



## GUÍA SOBRE CATALOGACIÓN DE LOS INSTRUMENTOS FINANCIEROS COMO COMPLEJOS O NO COMPLEJOS.

DEPARTAMENTO DE SUPERVISIÓN ESI-ECA

14 de octubre de 2010

**Este documento no tiene carácter normativo y por lo tanto no establece nuevas obligaciones. La guía tiene como finalidad transmitir al sector y, en concreto a las entidades que prestan servicios de inversión, pautas que la CNMV considera adecuadas para el cumplimiento de diversos aspectos de la normativa en vigor a la fecha de emisión de este documento y así facilitar su comprensión y la adaptación de las entidades a la misma.**

La finalidad de la evaluación de la conveniencia es conseguir la protección adecuada de los inversores en la venta de productos a clientes minoristas que no tengan la experiencia y/o conocimientos suficientes para entender las características y riesgos asociados a dichos productos.

El nivel de protección y los requisitos de conveniencia aplican de distinta forma si el instrumento se considera complejo o no complejo. Así, en el caso del servicio de recepción y transmisión de órdenes, bajo determinadas circunstancias que detalla el artículo 79 bis de la Ley del Mercado de Valores en su apartado octavo, no se requiere que las entidades obtengan información del cliente a efectos de evaluar la conveniencia si el producto es no complejo. En el caso de instrumentos complejos, la entidad siempre debe evaluar la conveniencia de tal forma que en el supuesto de que el instrumento no resulte conveniente para el cliente, la entidad sólo podrá tramitar la operación solicitada si previamente le advierte de ello. Por ello, una correcta clasificación de los instrumentos financieros por parte de las entidades es fundamental en atención a una adecuada protección de los clientes.

Teniendo en cuenta la relevancia de esta cuestión así como las dudas planteadas al respecto CESR publicó en noviembre de 2009 un documento de preguntas y respuestas<sup>1</sup> en el que detalla en qué categoría deberían incluirse determinados instrumentos financieros, que generalmente son o pueden ser dirigidos a clientes minoristas, así como diversas consideraciones y aclaraciones sobre los criterios recogidos en el artículo 38 de la Directiva 2006/73/EC<sup>2</sup> para considerar un producto como no complejo.

En el curso de las actuaciones de supervisión de la CNMV se han detectado algunas incidencias en relación con la clasificación de determinados instrumentos financieros comercializados a clientes minoristas, por lo que se considera conveniente recordar algunos de los criterios establecidos por CESR en su documento de preguntas y respuestas sobre productos complejos y no complejos que la CNMV viene aplicando en su práctica supervisora.

<sup>1</sup> CESR Q&A MiFID complex and non complex financial instruments for the purposes of the Directive's appropriateness requirements. (Ref: CESR/09-559)

<sup>2</sup> Recogidos en el artículo 79 bis apartado 8 letra a) párrafos 2 y 3 de la LMV

Se incorporan como anexos de la presente guía una tabla resumen con un listado no exhaustivo de instrumentos complejos y no complejos y el correspondiente documento de CESR.

## 1. Acciones preferentes o privilegiadas y participaciones preferentes.

Las acciones preferentes o privilegiadas que no incluyan un derivado implícito se consideran, a los efectos de aplicar los procedimientos relativos a la evaluación de la conveniencia, instrumentos no complejos si están admitidas a negociación en un mercado regulado. Si no lo están, deberán ser evaluadas teniendo en cuenta los criterios del segundo y tercer párrafo del artículo 79 bis 8 a) de la LMV. En caso de que incluyan un derivado implícito (un derecho de amortización anticipada por parte del emisor, por ejemplo) siempre se consideraran instrumentos complejos.

Las participaciones preferentes, en la medida que incorporan un derivado implícito, deberán considerarse instrumentos complejos.

## 2. Derechos de suscripción preferente.

En principio, los derechos de suscripción preferente entran en el tipo de valores mobiliarios que se describen en el artículo 79 bis 8 a) párrafo tercero<sup>3</sup> que no pueden clasificarse como instrumentos financieros no complejos.

Sin embargo, en el proceso de asignación automática a los accionistas con motivo por ejemplo de una ampliación de capital, los derechos de suscripción preferente no constituyen instrumentos financieros en sí mismos y deben ser considerados como un componente de la acción cuando el instrumento que se puede suscribir al ejercer el derecho sea el mismo que el que dio lugar al derecho de suscripción.

Esta interpretación es extensiva a la adquisición en el mercado secundario de los derechos de suscripción estrictamente necesarios para redondear el número de derechos necesarios para adquirir la acción pertinente.

No obstante cuando el ejercicio de los derechos de suscripción implica la compra de instrumentos financieros que son diferentes a las acciones que dieron lugar a los mismos, tales derechos deben considerarse como instrumentos complejos o no complejos según la clasificación de los instrumentos que se ofrecen para la compra. Por ejemplo si los derechos de suscripción que provienen de unas acciones dan derecho a adquirir obligaciones convertibles (instrumentos complejos), los citados derechos deben considerarse complejos.

Cuando los derechos de suscripción se adquirieran en el mercado secundario deberán ser clasificados como productos complejos, salvo en el caso mencionado anteriormente en relación con el redondeo necesario para adquirir la acción pertinente.

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<sup>3</sup> "valores que den derecho a adquirir o a vender otros valores negociables o que den lugar a su liquidación en efectivo, determinada por referencia a valores negociables, divisas, tipos de interés o rendimientos, materias primas u otros índices o medidas"

### 3. Instrumentos del mercado monetario, bonos y otras formas de deuda titulizada

Se considera como criterio general que este tipo de instrumentos financieros son no complejos, salvo que incorporen un derivado implícito o que incorporen estructuras que dificulten al inversor comprender el riesgo asociado al producto.

Algunos instrumentos de deuda que puede considerarse que incorporan un derivado implícito son: bonos vinculados a derivados de crédito (CDS), bonos estructurados cuyo rendimiento se referencia a la rentabilidad de un índice de deuda, bonos estructurados cuyo rendimiento se referencia a la rentabilidad de una cesta de acciones tanto si el nominal está 100% garantizado como si no lo está, instrumentos estructurados cuyo rendimiento se referencia a la rentabilidad de un subyacente como materias primas o cesta de materias primas.

Aquellos bonos u otro tipo de deuda que incorporan una opción de amortización anticipada para el emisor, el tenedor o para ambos, no pueden catalogarse como no complejos.

También se considerarían instrumentos complejos aquellos que incorporen estructuras que dificulten al inversor comprender el riesgo asociado al producto, por ejemplo, determinadas estructuras de deuda titulizada (MBS, CDO, ABS). En cualquier caso no necesariamente se debe clasificar este tipo de instrumentos automáticamente como no complejos, ya que tendrán que ser evaluados bajo los criterios del artículo 79 bis 8 a), párrafo 2 y 3 de la LMV para determinar su clasificación como complejos o no complejos.

### 4. Cédulas, bonos y participaciones hipotecarias y otros instrumentos que cuentan con el respaldo de un grupo de activos.

Este tipo de instrumentos se consideran instrumentos no complejos cuando se trata de bonos tradicionales con una garantía incorporada que mejora sus condiciones al disminuir el riesgo de impago.

No obstante, cuando el grupo de activos que respaldan la emisión está fuera del balance del emisor ("*structured covered bonds*"), se considera que el instrumento es similar a la deuda titulizada (en este caso un ABS o Asset Backed Security), por lo que no deben clasificarse automáticamente como no complejos.

Asimismo si estos instrumentos incorporan un derivado implícito o estructuras que hacen difícil para el inversor entender el riesgo asociado al producto, deben clasificarse como complejos.

### 5. Deuda subordinada

No se establecen criterios diferentes a los aplicables al resto de instrumentos de deuda ya analizados con respecto a este tipo de instrumento financiero, debiendo evaluarse los aspectos relacionados con la incorporación o no de derivados implícitos, y la estructura del instrumento.

## 6. IIC de inversión libre e IIC inmobiliarias

Las IIC de inversión libre y las inmobiliarias en general no están constituidas como IIC armonizadas por lo que deberán ser evaluados teniendo en cuenta los criterios establecidos en el artículo 79 bis 8 a) párrafo 2 de la LMV. Entre estos requisitos está el que existan posibilidades frecuentes de venta.

