



European Securities and
Markets Authority

Reply form for the Consultation Paper on draft guidelines on complex debt instruments and structured deposits



Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper on draft guidelines on complex debt instruments and structured deposits, published on the ESMA website.

Instructions

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type < ESMA_QUESTION_COMPLEX_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text "TYPE YOUR TEXT HERE" between the tags.

Responses are most helpful:

- if they respond to the question stated;
- contain a clear rationale, including on any related costs and benefits; and
- describe any alternatives that ESMA should consider

Naming protocol

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESMA_COMPLEXPRODUCTS_NAMEOFCOMPANY_NAMEOFDOCUMENT.

E.g. if the respondent were XXXX, the name of the reply form would be:

ESMA_COMPLEXPRODUCTS_XXXX_REPLYFORM or

ESMA_COMPLEXPRODUCTS_XXXX_ANNEX1

Deadline

Responses must reach us by **15 June 2015**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input/Consultations'.



Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the headings 'Legal notice' and 'Data protection'.



Introduction

Please make your introductory comments below, if any:

< ESMA_COMMENT_COMPLEX_1 >

CVA Services GmbH thanks ESMA for being an independent and transparent authority to enhance the protection of investors and reinforce stable and functioning financial markets in the European Union. We are pleased to respond to the ESMA Consultation Paper (CP) on draft guidelines on complex debt instruments and structured deposits. CVA Services GmbH is a leading consultancy company in Germany in the field of financial risk management. Our consultancy expertise is based on market, credit, liquidity and operational risk management and extends from accounting to IT service implementations within Risk Control and Trading departments. Providing managed services for CVA and exposure calculations based on Basel III SA-CCR and IFRS13 our company is in the process of relocating from Berlin to Frankfurt am Main in June 2015 and is focused on consultancy services. Most of our clients incur considerable costs for implementing and following new regulations or requests to respond to the proposed guidelines or draft regulations of ESMA or other authorities. Those costs incurred are part of what we refer to as RVA (regulatory value adjustments). Our mission is Excellence in Financial Risk Management and we are pleased to provide our response to the ESMA Consultation Paper on draft guidelines on complex debt instruments and structured deposits.

< ESMA_COMMENT_COMPLEX_1 >

Question 1: Do you agree with the examples of debt instruments that embed a derivative? If not, which examples do you not agree with, and why not?

<ESMA_QUESTION_COMPLEX_1>

In general CVA Services GmbH agrees with the examples of debt instruments that are generally deemed to embed a derivative.

For some instruments we would extend its definition on 'complex' and 'non-complex' considering its properties during lifetime and maturity. In general we think the maturity and its redemption or early redemption should be considered e.g. ISIN XS0222524372 shows diverse characteristics, which can illustrate our idea. This instrument is a bond, which pays a fixed coupon. After its next coupon payment (June 30th 2015) the instrument will become a floater. Since the instrument is callable and coupon payments are dependent on cash flows in the balance sheet of the issuer, there is no doubt that the instrument is complex from several perspectives. Therefore we would like to exemplify by engineering a less complex debt instrument for illustration purpose. Assume the instrument XS0222524372 would not be callable or puttable ('Callable or puttable bonds') and the special rules regarding its coupon payments dependent on cash flows in the balance sheet of the issuer would not exist. Then the instrument starting June 30th 2015 would not have any characteristics qualifying as complex. The instrument will become a floater.

There should be an exception to qualify an instrument 'non-complex' after its coupon payment becomes plain vanilla within its lifetime. The same holds for knock out options i.e. 'Warrants', which hit a barrier and its future cash flow is fixed and not dependent on future changes of its underlying anymore i.e. there is only the premium left, which is to be paid at maturity. Then this complex instrument can be considered to be a zero coupon bond.

In summary, the question would be: can an instrument change from 'complex' to 'non-complex' during its lifetime? We would argue 'yes' to extend liquidity and potential trading in such products.

Any instrument,ordinated or subordinated debt, should be able to become non-complex as outlined above. In general, **we would suggest to introduce and add 'perpetual and no-maturity' instruments** besides 'Convertible and exchangeable bonds', 'Indexed bonds and "turbo" certificates', 'Contingent convertible bonds', 'Inflation-indexed bonds', 'Callable or puttable bonds', 'Credit-linked notes' and 'Warrants' as a definition for a 'complex' security.

Perpetual or no-maturity should be considered to be put on the list, as indicated in '1.2. Debt instruments embedding a derivative 16. ff' which states the list is non-exhaustive. 'Perpetual' is mentioned in '1.3. Debt instruments incorporating a structure making it difficult for the client to understand the risk', but it is grouped within instruments incorporating a structure.

We would further suggest to introduce a flag for some instruments to be able to become a 'non-complex' instrument during lifetime to stimulate liquidity.

In regards to stocks, especially small caps with a low daily turnover, we think that those should be considered as 'complex' due to the potential lack of liquidity. For any instrument admitted to trading in a regulated market or in an equivalent third country market or in an MTF rules for delisting and paused trade execution should be implemented. Stocks or shares should become 'complex' if delisted or trade execution is halted or should be named e.g. 'non-liquid' to avoid confusion. Stocks can be defined as perpetual subordinated debt. Therefore liquid traded stocks with an existing order book and a bid/ask spread less than x% should be exempt. Other stocks should be deemed as 'non-complex' or 'liquid'.

In summary an instrument like ISIN XS0222524372 should be allowed to change its status from 'complex' to 'non-complex', if it was not perpetual (or no-maturity) and callable debt. It should not be qualified 'structure' or 'structured deposit' as defined in point (c) of Article 2(1) of Directive 2014/49/EU. A possible solution could be the introduction of a status 'liquid'/'non-liquid' e.g. classification according to a bid/ask spread less than x%'. x is a placeholder for the authority to determine the value. It could classify values according to 'complex', 'non-complex' or 'liquid' and 'non-liquid'. In contrast to liquidity the measure 'complex' and 'non-complex' is an observable, which is not time dependent. This is not convenient for some financial instruments. Therefore **we would recommend to allow changes from 'complex' to 'non-complex' during lifetime of an instrument, if the maturity is not longer than 10 or 15 years as considered in '1.3., 21. Perpetual' of this CP.**

<ESMA_QUESTION_COMPLEX_1>



Question 2: Do you agree with the definition of embedded derivative proposed in the Guidelines in Annex IV? If not, why not?

<ESMA_QUESTION_COMPLEX_2>
TYPE YOUR TEXT HERE
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Question 3: Do you agree with the examples of debt instruments that incorporate a structure making it difficult for the client to understand the risk? If not, which examples and why not?

<ESMA_QUESTION_COMPLEX_3>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_COMPLEX_3>

Question 4: Do you agree with the definition of a structure making it difficult for the client to understand the risk included in the Guidelines in Annex IV? If not, why not?

<ESMA_QUESTION_COMPLEX_4>
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<ESMA_QUESTION_COMPLEX_4>

Question 5: Do you agree with the definition of a structure making it difficult for the client to understand the risk of return of structured deposits and with the relevant examples proposed? If not, why not?

<ESMA_QUESTION_COMPLEX_5>
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Question 6: Do you agree with the definition of a structure making it difficult for the client to understand the cost of exiting a structured deposit before term and with the relevant examples proposed? If not, why not?

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Question 7: Please provide any specific evidence or data that would further inform the analysis of the likely cost and benefit impacts of the guidelines.

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