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Subject	**BELSIPA - FSMA Communication on Unfair Terms - concerns and proposal for a balanced alternative approach**
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Dear Sirs

We refer to the Communication of the FSMA of 30 January 2017 containing the position of the FSMA on the application of the Belgian rules on unfair contract terms to some clauses as part of the offer of investment instruments (the **FSMA Communication**).

On 10 May 2017, the Belgian Structured Investment Products Association (**BELSIPA**) had a meeting with the FSMA during which BELSIPA expressed its concerns in relation to the unbalanced outcome of the position of the FSMA in the FSMA Communication in the following situations:

- in case of an early redemption caused by a tax event affecting the deposit portion of the structured product, the issuer may need to pay an unreasonable compensation; and

- in case of a hedging disruption caused by a change in law, the issuer is not able to terminate the product.

The FSMA has invited BELSIPA to propose a balanced alternative to address these situations, corroborated by legal arguments and taking into account the rules on unfair contract terms in the Code on Economic Law (the **CEL**). We have been appointed as legal counsel to BELSIPA in this matter and in this capacity we address this letter to you.

1. “TAX EVENT” AFFECTING THE DEPOSIT PORTION OF THE STRUCTURED PRODUCT: ISSUE AND PROPOSED ALTERNATIVE

1.1 Context

When an issuer issues a capital-protected structured product, it will usually invest the subscription price in the following two products: (i) a safe investment product (for example, a zero coupon bond) that will ensure that the issuer can redeem the nominal (capital-protected) amount of the structured product at maturity; and (ii) a derivative instrument, which will create the exposure on the relevant underlying of the structured product.

If a tax event affects the deposit portion of the structured product (e.g. a new tax is due on the deposit portion at maturity)(a **Relevant Tax Event**), the issuer will not be able to ‘rebuild’ the capital of the structured product necessary to redeem the structured product at its nominal (capital-protected) value, on the maturity date. Indeed, the issuer would then itself be required to fund the ‘loss’ caused by the Relevant Tax Event. In order to avoid this situation, the issuer will seek to redeem the structured product upon the occurrence of the Relevant Tax Event, *i.e.* before the maturity date.

1.2 Relevant Tax Event & the FSMA Communication

The FSMA Communication takes the view, based on the CEL, that if an issuer terminates a capital-protected structured product before its maturity date, it must pay an early redemption amount equal to one of the following options:

- the highest of (i) the fair market value of the structured product and (ii) the capital protection amount (“highest of” option); or

- the investor is offered the choice between (i) an early redemption at fair market value and (ii) monetisation (the “choice” option).

In case of a Relevant Tax Event, both of these options create a significant financial burden for the issuer. Indeed, under the “highest of” option, the issuer may need to pay the capital protected amount, which has not yet been “rebuilt”. Under the “choice” option, the monetisation formula proposed by the FSMA does not take into account the detrimental effects of the tax event on the Issuer’s capability to rebuild and repay the capital protected amount at maturity.

2. BELSIPA’S BALANCED ALTERNATIVE: SUBSTITUTE PRODUCT OR AN EQUIVALENT CASH AMOUNT

Upon having consulted with its members, BELSIPA wants to propose, in the specific case of a Relevant Tax Event, an alternative approach regarding the early redemption of a structured product. BELSIPA proposes that in such circumstances, the issuer should:

- offer the investors the choice between (i) a “substitute” structured product, which comprises substantially identical characteristics as the original product, *i.e.* a product that reflects the same risk and pay-off structure and the same capital protected amount and maturity as the original structured product (a **Substitute Product**[1]); or (ii) redemption at fair market value and a *pro rata* refund of costs; or

[1] The substitute product, which logically is a product that is not affected by the impact of the tax event, should be economically substantially similar to the originally sold structured product. The new product would therefore maintain to the largest extent possible the essential characteristics of the original structured product, as these have been defined in the FSMA Communication, i.e.: (i) the yield (coupon structure); (ii) the underlying asset which is a determining factor for the yield; (iii) whether there is full or partial repayment of the investment at maturity (i.e. no capital protection, partial capital protection or full capital protection); (iv) the party or counterparty on which the investor is exposed to credit risk; and (v) the term of the structured product.