## 7. Evaluación bajo los criterios del artículo 79 bis apartado 8 letra a) párrafos 2 y 3 de la LMV.

El objetivo del párrafo 2 es definir un marco para catalogar como no complejos sólo a los productos transparentes, líquidos y que puedan ser entendidos por los clientes minoristas ya que no es posible enumerar todos los tipos de instrumentos financieros que pueden ser razonablemente clasificados como no complejos, a efectos de los requisitos de conveniencia.

Por su parte el párrafo 3 establece que los instrumentos derivados y otros similares no pueden en ningún caso clasificarse como no complejos.

Se considera relevante recordar algunas consideraciones y aclaraciones relacionadas con estos conceptos que CESR recoge en su documento:

- Respecto a la **frecuencia de las posibilidades de venta**, con carácter general se considera que la frecuencia debe ser diaria o semanal y, muy excepcionalmente, podrán considerarse plazos periódicos más largos. En los casos en los que la determinación de la frecuencia no es obvia, las entidades deben analizar el criterio de forma particular tomando en consideración la información disponible, el tipo de instrumento, así como las prácticas de mercado para ese instrumento en concreto.
- Puede entenderse que los **precios** están **públicamente disponibles** cuando los precios son fácilmente accesibles por medio de canales sencillos de localizar por el cliente medio.
- Los precios deben ser, bien **precios de mercado** (precios a los que un número de participantes en el mercado están dispuestos a operar y que son determinados siguiendo normas transparentes y no discrecionales) o, en su ausencia, **precios suministrados o validados por sistemas de valoración** independientes del emisor del producto (son sistemas de valoración aceptables aquellos suministrados por entidades expertas en proporcionar dichas valoraciones que se dedican a esta actividad de forma recurrente en el tiempo y que tengan en cuenta las disposiciones normativas sobre los conflictos de interés).
- No en todos los casos debe entenderse que un **instrumento admitido a cotización** en un mercado regulado, diferente del de las acciones, cumple el requisito de que existan posibilidades frecuentes de venta, reembolso u otro tipo de liquidación del instrumento. La admisión a negociación ofrece la posibilidad de que puedan existir oportunidades frecuentes de venta, pero no asegura que en la práctica existan. De forma análoga, la existencia de precios públicamente disponibles no asegura automáticamente que se cumpla el criterio de que existan posibilidades frecuentes de venta, reembolso u otro tipo de liquidación del instrumento.

Las entidades deben ser especialmente diligentes cuando evalúen instrumentos cotizados en mercados con escasa liquidez.

- Para considerar que existe **información suficiente a disposición del público sobre las características del instrumento** la información debe recoger con suficiente detalle las

características del instrumento financiero: precio, estructura, cómo se calcula su rentabilidad, rendimiento, emisor, mercado, existencia de garantías, riesgos, horizonte temporal, así como otras que puedan afectar a su valor, rendimiento o a la liquidez del instrumento, etc. Además, el acceso a la información debe ser fácil, y ésta será imparcial, clara y no engañosa de acuerdo con el artículo 79 bis 2 de la LMV.

Asimismo la entidad debe plantearse si el idioma en el que se facilita la información permite que sea comprensible de modo que un cliente minorista medio pueda emitir un juicio fundado para decidir si realiza una operación sobre ese instrumento.

- Se entiende que la **información se encuentra a disposición del público** si se puede acceder a ella a través de medios fáciles de encontrar por un cliente medio. Los criterios que definen la accesibilidad a la información son: número y naturaleza de las fuentes y canales que la publican y la facilidad del cliente para reproducir, imprimir o descargarse la información.

## ANEXO 1.- LISTADO (NO EXHAUSTIVO) DE INSTRUMENTOS FINANCIEROS COMPLEJOS Y NO COMPLEJOS:

INSTRUMENTOS NO COMPLEJOS	INSTRUMENTOS QUE DEBEN EVALUARSE BAJO LOS CRITERIOS DEL ARTÍCULO 79 BIS APARTADO 8 LETRA a) PÁRRAFOS 2 y 3.	INSTRUMENTOS COMPLEJOS
<b>1. ACCIONES</b>		
(i) Acciones ordinarias de sociedades admitidas a cotización en mercados regulados <sup>5</sup> (ii) Acciones privilegiadas ordinarias de sociedades admitidas a cotización en mercados regulados <sup>6</sup> . (iii) Derechos de suscripción preferente para adquirir acciones que sean automáticamente no complejas.	(i) Acciones que no estén admitidas a cotización en mercados regulados (ii) Acciones admitidas a cotización en mercados de terceros países <sup>7</sup> (iii) Certificados de depósito de acciones (iv) Derechos de suscripción preferente para adquirir acciones (u otros instrumentos) que no son automáticamente no complejas. (v) Acciones de instituciones de inversión colectiva no armonizadas abiertas o cerradas.	(i) Acciones convertibles. (ii) Acciones privilegiadas convertibles o con un derecho de amortización anticipada (derivado implícito) y Participaciones preferentes.
<b>2. INSTRUMENTOS DEL MERCADO MONETARIO, BONOS Y OTRAS FORMAS DE DEUDA TITULIZADA</b>		
(i) Instrumentos del mercado monetario que no incorporen un derivado implícito. Se incluyen:  - Letras del Tesoro. - Certificados de depósito.	(i) Certificados de depósito respecto de bonos y otras formas de deuda titulizada. (ii) Títulos de deuda de interés variable ( <i>floating rate notes</i> ) (iii) Determinados valores de deuda titulizada ( <i>Asset Backed Securities o ABS</i> ), otros instrumentos estructurados y bonos	(i) Instrumentos del mercado monetario, bonos y otras formas de deuda titulizada que incorporen un derivado implícito. Se incluyen:  - <i>Credit Linked Notes</i>

<sup>4</sup> Este cuadro debe leerse junto con el texto de la guía

<sup>5</sup> También se aplicará a acciones admitidas a cotización en mercados equivalentes de terceros países cuando la Comisión Europea haya publicado una lista de esos mercados.

<sup>6</sup> También se aplicará a acciones admitidas a cotización en mercados equivalentes de terceros países cuando la Comisión Europea haya publicado una lista de esos mercados

<sup>7</sup> Tras la publicación de la lista de mercados equivalentes de terceros países por la Comisión Europea solo se aplicará a aquellos mercados que no se hayan considerado equivalentes.

<ul style="list-style-type: none"> <li>- Pagarés</li> </ul> <p>(ii) Bonos que no incorporen un derivado implícito. Se incluyen entre otros:</p> <ul style="list-style-type: none"> <li>- Bonos y obligaciones corporativas.</li> <li>- Bonos del Tesoro.</li> <li>- Cédulas, bonos y participaciones hipotecarias.</li> </ul>	<p>estructurados con garantía de un grupo de activos.</p>	<ul style="list-style-type: none"> <li>- Instrumentos estructurados cuyo comportamiento está ligado al comportamiento de un índice de bonos.</li> <li>- Instrumentos estructurados cuyo comportamiento está ligado a al comportamiento de una cesta de acciones con o sin gestión activa.</li> <li>- Instrumentos estructurados con un nominal plenamente garantizado y cuyo comportamiento está ligado al comportamiento de una cesta de acciones, con o sin gestión activa.</li> <li>- Bonos y obligaciones convertibles.</li> <li>- Bonos que pueden amortizarse por el emisor antes de su madurez (<i>Callable Bonds</i>).</li> <li>- Bonos que permitan al tenedor obligar al emisor a recomprárselos en determinados momentos (<i>Puttable Bonds</i>).</li> </ul> <p>(ii) ABS (asset backed securities) y otros instrumentos estructurados que incluyan un derivado o incorporen estructuras que dificulten el entendimiento por parte del inversor del riesgo vinculado al producto.</p> <p>(iii) Bonos estructurados con garantía de un grupo de activos (por ejemplo bonos de titulización hipotecaria o de créditos públicos) que incluyan un derivado o que incorporen estructuras que dificulten el entendimiento por parte del inversor del riesgo vinculado al producto.</p>
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**3. UCITS Y OTRAS INSTITUCIONES DE INVERSIÓN COLECTIVA**

