CGIL is the oldest Italian trade union and it is also the most representative of Italian workers, with about 6 millions of members, including workers, pensioners and young people. CGIL is a member of European Confederation of trade unions (Ces) and of the International Confederation of trade unions (Ituc-Csi).

This document aims at expressing CGIL remarks about the Consultation Paper "*MiFID complex and non-complex financial instruments for the purposes of the Directive's appropriateness requirements*", issued by the CESR on May 2009, and, in particular, on the views expressed in Section 2 of the Consultation Paper concerning the classification as complex or non complex of the various types of money market instruments, bonds or other forms of securitised debt.

As known, MiFID allows investment firms to avoid appropriateness tests "*when providing investment services that only consist of execution and/or the reception and transmission of client orders with or without ancillary services*", provided that some conditions are satisfied, included the non-complexity of the financial instrument the service is related to.

Specifically, art. 19, par. 6, first subpar., of MiFID offers a list, even if not exhaustive, of non complex instruments. Such list includes: "*[…],money market instruments, bonds or other forms of securitised debt (excluding those bonds or securitised debt that embed a derivative), […]*", which are dealt by CESR Consultation Paper at Section 2.

Therefore, it is clear that European provisions of Level 1 establish that bonds and other forms of securitised debt which embed a derivative component must be necessarily classified as complex financial instruments.

The position of the European policy-maker is aimed at ensuring, for these instruments, a transparency approach suitable to allow investors for the full comprehension of the actual risk-reward profile of the investment as well as of the costs regime as implied by its underlying financial engineering.

It is straightforward that, according to MiFID classification, structured bonds and other debt securities with one or more derivative components such as covered warrants and certificates must be regarded as complex. In fact, for each of these instruments the presence of a derivative component can be immediately detected, being such component explicitly involved in their financial engineering.

Moreover, the wording chosen by the European policy-maker ("*excluding those bonds or securitised debt that embed a derivative"*) does not appear to apply only when the derivative is explicitly embedded in the financial instrument. On the contrary, it seems that also the instruments which implicitly contain a derivative component should be considered as complex.

This second case mainly occurs for bonds embedding a derivative component associated with the credit risk of the issuer. CGIL refers to subordinated bonds and also to senior bonds, the latter where issued by a subject whose credit standing is worse that that one of bonds issued by the Member State where the issuer has its registered offices.

In this regard, it is worth recalling that bonds issued by a subject exposed to default risk embed a credit derivative sold by the investor to the issuer. The higher is the credit risk of the issuer and/or the subordination level of the bond the higher is the value of this credit derivative. Hence, in order to guarantee the fair evaluation of the bond it becomes crucial that the credit derivative it embeds is correctly priced.

Further criteria to identify non complex products are given in Level 2 of MiFID, where it also specified that, in order to be considered as non complex, a financial instrument must "*not involve any actual or potential liability for the client that exceeds the cost of acquiring the instrument*".

This criterion definitely clarifies any doubt left by the Level 1 MiFiD provisions and, with reference to bonds exposed to default risk, it implies that the credit derivative embedded in their financial structure prevents their classification as non complex products. Indeed, would such credit derivative not fairly evaluated, the investor will remain exposed to a potential or effective loss in the case of default of the issuer.

CGIL wants to express its appreciation for the position expressed by the CESR in Section 2 of the Consultation paper, where, in line with the framework outlined by MiFID, it confirms that the presence of an embedded derivative is a sufficient condition to classify as complex all the instruments treated in the above mentioned Section, "*since all are forms of securitised debt*".

CESR analyses many types of money market instruments, bonds and other forms of securitised debt, and it correctly includes, by the way, in the category of complex products:

- callable and puttable bonds;
- convertible bonds;
- exchangeable bonds;
- credit linked notes;
- structured instruments whose performance is linked to the performance of a bond index;
- structured instruments whose performance is linked to the performance of a basket of shares with or without active management (also when their nominal is fully guaranteed;
- structured instruments whose performance is linked to the performance of another underlying such as a commodity or a commodity basket could also be added to this list.

CESR also proposes to consider as complex products many forms of securitised debt, such as Mortgage Backed Securities, Collateralised Debt Obligations, Asset Backed Commercial Papers and other Asset Backed Securities *"even where there may be a question as to whether or not they embed a derivative"*.

CESR explains this last clause referring to the general concept of derivative instrument (that is an instrument whose value depends on that of an underlying asset) and observing as the dependence on the evolution of an underlying asset is a feature shared also by securities as ABS.

In the light of the above mentioned MiFID provisions – which consider complex any "*bond or securitised debt that embed a derivative*" – CGIL agrees with the CESR classification of these instruments, but it also believes that CESR specification concerning the questionability, for this kind of financial structures, on the presence of a derivative component is unnecessary and potentially misleading (**This answers to Question 11 of the CESR Consultation Paper**).

In fact, there is no doubt that all of these instruments implicitly embed a credit derivative and, hence, their classification as complex is straightforward, in force of MiFID indications.

Moreover, CESR specification leads to an unsuitable classification of subordinated bonds, whose complex or non complex classification is uncertain, as the Consultation Paper leaves it to the general positions expressed for the other types of bonds and securitised debt.

On the contrary, CGIL believes that the credit derivative component featured by these bonds (as well as by senior bonds having a default risk higher than sovereign bonds) cannot be questioned, exactly as for the above mentioned forms of securitised debt, and, as a consequence, also these bonds should be categorised as complex.

The position expressed by CESR creates an inconsistency in the logical relationship existing between the complexity of an investment product and the difficulty encountered by investors in assessing its potential returns and, hence, its possible mispricing.

As an example take the case of Collateralised Debt Obligations. These securities are issued in several tranches (senior, mezzanine and junior) which only differ for the different exposure to the credit risk of the issuer.

It follows that some CDO tranches (the senior ones) are actually less risky than many subordinated bonds, while other tranches (the mezzanine ones) are completely equivalent to subordinated bonds, hence making unjustified the different classification proposed by the CESR.

More explicitly, according to the view of the CESR, the tranche senior included in a CDO and rated AAA would be considered as complex, while a subordinated bond rated B, could be classified as non complex, even if the latter is much riskier than the former, and also more difficult to be fully understood by investors in terms of potential returns and, hence, of possible mispricing. (**This answers to Question 19 of the CESR Consultation Paper**).

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