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International Organization of Securities Commissions (IOSCO)
General Secretariat
c/o Mr. Tim Pinkowski
Calle Oquendo 12
ES-28006 Madrid, Spain

Brussels, 13 June 2013

EUSIPA / comments on the IOSCO consultation on the Regulation of Retail Structured Products

Dear Mr. Pinkowski,

With pleasure we herewith would like to submit the response of EUSIPA, the European Structured Investment Products Association, to the IOSCO consultation on the regulation of retail structured products which was published in April 2013.

EUSIPA represents the issuers of note-based and listed Structured Investment Products to retail customers. Our members are national industry associations from Austria (ZFA), France (AFPDB), Germany (DDV), Italy (ACEPI), Sweden (SETIPA) and Switzerland (SVSP) and, as associated member, the relevant organisation from the UK (UK SPA). Members of these national associations are major banking institutions. The product landscape in the European main markets Germany and Switzerland provides for a combined volume (called open interest) of around 247b Euro (Q1 2013). More information can be found on our website www.eusipa.org.

The answers are compiled in the annexed document by referring always to the quoted question from the IOSCO consultation document CR05/13.

We hope you find our comments useful and are available for any further clarification on the made statements or the delivery of more background information.

Sincerely,

Reinhard Bellet	*Nikolaus Neundörfer*
President, EUSIPA	Head of Legal Committee, EUSIPA

ATTACHMENT (1)

ATTACHMENT

RESPONSE

TO

IOSCO'S CONSULTATION REPORT PUBLISHED IN APRIL 2013

ON

THE REGULATION OF RETAIL STRUCTURED PRODUCTS

This position paper represents the response by EUSIPA to the International Organization of Securities Commissions (IOSCO) in connection with the consultation report on the Regulation of Retail Structured Products published in April 2013 (Consultation Report).

EUSIPA, the European Structured Investment Products Association, represents the issuers of note-based and listed Structured Investment Products to retail customers. Our members are national industry associations from Austria (ZFA), France (AFPDB), Germany (DDV), Italy (SCEPI), Sweden (SETIPA) and Switzerland (SSVP) and, as associated member, the relevant organisation from the UK (UK SPA). Members of these national associations are major banking institutions. The product landscape in the EU's main markets Germany and Switzerland provides for a combined volume (called open interest) of around 247b Euro (Q1 2013). More information can be found under www.eusipa.org.

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Introduction

We appreciate the opportunity to comment on the Consultation Report on the Regulation of Retail Structured Products published by the International Organization of Securities Commissions (IOSCO). In particular, we appreciate the work undertaken by the Working Group on Retail Structured Products (Working Group) of the Task Force on Unregulated Markets and Products (TFUMP) to "understand and analyse trends and developments in the retail structured product market and related regulatory issues".

We would like to take the liberty to start our comments with a very general remark. In our view IOSCO should clarify that any final publications are **not** to be understood as recommendation to local regulators/IOSCO members to take the regulatory measures mentioned by IOSCO.

We appreciate that the potential regulatory measures mentioned on pp. 35 of the Consultation Report contain items only to identify options that IOSCO members may consider in their regulation. In fact, it is explicitly mentioned in the Consultation Report that "*No regulatory action is proposed to be mandated by the Toolkit.*" However, we are concerned that the Regulatory Toolkit will put pressure on IOSCO members to implement mentioned measures without carefully assessing the needs of any such measures in their local markets.

Moreover, in our view, it is important that any regulation of retail structured products creates or maintains a level playing field for the whole range of (financial) products (including bonds, shares and funds). Only a common level playing field for all (financial) products, which have in common that they are offered to retail investors, can ensure a sufficiently homogenous treatment of these products across the IOSCO members, thereby reducing potential product arbitrage and enhancing investor protection. Thus, should IOSCO decide to publish a Regulatory Toolkit for structured products, we would strongly recommend to add a clear statement **encouraging local regulators to consider aspects of level playing fields with other financial products** before implementing any regulatory measures for structured products.

For the purpose of achieving a common level playing field, we think that the definition of structured products as proposed in the Consultation Report

> ("*Structured products are compound financial instruments that have the characteristics of combining a base instrument (such as a note, fund, deposit or insurance contract) with an embedded derivative that provides economic exposure to reference assets, indices or portfolios. In this form, they provide investors, at predetermined times, with payoffs that are linked to the performance of reference assets, indices or other economic values.*")

is too narrow and, by way of example, excludes various (financial) products which are, in particular from a retail investor's perspective, comparable to typical structured products.