(i) Participaciones o acciones de IIC armonizadas	(i) Participaciones de fondos no armonizados (ii) Acciones de instituciones de inversión colectiva no armonizadas abiertas o cerradas.	
<b>4. OTROS INSTRUMENTOS FINANCIEROS</b>		
N/A	Otros instrumentos financieros que no estén específicamente mencionados en el primer párrafo del artículo 79 bis apartado 8 letra a) de la LMV.	<p>(i) Instrumentos financieros recogidos en los apartados 2 a 8 del artículo 2 de la LMV (derivados, CFD).</p> <p>(ii) Valores que den derecho a adquirir o a vender otros valores negociables o que den derecho a su liquidación en efectivo determinada por a valores negociables, divisas, tipos de interés o rendimientos, materias primas u otros índices o medidas incluyendo:</p> <ul style="list-style-type: none"> <li>- <i>Warrants</i></li> <li>- <i>Covered warrants</i></li> </ul>



ANEXO 2. CESR Q&A MiFID complex and non complex financial instruments for the purposes of the Directive's appropriateness requirements. (Ref: CESR/09-559)



Date: 3 November 2009  
Ref.: CESR/09-559

## **Q&A**

**MiFID complex and non –  
complex financial instruments  
for the purposes of the  
Directive’s appropriateness  
requirements**



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## Executive Summary

On 14 May 2009, CESR published a consultation paper (CP) entitled “MiFID complex and non-complex financial instruments for the purposes of the Directive’s appropriateness requirements” (Ref. CESR/09-295). In that CP, CESR set out for consultation its analysis of a range of types of MiFID financial instruments and its views on how these were likely to fit within the complex/non-complex categories of financial instruments for the purposes of the Directive’s appropriateness requirements.

Parallel to publishing this Q&A, CESR publishes its Feedback Statement (FS) responding to comments it received in response to the CP (Ref. CESR/09-558). This set of Q&As reflects CESR’s statement of its policy following its consultation paper. The Q&As should be read in conjunction with the preceding CP and the FS.

These Q&As clarify the categorisation of financial instruments as complex or non-complex for the purposes of MiFID’s appropriateness requirements, including the treatment of:

- types of shares and the categorisation of subscription/nil paid rights;
- money market instruments, bonds and other forms of securitised debt, including the treatment of money market instruments, asset-backed securities, bonds and other forms of securitised debt. Also clarified is the categorisation of instruments that embed a derivative, callable and puttable bonds, covered bonds and depository receipts among others;
- units in collective investment undertakings for the purposes of the appropriateness requirements, including UCITS<sup>1</sup> and non-UCITS; and
- certain other products such as Exchange Traded Commodities (ETCs).

It also clarifies the interpretation of the criteria set out under Art. 38 of the MiFID Level 2 Directive. This includes such issues as the interpretation of frequent opportunities to dispose or redeem an instrument, liquidity and also when comprehensive information can be considered to be publicly available.

CESR stresses that its analysis, and the range of products considered, does not aim to be exhaustive, given the number and variety of types of MiFID products traded in the world’s financial markets. Its focus is financial products that are (or can be) transacted by retail clients. The central aim of the MiFID appropriateness test is to prevent complex products from being sold on an ‘execution-only’ basis to retail clients who do not have the experience and/or knowledge to understand the risks of such products.

These Q&As do not consider any possible future extension of the scope of application of MiFID standards (for example, as a result of any current or future proposals from the European Commission).

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<sup>1</sup> Undertakings for Collective Investments in Transferable Securities.



## Introduction

1. On 14 May 2009, CESR published a consultation paper (CP) entitled “MiFID complex and non-complex financial instruments for the purposes of the Directive’s appropriateness requirements” (Ref. CESR/09-295). In that CP, CESR set out for consultation its analysis of a range of types of MiFID financial instruments and its views on how these were likely to fit within the complex/non-complex categories for the purposes of the Directive’s appropriateness requirements.<sup>2</sup>
2. Parallel to publishing this Q&A, CESR also publishes its Feedback Statement (FS) responding to comments it received during the consultation period (Ref. CESR/09-558). This set of Q&As reflects CESR’s statement of its policy following its consultation paper. The Q&As should be read in conjunction with the preceding CP and the FS.
3. CESR stresses that its analysis, and the range of products considered, does not aim to be exhaustive, given the number and variety of types of MiFID products traded in the world’s financial markets. Its focus is financial products that are (or can be) transacted by retail clients. The central aim of the MiFID appropriateness test is to prevent complex products from being sold on an ‘execution-only’ basis to retail clients who do not have the experience and/or knowledge to understand the risks of such products.
4. In terms of the type of instrument or financial product, the way in which the appropriateness requirements apply differs according to whether the instrument/product is deemed “non-complex” or “complex” for these purposes. In practical terms, this distinction matters because the appropriateness test must always have been undertaken by a MiFID firm where the service or transaction involves a “complex” product. For “non-complex” products, the test does not need to be undertaken in certain specified circumstances - meaning that the resulting transactions can be carried out in a way that can be described as ‘execution-only’. The MiFID Level 1 Directive (Art. 19(6)) lists specific types of instruments/products that can always be treated as non-complex for these purposes, then provides in the Level 2 Directive (Art. 38) a set of criteria for “other non-complex” products not specifically listed. These provisions together also indicate some specific types of MiFID products that should always be treated as “complex” for the purposes of the appropriateness requirements.
5. These Q&As do not consider any possible future extension of the scope of application of MiFID standards (for example, as a result of any current or future proposals from the European Commission).

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<sup>2</sup> This paper will make references to two MiFID Directives: the Level 1 Directive 2004/39/EC and the Level 2 Directive 2006/73/EC. The appropriateness requirements are set out in Art. 19(5) of the MiFID Level 1 Directive and Art.s 36 and 37 of the MiFID Level 2 Directive. The prescribed exceptions to the ‘appropriateness test’ are set out in Art. 19(6) of the MiFID Level 1 Directive and Art. 38 of the MiFID Level 2 Directive.

## Section 1 – Shares

6. According to the MiFID Level 1 Directive Art. 19(6), shares admitted to trading on a regulated market or in an equivalent third country market are ‘non-complex’ instruments for the purposes of the appropriateness requirements. Any other types of shares that are not expressly mentioned in Art. 19(6) will have to be assessed as per the criteria in Art. 38 of the Level 2 Directive.

*What is a regulated market?*

7. A market falling under MiFID’s (Level 1 Art. 4(1)(14)) definition of ‘regulated market’. This can include investment exchanges and other types of multilateral markets regulated in accordance with MiFID Title III; it does not include those systems defined by MiFID as multilateral trading facilities (MTFs). Art. 47 of the Level 1 Directive requires that each Member State maintains an updated list of regulated markets for which it is the home Member State and communicates this information to other Member States and the European Commission. The Commission is required to publish a list of regulated markets, notified to it, on a yearly basis in the Official Journal of the European Union.

*What is an ‘equivalent third country market’?*

8. Art. 19(6) of the MiFID Level 1 Directive states that ‘a third country market shall be considered as equivalent to a regulated market if it complies with equivalent requirements to those established under Title III. The Commission shall publish a list of those markets that are to be considered as equivalent. This list shall be updated periodically’. Since this list has not yet been published, there are no formal equivalent third country markets and there are two possible approaches to shares that admitted to trading on a third country market:
  - (i) either firms should assess such shares against the criteria in Art. 38 of the Level 2 Directive; or
  - (ii) in the absence of a list, all such shares would have to be treated as complex instruments.
9. Since one can assume that under the list, once published, some of these shares will be regarded as automatically non-complex and the others will need to be assessed against the Art. 38 criteria, CESR is inclined to the view that option (i) above is a more risk-based and proportionate approach until the list is published.

*What types of shares are specifically covered under Art. 19(6) as being non-complex?*

10. MiFID does not define the specific term “shares”, either for the purpose of Art. 19(6) or elsewhere. Furthermore, this element of company law is not harmonised at the EU level. However, in the definition of ‘transferable securities’ in MiFID Level 1 Directive Art. 4(1)(18)(a), a distinction is made between “shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares.”
11. CESR thus interprets the reference to shares in Art. 19(6) as capturing shares in companies where those shares are admitted to trading on a regulated market or an equivalent third country market, but excluding other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares. This means that shares in companies (when they are admitted to trading) will be automatically non-complex. Instruments other than such shares in companies admitted to trading will need to be assessed against the criteria in Art. 38 of the Level 2 Directive to determine whether they need to be treated as non-complex or complex instruments for the purposes of the appropriateness requirements.

