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Brussels, 14 October 2011

Dear Sir or Madam,

CONSULTATION ON THE INTRODUCTION OF A REGULATORY FRAMEWORK FOR THE DISTRIBUTION OF STRUCTURED PRODUCTS TO RETAIL INVESTORS

Please find enclosed the formal response of the European Structured Investment Products Association (eusipa) to the Belgian Financial Services and Markets Authority ("FSMA") Consultation Note of 12 August 2011 on the Introduction of a Regulatory Framework for the Distribution of Structured Products to Retail Investors (the "Consultation Note").

Eusipa is the voice of the structured investment products industry in Europe. It represents the major financial institutions active in the sector across Europe organised through its national member or affiliated organisations in Austria, France, Germany, Italy, Sweden, Switzerland and the UK.

We remain at your disposal to provide additional material on these issues and look forward to discussing these matters further in the near future.

Yours sincerely

Dr. Nikolaus Dominik Neundörfer
Chair of the eusipa Legal Committee

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EUROPEAN STRUCTURED INVESTMENT PRODUCTS ASSOCIATION

Response

to the FSMA's Consultation Note of 12 August 2011 on the Introduction of a Regulatory Framework for the Distribution of Structured Products to Retail Investors

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EXECUTIVE SUMMARY

eusipa supports adequate investor protection rules throughout the European Economic Area. It therefore supports several of the major themes addressed in the Consultation Note, including distributors' responsibility and increased transparency

However, eusipa feels that absolute bans of certain assets, strategies or product features for all retail investors would be arbitrary, as they would prohibit the sale of products even to investors who, due to their individual circumstances, have the sophistication and experience to understand and assess the product in question.

Instead, the regulation should focus on the distribution process, where suitability and appropriateness of a product for (retail) investors is to be decided on the basis of the circumstances of the individual product and the individual investor. It should be left to distributors to decide if certain products, their underlying, product features or their strategy, seem unsuitable and inappropriate for all kinds of retail investors, or if they could be offered to certain kinds of investors provided the circumstances of individual investors justify this.

eusipa also notices that the proposed rules go considerably further than the regulatory initiatives with respect to structured products recently taken by other Member States. Foreign issuers and foreign entities engaged in cross-border services risk to be exposed to the proposed stand-alone Belgian product intervention, which may increase operational, legal and compliance costs for such foreign entities wishing to access the Belgian market. The proposed rules therefore risk creating uneven level playing fields or hindering the access to the Belgian market.

eusipa also doubts that the proposed rules are compatible with European law and believes that product intervention, if any, would better be taken by ESMA.

GENERAL COMMENTS

Before explicitly addressing the specific questions raised by the FSMA and voicing our main concerns in connection with the suggested regulatory framework, we would like to stress that eusipa supports adequate investor protection rules throughout the European Economic Area. This is illustrated by eusipa's self-regulatory initiatives undertaken together with the relevant national industry associations to increase transparency in the market, and for example the introduction in various jurisdictions of standardised product classifications permitting investors to easily compare products of different issuers and to understand the various product categories and their inherent profit and loss expectations.

eusipa supports several of the major themes addressed in the Consultation Note, including distributors' responsibility and increased transparency. The proposals made in the Consultation Note in this regard mirror developments in other countries and at EU level. At the same time however, for the reasons set out below, eusipa is strongly opposed to prohibitions of certain product structures. A number of important points speak against such approach.

First, product bans include the impossibility to determine, on an objective basis and without arbitrariness, "where to draw the line" between allowed and forbidden products for retail investors, and the fact that this would effectively undermine the general approach in connection with distribution of financial products, as enshrined in MiFID, according to which suitability and appropriateness of a product for (retail) investors is to be decided on the basis of the circumstances of the individual product and the individual investor.

Second, when proposing product bans, or generally when deciding to engage in product intervention, the Member State should factor in the impact on cross-border services and on foreign issuers. Action undertaken at a specific Member State level should be in line with the European legal framework, including the EU Treaty (principle of non-discrimination; freedom of establishment and free movement of capital). Member State action should in no event create an uneven level playing field where foreign institutions are or could be discriminated against domestic institutions (or *vice versa*).

Third, regulatory action at a Member State level should be proportional and take into account the costs and potential disadvantages of product intervention. eusipa is concerned that certain proposed rules may reduce market efficiency, innovation, effective risk management, economic growth and market integration. In addition, bans may increase uncertainty and systemic risks, while being detrimental to investor confidence. Suitability requirements and rules on mis-selling should ensure adequate levels of investor protection and concerns regarding certain products should be addressed in the first instance as part of the ongoing supervision of individual firms.

