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Milan, 17 January 2008

Dear Sirs,

We have reviewed the Call for Evidence "*Need for a coherent approach to product transparency and distribution requirements for "substitute" retail investment products*".

Our comments are set out below.

EXECUTIVE SUMMARY

- Whether the "*fragmented regulatory landscape* [affecting retail structured products] *leads to unacceptably high variations in the level of product disclosure and investor protection, depending on the regulatory status of the investment product*" is highly debatable, and we tend to believe it is not the case.

- Regulatory arbitrage among wrappers could be beneficial, if the investors are put in a position to evaluate all pros and cons of the different investment propositions.

- The key issue appears to be complexity, rather than arbitrage. Complexity should be acknowledge by the structured products industry, who should hold itself to higher standards in terms of disclosure, relationship with intermediaries and marketing rules.

- Intervention by the lawmaker in this respect appears, at this stage, difficult and potentially counter productive; the structured product industry should be given a chance to self regulate itself.

1. Issues

In providing our comments, we deem useful to follow the thread provided for by the Executive Summary to the Call for Evidence.

As clearly indicated therein, the key issue tackled by the Call for Evidence is whether the "*fragmented regulatory landscape* [affecting retail structured products] *leads to unacceptably high variations in the level of product disclosure and investor protection, depending on the regulatory status of the investment product*".

On the one hand, the issue is exceptionally well identified by the sentence above: it is not simply an issue of *disclosure* (i.e. whether, for instance, prospectus requirements are more stringent for funds rather than for certificates) but more generally of *investors protection* (spanning from good standing requirements, supervision on issuers, reporting requirements etc). On the other hand, it

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appears to us that the issue is – for the very reason above, i.e. its multi-faced nature – one which does not lend itself to an "objective" answer. There will always be significantly different views, for instance, as to the effectiveness of a given tool for investors' protection; there will always be very different views as to whether, for example, the current investors' protection system surrounding an insurance product is more effective or less effective than the system surrounding an asset management product.

As a consequence, whether the (inevitable, we believe) *variations in product disclosure and investor protection* are to be deemed "*unacceptably high*" will likely be, in our view, always highly debatable.

As a further consequence, we will not attempt, in this paper, to provide an answer, *per se*, to the key issue outlined above, but rather to provide our views on some of the key points for discussion, in order to hopefully contribute in a positive and constructive manner to the provision of a suitable regulatory environment for a sustainable growth of the retail structured product market.

2. Regulatory Arbitrage: Healthy or Harmful?

There is a key statement in the Executive Summary to the Call for Evidence. It says that "*Investment propositions should not be packaged so as to circumvent inconvenient disclosure and regulatory requirements for the product originator or intermediary*".

In our experience, this is debatable.

Regulatory arbitrage sometimes drives innovation, ultimately also providing benefits to the investors. Many years ago (1998), in Italy semi-active investment strategies started to be embedded in securities (i.e. certificates) and provided a much cheaper structured alternative to mutual funds. At that time, issuers and investment banks started to realise that active managers would have likely underperformed their benchmarks, and semi-active management looked like a cheaper and more transparent investment solution. The setting up of a certificates platform appeared to many much easier and cheaper than running a fund platform. This determined the birth of a market which was destined to become one of the largest structured products markets in Europe, notwithstanding a particularly strong domestic fund industry.

Many years later, the very same issuers of certificates and structured products, facing strongest than expected competition from the traditional fund industry, started, with some success, to "wrap" in mutual funds investment profiles which were traditionally embedded in certificates and structured products.

As a result of this and other "wrapping migrations", today one can find – as the Call for Evidence clearly acknowledges – very similar investment profiles embedded in a number of different wrappers: certificates, bonds, insurance policies, etc. Whether this is *per se* healthy or harmful is

debatable. We believe it could be potentially healthy, because if a given investment strategy could be wrapped in a way that it could be cheaper for the investor, then it should be. The issue is disclosure: the investor should be put in a position to evaluate pros and cons of different wrappers.

Hence, the issue tackled by the Call for Evidence: are there "*unacceptably high variations in the level of product disclosure and investor protection, depending on the regulatory status of the investment product*"? As discussed, we believe that, as much as product disclosure and investor protection levels might (and most likely will) differ, it would be extremely difficult, if not impossible, to factor in all elements of investor protection and come to an unequivocal answer to the question.

For this we believe it would me much more useful to focus initially on whether product disclosure and investor protection appears to be *per se* effective when dealing with structured products (however wrapped). With this analysis, we shall try to provide useful elements for an answer to the key question posed by the Call for Evidence (i.e. is there an unacceptable variation in investor protection, and if so is there a need for action, and at what level).

3. Disclosure

The Call for Evidence asks whether "*there is substance to the perception that difference in the regulation of product transparency or distribution may leave investors exposed to risks of overcharging or being sold unsuitable products*".

This is, of course, part of the issue outlined above on whether there are unacceptably high variations of investor protection. As discussed, we believe that the answer to this question is almost an impossible one to be given objectively, as the product disclosure is, we feel, at least largely comparable among products.

That said, we also believe that it is particularly true what the Call for Evidence says elsewhere, i.e. that "*retail investors (…) are faced with increasingly complex products and associated outcomes*".

This is, we believe, a statement which leads to one of the key issues faced today by the structured products industry. The structured product industry has brought innovation and potential outperformance to the market, but has also brought, with them, additional levels of complexity and additional associated risks.

Before (derivatives based) structured products were introduced in Italy around ten years ago, investors had basically a choice between shares, UCITS funds, corporate bonds and Government bonds.