- in case the issuer cannot offer a Substitute Product[2], offer the investors an early redemption payment that is equal to the sum of (i) the fair market value of the structured product, (ii) a *pro rata* refund of the costs paid to the issuer; and (iii) the costs that an investor would bear if it would itself reinvest in a similar structured product (the **Alternative Redemption Amount**).

BELSIPA takes the view that this approach ensures a reasonable balance between the investors and the issuer. In this letter, we will argue that this alternative approach is in line with the unfair contract terms rules under the CEL.

3. LEGAL ANALYSIS: SUBSTITUTE PRODUCT OR CASH COMPENSATION

3.1 Introduction

We note that the FSMA bases its standpoint on early termination and compensation provisions in the FSMA Communication on Articles VI.8, 22° *juncto* VI.82 and VI.83, 10° of the CEL.

In this section, we will therefore first summarily discuss the concept of "compensation" under the Belgian unfair contract terms rules, as also interpreted by Belgian legal authors and by the European Court of Justice. We will then clarify that offering a consumer the choice between an early redemption at fair market value (increased with a *pro rata* refund of costs) or a Substitute Product or, where no Substitute Product is offered, a cash compensation equal to the Alternative Redemption Amount, complies with the provisions of the unfair contract term rules under the CEL, including the general principle under Article I.8, 22° of the CEL[3] (the **General Principle**).

3.2 Compensation under Article VI.83, 10° CEL

Pursuant to Article VI.83, 10° of the CEL[4], a contract term allowing the undertaking to unilaterally terminate a fixed-term contract without compensating, is an unfair term. However, this provision does not provide any criteria to determine what constitutes "compensation".

According to a number of legal authors, this article provides that a unilateral termination right for the undertaking is fair, given that compensation is paid [5]. They argue that only that *__a__* compensation is due and not that *__proper__* compensation is due [6]. The CEL does not impose a minimum level of compensation and such compensation is therefore subject only to general law restrictions. Under general contract law, the termination fee is the consideration of the termination right and the parties can freely decide on an appropriate amount. A number of authors further consider that the compensation cannot be a "symbolic" amount [7]. There is also a consensus that any compensation must be tested against the General Principle [8].

In line with this interpretation, the Commission on Unfair Terms has indicated that a termination fee cannot be significantly disproportional compared to a reasonable estimate of the damage incurred by the consumer,

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2 E.g. when it is technically impossible to create the Substitute Product or when the Substitute Product cannot be offered at a similar price as the existing one.

3 Article I.8, 22° of the CEL defines an unfair terms as *"any clause or condition in an agreement between an undertaking and a consumer that, by itself or together with one or more other clauses or conditions, creates a significant imbalance between the rights and obligations of the parties, to the detriment of the consumer*".

4 Article VI.83, 10° of the CEL provides that "*notwithstanding the application of article 1184 of the Belgian Civil Code, a contract term allowing the undertaking to unilaterally terminate a fixed-term contract without compensating the consumer, except in case of force majeure*"

5 R. STEENNOT and S. DEJONGHE, *Handboek consumentenbescherming en handelspraktijken*, Antwerpen, Intersentia, 2007, 144 (with reference to the unpublished doctoral thesis of I. DEMUYNCK).

6 See also: R. STEENNOT, "Art. 74.10 Wet betreffende marktpraktijken en consumentenbescherming" in *Handels- en economisch recht. Commentaar met overzicht van rechtspraak en rechtsleer*.

7 P. WOLFCARIUS, "La protection du consommateur en matière contractuelle: la réglementation des clauses abusives dans la nouvelle loi du 14 juillet 1991 sur les pratiques du commerce et l'information et la protection du consommateur" in *Pratiques du commerce et la protection et l'information du consommateur. Loi du 14-07-91*" ; P. CAMBIE, *Onrechtmatige bedingen*, Gent, Larcier, 2009, 311-312.

8 P. CAMBIE, *Onrechtmatige bedingen*, Gent, Larcier, 2009, 311-312; R. STEENNOT, "Art. 74.10 Wet betreffende marktpraktijken en consumentenbescherming" in *Handels- en economisch recht. Commentaar met overzicht van rechtspraak en rechtsleer*.

caused by a unilateral termination[9], and that a *"contractually agreed early termination fee must be a reasonable compensation of the damage incurred because of the call of the early termination right by the other party.*"[10].