Excluding securities with no embedded derivate, for example products tracking the performance of an underlying 1:1[1], from the scope of the Regulation of Retail Structured Products would not only constitute objectively unjustified unequal treatment of structured products as defined in the Consultation Report compared to other packaged investment products, but also result in potential product arbitrage by using matching wrapper structures.

In addition we find it inconsistent to consider structured products as "*typically **complex** financial instruments*" and at the same time exclude from the scope of the Regulation of Retail Structured Products, for example, the so-called **contracts for difference**, which are by definition considered complex products by European regulators such as ESMA and EBA[2]. In our view, the definition of structured products should not focus on the combination of a base instrument with an embedded derivative and on complexity *per se*. It should rather cover any investment where, regardless of the legal form/wrapper of the investment, the amount repayable to the investor is subject to fluctuations because of an exposure to reference values or to the performance of one or more assets which are not directly purchased by the investor; *cf.* the Proposal for a Regulation of the European Parliament and Council on Key Information Documents for Packaged Retail Investment Products (PRIPs).

On a more abstract level, we also see a substantial risk of making structured products subject to stricter rules than are in place for not-structured products with a similar degree of risk. For example, some shares are subject to a level of both risk and non-transparency (in terms of the investor's capability to understand and follow the factors driving the share price) which far exceeds that of many structured products.

In our view, IOSCO should, in its final guidance on the regulation of retail structured products, clearly point to that risk, and ask its members to ensure a level playing field for all products, whether structured or not, so to avoid the creation of rules only governing structured products (as the underlying risk or deficiency also exists for other products).

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[1] *Cf.* FAQs Eligible Assets (as at 15 October 2009) published by the German Federal Financial Services Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* - BaFin) (WA 41 - Wp 2136-2008/0001) according to which "Certificates with a delta not equal to 1 or which do not track the performance of the underlying asset 1:1 or whose performance is linked to a derivative underlying qualify as derivatives or financial instruments embedding a derivative within the meaning of section 51 (1) sentence 2 of the Investment Act.

[2] See ESMA and EBA press release of 28 February 2013. Andrea Enria and Steven Maijoor, Chairs of the EBA and ESMA, warned: "*Retail investors across the EU should be aware of all the risks arising from investing in CFDs. These products appear to promise investors substantial returns at a low cost but may ultimately cost them far more than they may have intended or could afford to lose. "**CFDs are complex products that are not suitable for all types of investors**, therefore you should always make sure that you understand how the product you are buying works, that it does what you want it to do and that you are in a position to take the loss if it fails*." This may serve as a real example of circumstances where existing regulatory regimes in one or more jurisdictions may alter the impact of any principles intended to create a level playing field and instead create unintended opportunities for regulatory arbitrage. The scope of the survey undertaken by the Working Group means that it cannot be excluded that there may be several existing regulatory regimes creating such unintended consequences.

We would like to comment on the issues for consultation raised by the Board of IOSCO as follows:

Issue 1 for consultation: Do you think the survey results accurately reflect the regulation and markets of the respondent jurisdictions? Are there any other relevant facts, regulations or dynamics that the Working Group should consider?

Comments: In our view, the results of the survey fairly reflect the regulation and markets in a number of European countries.

It is, however important for the purpose of the Consultation Report to highlight that Lehman's collapse as driver for regulation should not be overemphasized. A regulation on structured products driven mainly by Lehman’s collapse would be misguided because structured products were not a cause of such collapse and of the recent crisis nor are they likely to cause a future one.

Generally, it was not for not the potential lack of rules and regulations governing structured products (or Lehman’s failure in applying any such existing rules and regulations) that caused the collapse of the investment bank. Moreover, the losses suffered by investors were a result of the credit risk inherent to any claims against or participations in an insolvent creditor. They were not specifically related to structured products. Each investor, for example, in a bond bears the credit risk of the respective issuer.

