers and intermediaries/distributors compared with European competitors

The Interventions proposed in the Paper would, if implemented, risk facilitating discriminations and, ultimately, creating an unlevel playing field between the Italian market and foreign markets, and would result in a systemic disadvantage due to the reduction in the competitiveness and attractiveness of the Italian market at the global level, with consequential adverse effects not only for operators, but also for investors.

As mentioned above, the proposed recommendations are not applicable to foreign intermediaries located in an EU country and operating in Italy under regime of free provision of services (both in case of absence of a branch in Italy, or in case of double modality of free provision of services and establishment of branch) and are therefore ineffective against foreign intermediaries, even just in terms of "moral suasion".

As a result, it is clear that the Interventions could not achieved the "objective" (and per product) effectiveness claimed to be attributed to them in the intentions of the Paper.

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1. Impact on issuers' funding and on intermediaries' revenues (including in terms of costs for retail clients, for issuers placing products issued by them and for distributors of products issued by third parties).

The Interventions proposed in the Paper would, if implemented, also have a significant and potentially destabilising systemic impact on the players active in the Italian market, especially in terms of:

- (i) adequacy of the funding of banks;
- (ii) revenues arising from the marketing, the structuring and the market-making activity to support the liquidity of complex products in the listing markets. In this respect, please note that, in the Italian market, applying for the admission of complex products (in particular, certificates) to listing in regulated markets or other trading venues is the prevailing and established practice;
- (iii) absence of profit; and
- (iv) review of the organisational structures of the issuers and intermediaries active in the Italian market (with foreseeable consequences in terms of employment).

Another potential source of economic pressure for intermediaries is represented by complaints/litigations that retail clients already holding complex products may bring against the relevant intermediaries should they abstain in the future from distributing to retail clients complex products which no longer comply with the rules after the Interventions. Furthermore, the situation, as stated above, would be worsened by the resulting limited liquidity of the complex products in the portfolio of retail investors.

Such a conduct (which would be contradictory) may give rise to liabilities on the side of the intermediary and even of supervisory authorities, also because the amended approach would not be justified by the *ius superveniens*, *i.e.*, by a new provision of law or regulation requiring such change of approach (but would fall within a mere reinterpretation of the currently adopted regime and policy – as already approved by the supervisory authority – that would therefore be considered inappropriate in light of standards deemed more appropriate for the Italian market in the absence of new factual elements).

Please further note that the proposal contained in the Paper recommending the so called “advanced” advice for the distribution of highly complex products by intermediaries would entail updating the current internal audit systems and procedures relating to the distribution of products, a consequential reorganisation of the structures in charge and a rethinking of internal policies, with consequences in terms of timing – such a reorganisation could not be implemented within a short period of time and, moreover, would be burdensome in terms of costs for the intermediary. In particular, it should be noted that, for the time being, no distributor active in the Italian market is in a position to provide the type of advisory service in the terms identified in the Paper and that, for the purpose of the adjustment of the abovementioned systems and procedures to CONSOB’s guidelines, considerable investments will be required.

Consequently, the proposal in question would also result, in practice, in a moratorium on the distribution of products having characteristics of high complexity, as identified in the Paper.

In light of the above, it should be noted that the introduction of further safeguards in the distribution of highly complex products (*i.e.*, distribution only allowed if preceded by the “advanced” advisory service), as opposed to those currently provided for by laws and regulations, would generate, as a result, an increase in the costs associated with the distribution of such financial instruments for investors, which would be due to the need for issuers and intermediaries to make investments to update their structures and internal audit systems for the purpose of adopting the measures recommended by CONSOB.

Such additional costs are not foreseeable in light of the current applicable laws and regulations or those to be shortly adopted at the EU level, the evolution of which is constantly monitored by issuers and intermediaries, and there will therefore be a need to plan for costs and investments inherent in the timely update of their businesses to adapt to the proposed amendments. Legislative amendments of such importance are usually announced with adequate advance warning by the EU legislator and adopted after consultations and long exchanges of views (lasting for several years, in line with the regime governing the review of directives contained in the same directives).

Finally we note that the Interventions would also have a negative impact on issuers and intermediaries in terms of employment, given that the same would entail the need to restructure corporate functions as a result of the contraction of those business lines involved the distribution of complex products.

SECTION II.