On the basis what is set out above, we thus note that the offering of the choice between early redemption at fair market value (increased with a *pro rata* refund of costs) or Substitute Product or, where no Substitute Product is offered, the Alternative Redemption Amount would not be in breach of Article VI.83, 10° of the CEL. This compensation option should however also be tested against the General Principle. This is analysed below.

3.3 Early termination compensation and the General Principle

(a) Only a significant imbalance is prohibited

The purpose of the General Principle is to create a *legal* balance between the parties, *i.e.* a certain degree of equality of the contractual position and the mutual rights and obligations of the parties. The General Principle does not aim to prohibit a *factual* inequality, *i.e.* the fact that the mutual performances are not equal[11]. The General Principle also only prohibits contractual terms that create a significant imbalance between the parties. This means that the imbalance must be of a nature that amongst reasonable persons there can be no argument that the relevant term is unfair[12]. For that purpose, the term should create a manifest, evident and unacceptable imbalance. The court that must assess a term against the General Principle only has a *marginal* right of appreciation, meaning that it should take a conservative position.[13]

(b) ECJ case law

The General Principle is based on Article 3.1 of the Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (the **Unfair Terms Directive**). Even though the European Court of Justice (**ECJ**) confirms that the national courts must determine whether a contractual term satisfies the criteria of the General Principle[14], the ECJ has expressly held that "*the jurisdiction of the Court of Justice of the European Union extends to the interpretation of the concept of 'unfair term' ... and to the criteria which the national court may or must apply when examining a contractual term in the light of the provisions of that Directive*"[15]. Any interpretation of the General Principle under Belgian law will therefore also need to take into account the interpretation of this concept by the ECJ.

(i) Indicative black list under the Unfair Terms Directive

Although Article VI.83 of the CEL contains a list of 'per se' unfair terms (*i.e.* provisions that are always unfair), the list included as annex to the Unfair Terms Directive is to be considered as indicative[16]. As confirmed by the ECJ, this list may also be used by the national courts as a tool when assessing a term against the General Principle[17].

9 See page 28, available at: http://economie.fgov.be/nl/binaries/COB40_tcm325-282844.pdf.

10 See page 12, available at: http://economie.fgov.be/nl/binaries/COB13_tcm325-74393.pdf.

11 See for example P. CAMBIE, *Onrechtmatige bedingen*, Gent, Larcier, 2009, 167 and R. STEENNOT and S. DEJONGHE, *Handboek consumentenbescherming en handelspraktijken*, Antwerpen, Intersentia, 2007, 136.

12 CAMBIE, *Onrechtmatige bedingen*, Gent, Larcier, 2009, 167 and R. STEENNOT and S. DEJONGHE, *Handboek consumentenbescherming en handelspraktijken*, Antwerpen, Intersentia, 2007, 136.

13 L. CORNELIS, "Rechterlijke toetsing van onrechtmatige bedingen", in *Liber Amicorim Paul De Vroede*, Diegem, Kluwer, 1994, 332.

14 See for example C-237/02 (*Freiburger Kommunalbauten*) available at curia.europa.eu/juris/documents.jsf?num=C-237/02).

15 Case C-137/08 (*VB Pénzügyi Lízing Zrt. v Ferenc Schneider*) available at http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:62008CJ0137).

16 STEENNOT, R., Onrechtmatige bedingen, TPR 2015, afl. 3-4, 1521-1604, no. 190.

17 For example, see C-342/13 (*Katalyn Sebestyen*), available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=ecli:ECLI:EU:C:2014:1857)

Paragraph (d)[18] of this indicative black list confirms that the issuer may terminate the structured product, if it "*does not retain sums paid by the consumer*" but instead provides "*for the consumer to receive compensation of an equivalent amount*".

(ii) Non-mandatory rules of Belgian law

Belgian legal authors have long discussed whether the assessment of the unfair character of a term should also take into account rules of national law that are not of a mandatory nature, *i.e.* the rules that would have applied in the event that the parties would not have deviated therefrom by contract.[19] However, the ECJ has since confirmed that the concept of "significant imbalance" must be assessed by comparing the relevant contractual position against the applicable rules of national law that would apply in the absence of any agreement between the parties. If the provision places the consumer in a less favourable legal situation, this could indicate that there is a 'significant imbalance'[20].