In addition, it is in the context of understanding and analysing the retail structured product markets important to recognise, that different investor categories exist – even within the retail sector. Beside first time investors, which the Working Group seems to have regarded as typical retail investors, various markets are particularly characterised by including a large group of so-called self-directed investors. These investors are capable and willing, based on their investment experience and knowledge, to make informed investment decisions by themselves. To simply put these self-directed investors in a row with other (less informed) retail investors would not only mean that retail customers capable of understanding the relevant investment risks may potentially miss relevant opportunities, but would also create unjustified obstacles for self-directed investors to access structured products. This would, as a result, lead to a far-reaching intervention in the right of free decision of these investors.

In fact, when regulating structured products, in particular in the context of product bans, the individual characteristics of each investor category should be taken into account so to ensure thorough and proportionate regulation.

Finally, we consider the process of harmonization of financial regulation within the European Union to have arrived at a very advanced stage and being overall sufficient for regulating retail product distribution.

Overall, efforts at international financial regulatory harmonisation always run the serious danger to be misdirected, if even by technical errors only, thus potentially causing far greater mischief than the positive motivation that initiated action in the beginning.[3]

Issue 2 for consultation: Do you believe that inter- or intra-jurisdictional regulatory arbitrage is an issue within the retail structured product market where there is an integrated market? Why or why not? What if there is not an integrated market and different regulators within jurisdictions are involved? If so, do you think that the regulatory tool proposed above will help to address the issue? What alternative measures could IOSCO members consider?

Comments: As described in the introductory remark, we strongly believe that local IOSCO members should carefully consider the characteristics and specifics of their local markets before taking any local regulatory actions in relation to structured products. We support the work of IOSCO to the extent it offers its members an analysis of the regulatory measures implemented or planed in the various jurisdictions. However, we do not think that additional measures are required by IOSCO to address intra-jurisdictional regulatory arbitrage.

We regard it as important that any regulation of Retail Structured Products creates or maintains a level playing field for all (financial) products (including bonds, shares and funds) across, in particular, the EU / EEA jurisdictions. Such common level playing field may then ensure a sufficiently homogenous treatment of structured products, thereby reducing potential product arbitrage and enhancing investor protection.

Against this background, we regard the harmonisation of European capital markets rules and the integration of European markets, *e.g.* by the Directive 2003/71/EC on security prospectuses and 2004/109/EC on the harmonisation of transparency requirements, as crucial and necessary steps. In view of legal certainty and transparency, it is important that compulsory information documents on financial products that have already been approved by a competent authority in one jurisdiction are recognised by authorities in other jurisdictions where the products are offered.

[3] As some academics succinctly put it, "*While it is easy to be enthusiastic about harmonizing the right rules, in a rapidly changing financial system there is a very real danger that the wrong rules will be harmonized, or that rules that may be right for the moment will become wrong after they are implemented.*" Richard J. Herring and Robert E. Litan, Financial Regulation in the Global Economy134-135; George J. Benston, International Harmonization of Banking Regulations and Cooperation Among National Regulators: An Assessment

Only harmonised regulation and consistent regimes across the European Economic Area, as is also represented by the membership base of EUSIPA, will reduce potential market distortions and ensure proper investor protection.

On the other hand, it is also important that national regulators have the ability to carefully consider the characteristics and specifics of local markets, *e.g.* in terms of retail investor categories. Only a combination of a common level playing field with the ability of national regulators to consider local specifics will result in a thorough and proportionate regulation.

Issue 3 for consultation: Do you think that it would be useful for IOSCO members to take a *value-chain* approach to retail structured products? What issues do you think members could encounter in pursuing such an approach? How could those issues be overcome?

Comments: In our opinion, a *value-chain* approach to retail structured products "from issuance to distribution to investment", would be oversimplified and even misleading, since it cannot consider any characteristics and specifics of local markets and retail investor categories. As such, and without any case-by-case assessment of the specific regulatory measures proposed as part of such approach, it would result in an ineffective regulation based on blanket terms.

It follows from the general principle of proportionality that any regulation of retail structured products – as indeed any regulation – has to be appropriate, necessary and proportionate in the light of the purpose pursued. Basing the regulation on a *value-chain* approach, however, and thereby regulating each and any level within such chain without determining whether the regulation of a certain level is necessary, appropriate and proportionate (or e. g. already sufficiently covered by existing rules), would be disproportionate and may result in an unjustified restriction of both, the commercial freedom of issuers and free decision-making by investors.