12. It is important to note that where a share is admitted to trading on a regulated market, it is automatically non-complex, no matter where else it may be traded.
13. However, CESR believes that shares in a non-UCITS collective investment undertaking are first and foremost investments in a collective investment undertaking and that (for the purposes of the appropriateness requirements) this should prevail over the legal form they take (whether units or shares) in the interests of a consistent regulatory treatment of such investments for the purposes of the appropriateness requirements. CESR believes that shares in a non-UCITS undertaking should therefore be assessed against the Art. 38 criteria, unless the final Directive on Alternative Investment Fund Managers (AIFMD) prescribes a different treatment. Since UCITS are separately mentioned in Art. 19(6) as automatically non-complex, this is not an issue for shares in an UCITS.
14. Furthermore, CESR's view is that preference shares that do not embed a derivative should be considered as automatically non-complex for the purposes of the appropriateness requirements. Preference shares that embed a derivative should be considered as complex (for convertible preference shares, please see below).

*How should other types of equity securities be treated?*

15. All other types of equity securities that are not expressly mentioned in Art. 19(6) of the Level 1 Directive should be assessed against the criteria in Art. 38 of the Level 2 Directive. This includes:
  - **Shares that are not admitted to trading on a regulated market or in an equivalent third country market.** This category would include 'unlisted' or 'unquoted' shares that are not admitted to trading on any public market, as well as shares admitted to trading on a market which is not a regulated market (or equivalent third country market).
  - **Depository receipts for shares:** as noted above, the MiFID definition of transferable securities<sup>3</sup> distinguishes depository receipts in respect of shares (and bonds) from shares (and bonds) themselves.<sup>4</sup> This means that depository receipts admitted to trading on a regulated market are not identical to shares (or bonds) for these purposes and are therefore not automatically non-complex for the purposes of the appropriateness requirements<sup>5</sup>.
  - **Stapled securities that comprise different types of security (one of which is a share)** which are 'stapled' i.e. are contractually bound to form a single unit so that they cannot be bought or sold separately. For example, CESR is aware that in some financial markets (e.g. Australia), it is common for property trusts to have their units stapled to the shares of companies with which they are closely associated. This may be less common in European markets, certainly involving retail clients, though CESR is aware of at least one issue within the EU involving ordinary shares and warrants being stapled.

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<sup>3</sup> Art. 4(1)(18) of the Level 1 Directive

<sup>4</sup> At a simple level, a depository receipt can be defined as a type of transferable security representing another security (generally equity or debt) issued by a foreign listed company. The most common types of depository receipt are American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs)/European Depositary Receipts (EDRs).

<sup>5</sup> This does not mean that these instruments cannot be treated as equivalent to shares for other regulatory purposes.

*Do listed convertible shares fulfil the Art. 38 criteria for being non-complex?*

16. CESR believes that convertible shares (i.e. convertible preference shares or convertible preferred stock) fall within the type of transferable securities described in Art. 4(1)(18)(c) of MiFID Level 1 Directive, as ‘other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures’. The types of securities covered by Art. 4(1)(18)(c) are expressly excluded from eligibility as “other non-complex financial instruments” under the Art. 38 criteria<sup>6</sup>. This means that convertible shares should be treated as complex products for the purposes of the appropriateness test. This outcome would be logically consistent with the Directive’s treatment of convertible bonds (see below).

*Do subscription rights/nil-paid rights fulfil the Art. 38 criteria for being non-complex?*

17. These are rights that give shareholders an opportunity to purchase more shares, usually at discount. They are usually given by the issuer of the original shares. The shareholders receive these rights at no cost, and if the rights are renounceable, the shareholders can choose to sell them on the market. The issuance of these rights is not a MiFID activity, but the appropriateness requirements can apply to MiFID activities such as the secondary trading of these instruments (i.e. when the shareholders choose to sell them).
18. The starting point is that subscription rights/nil paid rights fall within the type of transferable securities described in Art. 4(1)(18)(c) of MiFID Level 1 Directive, as ‘other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures’. Since securities covered by Art. 4(1)(18)(c) are expressly excluded from eligibility as “other non-complex financial instruments” under the Art. 38 criteria, this means that subscription rights/nil-paid rights should be treated as complex products for the purposes of the appropriateness test.
19. However, for the purposes of the exercise and sale of these rights by shareholders to whom they have been granted, they should not be seen as financial instruments in themselves. They should be considered as a component of the share itself (the right is separated from the share only to facilitate the trading of the rights). It would be reasonable therefore for these rights to be categorised in the same way as the share itself, but only where the instrument that they give right to subscribe is the same financial instrument that gave rise to the subscription right. This interpretation could also cover the strictly necessary acquisition in the secondary market of subscription rights to round up the numbers of rights necessary to acquire the relevant share.
20. Where the exercise of the subscription rights involves the purchase of financial instruments which are different to the shares which gave rise to the subscription rights, then the exercise of such subscription rights should be regarded as complex or non-complex depending on the classification of the financial instrument being offered for purchase.
21. CESR therefore concludes that if the type of share itself is non-complex, the primary market acquisition and exercise of subscription rights/nil paid rights (including the strictly necessary acquisitions in the secondary market of subscription rights to round up the numbers) should also be classified as non-complex for the purposes of the appropriateness test. If, on the other hand, the share is classified as complex, then the primary market acquisition and exercise of subscription rights/nil paid rights should also be classified as complex for the purposes of the appropriateness test.

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<sup>6</sup> Art. 38(a) of the Level 2 Directive.



22. For the purposes of secondary market acquisitions of subscription rights/nil paid rights these instruments ought to be classified as falling within Art. 4(1)(18)(c) of MiFID Level 1 Directive, and therefore are complex products for the purposes of the appropriateness test.
23. Secondary market disposals of subscription rights/nil paid rights by shareholders to whom these instruments have been granted can be regarded as necessary actions to obtain monies equivalent to dividends. Therefore the application of the appropriateness test to such transactions would be unnecessary in these circumstances.

## **Section 2 – Money market instruments, bonds and other forms of securitised debt**

24. MiFID Level 1 Directive Art. 19(6) suggests that money market instruments, bonds and other forms of securitised debt are ‘non-complex’ instruments for the purposes of the appropriateness requirements, unless they embed a derivative. CESR sees the exception for instruments that embed a derivative as applying to all of these instruments, since all are forms of securitised debt.

*What does the category of money market instruments cover?*

25. Money market instruments are defined in MiFID Level 1 Directive Art 4(1)(19) as those classes of instruments which are normally dealt in on the money market, such as:
  - Treasury bills;
  - certificates of deposits; and
  - commercial paper.
26. Q&A 167 in the European Commission’s MiFID Q&A database<sup>7</sup> expands on the Directive’s definition in commenting that “it is commonly understood that money-market instruments are liquid debt instruments that are capable of being traded (although in practice most are held until maturity). They usually mature in less than one year. The list of examples referred to in MiFID is not exhaustive (Art. 4(1)(19) of Directive 2004/39/EC). Several EC Directives define “money market instruments”. Please see: Art. 1(1) of Directive 85/611/EEC; Recital 4 of Directive 2001/108/EC; Recital 9 of Directive 2007/16/EC.” The Commission answer also references the ECB statistical framework which defines money market instruments as “those classes of transferable debt instruments which are normally traded on the money market (for example, certificates of deposit, commercial paper and banker’s acceptances, treasury and local authority bills)...” and which may be “issued by:
  - a central, regional or local authority, a central bank of a Member State, the European Union, the ECB, the European Investment Bank, a non-Member State or, if the latter is a federal State, by one of the members making up the federation, or by a public international body to which one or more Member States belong; or
  - an establishment subject to prudential supervision, in accordance with criteria defined by Community law or by an establishment which is subject to and complies with prudential rules considered by the competent authorities to be at least as stringent as those laid down by Community law, or guaranteed by any such establishment; or
  - an undertaking the securities of which have been admitted to an official listing on a stock exchange or are traded on other regulated markets which operate regularly, are recognised and are open to the public.”