In this case, it is however not clear against which non-mandatory rules of Belgian law the proposed early redemption approach should be tested[21]. Under common contract law, an agreement entered into for a fixed term (such as a structured product with a fixed termination date) can in principle not be terminated. This would then mean that any early termination right would create a "significant imbalance", which can of course not be defended. Indeed, under Belgian contract law, it is accepted that parties can agree to include a unilateral early termination provision in their agreement[22]. As indicated in the previous section, the right for an undertaking to terminate an agreement before its term is even implied in the indicative black list under the Unfair Terms Directive, and the FSMA Communication also accepts this principle.

In our view, it is clear that the compensation mechanism proposed in this letter should thus be tested against the rules of common contract law applicable to the concept of unilateral termination (*eenzijdige opzegging*) [23]. We must however note that Belgian contract law does not require that a compensation (*schadevergoeding*) is paid in case of an early termination pursuant to a unilateral termination. Hence, this provides little guidance.

Nevertheless, Article VI.83, 10° of the CEL expressly refers to a "compensation" (*schadeloosstelling / dédommagement*) that is due by the undertaking, if it unilaterally terminates the agreement. Even though the proposed early termination mechanism is not triggered by a breach of contract, we hold that it is reasonable (taking into account the ECJ case law discussed above) to test the proposed compensation mechanism against the "due compensation" rules under common contract law. Such rules aim to restore the party incurring damage in the hypothetical position it would be in, if its counterparty would have duly performed

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18 Paragraph (d) provides: "*(d) permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract"*

19 R. STEENNOT., "Onrechtmatige bedingen", TPR 2015, afl. 3-4, 1521-1604, no. 191.

20 See Case C-415/11 (*Mohammed Aziz*, available at http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:62011CJ0415): "*the concept of 'significant imbalance' to the detriment of the consumer must be assessed in the light of an analysis of the rules of national law applicable in the absence of any agreement between the parties, in order to determine whether, and if so to what extent, the contract places the consumer in a less favourable legal situation than that provided for by the national law in force. To that end, an assessment of the legal situation of that consumer having regard to the means at his disposal, under national law, to prevent continued use of unfair terms, should also be carried out*" and Case C-226/12 (*Constructora Principada*, available at http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:62012CJ0226 : "*... a comparative analysis will enable the national court to evaluate whether and, as the case may be, to what extent, the contract places the consumer in a legal situation less favourable than that provided for by the national law in force*"

21 The relevant ECJ's case law in *Constructora Principada* related to provisions where a consumer purchased a real property and was held to pay a capital gains tax that under Spanish law is in principle to be paid by the undertaking, and where the consumer was asked to pay the connection to various utilities, whereas Spanish law provides that a real property must be sold in habitable state.

22 See, for example: S. STIJNS, *De Gerechtelijke en de buitengerechtelijke ontbinding van overeenkomsten*, Maklu, 1994, no. 18; L. CORNELIS, *Algemene theorie van de verbintenis*, Intersentia, 2000, no. 633

23 It is important to distinguish the legal concept of unilateral termination (*eenzijdige opzegging*) from the concept of rescission (*ontbinding*) in the meaning of Article 1184 of the Civil Code. The latter implies that a breach of contract has occurred, whereas a unilateral termination right may be exercised even if this is not the case. Given that the proposed mechanism is indeed based on the concept of a unilateral redemption right (outside of the hypothesis of a breach of contract), the consequences of a rescission are in our view not relevant for the current analysis.

its obligation, which in our view is aligned to the concept of *schadeloosstelling*. In the section below, we will therefore summarily discuss these principles of "due compensation".

(iii) "Due compensation" under Belgian contract law

General contract law rules on due compensation aim to restore the party incurring damage in the hypothetical position it would be in, if its counterparty would have duly performed its obligations under the contractual agreement[24], and provide for the following principles (without being exhaustive):

- compensation *in natura* (i.e. the party not performing an obligation must perform it all the same) has priority over the payment of damages, as it serves best to compensate the party incurring damage and to meet the purpose of the contract. Only if such compensation *in natura* is not possible or would constitute an abuse of right, is it allowed to compensate the other party by payment of damages[25]; and

- the party incurring damages must be *fully* compensated, i.e. for losses incurred, profits lost and any reasonable costs incurred by that party and caused by the event of default[26];

On the basis what is set out above, we argue that a compensation mechanism must ensure that the consumer will not be "worse off" than it would have been, if it would have been able to claim for damages under Belgian common contract law. If this is the case, this satisfies the conditions under the General Principle. This is further developed in section 3.4 below.

