European Banking Federation
Secretary General

0298-2009
UW/GB

Mr Carlo COMPORTI
Secretary General
The Committee of European Securities Regulators (CESR)
ccomporti@cesr-eu.org

Email

Brussels, 17 July 2009

Subject: ***Response to CESR Consultation Paper on MiFID complex and non-complex financial instruments***

Dear Mr. Comporti,

The EBF welcomes the opportunity to comment on CESR's proposals for the classification of financial instruments as complex or non-complex under MiFID. Generally, European banks do however not believe that further guidance at the current point in time would be helpful for the purposes of either investor protection or competitive equality. It would therefore be the Federation's preference that CESR recognises the solutions that have already been established at national level.

Please find our detailed comments enclosed. In recognition of CESR's determination to release further guidance, these nevertheless include a number of comments on CESR's specific recommendations.

Please do not hesitate to contact me or my colleague Uta Wassmuth (u.wassmuth@ebf-fbe.eu) for any question you may have.

Yours sincerely,

Guido Ravoet

Encl.: (D1037E-2009)

a.i.s.b.l.

10 rue Montoyer B- 1000 Brussels
+32 (0)2 508 37 11 phone
+32 (0)2 511 23 28 fax
http://www.ebf-fbe.eu

EBF Ref.: D1037E
Brussels, 17 July 2009

MiFID

Response to CESR Consultation Paper on MiFID complex and non-complex financial instruments for the purposes of the Directive's appropriateness requirements

Key Points

- **The EBF considers problematic the approach of MiFID of classifying instruments as complex or non-complex. Ideally, a consistent approach would look at the substance and functioning rather than just the structure of financial instruments.**

- **However, effective and sound solutions have by now been established in all MiFID jurisdictions. Additional guidance at the current point in time is therefore not considered helpful, but might rather lead to confusion and legal uncertainty.**

- **If CESR nevertheless insists on issuing further guidance, then this should usefully be complemented with a substantiation of the underlying criteria which lead to the proposed classification. This would be both to ensure consistency in the classification and in recognition of the evolving product landscape.**

- **The EBF also questions a number of CESR's detailed recommendations on the classification of products.**

Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.
The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

Contact Person: Uta Wassmuth, u.wassmuth@ebf-fbe.eu
Related documents: CESR Consultation Paper: http://www.cesr-eu.org/popup2.php?id=5721

General remarks

1. The European Banking Federation welcomes the opportunity to comment on CESR's thinking on complex and non-complex financial instruments under MiFID.

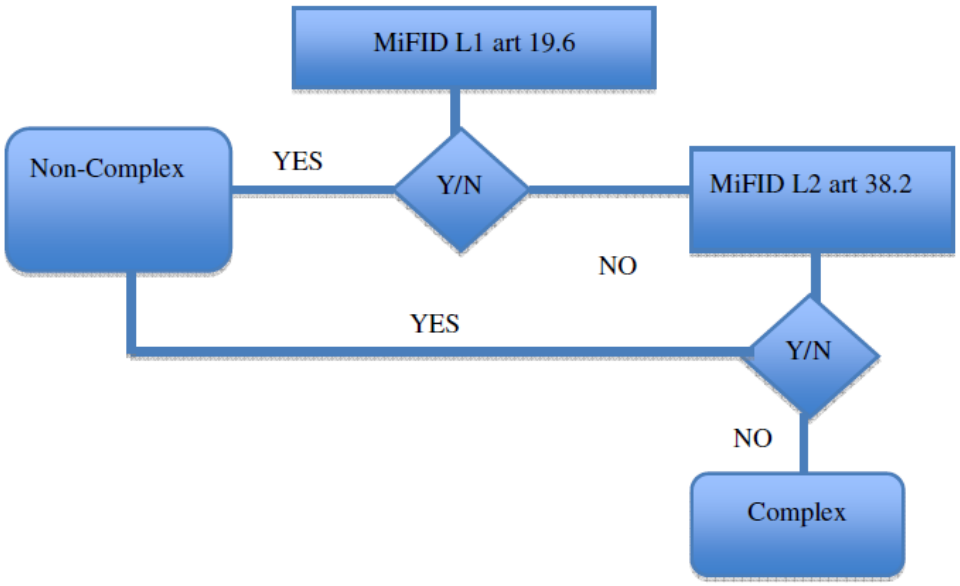
2. Whilst the EBF supports the focus that MiFID gives to investor protection and more specifically, to the protection of retail investors, the Federation does not however believe that the distinction between "complex" and "non-complex" instruments is helpful for this purpose. Rather than distinguishing products by structure, the **requirements for appropriateness tests should in principle also take account of products' risk levels**.