Issue 4 for consultation: Do you think that IOSCO members (that have the legal framework that would permit them to do so) could make issuers consider improvements to their market assessment process in light of their findings (where market assessments are required)? What do you consider to be the role of IOSCO members in the development and sale of retail structured products?

Issue 5 for consultation: Could the use of modelling as contemplated by this regulatory tool have an impact on the production of better value products and products that perform as intended or better disclosure? If yes, why? If not, why? What are the risks with using modelling as contemplated by this regulatory tool? Do you think investors would benefit from having access to the results of the modelling? Could IOSCO members require issuers to provide other information on the potential performance of the product? Please explain.

Comments: We agree in principle that issuers of retail structured products should put reasonable emphasis on assessing the appropriate end market for their products.

Such obligation should, however, be restricted to a general duty to introduce appropriate internal product approval procedures and to identify target markets, without determining a list of more detailed steps and procedure which would always have to be included.

While we agree that, as stated in the Consultation Report, issuers may, in principle, understand what features of a structured product will be useful or not for investors, such finding of the Working Group may be helpful in the context of a regulation of structured products if the issuer had detailed knowledge of the actual investor basis. The knowledge of the actual investor base usually is, however, not with the issuer, but with the distributors. As a result, any involvement of the issuer can only be strictly limited to a general perspective and product assessment **on an abstract basis**, *i.e.* without taking into account the individual specifics of potential investors.

We would regard the use of **modelling** to be frequently a part of an appropriate product design process. However, we are not convinced that modelling should be prescribed, since information on modelling can hardly give retail investors useful information. In addition, issuers should not be obliged to publish their underlying concepts used in the internal product approval procedures. Any such publication could mislead investors if, as already stated by the Working Group, issuers intentionally or mistakenly use incorrect assumptions and inputs in their modelling work. Even if issuers perform the modelling correctly, publication of results may make investors unduly relying on the results of the modelling. As already stated by the Working Group, investors may believe that the modelled returns will always occur and may fail to analyse the product properly because they believe the modelling means they do not need to do this.

Issue 6 for consultation:
Internal approval process
Do you think that a mandated internal approval process for issuers is warranted, or do most issuers already have this process in place? If the issuers already have such an internal approval process in place, how could it be improved? What should be the key elements in such an internal approval process? How effective are internal approval processes in vetting products before they are issued?

Regulatory pre-approval
Do you think it appropriate that regulators pre-approve products before they can be issued? Does the Consultation Report correctly describe the benefits and risks of such a process? If not, what are the benefits and risks? What do you think should be the criteria, standards and requirements for approval by the regulator?

Comments: With regard to the introduction of a mandatory **internal approval process**, we think that IOSCO members should, if at all, only impose a very generic requirement for appropriate internal product production procedures; *cf.* our response to Issue 4 and 5 above. In our view, the vast majority of issuers does already have some form of internal approval process in place.

Regarding a potential regulatory **pre-approval** process, we strongly agree with the statement in the Consultation Paper that this would provide very limited benefits, if any at all. Moreover, any such process would introduce significant risks for both, investors and the regulatory authority in charge of the pre-approval:

- As mentioned in the Consultation Paper, introducing a mandatory regulatory pre-approval process would involve the risk that retail investors capable of understanding the relevant investment risks miss relevant investment opportunities, constituting a far-reaching intervention in the decision-making freedom of these investors. In addition, investors may also assume that they have less responsibility in informing themselves about a proposed investment as they believe that the product has been checked by the regulator for them. This may lead to less cautious investment behaviour and thus increase the risk of regulatory failure. Moreover, investors relying on such pre-approval may try to hold the competent regulatory authority responsible for their (the authority's) assessment.

- In addition, we share the Working Group's finding that the implementation of a regulatory pre-approval process would have significant resource implications on the side of the local IOSCO member, since, in particular, such pre-approval processes would need to be administered by individuals who understand how structured products work from a financial perspective, as well what requirements the products need to comply with.

Regulatory failure in providing such pre-approval process would, however, massively jeopardise the intended retail investor protection.

- Last, but not least, weighing related risks and potential benefit for retail investors, we would regard a regulatory pre-approval process as disproportionate, resulting in an unjustified intervention in both, the economic freedom of issuers and the decision-making freedom of investors. A regulatory preapproval power may easily turn out into a veto power for protectionist reasons (i.e. to protect local players and their products from outside competitors) and reduce diversity of the system by pushing the market and product manufacturers in a mono-line direction, thus becoming perhaps more vulnerable to shocks.