(c) Article VI.82 of the CEL

The General Principe as defined in Article I.8, 22° of the CEL must also be read together with Article VI.82 of the CEL, which sets out the criteria that must be taken into account when applying the General Principle to a concrete contract term[27]: (i) the nature of the goods and services for which the contract was concluded; (ii) the circumstances attending the conclusion of the contract; and (iii) all the other terms of the contract or of another contract on which it is dependent.

Items (ii) and (iii) relate to concrete circumstances, and are hence not further discussed. We note however that item (i) above clearly indicates that any assessment against the General Principle must take into account the <u>nature</u> of the structured products.

Any assessment of the offering of the choice between early redemption at fair market value (increased with a *pro rata* refund of costs) or Substitute Product or, where no Substitute Product is offered, the Alternative Redemption Amount, must thus take into account that an investor who subscribes to a structured product, will in principle have accepted that it invests in an instrument with an uncertain *yield* (as this will depend on the value of the underlying, calculated in accordance with complex mathematical calculations), even if it enjoys "capital protection". In other words: the investor makes the conscious choice of investing in an instrument that may not pay out any yield, as compared to (for example) a more secure investment such as a

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24 S. STIJNS, *Verbintenissenrecht*, Brugge, Die Keure, 2005, 178; P. VAN OMMESLAGHE, *Droit des obligations. II. Source des obligations*, Brussel, Bruylant, 2010, 1595.

25 Following P. WÉRY, a distinction is often made between the performance *in natura* of a party's obligations (i.e. in which case the other party only has to prove the existence of said obligation) and compensation of the damage incurred by a party due to an event of default on behalf of its counterparty, be it compensation *in natura* or by paying damages (i.e. in which case the event of default must be proved). The Belgian Supreme Court (*Hof van Cassatie*/*Court de Cassation*) has repeatedly stated that the performance *in natura* has priority as long as it is reasonably possible. P. VAN OMMESLAGHE in our view rightfully states that this priority applies as well in respect of the compensation *in natura* and by paying damages. The reasoning is in any case the same, i.e. by performing the obligation *in natura*, the party incurring damage is in principle best restored in the position it would have been in without the event of default (i.e. damages are only an imperfect substitution for the impossibility of such performance *in natura*). See P. WÉRY, *L'exécution forcée en nature des obligations contractuelles non pecuniaire*, Brussel, Kluwer, 1993, 135-193 ; P. VAN OMMESLAGHE, *Droit des obligations. II. Source des obligations*, Brussel, Bruylant, 2010, 1600.

26 See article 1149 of the Belgian Civil Code.

27 R. STEENNOT, "Commentaar bij Art. VI.82 WER", *Artikelswijze Commentaar*, Augustus 2016, No. 1.

government bond or a term savings account. The nature of structured products should indeed be taken into account when assessing any other terms of the agreement against the General Principle.

3.4 Early termination of a structured note: "due compensation" under common contract law

Under a structured product with capital protection, the consumer only has a contractual right to receive the full nominal amount of the structured product <u>at maturity</u>. Upon an early termination, the "damage" incurred by the consumer is therefore not the *nominal amount of the structured product*, but instead *the right to receive the nominal amount at maturity* increased with *the loss of potential to receive interests under the structured product*. The consumer's compensation should thus cover the latter, but not the former.

As the structured product is terminated early, the consumer cannot be compensated "*in natura*". Therefore, the consumer must be put into a position so that it is restored in the hypothetical position it would be in, if the issuer would have duly performed its obligations under the structured product. In other words, the consumer must receive a certain compensation <u>today</u>, so that <u>at maturity</u> it will be in the possession of the amount it would have received, had the instrument not been terminated.