1. Level playing field considerations

The proposed rules go considerably further than the regulatory initiatives with respect to structured products recently taken by other Member States and set out in footnote 1 of the Consultation Note. In particular, eusipa analysed the following initiatives:

- the Discussion Paper 11/1 on Product Intervention published by the UK FSA in January 2011, including the recent "Feedback Statement" published in June 2011
- the position of the French AMF dated 15 October 2010 concerning the distribution of complex financial instruments
- the Italian Consob notice no. 9019104 of 2 March 2009 on the intermediary's duty of correct and transparent conduct in the distribution of illiquid financial products
- the Danish Executive Order no. 345 dated 15 April 2011 on risk-labelling of investment products
- the Dutch legal framework on the "financiële bijsluiter" and
- the German Gesetz zur Stärkung des Anlegerschutzes und Verbesserung der Funktionsfähigkeit des Kapitalmarktes (AnsFuG, April 2011).

It follows from the above that eusipa not only analysed the regulatory framework of most key European financial markets (Germany, the UK, France, the Netherlands) but also the regulations of the other EU jurisdictions referred to by the FSMA in its Consultation Note.

eusipa's conclusion is that most jurisdictions focus on increased disclosure and innovations in disclosure (Germany, the Netherlands, Italy, Denmark). Many of these innovations reflect advances in behavioural law and economics, as well as the work done by ESMA and the European Commission in the context of the UCITS IV "key investor information" (KIID).

As far as we are aware:

- except for France, no jurisdiction has proposed product bans that resemble the moratorium or the proposals made in the Consultation Note

- the French AMF Position of October 2010 has a substantially more limited scope than the proposed Belgian rules. For instance, it does not apply to capital protected structured products. In addition, much of the AMF Position deals with disclosure (risk warnings) and

- in the FSA's Discussion Paper, product banning is considered a radical measure, which is to be applied in rare instances, given the risks and costs of such measure. Recent statements by FSA senior officers indicate that product banning is not a policy option that will be adopted without serious further investigation.

Taking into account the current state of regulation existing in the other Member States analysed for the purposes of this response, eusipa concludes that the Consultation Note is a unique policy document which, as far as we are aware, stands out in comparison to regulatory measures taken by other European competent authorities. eusipa therefore believes that it is important to note that foreign issuers and foreign entities engaged in cross-border services risk to be exposed to such stand-alone Belgian product intervention, which may increase operational, legal and compliance costs for such foreign entities wishing to access the Belgian market. By way of illustration, we give the example of a structured product offered to retail clients throughout the EU on the basis of a Luxembourg prospectus, validly approved by the CSSF in accordance with the Prospectus Directive and the Prospectus Regulation, and passported into the jurisdictions concerned using a valid European passport. In such context, the Consultation Note could lead to various questions, each with an important bearing on the liability of the issuer and offeror of this product:

- will the validity of the offer in Belgium be affected (notwithstanding the fact that the prospectus was approved by the competent authority and validly passported into Belgium)?

- is the issuer (or its advisors) under an obligation to review whether the structured product offered falls within the scope of the Belgian rules?

- and if so, is the issuer required to adapt the wording in the prospectus (e.g., add selling restrictions, adjust the summary or increase transparency on certain issues, such as transparency on costs or investment strategy)?

2. Responses to the Consultation Note

Objectives of the regulation

Question 1

Do you think that structured products are too complex to distribute to retail investors, or do you accept complexity up to a certain point and under certain conditions, including with regard to transparency?

We refer to the FSA Discussion Paper 11/1, and in particular to the statement that "[p]roduct complexity may *be a necessary feature to obtain benefits for the customer* (such as the range of illnesses covered by critical illness policies). Or the complexity may be an unnecessary complication, providing limited benefits that the consumer could have obtained elsewhere with a simpler, cheaper strategy" (paragraph 3.4.1; own italics) and "[i]t is important to distinguish inherent product complexity (i.e. complexity necessary to provide a particular set of benefits) and complexity that is introduced to exploit consumer behavioural biases. It is the latter that is of concern to us" (footnote 22).

Certain investors – be they professional or non-professional investors under MiFID – actually do benefit from complex products. In fact, complexity often results from adding elements of protection against negative market impacts to a specific product. These elements in turn reduce risks for investors and add to the protection of a specific client's portfolio or investment strategy.

eusipa believes that product bans are the wrong regulatory answer to the distribution of unsuitable products to unsophisticated retail investors. Instead, regulators should implement adequate rules increasing transparency as well as suitability and appropriateness checks in the distribution process. These rules should not apply to distribution of structured products only, but to distribution of all investment products to retail investors.