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<sup>7</sup> [http://ec.europa.eu/internal\\_market/securities/docs/isd/questions/questions\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/isd/questions/questions_en.pdf)



*What does the category of Treasury bills cover?*

27. Treasury bills are traditionally short-term debt securities (with a maturity of less than one year) backed primarily by the U.S. government. However, it is clear from the context of MiFID and from the ECB discussion above that the reference to Treasury bills should be read more widely than this, as covering securities issued or backed by any central, regional or local authority, a central bank of a Member State, the European Union, the ECB, the European Investment Bank, a non-Member State or, if the latter is a federal State, by one of the members making up the federation.
28. It is not clear whether a distinction is intended between short term securities (bills) and longer term securities (with maturities of greater than one year) which might better be regarded as government/public bonds. In practice, this question should not matter since both Treasury bills and government/public bonds would be covered by the references in Art. 19(6) to money market instruments and bonds.

*What does the category of certificates of deposits cover?*

29. A certificate of deposit would be covered by MiFID where it is a transferable security, negotiable on the capital market. If it is not negotiable, then it would be excluded from MiFID as an instrument of payment.

*What does the category of commercial paper cover?*

30. Commercial paper has a common interpretation in the global money markets, basically as an unsecured promissory note with a fixed maturity of up to 270 days and variable interest rates, generally issued by credit institutions or large corporates. Regardless of the credit rating of the issuer (which will obviously determine the price and value of the instrument), MiFID would treat most commercial paper as automatically non-complex for the purposes of the appropriateness requirement. The exceptions to this would, in CESR's view, be commercial paper that embeds a derivative, and asset-backed commercial paper (see below), which CESR believes should not be treated as automatically non-complex instruments for the purposes of the appropriateness requirements. CESR does not believe that direct retail client investment in commercial paper is significant in Europe.

*What types of money market instruments would be regarded as embedding a derivative and would therefore be complex instruments for the purposes of the appropriateness requirements?*

31. CESR considers the concept of instruments that embed a derivative below. Examples of common money market instruments that embed a derivative would include certain certificates of deposits or Medium Term Notes.

*Which types of instruments are included in this category as bonds and other forms of securitised debt?*

32. In CESR's view, the reference to 'bonds' in Art. 19(6) covers traditional bonds, where the bond holder is in effect lender to the issuer and the issuer has to pay back the totality of the nominal value of the bond to the bond holder at maturity. Such bonds usually have a defined term or maturity, after which the bonds are redeemed. Traditional bonds are in general issued by corporate bodies or public authorities.
33. For the purpose of Art. 19(6) CESR reads the term 'securitised debt' as meaning debt that is incorporated in a security. It then follows that the term 'other forms of securitised debt' means debt securities other than bonds or money market instruments.



*Does this mean that all debt securities (bonds, money market instruments and other debt securities) are non-complex financial instruments?*

34. No. CESR rejects the interpretation that reads the term ‘other forms of securitised debt’ as meaning debt that has undergone a securitisation process. Such an interpretation would reach a conclusion that makes instruments such as Mortgage Backed Securities (residential or commercial), Collateralised Debt Obligations, or other Asset Backed Securities (including those backed by e.g. auto-loans, credit card loans or equipment lease receivables) non-complex financial instruments.<sup>8</sup>
35. CESR takes the view that a number of types of securitised debt structures cannot accurately be described as ‘non-complex’. Some of the examples of structures of Mortgage Backed Securities, Collateralised Debt Obligations, Asset Backed Commercial Paper and other Asset Backed Securities that are covered in the CESR Report on “Transparency of corporate bond, structured finance product and credit derivatives markets”<sup>9</sup> are good illustrations of complex structures, which will affect the ease with which the risk attached to the product may be understood. Cash-flows and the ultimate cash settlement will also be determined by reference to the underlying assets, similarly to those types of transferable securities that are automatically complex for the purposes of the appropriateness requirements because they fall within MiFID Art. 4(1)(18)(c). There are also similarities with instruments that embed a derivative.
36. Most retail clients will not be investing directly in most types of Asset Backed Securities (and certainly not without investment advice). However, given the structures of these instruments, the issues that have emerged in the financial markets involving Asset Backed Securities, and the involvement of some retail investors, CESR is of the view that Asset Backed Securities should not be regarded as automatically non-complex instruments for the purposes of MiFID Art. 19(6) and should not be transacted for retail clients on a non-advised basis without the appropriateness test being carried out – i.e. without a firm asking retail clients about their knowledge/experience to understand the risks and, if necessary, giving the clients a warning.
37. Amongst the population of financial instruments falling within ‘other forms of securitised’ debt’, those that embed a derivative and those that incorporate structures which make it difficult for the investor to understand the risk attached to the product should be considered as complex products for the purposes of the appropriateness requirements. However, pending further review by the EU institutions of the drafting of MiFID Art. 19(6), CESR believes that at least some products considered as ‘other forms of securitised’ debt’ will need to be assessed against the criteria in Art. 38 of the MiFID Level 2 Directive. The likely result of such an assessment is that almost all, if not all, such products will be considered complex,
38. CESR would also stress that where firms are marketing debt instruments to retail clients they are under a MiFID obligation to provide appropriate information, in a comprehensible form, about these financial instruments and proposed investment strategies. This includes appropriate guidance on and warnings of the risks associated with investments in those instruments or in respect of particular investment strategies, so that clients are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis<sup>10</sup>.

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<sup>8</sup> CESR recognises that not all of these instruments are likely to be transacted by retail clients directly (as opposed to investment by funds in which retail clients may invest).

<sup>9</sup> Ref: CESR/09-348, July 2009.

<sup>10</sup> Art. 31 of the Level 2 Directive is particularly relevant in the context of debt instruments. For example, it includes the requirement that “in the case of financial instruments that incorporate a guarantee by a third party, the information about the guarantee shall include sufficient detail about the guarantor and the guarantee to enable the retail client or potential retail client to make a fair assessment of the guarantee.”

*Is there a definition for bonds and other forms of securitised debt that embed a derivative?*

39. MiFID does not include a definition of bonds and other forms of securitised debt that embed a derivative, either at Level 1 or Level 2. However, the concept of an instrument “embedding a derivative” is being increasingly used and discussed by bodies and groups that are active in the capital markets – notably those bodies involved in the development and setting of appropriate accounting standards.
40. CESR itself considered the concept in its “Advice to the European Commission on Clarification of Definitions concerning Eligible Assets for Investments of UCITS” (January 2006, Ref. CESR/06-005). In formulating this advice, CESR took account of IAS 39<sup>11</sup>, noting that “paragraph 10 of the IAS 39 defines an embedded derivative as “a component of a hybrid (combined) instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a standalone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable. A derivative that is attached to a financial instrument, but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument ”.

*What types of instruments are included in this category?*

41. CESR’s advice on eligible assets for investments of UCITS referred to above also includes an “illustrative and non-exhaustive list” of financial instruments that CESR believes could be assumed to embed a derivative. This list comprises the following, all of which could be examples of money market instruments, bonds and other forms of securitised debt embedding a derivative:
- credit linked notes;<sup>12</sup>
  - structured instruments whose performance is linked to the performance of a bond index;
  - structured instruments whose performance is linked to the performance of a basket of shares with or without active management;
  - structured instruments with a nominal fully guaranteed whose performance is linked to the performance of a basket of shares, with or without active management;
  - convertible bonds; and
  - exchangeable bonds.
42. Structured instruments whose performance is linked to the performance of another underlying such as a commodity or a commodity basket should also be added to this list.

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<sup>11</sup> The objective of International Accounting Standard 39 is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.

<sup>12</sup> Essentially a security with an embedded credit default swap, allowing the issuer to transfer a specific credit risk to investors.



*Why are money market instruments, bonds or other forms of securitised debt that embed a derivative always complex instruments for the purposes of the appropriateness requirements?*

43. CESR believes that both a literal and risk-based reading of Art. 19(6) leads to the conclusion that money market instruments, bonds and other forms of securitised debt that embed a derivative should not be categorised as “non-complex” for the purposes of the appropriateness test. If an instrument is explicitly excluded from the list of non-complex instruments in Art. 19(6), it should not be brought back in via Art. 38. Only those instruments not specifically mentioned in Art. 19(6) in the first place should be assessed against the criteria in Art. 38 as potentially “other non-complex financial instruments.”