This is best demonstrated by an example. Assume a structured product with capital protected nominal amount of 100 and a maturity of 10 years, which is terminated after five years. If the investor receives the full (capital protected) nominal amount of the structured product at this early redemption date, the compensation actually exceeds the actual value of the structured product today. According to the compensation principles under contract law, this would in fact constitute an *over*compensation Indeed, one should take into account that the value of 100 today is not equal to the value of 100 at the maturity date, five years in the future. As explained above, the investor's loss is in fact "100 at the maturity date". If this amount of 100 is instead paid out today, it must be discounted to its present value.

This concept is also expressly recognised under Belgian contract law, in the concept of "benefit allocation" (*voordeelstoerekening*). Pursuant to this principle, if a breach of contract not only entails a disadvantage for the wronged party but also certain benefits, the latter must be taken into account by the court when deciding on the damages[28]. The court must compare the wronged party's current situation with its future situation (*nakomingstoestand*). Indeed, when deciding on damages, the court must ensure that the wronged party will not be in a situation where it is "better off" than if the original agreement would have run its normal course[29]. In the hypothesis above, it is clear that an investor who receives 100 at the early redemption date, can reinvest such amount at market rates, and will at the original maturity date possess an amount exceeding the 100 it would have originally received. If the investor would receive 100 five years before the original maturity date, this constitutes an over-compensation. Of course, one should take into account that a reinvestment may not always be possible and may lead to the investor incurring certain costs. This is however foreseen and addressed, in the compensation mechanism discussed in this letter.

In the following section, we will further specify (and quantify) what this *right to receive payment on maturity* is worth, as at the date of the early termination of the structured product.

3.5 Substitute Product / Alternative Redemption Amount

BELSIPA proposes that in the structured products' programme's terms and conditions, the issuer will clearly define the concept of Relevant Tax Event. Upon the occurrence of a Relevant Tax Event, the issuer will offer the consumer the choice between early redemption at fair market value (increased with a *pro rata* refund of costs) or Substitute Product or, where no Substitute Product can be offered, the Alternative Redemption Amount.

(a) Substitute Product

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28 See, for example, B. VERKEMPINCK, *Schadevergoeding wegens wanprestatie in Europees perspectief,* Die Keure, 2017, no. 452; J. BACK, *Restiutie na vernietiging of ontbinding van overeenkomsten*, Intersentia, 2012, no.504-505.

29 B. VERKEMPINCK, *Schadevergoeding wegens wanprestatie in Europees perspectief,* Die Keure, 2017, no. 214.

Where the consumer is offered the choice between early redemption at fair market value (increased with a *pro rata* refund of costs) or a Substitute Product, it is clear that the investor will, in principle by definition, at the maturity date of the 'original' structured product, be in a position that is substantially identical to its position under such 'original' structured product.

In our view, it is therefore clear that the offering of a Substitute Product (without any additional costs) complies with the unfair contract terms rules under the CEL.

(b) Alternative Redemption Amount

In certain cases, it may not be possible for the issuer to offer a Substitute Product to the investor. In such case the consumer must receive compensation in cash. In line with the principles discussed above, if this compensation allows the investor to invest in a financial instrument that provides for a similar/identical pay-off and risk structure and the same capital protection amount at maturity, this compensation will in our view be in line with the "due compensation" principles under common contract law.

We argue that this condition is satisfied if the investor would receive a cash amount equal to the sum of: (i) the fair market value of the structured product; (ii) the substitution costs; and (iii) a *pro rata* refund of the costs paid by the investor to the issuer when subscribing for the original instrument:

- ***Fair market value of the structured product***

  The fair market value of the structured product will be equal to the sum of the fair market value of the deposit component and the fair market value of the derivative component of the structured product (whereby we note that the FSMA itself also uses these concepts in the monetisation formula in the FSMA Communication). To guarantee that the value is fair, the terms and conditions can for example include that the calculations made by the calculation agent are validated by an independent third party (such as another market counterparty or a company specialised in valuation).

- ***Substitution costs***

  In theory, if the investor would receive a cash amount equal to the market value of the structured product, it should be able to apply such cash amount in subscribing for an identical instrument. This is however not the case, given that the price at which an issuer offers structured products to consumers (and hence the price at which consumers can subscribe for structured products), differs from their market value after being issued. Therefore, any Alternative Redemption Amount should also include the 'substitution costs', *i.e.* the difference between the offer price at which the consumer could subscribe for a (similar) structured product and the market value of the terminated structured product.