The proposed rules – especially if the current four prong test is maintained – are likely to result in the (unintended) situation that retail investors in other Member States could be better protected by their local regulations than Belgian retail investors.

Do you believe that there should be a specific regime for capital-protected structured products, and do you consider that greater complexity is acceptable for this sort of product?

We believe that the French AMF position sets a sensible standard. Provided that the capital protection covers at least 90% of the capital invested, the complexity of the structured product should be considered irrelevant.

Can risk be another approach for the framework to regulate distribution of structured products and, if so, what distinction should be made among risks: are there risks that you consider too great for the retail investor?

eusipa considers that – if properly designed – a risk-based approach might indeed take away various concerns expressed above, especially if such risk-based approach is linked to increased disclosure. Moreover, if a risk-based approach is used, complexity could be one of the factors to be examined. However, as far as "hard rules" – as opposed to transparency-based classification systems – are concerned, the riskiness of products should always be considered by distributors as part of their responsibility only to sell products to investors for whom they are suitable or appropriate, so as to ensure that the circumstances (sophistication, experience, financial means etc.) of the individual investor can be taken into account.

In this respect, eusipa refers to the Danish Executive Order no. 345 of 15 April 2011 on risk-labelling of investment products (which entered into force on 1 July 2011). It is clear that this Executive Order does not authorize the right to ban certain products. Instead, a risk-labelling is proposed whereby investment products are divided into three categories: green, yellow and red. An investment product is in the category "green" if the risk of losing the whole amount invested is very small, and if the product is not difficult to understand. "Yellow" means that there is a risk that the amount invested can be lost wholly or partly, and that the product is not difficult to understand. "Red" means that there is a risk of losing more than the amount invested, or that the product is difficult to understand.

Other illustrations of a sensible risk-based approach are the Italian product information sheet or the Dutch "financiële bijsluiter".

Scope of the regulation

Question 2

Do you agree with this scope and the proposed definitions of a structured product distribution, distributor and retail investor? If not, why not?

eusipa makes the following comments:

(a) One major issue - also raised by the FSA in its Discussion Paper - is that very often it is difficult to draw the line between products the complexity of which is beneficial and products without beneficial complexity. If there is an outright product ban, product designs will likely be amended to fall outside the scope of such ban. This raises the point of definitional difficulties. The approach chosen by the FSMA in its Consultation Note – i.e. the introduction of new, (over)broad and vague definitions – does not seem to be a sensible solution. This is a key reason why eusipa considers that a product ban, such as the ban based on the four prong test of the moratorium, cannot be effective on the long term.

(b) The definition of "distribution" is too broad. Under its current definition, this notion includes private placements, discretionary portfolio management and execution-only. It can be contrasted with the much more limited scope of the French AMF Position. More specifically:

- to bring the proposed rules in line with the Prospectus Directive, eusipa believes that private placements of structured products should be excluded from the scope of the proposed rules. This also makes sense as the threshold for private placements will be brought to 100.000 EUR (currently 50.000 EUR) further to the implementation of the Reviewed Prospectus Directive 2010/73/EC

- the scope of the rules should be restricted to where products are offered on an advisory basis. In case of execution-only following an unsolicited request of the client, eusipa considers that a disclaimer (or an explicit risk warning) should be sufficient. This ensures that a *sophisticated* retail client (which may not be a "professional investor" under MiFID) would still have a possibility to acquire the product and

- in case of discretionary management, the fact that decision is taken by a professional investor and not by a retail investor should be better reflected in the proposed rules.

(c) The notion "distributor" includes both Belgian and non-Belgian entities provided that (and to the extent that) they distribute products in Belgium. eusipa wonders how foreign financial institutions with operations in Belgium should deal with the Belgian rules. A further question is whether the proposed definition of "distributor" which includes independent brokers distributing third party structured products would render it impossible (*de jure* or *de facto*) for such brokers to distribute structured products by non-Belgian entities.

(d) As to the opt-out, eusipa is concerned that this may result in an unfair advantage to the distributor – typically a large Belgian bank – where the investor holds most of its deposits and financial instruments, because only in such case the client shall be able to benefit from the opt-out. On top of a potential discriminatory effect, this may lead to a concentration of investors' assets with fewer distributors, which might in turn increase risks for the investor.

Question 3

Should the Regulation be extended to cover structured products that have not been offered on a primary market and that can be acquired only via a regulated market or an MTF, or can a different approach be justified? If the latter, what other approach would you consider?

eusipa agrees that the transparency requirements for listing of products on regulated markets and the liquidity of such markets are adequate and sufficient means to guarantee investor protection for retail investors and, thus, the proposed rules should not apply to these markets. This being said, eusipa believes that the scope of the carve-out is not entirely clear.