*What is the categorisation of convertible bonds?*

44. As indicated in the illustrative list above, CESR believes that convertible bonds, reverse convertible bonds and other exchangeable bonds can be regarded as bonds embedding a derivative and thus ineligible to be regarded as non-complex instruments for the purposes of the appropriateness test.<sup>13 14</sup>

*Are callable and puttable bonds non-complex or complex financial instruments for the purposes of the appropriateness test?*

45. Callable bonds give the issuer of the bond the right to redeem the bond prior to the maturity date, under certain conditions. Puttable bonds (or put bonds) give the holder of the bond the right to force the issuer to repurchase the security before its maturity, under certain conditions. Each set of rights will be reflected in the coupon rate on the bond, and it is possible for a bond to embed both types of rights.
46. CESR believes that it is reasonable to regard such callable and puttable bonds as bonds embedding a call or put option, with the price of the bond taking these components into account. This means that such bonds should not be regarded as non-complex instruments for the purposes of the appropriateness requirements. It has also been suggested to CESR that the increased volatility risks of these instruments also makes them complex products.

*What is the categorisation of covered bonds?*

47. The term ‘covered bond’ is used for a number of financial instruments with different characteristics. Traditional covered bonds are corporate bonds with an enhancement in the form of a recourse to a ring-fenced pool of assets that remains on the balance sheet of the issuer. This pool of assets secures or “covers” the bond if the issuer (usually a financial institution) becomes insolvent. Issuers must ensure that the pool of assets consistently backs the covered bond. In case of insolvency, the investor has access to both the pool of assets and the issuer. CESR is of the opinion that these traditional covered bonds which include all of the above features are non-complex instruments as they are essentially ordinary corporate bonds with an enhancement.
48. CESR is also of the opinion that mortgage bonds issued by a credit institution under the conditions stated by Art. 5(4)(b) of the Prospectus Directive should also be considered to be

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<sup>13</sup> A convertible bond is an instrument that gives the holder the option to convert the bond for other securities (including securities offered by the issuer). A reverse convertible bond gives the issuer the option to convert the bond. An exchangeable bond will involve features of an option, to convert before the maturity of the bond under prescribed conditions.

<sup>14</sup> An alternative rationale is provided by the European Commission in its MiFID Q&A database, Q93. However, this also leads to the same conclusion that a convertible bond is a complex instrument for the purposes of the appropriateness test.



non-complex instruments (see recital 13 of the implementing regulation of the Prospectus Directive).

49. However, structured covered bonds could be described as bonds backed by a pool of assets which is off-balance sheet (held on a corporate structure separate from the financial institution). The issuer of these bonds is sometimes not the financial institution itself but the corporate structure that is wholly owned by the financial institution's group. These structured covered bonds are similar to Asset Backed Securities and their regulatory treatment should arguably be the same. CESR therefore considers that pending any review of the text of Art. 19(6), structured covered bonds should not be treated as automatically non-complex. Those structured covered bonds that embed a derivative and those that incorporate structures which make it difficult for the investor to understand the risk attached to the product should be considered as complex products for the purposes of the appropriateness requirements. Other structured covered bonds should be assessed against the criteria in Art. 38 of the Level 2 Directive. The likely result of such an assessment is that almost all, if not all, such bonds will be considered complex, especially if the investor has no recourse to the financial institution that has issued or sponsored the instrument.

*What is the categorisation of subordinated bonds?*

50. Although subordinated bonds have particular characteristics in the event of the bankruptcy or liquidation of the issuer, CESR does not believe that Art. 19(6) provides grounds to treat these as a further distinct category beyond those types of bonds or other securitised debt already mentioned. The same considerations should therefore apply to their categorisation as for other types of bonds and securitised debt. However, given the greater risks associated with subordinated bonds in terms of repayment in the event of insolvency, MiFID's general risk disclosure obligations (including Art. 19(3) of the Level 1 Directive) are again particularly relevant.

*What is the categorisation of depositary receipts in respect of bonds or other forms of securitised debt?*

51. As with depositary receipts in respect of shares, the MiFID definition of "transferable securities" at Level 1 Directive Art.4(1)(18)(b) distinguishes depositary receipts in respect of bonds or other forms of securitised debt from bonds or other forms of securitised debt themselves. It seems reasonable to read Art. 19(6) in the same way. In CESR's view, this means that depositary receipts in respect of bonds or other forms of securitised debt need to be assessed against the criteria in Art. 38 of the Level 2 Directive in determining whether they can be treated as non-complex instruments.

*What is the categorisation of step-up notes and floating rate notes?*

52. CESR understands step-up notes to be debt securities, usually callable, with interest rates that increase over time. If the notes are not called by the issuer, their coupons increase according to a predefined schedule. In CESR's view, for the purposes of the appropriateness requirements, callable step-up notes will not be non-complex as they embed a call option. Non-callable step-up notes that simply move to a higher interest rate after a pre-defined time period may be treated as non-complex debt securities because they do not embed an option.
53. Floating-rate notes are notes with a variable interest rate. Given the different variations and structures of floating-rate notes, CESR again would not consider such instruments as automatically non-complex. These notes should therefore be assessed against the Art. 38 criteria – including the first criterion covering derivatives and similar instruments. CESR would expect that notes whose only particularity is the floating rate payment structure would be non-complex.



### Section 3 – UCITS and other collective investment undertakings

54. According to MiFID Level 1 Directive Art. 19(6) UCITS are ‘non-complex’ instruments for the purposes of the appropriateness requirements. Other units in collective investment undertakings within the scope of Annex I to the MiFID Level 1 Directive will need to be assessed against the criteria in Art. 38 of the Level 2 Directive, unless the final text of the Directive on Alternative Investment Fund Managers prescribes a different treatment.

*What is a UCITS for the purpose of the appropriateness requirements?*

55. There is no special meaning of the term "UCITS" for the purpose of the appropriateness requirements. The reference therefore captures investments in a collective investment undertaking which is constituted according to the UCITS Directive (Directive 85/611/EC, as amended). UCITS may be constituted according to national law, either under the law of contract (as common funds managed by management companies), trust law (as a unit trust) or under statute (as investment companies). Depending on the form under which it has been constituted, a UCITS will be represented by units (when it is a common fund) or by shares (when it is a company). Art. 1 of the UCITS Directive furthermore confirms that the concept of units in collective investment undertakings also includes shares of such undertakings.

56. All investments in UCITS are non-complex instruments by definition, for the purposes of the appropriateness requirements, regardless of the underlying instruments in which the UCITS invests. Nothing in MiFID Art. 19(6) requires a person to look through to the underlying investments of the UCITS for these purposes.

*How should collective investment undertakings other than UCITS be classified for the purpose of the appropriateness requirements?*

57. Units in collective investment undertakings that are not constituted according to the UCITS directive (‘non-UCITS’) are not automatically non-complex instruments (see below).

*When can a non-UCITS be categorised as a non-complex financial instrument?*

58. As MiFID stands, any unit or share in a non-UCITS collective investment undertaking can be categorised as a non-complex instrument if it fulfils all the criteria in Art. 38 of the Level 2 Directive. However, CESR notes the Commission’s proposal for a Directive on Alternative Investment Fund Managers (AIFMD), which will have a bearing on non-UCITS funds. Their final treatment for the purposes of the appropriateness requirements may be prescribed by the AIFMD.

59. The characteristics of a particular non-UCITS might also have an impact on whether it satisfies all the criteria in Art. 38. For example, some non-UCITS may be less likely to satisfy all the criteria of Art. 38 (especially Art. 38(b), (c) and (d)).

*What types of non-UCITS collective investment undertakings might be particularly relevant for the purpose of the appropriateness requirement?*

60. Units (or shares) in all collective investment undertakings are financial instruments under MiFID Level 1 Directive (Annex 1, Section C (3)), unless they are specifically excluded from the Directive’s scope (as, for example, insurance or pension products).

