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Q&A: Italy's structured products body on complexity crackdown

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Italy's Consob has taken a tough line on complex products since the financial crisis, but Dario Savoia, chairman of the country's structured products association, believes the sector has a bright future

Italy's structured products market is enjoying a vintage year. Issuance in the primary market up to the end of September was just under €8 billion ($8.7 billion) across 403 International Securities Identification Numbers, close to the total figure for the whole of 2014, according to L'Associazione Italiana Certificati e Prodotti di Investimento (Acepi), the Italian structured products association. The market has come a long way since 2008, when volumes collapsed at the height of the financial crisis.

But regulation and oversight of the industry has also changed dramatically. In 2009, securities market watchdog Commissione Nazionale per le Società e la Borsa (Consob) issued rules distinguishing between liquid and illiquid products that foisted new documentation, pricing and reporting requirements on complex over-the-counter products, increasing dealers' focus on the listed market. The majority of trading today takes place on Borsa Italiana, where interest is concentrated on equity underlyings - primarily the FTSE Milano Italia Borsa Index.

In terms of structures, appetite is roughly divided between: express certificates, which track the price of an underlying and knock out with a big payoff if this price breaches an upside barrier; bonus certificates, which offer fat coupons as long as the price of an underlying stays within a fixed range; and 100% capital-protected equity-linked products. More exotic products, such as credit-linked notes (CLNs) and asset-backed securities, have faded away as regulatory scrutiny has intensified.

Given the current extraordinarily low yields, I expect more and more interest in structured products

The Italian market is therefore more liquid, more accessible and arguably more vanilla than some of its neighbouring countries. But like other European markets, Italy is also wrestling with the impact of the forthcoming Packaged Retail and Insurance-based Investment Products (Priips) regulation and the review of the Markets in Financial Instruments Directive (Mifid II).

On the domestic front, Consob is implementing an enhanced customer protection agenda. Hot on the heels of an opinion paper published by the European Securities and Markets Authority (Esma) on the distribution of complex financial products in February 2014, Consob published its own communication identifying a number of complex financial products it felt were generally unsuitable for retail investors, explaining that they should not be offered by intermediaries unless enhanced customer protection measures were put in place.

In June 2015, Consob followed this up with a Q&A to assist intermediaries in complying with the recommendations. While these initiatives fell short of an outright product ban such as the one introduced in Belgium, they served to drive issuers and intermediaries away from exotic structured products towards simpler, safer investments. Public data is testament to the communication's effectiveness. In the first quarter of 2014, CLNs comprised 14% of Italy's primary issuance. Following the publication of the communication identifying CLNs as complex instruments, the commensurate figure for the first quarter of 2015 was 1%.

Dario Savoia, chairman of Acepi, talks to *Risk.net* to explain how the Italian market is dealing with the challenging regulatory environment, and what's next for the industry.

Consob issued rules on illiquid products in 2009 to incentivise distributors to list the majority of their products on exchange. Six years on, how has this shaped the Italian structured products market?
Dario Savoia: Most products were already listed on Borsa Italiana or EuroTLX, a multilateral trading facility, when this communication was issued in 2009. The industry worked with the regulator on shaping the guidelines and nowadays virtually all products offered in Italy are negotiated on those markets. It was not a revolution but it definitely helped to increase liquidity.

How does Acepi work with Consob to ensure appropriate regulation of the structured products market?
DS: Acepi regularly contributes to consultations and provides the industry's view and inputs on relevant Italian matters to Consob, as well as sharing our own research or guidelines. Consob is different from other European regulators where the dialogue with the industry is often more intense, yet we talk with them regularly and have a good relationship.
Regulation for structured products is, however, mainly at the European Union level today, so we work closely with our umbrella association, the European Structured Products Association (Eusipa), to co-ordinate actions and support uniform market standards. Our mission is to make sure national markets grow together and foster a cross-border level playing field.