3. **Further inconsistencies arise from other specific aspects of the MiFID rules**, for example the fact that corporate bonds are classified as non-complex, despite their single-issuer risk and low liquidity levels; the fact that all UCITS investment funds are categorised as non-complex; and the automatic consideration of all kinds of structured bonds as being complex.

4. **The EBF does therefore not believe that further guidance on the classification of products as complex or non-complex would be beneficial for the purpose of retail investor protection.**

5. Neither would the EBF expect the guidance proposed by CESR to be satisfactory from a competition point of view. Rather, the potential for an unlevel playing field arises from the rigidity of the Level 1 Directive, which is based on a structural approach, as opposed to the more flexible and qualitative approach of Article 38 of the Level 2 Directive.

6. However, these difficulties became apparent at a relatively early stage in the MiFID implementation process and have been resolved in different ways in different Member States. For example, common categories of complex and non-complex products have been established in some countries. In accordance with the requirements of Article 19.6 of the MiFID Level 1 Directive and Article 38.2 of the Level 2 Directive, this is done in an iterative process as shown by the following diagram:



7. In other countries, the distinction between complex and non-complex products is not used in practice. Instead, intermediaries are consistently carrying out appropriateness tests.

8. Despite the initial work load and costs involved, the application of the rules is now working in practice. **The Federation does therefore also not find the timing of CESR's consultation paper helpful. Firms should not at this point in time be required to change the established classifications, for no practical benefit.**

9. The discussions so far have in addition revealed the great **practical difficulties in classifying products**, in view of the sheer number of different products that is also evident from CESR's consultation paper itself. It would seem a very cumbersome task for CESR to classify every single investment product as either complex or non-complex. Added to that would be the **work load of keeping such a list updated**, in line with further product developments.

10. The EBF is furthermore concerned as regards the possible overlap of CESR's current consultation with the European Commission's ongoing work on "packaged retail investment products". The Federation supports in principle the work being carried out by the Commission and is prepared to work with the Commission on practical disclosure solutions for some of the products in the Commission's focus. However, banks caution **that "complex products" under MiFID must not be equated with "packaged retail investment products"**.

11. CESR itself seems to raise questions that also point to the inconsistencies of the complex/ non-complex classification, as opposed to a consideration of risk levels. As practical solutions have now been established the EBF does not believe that MiFID should be re-opened at the current point in time to address this issue. However, should such a further-going review be considered for the foreseeable future it would be all the

more regrettable that the industry be forced to implement any systems changes for a rather limited period of time.

12. As and when a more general assessment of the classification of financial instruments is initiated, the EBF notes that this would involve thorough and difficult considerations. Whilst more meaningful in terms of investor protection, classifying risks is clearly not any more straight-forward as a procedure.

13. The Federation is aware of CESR's determination, in spite of the mentioned reservations, to nevertheless release guidance on the interpretation of complex and non-complex instruments. If this work is undertaken, then it would be helpful for CESR to **complement the classification of instruments with a substantiation of the underlying criteria that lead to this categorisation**. This is both for the sake of consistency and in recognition of the evolving product landscape.