ANSWERS TO THE QUESTIONS ASKED IN THE PAPER

1. Do you think that the definition of complexity adopted in this paper contains all of the elements required to identify products not suitable for the direct distribution to retail clients?

On the basis of the considerations exposed herein and, in particular, in light of what is explained in paragraph 7 above, we consider that (i) there does not exist a relationship between complexity and risk, (ii) the identification of products that preemptively and generally cannot be distributed to retail clients is not in line with the current legal framework, and (iii) a general definition of complexity/risk disregarding a legislative definition decided at the EU level – for that specific purpose and targeted to the identification of a general moratorium – may be questionable and ambiguous because of the various options and theories available also at a financial level, one of which the local authority of its sole discretion selects as the legally relevant one at the national level.

2. Do you share the approach whereby the level of complexity of a financial product can be assessed also with reference to the number of derivative components that characterize its financial structure?

On the basis of the considerations exposed herein and, in particular, in light of what is explained in paragraph 7 above, we consider that (i) the identification of a pre-set number of derivative components that would *per se* make a product complex/risky is not in line with the current legal framework, and (ii) in the absence of criteria set forth at the EU level – for that specific purpose and functional to the identification of a general moratorium – it is difficult to find an unequivocal and unquestionable definition of “derivative component”, and accordingly of the relevant number, identifiable as being embedded in the product itself.

3. Is a distinction of the “derivative components” embedded in the products, in light of their various level of complexity, appropriate and feasible in a sufficiently precise fashion?

Please refer to the consideration expressed with regard to question 2 above.

4. Do you believe it would be appropriate to include in the list of “managed” products such as insurance policies and/or OICR (the latter where not already specifically included)?

On the basis of the considerations exposed herein, we consider the creation of such lists not to be in line with the current legal framework, either because, firstly, instrumental to what would be a general and preemptive moratorium cannot be justified either from an EU legislation perspective, as interpreted by the same opinions issued by ESMA, or from a substantial opportunity/need perspective, as no anomalies typical of the Italian market have emerged from the regular and precise regulatory activity carried out by this honorable Commission that may suggest, even at factual level, the need for such a moratorium; secondly, such lists would be based on arbitrary choices, with reference to the choice of the notion also of a financial nature to be preferred at legal level, with respect to the many available options, choices that, where not supported by “legislative” guidelines set forth for this purpose at the EU level, risk *per se* being questionable and giving rise to a national difference that risks jeopardizing the maximum harmonization in the matter under discussion, as well as the competitiveness of the “Italy system” and the fulfillment of investors’ interests. The latter would in fact witness a crunch in investment opportunities offered to investors in our country, without at the same time making it possible to prevent seeking on such opportunities, through the use of the Internet, in other markets, also non-EU and characterised by less protections.

In this sense, we do not believe a supplement of the lists to be necessary and/or appropriate. In particular, the observations on the merit and method expressed herein are applicable also for such “managed” products.

5. Do you believe that other and further characteristics useful to identify the advice service with higher added value (so called “advanced”) may exist?

As stated, we do not consider the adoption of strengthening measures of existing safeguards to be necessary and/or appropriate. Furthermore, with regards to the abovementioned exclusions, we believe that an evaluation of the necessity of associating the provision of the consulting service on investments to the distribution of complex products would be advisable.

Contrary to other investment services, the advice investment service in the matter of investments, pursuant to current laws and regulations, together with that relating to individual portfolio management, provides in its supply phase for already very restrictive protective measures, consisting of a strict verification of the suitability of a financial product measured against the risk profile assigned to the client, his investment goals and his financial situation, in addition to the experience and knowledge level declared by the client.

Such verification presupposes a deep knowledge of the client and a precise verification of his needs and opportunities and provides, therefore, a protection level for the investor in potentially “complex” financial products much higher than a mere evaluation of the level of experience and knowledge provided for by the appropriateness verification connected to services other than management and advice.

As for the management choices, also the personalized investment recommendations have to be necessarily adequate. The adequacy of the recommended operations must be “reinforced” in comparison to that which characterizes the manager’s choices, as a consequence of the necessary and specific improvement of the level of “financial knowledge and experience” of the client, in that the client himself, not the financial intermediary, will dispose the operation. The abovementioned exclusion would allow one not to disown the “trade” and the responsibility of the service-providing intermediaries, who, even behind the push in the actions of guidance and supervision by this Authority, have, throughout the years, invested significantly in the improvement of the questionnaires presented to clients and in the improvement of the algorithms for the evaluation of coherence (through a necessarily “multivariate” approach) between characteristics of the client,

on the one hand, and on the product/portfolio on the other.