Product approval process

Question 4

Do you agree with the various aspects of the product approval process? Are there other aspects that should be included in that process, or that should not be included?

eusipa submits the following comments:

(a) eusipa would welcome the replacement of the "mechanical four prong" test (set out in the current moratorium) by a "product approval process". In this approval-approach it would be the responsibility of the distributor to set up the necessary internal product checks and to decide whether or not a particular product can be sold to retail clients or not. In this way, the difficulties and problems associated with a mechanical test would be avoided. Such approach would also allow restricting product bans to products which seem inappropriate and unsuitable for all kinds of retail investors, and otherwise define classes of retail investors to which products can be sold if the circumstances of the individual investor allow for this.

(b) eusipa also believes that the FSMA could set more precise criteria and conditions for such product approval process. In particular, open-ended notions such as "well-founded customer need" or "alternatives on the market" should be avoided, especially taking into account potential liability and level playing field concerns. Vague notions should be avoided to ensure that issuers, distributors (and ultimately, investors) enjoy maximum legal certainty.

Transparency regarding certain aspects of the product

Question 5

As a general comment, eusipa supports the approach to enhance transparency for retail investors, and to ensure they are provided with understandable information on products before making an investment decision. On this basis, several European countries have already introduced "product information sheets" to be handed out by distributors. At the same time, the ongoing PRIPS initiative of the European Commission aims at introducing a KIID style information document to all kinds of structured products.

In eusipa's view, a requirement for additional transparency in the form of short form disclosure document should follow the examples of other European countries where such documents have already been introduced, e. g. Germany, and the concept of the KIID, as prescribed for UCITS and discussed for other products covered by the PRIPS initiative.

Do you consider it advisable for there to be transparency regarding the building blocks and the expected value of a product? How can these elements be communicated to the consumer in a comprehensible manner?

eusipa is not sure if additional disclosure on "the building blocks of a structured product", as contemplated in the Consultation Note, would really help investors to understand the product at hand. Very often, such building blocks would, on their own, be difficult to understand for investors, whereas the features of the combined product – at which the aim of transparency would have to be directed - are easier to describe to investors.

Regarding expected value, eusipa agrees with the general concept to provide investors with performance scenarios, as also required for the KIIDs for structured UCITS. The selection of appropriate scenarios should be left to the individual case. However, there should not be a requirement to disclose probability distribution functions of the returns at maturity; this approach has correctly already been turn down when the exact contents of UCITS KIIDs were determined.

> *What is your view of the idea of establishing a uniform classification, for the entire sector, of the most significant risks?*

The possibility of a uniform classification could certainly be further examined. eusipa is, however, sceptical that a "one size fits all" approach that works for all kinds of products can be found.

> *Concerning what costs should there be transparency and how can this be done in such a way that the costs can be calculated in a uniform manner?*

As regards costs, eusipa considers that the level of transparency on costs should be in line with the requirements under the Prospectus Directive (and Prospectus Regulation), MiFID and UCITS IV. To the extent the proposed Belgian rules would require foreign issuers to disclose additional information – beyond what is required by the competent authorities under the current European rules – these rules risk to hinder access to the Belgian market.

Also, it will not always be possible for issuers to provide full transparency on costs. Therefore, the liability consequences should be considered. For instance, the FSMA could state that lack of full transparency on costs does not result in the investment being declared illegal and the investor being reimbursed.

Accessibility of the underlying – strategy of the structured product – calculation of the formula

Question 6

Do you agree with the principle that the value of the underlyings of a structured product should be sufficiently observable by retail investors, and do you agree with the interpretation of "accessibility" given in the moratorium?

Given the liability risks for financial institutions, eusipa believes that the FSMA should offer more guidance on the notion of "economic foundation and be in the interests of the customer". Again, vague notions should be avoided so as to ensure that issuers, distributors (and ultimately, investors) benefit from maximum legal certainty. As set out before, eusipa also believes that it should be left to distributors to decide if certain assets seem unsuitable and inappropriate for all kinds of retail investors, or if they could be offered to certain kinds of investors provided the circumstances of individual investors justify this. Absolute bans of certain assets, strategies or product features for all retail investors would be nothing less than arbitrary, as they would prohibit the sale of products even to investors who, due to their individual circumstances, have the sophistication and experience to understand and assess the product in question.