14. EBF members would furthermore like to draw CESR's attention to a number of specific comments on CESR's proposed classification, which are summarised below.

Specific comments

Question 1: Do you have any comments on CESR's view that Art. 19(6)'s reference to shares may best be read as capturing a particular range of shares and exclude other types of equity securities negotiable in the capital markets?

15. The EBF would agree with CESR's interpretation that listed shares in companies would be automatically considered as non-complex; and that other instruments such as depositary receipts should be assessed against the criteria of Article 38 of the Level 2 Directive.

Question 6: Do you agree with an interpretation that subscription rights/ nil-paid rights for shares would be complex under the appropriateness requirement?

16. The EBF supports the view that the rights in general should be considered a component of the share itself, which is separated from the share only to facilitate the trading of rights. The rights should therefore be categorised in the same way as the share. This is furthermore in support of CESR's argument that it would be disproportionate to require an appropriateness test where the shareholder has received the rights free of charge.

Treatment of money market instruments that embed a derivative (§56 of the Consultation paper)

17. The EBF does not agree with CESR's reading of Article 19(6) of MiFID that instruments that do not meet the criteria of this Article should automatically be considered as complex. Indeed, MiFID does not make any provisions for instruments that should automatically be considered as complex, but only defines those instruments that would always be considered non-complex. This is the case for Article 19. As opposed to this, any other instruments should be assessed individually against the Article 38 criteria.

Question 16: Do you agree with CESR's view that it is reasonable to categorise callable and puttable bonds as complex financial instruments for the purpose of the appropriateness test?

18. It would be a far-reaching conclusion to automatically consider all callable and puttable bonds as complex. Financial instruments like fixed rate notes, treasury bills and medium term notes are often callable or puttable without having an actual derivative built into them.

Question 17: Do you agree with CESR's distinction between traditional covered bonds and structured covered bonds? Is there a need for further distinctions in this space?

19. The EBF agrees that all traditional covered bonds and mortgage bonds should be considered non-complex.

20. However, it is also true that all EU covered bonds are secured by an enhancement in the form of recourse to a ring-fenced pool of assets. CESR's proposed distinction according to whether these assets are held on-balance sheet or off-balance sheet seems to rely on a perceived risk argument, rather than the complexity of the structure. The EBF is not convinced that this would be correct in such a blunt way, and would furthermore object to an arbitrary approach by CESR regarding whether or not to consider risks in addition to product structure.

Question 20: Are there other specific types of such instruments that should be explicitly mentioned in a list of complex/ non-complex financial instruments for the purposes of CESR's exercise?

21. Step-up notes and floating rate notes could be mentioned as non-complex instruments.

Question 21: Do you agree with CESR's view that non-UCITS undertakings should not automatically be categorised as complex instruments simply due to the fact that they invest in complex instruments?

22. The EBF fully supports this view. The categorisation of non-UCITS products should individually be assessed against the criteria of Article 38 of the Level 2 Directive.

Question 22: Do you agree with CESR's analysis of the treatment of units in collective investment undertakings for the purposes of the appropriateness requirements?

23. As noted above, the Federation believes that conceptually, the categorisation of instruments for investor protection purposes should be related to the risks of instruments, rather than their complexity. However, given that practical solutions have been established this consideration would not justify a review of MiFID in this respect, at the current point in time.

Question 27: Do you agree with CESR's point of view on how prices should be determined and when it is considered that those prices are publicly available?

24. The EBF considers that the requirement for objective valuation might also be met when valuation is made by the issuer itself, in compliance with the MiFID's conduct of business rules.

Question 31: Do you agree with CESR's analysis of the position of these instruments?

25. The EBF would like to question in this context the European Commission's interpretation that a "deposit with an embedded derivative that has the potential of reducing the capital invested" should always be considered a financial instrument under MiFID. Deposits would not typically satisfy the criterion of transferability.