61. Therefore, non-UCITS collective investment undertakings potentially covered by the appropriateness test requirement are those within MiFID scope that are not authorised in accordance with the UCITS Directive. This may cover undertakings which do not fulfill the requirements of the UCITS Directive or those that choose not to follow the UCITS route.

62. At present, the AIFMD aims to cover all non-UCITS collective investment undertakings, so the scope of such undertakings should be clarified by the final text of that Directive. The scope is likely to cover (among others) such investments as real estate funds, private equity and venture capital funds, hedge funds and funds of hedge funds (if not constituted as UCITS), commodity funds and infrastructure funds.

*How should undertakings such as Exchange Traded Funds (ETFs), capital protected funds or hedge funds be categorised?*

63. ETFs which are structured as UCITS will be automatically non-complex. The treatment of ETFs which are non-UCITS will be as described above.
64. If a capital protected fund is an authorised UCITS, it will be categorised as a non-complex instrument by definition. Other types of capital protected funds will currently have to be assessed against the criteria in Art. 38 of the Level 2 Directive.
65. Pending the outcome on the AIFMD, hedge funds are currently in the same position for these purposes, although a hedge fund is traditionally less likely to be a collective investment undertaking authorised under the UCITS Directive. However, since it is likely that in some cases such an undertaking will not itself be authorised or regulated and that it will not be permitted to market to the public without restrictions, it seems reasonable to consider that it may not readily satisfy the criteria in Art. 38 of the Level 2 Directive where this is the determining factor.



## Section 4 – “Other non-complex financial instruments” under Art. 38 of the Level 2 Directive: Issues of general interpretation

66. According to MiFID Level 2 Directive Art. 38, other MiFID financial instruments which are not specifically mentioned in the first indent of Art. 19(6) can be considered as non-complex instruments if they satisfy four criteria.
67. The four criteria to be satisfied by such an instrument are:
- (a) *It does not fall within Article 4(1)(18)(c) of, or points (4) to (10) of Section C of Annex I to, Directive 2004/39/EC*
  - (b) *There are frequent opportunities to dispose of, redeem, or otherwise realise that instrument at prices that are publicly available to market participants and that are either market prices or prices made available, or validated, by valuation systems independent of the issuer;*
  - (c) *It does not involve any actual or potential liability for the client that exceeds the cost of acquiring the instrument;*
  - (d) *Adequately comprehensive information on its characteristics is publicly available and is likely to be readily understood so as to enable the average retail client to make an informed judgment as to whether to enter into a transaction in that instrument.*
68. The need for these criteria is that it is not practical for the MiFID Level 1 Directive to attempt to list all types of financial instruments that may (now or in the future) reasonably be treated as ‘non-complex’ for the purposes of the appropriateness requirements. It therefore includes a reference to ‘other non-complex financial instruments’. CESR was asked by the Commission to advise on a set of criteria to guide the scope of this reference, which informed the Commission’s Level 2 Directive on this point. Although there is room for interpretation on some of the criteria, the purpose of Art. 38 is to confine the scope of ‘other’ non-complex instruments only to those products that are adequately transparent, liquid and capable of being readily understood by retail clients. MiFID derivatives and certain similar instruments cannot qualify as ‘non-complex’ under the criteria.

### *Consideration of each criterion*

*38(a): The instrument does not fall within Article 4(1)(18)(c) of, or points (4) to (10) of Section C of Annex I to, Directive 2004/39/EC*

69. The first of the criteria (38(a)) is quite direct. It has to be checked that the instrument does not fall within
- the types of derivative contracts covered by MiFID, as listed at points (4) to (10) of Section C of Annex I to the Level 1 Directive; or
  - that part of the MiFID definition of transferable securities covering “any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.” (Art. 4(1)(18)(c) of MiFID Level 1 Directive).
70. This criterion prevents a large number of MiFID instruments from being treated as ‘non-complex’ for the purposes of the appropriateness test. It covers a wide range of futures, options, swaps, forward rate agreements, and financial contracts for differences.

71. In CESR's view, the types of such MiFID instruments most likely to be commonly traded by retail clients as direct investments (as opposed to investments via funds), on a non-advised basis, include:

- Warrants (see also Q.184 of the EC Q&A database)
- Covered warrants<sup>15</sup>; and
- Financial contracts for differences (including financial 'spread bets', common in some Member States).

*38(b) How often should a client have the opportunity to dispose, redeem or otherwise realise the instrument to consider that those opportunities are frequent?*

72. CESR believes that the reference to frequent opportunities is capable of accommodating a range of frequencies: daily, weekly and, possibly, in a few cases, longer regular frequencies.

73. Where the position may not be obvious, firms should consider this criterion on a case-by-case basis, taking account of information available, the particular instrument in question, and the standard practice in the markets for that instrument. For example, in the case of shares admitted to trading on non-regulated markets only, a number of venues support trading by market makers who are obliged to quote two way prices during the trading day - thereby ensuring that a market exists - and in some cases are subject to maximum spread restrictions. In such cases, the opportunity to trade is in theory there throughout the day.

*38(b) When are prices publicly available to market participants and how should prices be determined to meet the criterion?*

74. In general CESR believes that prices are publicly available to market participants when they are easily accessible through channels that are easy to find for the relevant clients. For example, it may be considered that prices are publicly available when MiFID pre- and post-trade transparency requirements, or similar national requirements for financial instruments other than shares, apply.

75. Prices should be either market prices (i.e. prices at which a number of market participants are willing to trade and which are determined following transparent and non-discretionary rules), or (in the absence of market prices) prices made available, or validated, by valuation systems independent of the issuer. In CESR's opinion, acceptable valuation systems for these purposes should be those which are generally recognised as being experts in providing such valuations and devoted to this activity on a consistent basis. These valuation systems must be independent of the issuer (and to this end firms should remember MiFID provisions on conflicts of interest).

76. In the case of units in non-UCITS, Recital 61 of the MiFID Level 2 Directive specifies the following with regard to criterion 38(b): 'the circumstances in which valuation systems will be independent of the issuer should include where they are overseen by a depositary that is regulated as a provider of depositary services in a Member State'. Again, the final AIFMD may have a bearing here.

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<sup>15</sup> A covered warrant is a right to buy or sell an underlying asset (at or before a prescribed date at a specified price) that is issued by a third party, usually a financial institution. The warrants can be issued on any number of underlying securities, including single equities, a basket of shares, or a market index. The issuer of the warrant hedges its position using derivatives, such as traded options, and underlying shares; hence the term covered. A covered warrant can be cash-settled.

77. CESR accepts that where funds calculate their redemption prices under supervision of or in cooperation with a depositary, custodian or independent party, these should be deemed to meet this element of the criterion.
78. However, CESR does not consider that the non-market price requirement would be satisfied simply by an objective valuation made by the issuer itself in compliance with MiFID's conduct of business rules. Such an evaluation would need to be verified independently of the issuer, for the reasons stated in the CP.
79. CESR believes that the net asset values published by investment funds in line with the relevant UCITS requirements are sufficient for the purposes of the criterion.

*38(b) Does it mean that a product admitted to trading on a regulated market (other than shares) complies with the requirement of "frequent opportunities to dispose of, redeem, or otherwise realise that instrument"?*

80. This will not automatically be so in every case. The admission to trading of the product offers the potentiality of having frequent opportunities to dispose of, redeem, or otherwise realise that instrument but does not ensure that in practice a range of frequencies will exist. Similarly, the existence of prices publicly available (determined either by the market or by valuation systems) in CESR's opinion does not automatically ensure that Art. 38(b) will be satisfied, if frequent opportunities to trade do not exist. Firms will need to be particularly diligent when considering securities trading on a market where liquidity is thin.

*38(c) Under what circumstances can it be considered that the client has an actual or potential liability that exceeds the cost of acquiring the instrument?*

81. The existence of an actual or potential liability can be understood as the possibility that, at any time, the investor runs the risk of being liable to make a payment above the initial outlay made in order to acquire the instrument, i.e. the cost of the financial instrument itself as well as the commissions and fees charged.