- ***Pro rata refund of costs paid***

  This component refers to the concept of *pro rata* costs refund as included in the FSMA Communication.

The sum of these amounts allows the investor to itself subscribe for a new structured product that is similar to the terminated instrument, and hence complies with the "due compensation" principles under common contract law.

3.6 Conclusion

In our view, if a structured products programme provides for an early termination provision upon a Relevant Tax Event, whereby the compensation would be the offering of the choice between early redemption at fair market value (increased with a *pro rata* refund of costs) or Substitute Product or, where no Substitute

Product is offered, an Alternative Redemption Amount, this cannot be considered to constitute an unfair term:

- The proposed compensation is in line with the text of Article VI.83, 10° of the CEL, as interpreted by Belgian legal authors;
- The proposed compensation is clearly in line with the common contract law principles regarding the due compensation pursuant to wrongful termination of a fixed term contract. The proposed compensation thus does not create a 'significant imbalance', and does not constitute an 'unfair term'.

4. THE POSSIBILITY TO EARLY REDEEM THE STRUCTURED PRODUCT IN CASE OF A HEDGING DISRUPTION CAUSED BY A CHANGE IN LAW

4.1 FSMA Communication and hedging events

As the FSMA is aware, an issuer of structured products will always hedge its position on the "underlying" of the structured product (e.g. in case of an equity-linked structured product, it will have completely hedged the position taken on the equity exposure towards the holder of the instrument).

In the FSMA Communication, the FSMA takes the view that a 'hedging disruption' or 'increased costs of hedging' event is intrinsic to the issuer's activity and cannot qualify as a force majeure event or as an "*event which significantly alters the economics of the contract as initially agreed between the parties and for which the issuer is not accountable, even if it does not make the performance of the contract definitively impossible*" (further referred to as a **Significant Change**)". Hence, such event cannot trigger an early redemption of the investment instrument.

4.2 BELSIPA position

The FSMA Communication accepts that cases of illegality[30], which include events such as a 'change in law', in principle *can* constitute a force majeure event or a Significant Change. However, where a 'hedging event' is triggered by a 'change in law', this does not apply.

BELSIPA takes the view that where a "hedging disruption" or an "increased cost of hedging" is the consequence of a change in law, it should be possible for the issuer the terminate the structured product. In this letter, we will argue that BELSIPA's position in fact complies with the relevant provisions of the CEL (*i.e.* Article VI.83, 10° of the CEL or the General Principle).

As a general comment, we already note that it is unlikely that a "hedging disruption" which is caused by a change of law would be "intrinsic" to the issuer's activities. The activity of entering into hedging transaction may indeed be intrinsic to the issuer's activities, but if an external event such as a change of law would disrupt this, this is clearly an external event that is not attributable to the issuer[31].

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[30] To illustrate the foregoing provisions we hereby give three realistic examples of hedging disruption which impair the issuer to continue the transaction due to regulatory injunction: (i) Change of regulation prohibiting specific asset categories (for example, under the US Volcker Rule, holding significant ownership interests in covered funds became prohibited for banking entities and any therefore structured products issued by a banking entity that comprised the performance of one or several covered funds, would become technically un-hedgable); (ii) International conflict/tension resulting in prohibiting specific asset geography (for example, an international ban affecting one or several countries which would prohibit banks from holding of and/or transacting in assets from such countries and/or in the currencies of such countries); (iii) National/international law restricting/prohibiting specific assets in relation with unethical activity (for example, a law or executive order prohibiting holding of and/or transacting in assets that may relate to weapons production, environmental abuse, child work abuse, etc.).

[31] This analysis is mainly relevant for structured products issued by credit institutions. We have not considered the situation of structured products issued by special purpose vehicles (for example, whether a change in law affecting the hedging position could constitute a "force majeure" event).

4.3 Article VI.83, 10° of the CEL: prohibition to terminate a fixed term contract without due compensation

Article VI.83, 10° of the CEL[32] does not require that an early termination by the undertaking can only be triggered by force majeure or a Significant Change. Indeed, this article (taken by itself) instead implies that an undertaking can at any time unilaterally terminate an agreement entered into for a definite term, subject only to paying a "compensation" for the consumer. This is confirmed by several legal authors[33]. In other words, it can be held that pursuant to Article VI.83, 10° of the CEL, an issuer is allowed to terminate a structured product upon the occurrence of a "hedging disruption", if such termination right also complies the General Principle.