Questions 7 to 11

Do you agree with the interpretation of "complex strategy" provided in the moratorium? Are there other strategies that you consider unacceptable for retail investors? Do you consider that the number of mechanisms should be limited and, if so, should they be for capital-protected products as well?

Once again, eusipa believes that it should be left to distributors to decide if certain assets, strategies or product features seem unsuitable and inappropriate for all kinds of retail investors, or if they could be offered to certain kinds of investors provided the circumstances of individual investors justify this.

Absolute bans of certain assets, strategies or product features for all retail investors would be nothing less than arbitrary, as they would prohibit the sale of products even to investors who, due to their individual circumstances, have the sophistication and experience to understand and assess the product in question. It is simply impossible to determine, on an abstract basis, the dividing line between e.g. the number of features that any retail investor can still understand, or the required level of a "teasing" feature which creates a particular risk of misleading all retail investors.

In addition, the proposed rules on baskets of shares, customized indexes or other composite underlyings as well as the proposed rules on the complexity of the strategy are likely to have a direct impact on how foreign issuers would structure their products. It should be examined by the FSMA if there might be a discriminatory effect (e.g. that Belgian issuers are favoured over foreign issuers) and what would be the impact on cross-border services.

Question 12

Is it reasonable to make an exception for certain mechanisms that are to the customer's advantage, even if these involve additional complexity?

As mentioned above, eusipa considers that it is.

After-sales service

Question 14

What is your opinion of the proposals concerning follow-up after distribution? Are there other aspects that could be included in after-sales service in this regard?

eusipa is not against rules on after-sale services. The precise obligations should be clearly described (for instance a “significant change” should be defined). Also the FSMA should consider the impact of any such requirement on the costs for foreign issuers or distributors if they have to do this follow up only for Belgian investors. It seems in our opinion that such rule would better be imposed at a European level.

Considerations about non-compliance

Question 16

What approach would you favour, and why?

As set out before, eusipa believes that it should be left to distributors to decide if certain assets, strategies or product features seem unsuitable and inappropriate for all kinds of retail investors, or if they could be offered to certain kinds of investors provided the circumstances of individual investors justify this.

Absolute bans of certain assets, strategies or product features for all retail investors would be nothing less than arbitrary, as they would prohibit the sale of products even to investors who, due to their individual circumstances, have the sophistication and experience to understand and assess the product in question.

As mentioned before, an alternative approach to absolute product bans could also be to provide investors with guidance on the riskiness of a product, by way of a general product classification system. Labelling marketing material, as also contemplated in the Consultation Note, would be preferable to introducing absolute product bans in terms of proportionality, but still be based on the concept of an "objective dividing line" between products generally suitable and generally unsuitable for retail investors. This is not possible in eusipa's view.

As stated above, the proposed rules may also entail serious civil liability risks. These risks are even magnified for foreign issuers or foreign distributors as they could not have an easy access to the FSMA.

eusipa therefore considers that the FSMA should provide a clear carve-out for foreign issuers and foreign distributors who may have a compliance issue but have acted in good faith; such entities should not be held civilly or criminally liable.

Marketing material

Question 17

Do you share the FSMA's standpoint that the additional transparency requirements which the Regulation may lay down should be complied with in the marketing materials?

Labelling marketing material, as contemplated in the Consultation Note, would be preferable to introducing absolute product bans in terms of proportionality, but still be based on the concept of an "objective dividing line" between products generally suitable and generally unsuitable for retail investors. This is not possible in eusipa's view.

Do you think that the standardization of the content of marketing materials using a set template and restrictions on the scope of marketing materials can make them more comprehensible to investors?

eusipa is highly sceptical that a standard template can be developed that works for all kinds of products, given the wide divergence in products and product features.

Other comments

eusipa expresses doubts about the compatibility of the proposed product approval rules with certain Directives. In particular – and without having examined the compatibility with other Directives – it is difficult to see how the proposed product ban is compatible with UCITS IV. Furthermore, there might be concerns that such product ban would impede on the freedom of establishment or the free movement of capital under the EU Treaty. As mentioned in our general comments, the proposed rules risk creating uneven level playing fields or hinder access to the Belgian market.

For that reason, eusipa also believes that product intervention, if any, would better be taken by ESMA.

If this is not feasible and the FSMA considers that action at Member State's level is compatible with European law, the FSMA should make sure that the costs of its intervention for foreign issuers and cross-border services is zero, for instance by replacing the four prong test by a product approval process (putting the burden of "approving" products with distributors, on the basis of sensible criteria to be internally assessed) and addressing the concerns expressed above.

To the extent not already done, eusipa also believes that the FSMA should consult with other Member States so that its rules are in line with their existing and forthcoming regulations.