



**RESPONSE
TO**

IOSCO'S CONSULTATION REPORT DATED FEBRUARY 2012

**ON SUITABILITY REQUIREMENTS WITH RESPECT TO THE DISTRIBUTION OF COMPLEX FINANCIAL
PRODUCTS (CR 03/12)**

This position paper constitutes the response by the Deutscher Derivate Verband e.V. (DDV) to the IOSCO in connection with the Consultation Report dated February 2012 regarding Suitability Requirements with respect to the Distribution of Complex Financial Products (CR 03/12).

The DDV represents 17 leading issuers of derivative securities in Germany: Barclays, BNP Paribas, Citigroup, Commerzbank, Deutsche Bank, DZ BANK, Goldman Sachs, HSBC Trinkaus, HypoVereinsbank/Unicredit, JP Morgan, LBBW, MACQUARIE, Royal Bank of Scotland, Société Générale, UBS, Vontobel, WestLB. It was founded in Frankfurt am Main on 14 February 2008 and has its offices in Frankfurt and Berlin. The DDV is active in both Berlin and Brussels. It aims to promote the market and the acceptance of certificates, warrants and other structured products in Germany. Furthermore, it works towards improving the general understanding of structured products and product transparency in the derivatives market and furthering investor protection. Together with its members, the DDV advocates the establishment of industry standards and self-regulation. As a political advocacy group the DDV is involved in national and European legislative initiatives by issuing position papers and petitions.

DDV members have established various issuance programmes for retail structured products targeting not only the German market, but also many other EU Member States and for which the prospectuses are not only approved by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) as the German competent authority for prospectus approval, but also by other competent authorities within the EU. In terms of the number of base prospectuses approved, final terms filed and passporting requests, the activities of DDV members stand for a significant proportion of the German and potentially also the EU market.

The Draft Principles will have an impact on the issuance of retail structured products in that they relate to, and may affect, their distribution. DDV therefore strongly believes that the Draft Principles and their legislative implementation may have a significant impact on the structured products market. We therefore hope that you will give this fact and our response to the consultation consideration.

Yours sincerely



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DDV welcomes the chance to comment on the Draft Principles and related guidance and generally supports IOSCO's engagement in the area of investor protection. However, the proposed principles and standards relating to the distribution of financial products to investors would in our view be far more meaningful and effective though if they applied to all financial products (securities, collective investment schemes and related derivatives instruments) and therefore the final Principles should not focus on "complex" financial products.

1. GENERAL COMMENTS ON THE DRAFT PRINCIPLES

DDV is generally supportive of the direction of the Draft Principles and fully recognises the need for a high level of protection of investors that aims to ensure that intermediaries only distribute financial products that are suitable for the type of customer concerned and, in particular, to avoid mis-selling. However, we strongly feel that any rules that aim to protect investors in this regard should not merely focus on "complexity" of financial products but should primarily take into account the element of risk inherent to an investment in a specific financial product. On the one hand, complexity does not necessarily mean additional risk and conversely, non-complex products may be of much higher risk. By contrast, the use of derivatives as part of a principal-protected product can serve to significantly decrease risk for investors although this product might well be far more complex than another financial product which inherits higher risks. On the other hand, complexity is a relative concept and not an absolute one and it would be difficult for regulatory authorities, investment firms and customers to assess "complexity" and to implement and administer rules specifically restricting the distribution of "complex" financial products.

We therefore strongly suggest that IOSCO apply the final Principles and related guidance to the distribution of all financial products such as securities, collective investment schemes and related derivatives instruments and the balance of risk and reward associated therewith in the individual case. On that basis, the references to "complex" financial products should be largely dropped from the Principles and related guidance. In particular, we strongly feel that there should be no general regulatory requirements or restrictions to the distribution of a particular product, such as "complex" products, to a particular category of customers, such as retail customers, as long as the specific product is suitable to the type of customer intended to solicit. This approach would underline the fact that all customers deserve these standards of care and a high standard of protection, rather than only those customers investing in "complex" products.

2. SPECIFIC COMMENTS ON CERTAIN DRAFT PRINCIPLES

Notwithstanding the forgoing general comments, we feel that the below mentioned references to general prohibitions or automatic restrictions of the distribution of complex products in the Draft Principles and related guidance should specifically be removed or at least redrafted:

Draft Principle 4 currently reads as follows:

"Principle 4: Even when an intermediary sells to a customer a complex financial product on an unsolicited basis (no management, advice or recommendation), the regulatory system should provide for adequate means to protect customers from associated risks."

In the explanatory statement relating thereto (cf. page 20 of the Consultation Report) it is stated that additional possible means for client protection could include:

- *"imposing specific requirements with respect to transactions in certain complex financial products (e.g., index warrants, currency index warrants and options), including requiring written approval to open an account to trade such products;*
- *requiring the intermediary to assess suitability of a service that may give access to trading complex financial products (e.g. retail trading platforms on contracts for difference, margin trading), when recommending that a customer use that service; and*
- *prohibiting or restricting automatically the distribution of certain categories of more risky or complex products to certain categories of customers, such as retail customers.*

The regulatory system should provide for appropriate safeguards if a certain type of complex financial product may not per se be suitable for particular customers. At a minimum, the regulatory system should require the intermediary to collect relevant information from the customer in order to be able make a reasonable determination as to whether certain categories of transactions should be restricted or additional warnings/disclosure given for certain categories of customers, whether or not a recommendation is made."

Draft Principle 6 currently reads as follows:

"An intermediary should have sufficient information in order to have a reasonable basis for any recommendation, advice or exercise of investment discretion made to a customer in connection with the distribution of a complex financial product."

In the explanatory statement relating thereto (cf. page 22 et seq. of the Consultation Report) it is stated as follows:

"Another possible means to mitigate the risk of mis-selling is to prohibit or restrict automatically the recommendation of certain categories of more risky or complex financial products to certain categories of customers, such as retail customers."

Based on the reasoning that the "complexity" of a financial product is not necessarily an appropriate indicator for the risks inherent in a particular investment, we strongly feel that there should not be any general prohibition or automatic restriction of the distribution of certain categories of complex products to certain categories of customers, such as retail customers. Rather investor protection can be more effectively achieved if the respective investor receives all material information that he/she requires in order to evaluate the nature, costs and specific risks

associated with a specific investment in a financial product. In other words: investor's interests can be protected much more efficiently and effectively by means of appropriate disclosure and information rather than by general regulatory prohibitions of certain categories of investments for certain categories of investors. This approach would better serve investors' interests since it allows to take into account the level of experience, knowledge, investment objectives, risk appetite and capacity for loss of the respective investor whilst at the same time not imposing undue restrictions on the availability of a range of investment products that could adversely affect investor choice if such discretion were exercised with broad bans of certain categories of products, such as "complex" retail products.

For example, certain retail investors, such as high net worth individuals, may have far higher levels of financial knowledge, experience and resources than other retail investors and may, therefore, be interested in and find more sophisticated products of great value to their financial planning. Restricting distribution activities to retail customers generally may thus go far beyond what is necessary in order to ensure proper investor protection.

Based on the foregoing, we feel that the aforementioned wording in paragraph 4 and 5 of the Consultation Report as drafted is too vague and likely to lead to an expansive interpretation. We would therefore strongly suggest to delete the current references to a potential general prohibition or automatic restriction of the distribution of "complex" products to certain categories of customers.