For the avoidance of doubt, BELSIPA does not have an issue with the FSMA's position on the calculation of the early redemption amount in the context of the Hedging Termination Right, and accepts that any compensation to the consumer must comply with the FSMA Communication.

4.4 Early termination upon a "hedging disruption" and the General Principle

We argue that the right to terminate the structured product prior to maturity pursuant to the occurrence of a "hedging disruption" caused by a "change of law" (a **Hedging Termination Right**), in principle does not create a "significant imbalance" within the meaning of the General Principle.

(a) Hedging Termination Right is not discretionary

If the Hedging Termination Right is carefully drafted in the terms and conditions (ensuring that the issuer does not have a large degree of discretion in assessing whether or not a "change of law" triggers a "hedging disruption" or in assessing when a "hedging disruption" has taken place), it will only be triggered upon the occurrence of certain "external" events that cannot be attributable to the issuer. In such case, the Hedging Termination Right will comply with the guidance of the Commission for Unfair Terms'[34].

(b) Criteria under Article VI.82 of the CEL: "nature of the product"

Any analysis of the Hedging Termination Right will also need to take into account the fact that this relates to a structured product. The considerations set out in section 3.3(c) therefore also apply (*mutatis mutandis*) to this question.

(c) Indicative "black list" annexed to the Unfair Terms Directive

The indicative list included in the annex to the Unfair Terms Directive does not contain an express reference to terms relating to the early termination of an agreement entered into for a fixed term, by the undertaking. However, paragraph (d)[35] implies that the seller may be allowed to 'cancel' an agreement, if the consumer receives a compensation. It does not mention that such cancellation must be triggered by a force majeure or a Significant Change. The second part of paragraph (f)[36] implies that a seller may dissolve a contract with a

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32 We note that this provision is not included in the indicative 'black list" annexed to the Unfair Terms Directive.

33 See for example: (i) STEENNOT: "*Article VI.83, 10° CEL prohibits the undertaking to have the right to unilaterally terminate a fixed-term agreement without paying a compensation to the consumer*" (STEENNOT, R., Onrechtmatige bedingen, TPR 2015, afl. 3-4, 1521-1604, no. 210); or (ii) CAMBIE "*attempts to prevent that the seller can unilaterally cancel the agreement without indemnifying the consumer for such unilateral termination" (*see CAMBIE, *Onrechtmatige bedingen*, Gent, Larcier, 2009, 311)

34 The Commission for Unfair Terms has stated that "*a term that gives a discretionary right to fully and without restrictions unilaterally (and immediately) terminate an agreement, creates a significant imbalance and is hence an unfair term*" (Advice on the general conditions of social networking sites, page 35). Even though this position was taken in respect of agreements entered into for an undetermined duration, it is in our view also relevant for agreements entered into for a definite duration, as the Commission for Unfair Terms clearly takes a negative view on terms that grant very broad, discretionary rights to the undertaking.

35 *(d) permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract*

36 *(f) authorizing the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer, or permitting the seller or supplier to retain the sums paid for services not yet supplied by him where it is the seller or supplier himself who dissolves the contract*

consumer (although not on a discretionary basis, unless the consumer has the same right, cf. the first part of this paragraph) if it does not retain any sums it has received where it has not yet supplied the corresponding services. These two paragraphs imply that an early termination of an agreement by the undertaking is possible, subject to the consumer being indemnified.

(d) Comparison with non-mandatory rules of national law

We refer to the analysis set out in section 3.3(b)(ii) above.

4.5 Conclusion

Article VI.83, 10° of the CEL does not prohibit a Hedging Termination Right, subject to a due compensation being paid by the issuer.

A Hedging Termination Right is also not prohibited by the General Principle:

- This is in particular the case if the terms and conditions do not provide for a discretionary right of the issuer, but instead ensure that this right is triggered by an external event (*i.e.* a change in law).

- This type of early termination can be defended on the basis of the criteria set forth under Article VI.82 of the CEL, in particular the “nature” of the structured product

- The indicative “black list” does not to prohibit this type of early termination and even implies that a cancellation by the undertaking is indeed possible, in principle.

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