We do not believe that one could even doubt that the complexity of the certificates introduced at the time was significantly higher than the complexity of the above mentioned products. Irrespective of

that, the regulatory framework for the relevant disclosure was (and still is) the same than that provided for more "traditional" products. As we will discuss under 4. below, such complexity was also – to our knowledge – not given any particular attention in the relationship between issuers and distributors.

Today, the situation is largely the same. We do not believe it could be put into question that, for instance, an "equity protection" certificate is more complex than a straight corporate bond. Similarly, we believe that a UCITS fund embedding a so called "CPPI" strategy is rather more complex than an actively managed one.

Let us be clear here. We do not believe that "more complex" means less transparent, let alone "worse" or "less convenient". Complexity does not imply a negative judgement. Complexity is a statement of fact based on a discretionary analysis. Complexity *can* lead to cheaper downside protection, outperformance, diversification, etc. However, complexity must also be suitably tackled.

This is, we believe, one of the key challenges of the structured products industry.

While we can anticipate that in our view it may prove extremely difficult, for the lawmaker, at national or European level, to provide a suitable tailored disclosure framework for retail structured products (mainly because the borders of such notion are extremely blurred, and keep moving), the industry players should recognise that the additional complexity they are bringing to the market is not *directly* taken into account by existing regulations, and that it is in their very interest to take action themselves to tackle such complexity efficiently.

Giving advice on how to provide more efficient disclosure for retail structured products is well beyond the scope of this paper. It has been suggested that it could take the form of risk indicators, additional key information documents, additional information in the documentation currently mandatorily required etc. As mentioned, we do not express any view on this specific point. However, to conclude, it appears rather clear to us that:

(i) derivative based structured products are generally more complex than "traditional" products;
(ii) such complexity is not taken into account by existing regulations on disclosure;
(iii) given the extremely blurred borders of the notion of structured products, it may prove very difficult for the lawmaker to tackle this complexity and the alleged regulatory arbitrage it could bring;
(iv) as a consequence, we do not believe there is currently a need for action on the lawmaker's part to further govern disclosure of retail structured products;
(v) however, we believe it would be in the self interest of the retail structured products industry, and with it in the interest of the retail investors, that the industry proactively takes into account the additional complexity of the products it is bringing to the market and provides additional suitable disclosure. The additional, *tailored* transparency that this exercise could bring would, in our view, much better position the retail structured product industry vis-à-vis its competition.

The above mentioned features of complexity also stray into issues concerning relationship with distributors.

4. Relationship with Distributors and Intermediaries in general

There is little doubt that recent European directives like MiFID and its implementing provisions will overall improve investors' protection in the context of the distribution of securities in general and of retail structured products in particular.

Similarly, however, there is little doubt that the peculiarities and the complexity of retail structured products are hardly taken into account by such directives. Indeed, the relevant provisions are "catch all", and (for instance) differences in the conduct of business rules imposed on intermediaries when placing, let's say, corporate bonds vis-à-vis when certificates, are little to none. This is, we believe, a situation which leads to another of the key issues faced by the industry.

In our experience, distribution networks still lack, very often, a sufficient understanding of retail structured products. Investment proposition that can be perceived as "standard" or "plain vanilla" by the issuers are often still rather obscure to the distribution channels. Tied agents still have, often, a rather partial understanding of the potential upsides and downsides of retail structured products. The payouts are broadly perceived, not fully understood. The appreciation of real risks and rewards is, we believe, often weak.

Hence, the issue: products whose disclosure can, as discussed, be improved, are also dealt with by intermediaries who do not appear to have yet enough understanding thereof.

We have, unfortunately, no hard evidence of the above; however, that is based on our experience of many years dealing with issuers and intermediaries.

Also in this respect, we do not believe that the immediate solution would be for the lawmaker (either at national or European level) to intervene. Again, the extremely blurred borders of the subject matter would risk making any intervention counter productive. However, we also believe that the retail structured products industry should tackle the issue by itself. Pointing at solutions is well beyond the scope of this paper, but a few of these are clearly in sight: joint training of the saleforces given by issuers and intermediaries; education seminars open to regulators and distributors; publications dedicated to intermediaries; etc etc.

However achieved, we believe that an improved understanding of retail structured products by distributors and intermediaries could only benefit the retail structured products industry as a whole.

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5. Advertising and Marketing

It may come at no surprise to you if our view on advertising and marketing is similar to our views on disclosure and relationship with the intermediaries.

Indeed, the extremely blurred notion of retail structured products would, in our view, make any specific regulation extremely difficult to be given a perimeter which would prevent dangerous circumvention and arbitrage. As a consequence, we believe that also in relation to advertising and marketing, the structured products industry should be given a chance to regulate itself, providing useful, efficient information rather than simply powerful marketing messages.

In our experience, this is sometimes done already by certain issuers. There is plenty of advertising material that we regularly review that we feel being extremely useful to the investor, because it actually illustrates in simple terms the real upside and downsides of the products.

Also in this respect, pointing at potential solutions is beyond the scope of these lines. Similarly though, these are clearly in sight: code of conducts, binding guidelines, etc.

6. Conclusions

We are not in a position to detect real and significant risk to the investors resulting from the (alleged) different level of disclosure or intermediary regulation embodied in EU financial services regulation.

Significant risks could however arise from complexity of products. Complexity can be found in all sort of wrappers. The “structured products industry”, however identified, should be given, in this respect, a chance to regulate itself. This should not, as discussed, be taken as a view that the status quo is ideal, rather the contrary. The “structured product industry” should acknowledge that its products (however wrapped) are by definition and as a matter of fact more complex that “traditional” products. As a consequence, such industry should hold itself – for its own sake, and for the sake of exploiting its potential of providing better results for the investors, and for the purpose of avoiding significant downside – to higher degree of disclosure, advertising standards and intermediaries’ education.

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Yours faithfully,