*38(d) What does the information referred to in Art. 38(d) cover?*

82. It refers to adequately comprehensive information on the characteristics of a financial instrument. This is a wider concept than price (covered in criterion (b)), and potentially covers such points as the structure of the instrument, how the return is calculated, performance, the issuer, the market in the instrument, any guarantees, the risks, time horizons, and any other particular features that may affect the value, performance or liquidity of the instrument etc. The criterion also indicates the need for the client to have easy access to this information and that it should be described in a fair, clear and not misleading way.

*38(d) When can it be considered that comprehensive information is publicly available?*

83. Information is publicly available when it is easily accessible through channels that are easy to find for the relevant clients. Some factors that could be considered to check the accessibility to the information are: number of sources through which information is available, the nature of the sources and channels, and the ability of the client to reproduce, download or print the information he needs. MiFID does not require an intermediary to create new information for the purposes of this criterion, if adequately comprehensive and understandable information is publicly available from other sources (including e.g. the issuer of the instrument). But if the firm is creating the information that is to be made publicly available, then the firm must ensure that it is fair, clear and not misleading and complies with any other applicable legal requirements.



84. A firm will also need to consider whether the language in which the comprehensive information is available will affect its ability to be readily understood so as to enable the average retail client to make an informed judgment as to whether to enter into a transaction in that instrument. Subject to this point, CESR considers that product information in the client's language provided in a durable medium by an information agent in the investor's jurisdiction can be considered publicly available information.
85. Information comparable to a UCITS prospectus or other form of documentation recognised by EU law and produced to that standard should usually be considered as comprehensive information. The simple volume of information (e.g. length of a prospectus) need not be a determining factor under Art. 38(d), where a shorter document is adequately comprehensive. Information could be considered publicly available if it is produced in compliance with the Prospectus Directive.
86. CESR acknowledges that the considerations set out above as to what could be considered as comprehensible and publicly available information cannot be considered exhaustive or complete.

## **Section 5 – Other products**

*Do the appropriateness requirements apply to deposits, loans, mortgages or life insurance products?*

87. These questions have been addressed by the European Commission in its MiFID Q&A database (notably Q&As 118 and 203). In summary, the answer is “no” to all of the above, since these are not MiFID financial instruments listed in Section C to Annex 1 of the MiFID Level 1 Directive. The exception to this is that the Commission regards a deposit with an embedded derivative that has the potential of reducing the initial capital invested as a financial instrument under MiFID.

*What is the position of Exchange Traded Commodities (ETCs)?*

88. CESR recognises that ETCs are increasingly traded by retail investors in a number of Member States. It is possible for these instruments to be structured in a number of ways. Some are structured in a way that combines features of contracts for differences and transferable securities. These investment instruments are sometimes listed on exchanges, but they have no specified maturity date and do not pay interest. The main element of return on the investment is an amount related to the price of a commodity, or level of a commodity index or indexes.
89. ETCs that are (in part) contracts for differences will need to be treated as 'complex' instruments for the purposes of the appropriateness test, since they do not satisfy the first condition of Art. 38 of the Level 2 Directive. ETCs structured as other securities giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures, will also be complex instruments because they will not meet the first condition of Art. 38. Any that are structured as debt securities that embed a derivative would also not be non-complex.
90. Since different structures can exist, firms should consider the regulatory classification in each case for the purposes of the appropriateness test. However, it is likely that most ETCs will not be capable of being treated as non-complex instruments for the purposes of the appropriateness requirements, for the reasons set out above.



## ANNEX I – Non-exhaustive list of MiFID complex / non-complex financial instruments

(to be read in conjunction with the text of the paper)

AUTOMATICALLY NON-COMPLEX UNDER ART. 19(6)	TO BE ASSESSED AGAINST THE CRITERIA IN ART. 38 OF THE MiFID LEVEL 2 DIRECTIVE	ALWAYS COMPLEX UNDER ART. 38 OF THE MiFID LEVEL 2 DIRECTIVE
<b>1. SHARES</b>		
<p>(i) Ordinary/ common shares in companies, admitted to trading on a regulated market.<sup>16</sup></p> <p>(ii) Ordinary preference shares in companies admitted to trading on a regulated market.<sup>17</sup></p> <p>(iii) Subscription rights/nil-paid rights to acquire shares that are automatically non-complex.</p>	<p>(i) Shares that are not admitted to trading on a regulated market</p> <p>(ii) Shares admitted to trading on a third country market<sup>18</sup></p> <p>(iii) Depositary receipts in respect of shares</p> <p>(iv) Subscription rights/ nil-paid rights to acquire shares that are not automatically non-complex</p> <p>(v) ‘Stapled securities’ that comprise a share and a different type of security</p> <p>(vi) Shares in non-UCITS open-ended collective investment undertakings</p> <p>(vii) Shares in non-UCITS closed-ended collective investment undertakings</p>	<p>(i) Convertible shares.</p> <p>(ii) Callable/ convertible preference shares</p>
<b>2. MONEY MARKET INSTRUMENTS, BONDS AND OTHER FORMS OF SECURITISED DEBT</b>		
<p>(i) Money market instruments that do not embed a derivative. Including:</p> <ul style="list-style-type: none"> <li>• Treasury bills</li> <li>• Certificates of deposit</li> <li>• Commercial paper</li> </ul> <p>(ii) Bonds that do not embed a derivative Including</p> <ul style="list-style-type: none"> <li>• Corporate bonds</li> <li>• Government/public bonds</li> <li>• Traditional covered bonds</li> </ul>	<p>(i) Depositary receipts in respect of bonds or other forms of securitised debt.</p> <p>(ii) floating rate notes</p> <p>(iii) possibly some asset-backed securities, other structured instruments and structured covered bonds</p>	<p>(i) Money market instruments, bonds and other forms of securitised debt that embed a derivative. Including</p> <ul style="list-style-type: none"> <li>• credit linked notes</li> <li>• structured instruments whose performance is linked to the performance of a bond index</li> <li>• structured instruments whose performance is linked to the performance of a basket of shares with or without active management</li> <li>• structured instruments with a nominal fully guaranteed whose</li> </ul>

<sup>16</sup> This would also apply to equivalent third country markets after the Commission has published a list of those markets.

<sup>17</sup> This would also apply to equivalent third country markets after the Commission has published a list of those markets.

<sup>18</sup> After the Commission has published the list on equivalent third country markets, this would apply only to those markets that have not been considered to be equivalent.

		<p>performance is linked to the performance of a basket of shares, with or without active management</p> <ul style="list-style-type: none"> <li>• convertible bonds</li> <li>• other exchangeable bonds</li> <li>• callable bonds (including callable step-up notes)</li> <li>• puttable bonds</li> </ul> <p>(ii) Asset-backed securities and other structured instruments that embed a derivative or incorporate structures which make it difficult for the investor to understand the risk attached to the product</p> <p>(iii) Structured covered bonds that embed a derivative or incorporate structures which make it difficult for the investor to understand the risk attached to the product</p>
<b>3. UCITS AND OTHER COLLECTIVE INVESTMENT UNDERTAKINGS</b>		
(i) Units (or 'shares') in any UCITS	<p>(i) Units in a non-UCITS fund</p> <p>(ii) Shares in a non-UCITS open-ended collective investment undertaking</p> <p>(iii) Shares in non-UCITS closed-ended collective investment undertakings</p>	<ul style="list-style-type: none"> <li>• None are automatically complex as MiFID is drafted. (Note: the fact that an undertaking invests in derivatives will not automatically make it 'complex' for these purposes.)</li> </ul>
<b>4. OTHER FINANCIAL INSTRUMENTS</b>		
N/A	Other MiFID financial instruments which are not specifically mentioned in the first indent of Art. 19(6) of the Level 1 Directive	<p>(i) MiFID-scope derivatives covered by items 4-10 of Section C of the Annex to MiFID</p> <p>(ii) Other securities giving the right to acquire or sell a transferable security or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures (Art. 4(1)(18)(c) of MiFID Level 1 Directive), including:</p> <ul style="list-style-type: none"> <li>• Warrants</li> <li>• Covered warrants (It can be argued either that covered warrants fall under items 4-10 of Section C of the Annex I to MiFID or that they are securities covered by c) of Art. 4(1)(18) of MiFID)</li> <li>• Financial contracts for differences (including e.g. Exchange Traded</li> </ul>



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		Commodities that are contracts for differences or structured as debt securities that embed a derivative and financial 'spread bets')
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