Issue 7 for consultation: Do you think it appropriate that regulators play a role in setting product standards for retail structured products? If regulators do set such criteria, how should they do this, and what are the risks to the regulator and the market?

Comments: We recognise the important role of regulators in retail markets for financial products generally, and particularly in observing, and reacting to, developments in the retail structured product markets.

In particular, we think that the possibility for regulators to assess the offering and sale of financial products in order to prevent those that result <u>in clear investor detriment</u> should be part of the regulatory toolkit available to authorities.

However, in our view, product intervention measures require appropriate judgement and always have to be in line with the general principles for the distribution of financial products, the economic freedom of issuers and the decision-making freedom of investors. In particular, intervention should not prohibit retail investors from accessing complex products if the level of complexity is a necessary feature to increase the protection of the investment.

To the extent such distribution rules require distributors to assess, on a case-by-case basis, which products are suitable or appropriate for which kinds of investors (as in the EU under the MiFID Directive), we think that neither the possibility of product bans nor abstract product standards should give regulators the right to deviate from such general distribution principles. In particular, as long as certain products still appear suitable or appropriate for a certain investor audience (even a sophisticated one), we see no room for a general ban of products. Such measures would not be based on concrete risks and tangible investor detriment, but would be based on generalisations, and be disproportionate by including investors for which they are not required (in many cases, they would also exceed the regulatory powers transferred to authorities).

In our view, criteria and factors that can be of relevance when assessing the unsuitability or inappropriateness for a specific retail investor include[4]:

a. the degree of complexity of a financial instrument and the relation to the type of investors to whom it is marketed and sold; or

b. the degree of innovation of a financial instrument; or

c. the leverage a structured product provides; or

d. whether the investor's loss is limited to its investment (excluding transactional costs).

Relevant products should then only be offered to experienced retail investors, for example, self-directed investors or other investors capable of understanding the relevant investment risks.

In any case, regulators should not simply equate complexity of a structured product with riskiness and start to limit product complexity based on, for example, the complexity of the product's calculation formula, overly complex investment strategies or a lack of transparency. Any determination of complexity of a structured product and resulting attempts to limit such complexity would, in addition to significant resources implications, involve significant risks for the competent regulatory authority as well as for the retail investor; *cf.* our response to Issue 6 above.

Rather, complexity has to be determined based on transparent criteria and in relation to the targeted investor.

Issue 8 for consultation: How prescriptive is it appropriate for IOSCO members to be in setting issuer disclosure standards? What topics or items could benefit from specific explanation requirements? Do you think that risk indicators or minimum information requirements are useful? If so, what should the indicators or requirements be? How else could disclosure to investors on retail structured products be improved? Is there any disclosure that should be prescribed or proscribed?

Comments: We agree with the Working Group that clear, complete and non-misleading information about financial products at the pre-contractual phase is an essential precondition for investors being able to make a well informed investment decision.

4 *Cf.* Article 32 para. 6 of the Proposal for a Regulation of the European Parliament and of the Council on markets in financial instruments and amending Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories (*Presidency compromise*).

Existing disclosure standards for structured products set by the European prospectus laws, in particular,

- the Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (and amendments thereto, including the Directive 2010/73/EU), and

- the Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements,

both require that in case of a public offering all essential information (including related risks and explanations concerning specific topics) about the relevant security and the issuer is included in a prospectus, which is to be approved by the competent authority and be made available before the investor decides whether or not to buy the product. Based on such prospectus, the investor is able to make a well informed investment decision.

These disclosure standards, which are consistently applied across Europe, have in the recent years proved to provide for efficient investor protection.

The same is true for the Swiss disclosure standards for structured products distributed to non-qualified investors. The Swiss Federal Collective Investment Schemes Act requires that a simplified prospectus is made available free of charge to non-qualified investors. The simplified prospectus is a short offering document, which must inform investors in an easy to understand way of the main characteristics, features and risks of a structured product. The minimum information which needs to be disclosed is set out in a legally binding directive issued by the Swiss Bankers' Association and approved by the Swiss regulator.