We underline, in addition, that (i) the Italian market adopted and applied the guidelines approved by ESMA on the evaluation of suitability, and (ii) the same ESMA “*MiFID practices for firms selling complex products*” opinion of 7 February 2014 requires linking the distribution of “complex products” to the advice service in a way that is not clearly defined.

A change in the structure of the advice service, in addition to not being compatible with applicable EU laws and regulations and the aforementioned ESMA guidelines, would entail a significant and disproportionate increase of costs, both of an operational and organisational nature, for intermediaries.

6. Do you think there may be other distribution modalities that may be excluded from the scope of application of the orientations thought of above for products included in lists 1 and 2?

The on-line trading and, in general, the execution of orders on behalf of clients as well as receipt and transmission of orders services, for their inherent characteristics, should be excluded from the scope of application of any Intervention.

Reference is further made to the considerations set forth under the answer to Question 5 regarding the use of the advice service.

7. Do you think it would be possible to identify retail client categories – according to objective criteria (for instance, assets, specific competences ...) – in respect of which no prohibitions or specific warnings in the distribution of complex products are necessary?

The segmentation of retail clients on the basis of the abovementioned criteria appears, besides being difficult to apply practically, also to not be in line with the current Italian or the European legal framework.

MiFID provides for category distinctions of clients exclusively based on the investment service provided and not depending on the financial instrument underlying such service and, being a maximum harmonisation regime, does not provide for categories other than those provided for therein to be created at a national level.

In any event, accepting the invitation by this honourable Commission to share further thoughts, we confirm as of today our availability to discuss those matters, according whatever modalities considered most appropriate.

We do not intend to submit observations in respect of Questions 8, 9 and 10 of the Consultation Paper.

SECTION III.

FINAL CONSIDERATIONS

In light of the considerations set forth above, the intervention of this honourable Commission that, by means of the consultation instrument and the resulting debate with the market, generated both a satisfactory and constructive consideration and self-evaluation by issuers and intermediaries acting on the Italian market of the effectiveness of the audit systems and of the procedures adopted so far and of the extent to which they meet clients’ needs, appears to be extremely relevant.

The maintenance of high protection standards in favour of retail investors representing the Italian market and

the timely adoption of these standards by means of relevant investments in light of applicable laws and regulations also with European origin, and the relating guidelines and orientations of ESMA, is in fact, a common interest of this honourable Commission and of all market operators.

In line, therefore, with ESMA's invitation to achieve the efficiency and effectiveness, where necessary at a national level, of the existing safeguards focused on disclosure and behavioural protection and shaped depending on the type of investment service provided, the beginning of the consultation seems to us an important step representing a moment of dialogue and self-assessment of the system, and, as an outcome thereof, an acknowledgment of the efficiency of the "Italy system" and a recommendation inviting intermediaries to persist in the effort – continuous and constant – to provide adequate protection to its retail clients is expected. Certainly, given the current legislative and factual premises, a general moratorium realised through recommendations to abstain from distributing products of "very high complexity" cannot be accepted; such recommendations in fact, as indicated, would have the effect of creating a non-harmonised national regime, compromising the competitiveness of the country and operators, as well as reducing investment options available to investors that, through the Internet (an important investment tool, as indicated in the Paper) could move a relevant portion of their financial resources towards investments in other countries, often non-EU, and less sophisticated and evolved in terms of retail client protection.

Therefore, in consideration of the above, we deem it appropriate to set up a debate, according to whatever modalities are considered most appropriate, between this honourable Commission and the workout participants for the purpose of reaching shared and adequate solutions with reference to the level of services provided to the Italian market, in light of the specific needs of such market.

Furthermore, without prejudice to the observations expressed in this document regarding the legislative and factual assumptions of the envisaged interventions, we highlight that any intervention that this honourable Commission may propose, should consider, for the purpose of the potential adhesion of market players to such Interventions, the timeframe and the cost of the investments required by market players to update their internal systems and that, accordingly any such intervention should not become effective as from the beginning of the coming year, since such cost have not been included in the budgets/business plans already approved by the same market players for the current year (that, furthermore, may not necessarily coincide with the calendar year).

For further information on this document and on CONSOB consultation process please refer to the following contacts or your usual White & Case contact.

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