Consob issued a communication on the distribution of complex financial products to retail clients earlier this year and followed up with a Q&A clarifying certain aspects of the communication on June 23. What were the aims of this communication and how did Acepi respond?
DS: The first draft of the communication was subject to a consultation in June 2014 and was not welcomed either by us or the industry, nor by the International Swaps and Derivatives Association or the Italian Banking Association. The final Consob communication of December 2014 on complex products – including notes, funds, insurance policies and certificates – is more balanced and in line with Esma's opinions on good practices recommended for the design and distribution of complex retail products.
This communication does not take the form of statutory regulation but rather a recommendation to induce the desired responses from the structured products industry. It expressly acknowledges that complexity is a general, ever-changing concept and that complex products may entail low risk, while simple products may entail high risk for retail investors. It is not a product ban. The key message in the communication is: take care. You can sell complex products, including CLNs and over-the-counter products, but you need to have special conditions in place.
The final communication also marks a shift of focus from the products themselves onto the due diligence of intermediaries and the enhanced care they have to take in the design and sale of products, in line with Esma opinions. These include having in place clear client and product classifications, and defining certain specific

investment limits in advance, such as quantitative thresholds in the form of a minimum investment size and maximum concentration in the client portfolio.
Following this communication, Consob published a Q&A in June 2015 that clarified some minor details and did not change the sentiment of the industry, which is now generally positive.

What has been the overall impact of the Consob communication on the Italian structured products market?
DS: Overall the Italian retail structured products market has not suffered a huge impact. Sales volumes are up in 2015 and compliance costs borne by banks for the implementation of recommended good practices did not increase dramatically. This is because most market players in Italy have already put in place good practices, from both a legal and compliance point of view, in line with applicable EU regulation. I believe the Italian industry already met high compliance standards, as evidenced also by the absence of market failures and litigation relating to structured products in Italy, but nevertheless took the opportunity to review and improve its set-up. The more burdensome Consob recommendations may relate to credit-linked notes and OTC instruments, which represent a relatively small proportion of the wide array of products sold in Italy.

How are Italian issuers preparing for Priips?
DS: Italian issuers are closely following developments. Acepi believes that the key information document (KID) is paramount for investors' knowledge and comprehension of retail structured products. We are actively involved in the definition of risk and cost indicators within the KID as Acepi's secretary-general, Giovanna Zanotti, is a member of the expert commission advising Esma on the definition of relevant technical standards.
In each member state there is no single view on how the risk and cost indicators should be determined. Each market has different players with their own preferred approaches. Ultimately, our view is the same as that of Eusipa, which is in favour of a quantitative approach that takes into account the current risk measurement practices of financial institutions. But this is still an open discussion at the Esma level.

Do you believe that European structured products markets will become more harmonised in the coming years?
DS: We hope so. It's not an easy task and there is a long way to go before a true level playing field is established. The Capital Markets Union (CMU) action plan recently issued by the European Commission is good news though: retail financial services will be part of CMU activities going forward. When it comes to Mifid II, harmonisation will also be in the area of product intervention. This will be a powerful tool for regulators and is necessary for a co-ordinated approach across Europe. For example, if a German bank offers products in Italy but Consob wanted to use product intervention powers, it would have to talk with Bafin [the German financial regulator] as the primary regulator first, and with the European Banking Authority. A harmonised approach will make this co-ordination easier and prevent discrimination. However, there is an issue that needs to be addressed with regard to regulators' capabilities. Not all of them in Europe are ready for extensive product intervention; they will have to monitor and check so many products, and I don't know if they are all prepared.

Is there a place for complex structured products in Italy in the future?
DS: Of course. Given the current extraordinarily low yields, I expect more and more interest in structured products. Investment certificates in particular are perceived as very transparent in comparison to other products and are efficient, given the fact the payoff is well known from the beginning and scenarios are well defined in advance in every market condition. Investor appetite at present is mainly for autocallables, also known as express certificates.