In the context of disclosure standards, we recognize the importance and, in some circumstances, the usefulness of risk indicators and/or minimum information about the product in order to ensure comprehensiveness and to allow for comparability with other products. In particular, risk indicators may be helpful for retail investors, since even inexperienced retail investors are, based on these indictors, able to quickly evaluate the risk of a structured product.

However the efficiency and reliability of risk indicators is disputed, and there is an ongoing debate on which risk indicators are appropriate. In particular the use of risk indicators that summarise different risks in a single value/parameter is currently debated and there is also a consultation launched by ESMA on Credit Rating Agencies[5] and relevant methodology,

[5] The EU Internal Market Commissioner, Michel Barnier, said: "*Ratings have a direct impact on the markets and the wider economy and thus on the prosperity of European citizens. They are not just simple opinions. And rating agencies have made serious mistakes in the past*."

originating in the need of stricter supervision and the alleged excessive investor reliance on rating.

For the purpose of risk indicators being efficient, any risk indicator not only has to be appropriate, but also to reflect all risk factors of structured products (*e.g.* underlying and volatility risks, interest rates as well as credit and potentially currency exchange rate risks). In addition, standardization of indicators is an important factor. Although standardization involves the abstract risk that indicators may be static and not aligned with investors' profiles, only a minimum standardization ensures that investors are capable of easy understanding the indicator and its implications on the product as well as to allow for comparability with other products across asset classes.

Issue 9 for consultation: Do you think it appropriate that IOSCO members mandate or encourage short-form or summary disclosure? Would such disclosure be helpful to investors in understanding the products that they are purchasing? What are the risks associated with such disclosure?

At what point in time should investors be provided access to this disclosure and what responsibility should the issuer have with respect to the content of the disclosure?

What information do you believe IOSCO members could require to include in a short-form or summary disclosure?

If IOSCO members require the use a short form or summary disclosure, should this disclosure allow comparisons across products and, if so, what products should be able to be compared?

Comments: We agree with the Working Group that short-form or summary disclosure on financial products may help investors to make a well informed investment decision. As mentioned in the Consultation Paper, such short-form disclosure is already in force in some countries (e. g. Germany, Switzerland).

In order to be effective and to allow benchmarking or comparison by investors across different products, it is in our view crucial to strictly limit any short-form or summary disclosure on financial products to the essentials of a structured product. In addition and for the purpose of comparability, the information contained in the short-form or summary disclosure should be strictly limited to the product specifics without consideration of the individual circumstances of the investor.

The more information is mandatorily to be disclosed, the more the purpose of a short-form or summary disclosure, *i.e.* to enable the investor to easily analyse and compare, would be jeopardised. In the context of the Consultation Paper, we are concerned that the contemplated disclosure requirements would already be too detailed (*e.g. cf.* our response to Issue 12 below) and would, hence, not achieve the Working Group's intention to the fullest extent. For the sake of effectiveness, we would therefore recommend to strictly limit any short-form or summary disclosure on financial products to the essentials of a structured product.

Issue 10 for consultation: Do you agree that disclosure of disaggregated costs be made public or, alternatively, exchanged between the issuer and the distributor or the IOSCO member? Do you consider there to be an alternative mechanism to make disaggregated costs more transparent for retail investors? Do you think that the disclosure of such disaggregated costs would be useful to retail investors?

Comments: We agree with the Working Group that transparency, also on costs and fees attached to a structured product, is important for effective investor information.

However, structured products offer a pre-defined return on investment, either in form of a fixed amount or of an amount which is calculated based on pre-defined objective criteria, and, thus, the entitlements under, and prices of, different structured products can easily be compared by an investor. Accordingly, costs and fees of structured products are less crucial for the investment decision than the fees and costs of an investment in funds. Furthermore, investors in structured products can sell the products on the secondary market and investors are not exposed to early-redemption costs and fees as they are with respect to funds.

Any information regarding costs and fees, is only useful for investors if it is accurate, presented in a comprehensive way and based on objective criteria. In our view, the specific measures to achieve cost transparency as were discussed in the Consultation Paper would not be objective and transparent, but could (mis-)lead investors into thinking that they can rely on the detailed figures specified on this basis, particularly for the following reasons:

- In our view, most retail investors in structured products are interested in the idea underlying a product (for example, easy entry in an exotic market), its re-payment product structure (for example, capital protection) and its total costs and fees (*e.g.* upfront premium, index fees) rather than in the components of a structured product. In fact, a detailed separation of components and disclosure of disaggregated costs on the level of each component would be based on the underlying financial model. This again can only be described by referring to financial and mathematical formulas, which are often incomprehensible for retail investors. It wound therefore create an overload of information and jeopardise the intended comprehensiveness. In particular, since investors are already well informed about total costs and fees related to the relevant structured product (by disclosure in the prospectus and the product information sheet), any mandatory disclosure of disaggregated costs also seems disproportionate.

- Moreover, it needs to be considered that disclosure of disaggregated costs could not be based on objective criteria, since fair model prices (and costs) for single components of structured products cannot be objectively determined. The reason for this is that different issuers have different hedging strategies (*e.g.* macro versus micro hedging). Hence, there is no "purchase price" for specific product components. In addition, estimates for input factors (*e.g.* expectation for implied volatilities or dividends) for a valuation of the components differ across different issuers of structured products. As a result, the assumption underlying the disclosure of disaggregated costs that "costs divided by each component are comparable", thereby allowing investors to compare costs embedded in different products, is **not correct**. As explained, costs divided by each component are not comparable and do in particular not reflect cost advantages of issuers due to favourable hedging positions. Therefore, a disclosure of disaggregated costs may even be misleading information – not only for retail investors but also for sophisticated investors and even regulators.

We would like to stress that we are not objecting the introduction of cost disclosure as such. However, we think that the obstacles mentioned above, particularly in terms of subjectivity of any calculations, have not been overcome by any approach we are aware of, yet. In general, we are somewhat sceptical that such approach can be found, but would support to verify any alternative approaches to cost disclosure that address the mentioned shortcomings.

Issue 11 for consultation: Do you think disclosing the estimated fair value of a structured product at the time of issuance will be helpful to investors? If so, why? If not, why not? What alternative information could be disclosed?

Comments: As described above (*cf.* our response to Issue 10 above), prices for structured products depend on hedging strategies, model selection and market expectations of the relevant issuer. According to these differences, a "fair value" for structured products does not exist. It is possible to calculate a price on the basis of an average market expectation but this price does not reflect the individual situation of the issuer, *i.e.* the difference between market price and calculated price can generally not be assumed as the overall costs.

In addition the supposed “fair value” of a financial product may fluctuate over time and the calculation at the time of issuance (only) would not be helpful for investors intending to buy the product on the secondary market.

Hence disclosing an alleged "estimated fair value" of a structured product or a price on the basis of an average market expectation would, in our view, be misleading for investors and jeopardise retail investor protection.

Issue 12 for consultation: Do you think it appropriate that IOSCO members prescribe disclosure of scenarios? If so, what should these scenarios be? Do you consider there to be an alternative/simpler method of disclosing scenarios to retail investors? Please explain.

Comments: In some instances certain investors may better understand the characteristics of a product, if the value of the product in different market scenarios is disclosed to investors. However, we do not think that it is necessary for regulators to require scenarios to be included in all information documents prepared by issuers. Depending on the structured product other means, such as short descriptions of the repayment details or pay-off diagrams, may be more appropriate.

Generally, an effective explanation to investors that makes them recognise the specifics of a structured product, is important. Not all structured products, for example, will require a scenario analysis providing for the worst, the break-even and the best cases. In case, *e.g.* of a reverse convertible bond, there are only two possible scenarios for the redemption at maturity:

1. In case the price of the underlying on the valuation date **is equal to or above** the Strike, the investor will receive per bond a cash amount equal to the denomination,

2. In case the price of the underlying on the valuation date **is below** the strike, the investor will receive per bond physical delivery of a fixed number of securities.

Accordingly, there should not be a requirement to provide a fixed number of scenarios in all cases. In addition, we think that scenarios should be made part of short-form or summary, but not necessarily of prospectus disclosure.

Issue 13 for consultation: Do you think that disclosure of back-testing is useful to investors? What are the risks associated with such disclosure? Is there any other way to use back-testing to help retail investors?

Comments: We regard disclosure of back-testing as not being useful to investors. In fact, the disclosure of a back-testing result for a structured product may even be misleading for retail investors. Based on positive back-testing results, investors may assume they have less responsibility for informing themselves about a proposed investment if they believe that the product has been "tested" for them – even despite appropriate disclaimers, explicitly stating that past performance is no indicator for future performance. This may lead to less cautious investment behaviour and jeopardise retail investor protection.

Issue 14 for consultation: What education tools could IOSCO members use when educating retail investors on retail structured products? What guidance could IOSCO provide to its members to facilitate better investor understanding of retail structured products?

Comments: We agree with the Working Group's assessment that education tools, for example investor guides and interactive online materials, may be useful to educate retail investors on retail structured products. Education tools that facilitate the understanding of investors of structured products can help improve their skill-set to engage with structured products.

We think, however, that providing these education tools should not be the responsibility of IOSCO members. IOSCO members could provide, either formally or informally, their expert view on financial education tools but should not have the primary responsibility. This would not only have huge resource implications, including necessary training of the staff responsible for education tools, but also run the danger that any regulatory failure in such context, in particular in relation to necessary updates of latest developments, would massively jeopardise the intended protection of retail investors.

Rather, providing for appropriate education tools should form part of the obligations of distributors under the "Suitability Principles", in particular the suitability and appropriateness tests under the European MiFID regulation.

Issue 15 for consultation: Do you think it appropriate for IOSCO members to require or encourage issuers to take some form of responsibility for the actions of the distributors that distribute their products? What impediments might IOSCO members face in implementing these types of requirements? Would the requirements have an effect on distributor behaviour?

Comments: Leaving aside the feasibility from a legal and factual point of view on "*forms of control over distribution channels by the issuer*", given the fact that issuer and distributors are quite often different legal entities, we think that issuers should not mandatorily take any form of responsibility for the actions of the distributors of their products. In fact, and as described in our response to Issue 2 above, any involvement of the issuer has to be strictly limited to a general perspective and a product assessment on an abstract basis, *i.e.* without taking into account the individual specifics of potential investors.

Conduct rules and relevant liability regime governing the distribution of structured products are already clearly set out at legislative level within the European Union. Where firms are marketing debt instruments to retail clients they are under a MiFID obligation to provide appropriate information, in comprehensible format, about these financial instruments and appropriate guidance on and warnings of the risks associated with investments in those instruments.

It should, in this context, be recognised by the Working Group that issuers have a vital interest in their reputation and their products. In case, for example, of distributors miss-selling structured products, it will also be the issuer's reputation which is put at risk. Since distributors must for commercial reasons make sure to offer an attractive range of products to investors, most issuers do not only exercise commercial pressure on distributors to sell retail structured products in accordance with applicable laws, but also offer training and education tools, such as investor guides and interactive online materials, to distributors.

Against this background, and given the impossibility for issuers to effectively control the distribution in practice, we would consider any mandatory responsibility of issues for the actions of the distributors as unjustified.

Issue 16 for consultation: What other areas of activity could IOSCO members consider in the post sales period? Please explain. Are there issuers, that are not distributors, that make a secondary market in retail structured products (i.e., would the regulatory tool on secondary market making ever be relevant)?

Comments: In our view, IOSCO members should not consider any other areas in the post sales period. In fact, we already do not agree with, and are highly concerned about, the specific measures envisaged by the Working Group. In our view they would create extensive obligations for issuers in the post sales period, and result in an unjustified intervention in the economic freedom of issuers.

Some regulators have expressed concerns that there is a risk that transactions are undertaken in the secondary market in the interest of the financial intermediary rather than in the best interests of the relevant investors. Many structured products, but not all, are investments of a buy-and-hold nature rather than intended to provide short-term trading opportunities. Conversely, many other structured products may be designed with the explicit purpose of providing short-term trading opportunities and are not suitable as buy-and-hold investments. Other structured products may have features which make such products fall into either category depending on market conditions prevailing at different moments in time during the term of the relevant investment.

Any regulatory tools introduced in respect of the post sales period or secondary market must hence take into account the full range of structured products available in the markets and the very different purposes such products serve. Further, any new regulatory tools regarding the post-sales period and secondary market must contain appropriate safeguards such that any new regulatory tools do not increase the risk for secondary market activities which are not driven by the best interests of the investors.

Other proposed measures (dispute resolution forums, complaints data processing) appear unfeasible from a legal and factual point of view in most European jurisdictions, most of which have in place various sophisticated legal tools for handling disputes.

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