

October 18, 2013

Secretariat of the Joint Forum (BCBS Secretariat)
Joint Forum c/o Bank of International Settlements
CH-4002 Basel
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By EMAIL

Dear Sir/Madam

JAC Response to the Joint Forum Consultative Document: Point of Sale disclosure in the insurance, banking and securities sector (the “Response”)

This paper responds to the Joint Forum Consultative Document: Point of Sale disclosure in the insurance, banking and securities sector (the “Consultation”) which has been prepared in order to identify and assess differences and gaps in regulatory approaches to Point of Sale (“POS”) disclosure in relation to investment or savings products in the insurance, banking and securities sectors. The Joint Associations Committee on Retail Structured Products (the “JAC”)¹ welcomes the opportunity to comment on the recommendations and issues set out in the Consultation. We agree with and fully support the objective of enhancing consumer protection by providing guidance to regulators/supervisors that are considering developing or reviewing their POS disclosure requirements.

The members of the JAC comprise a large proportion of the major firms involved in the creation, manufacturing and distribution within the European Union of retail structured products². The Consultation covers and the JAC focuses on the structured products market, the current POS disclosure framework, regulatory drivers and regulatory effectiveness. The JAC was formed to address the issues which arise out of the retail distribution of structured returns and for most members this issue arises predominantly in the field of retail distribution of structured securities. Many members also distribute structured returns through structured funds and almost all provide structures to insurance companies and other investors which may be repackaged into retail products. The JAC, therefore, does not focus exclusively on one product type.

¹ The JAC is sponsored by multiple associations with an interest in retail products. In the first instance, queries may be addressed to ftaylor@isda.org.

² This paper represents the views of members of the JAC with regard to the regulation of retail structured products in the UK and EU. As such, this paper should not be taken to represent views regarding retail structured products in any other jurisdiction.

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However, it is felt that it is most useful for the JAC to provide information as regards securities. This response, therefore, principally focuses on the issues which arise out of the sale of structured securities to retail investors. Structured securities in this context are primarily in the form of debt securities, certificates and warrants that combine various cash assets and/or derivatives to provide a particular risk/reward profile that allows investors access to broader investment opportunities.

The return on structured securities is usually derived from the performance of one or more underlying assets. The JAC has itself produced the July 2007 Provider-Distributor Principles (Annex 1) and the July 2008 Distributor-Investor Principles (Annex 2) (the “JAC Principles”) applicable to retail structured products on a global basis.

The current EU Commission initiative on Packaged Retail Investment Products (“PRIIPS”) is aimed at achieving consistent and effective standard for investor protection across a wide range of investment and to ensure that there is a level-playing field for distributors and providers of investment products. As there is a significant degree of overlap between the issues raised in the Consultation and those raised in the PRIIPS initiative the JAC members suggest that regulators and supervisors may wish to delay any action as a result of the Consultation until the PRIIPS regulation is in force and its implications can be seen in practice.

The JAC wholly supports the objectives of the Joint Forum in providing regulators and supervisors with a set of recommendations aimed at assisting them in considering, developing or modifying POS disclosure regulations. We believe that it is essential for the success of retail financial services worldwide that investors have access to high quality products which meet their investment needs and which are marketed in such a way that can be easily understood and compared. We support the introduction of global principles, since it is appropriate that regulators and supervisors maintain high standards of market practice, and the maintenance of such high standards improves consumer confidence.

We believe that the primary objectives of the process should be:

- to ensure that consumers are provided with sufficient information about financial products to enable them to evaluate those products and to determine what their risk exposure and expectation of investment return should be; and
- to ensure that those selling financial products to consumers should be subject to common regulatory driven standards regardless of the nature of the product sold.

We acknowledge that these recommendations are intended to assist regulators and supervisors in considering, developing or modifying POS disclosure regulations, but we would urge the Joint Forum to carry out further work in order to provide further clarity around roles and responsibilities of different parties within the distribution chain, primarily product providers and distributors and how POS disclosure regulations are intended to operate in practice.

We agree with the Joint Forum that good POS disclosure is only one aspect of a strong consumer protection regime and it should not relieve financial services salespersons of their other sales practice obligations or result in a “caveat emptor” oversight standard in which the appropriateness or suitability of a salesperson’s recommendation is rendered less important or relevant.

This Response provides detailed comments on a number of issues raised in the Consultation, with the hope that this will be helpful in informing the development of regulatory tools and ensure the best possible outcome for both consumers and the retail structured product market. We would be very happy to provide further input on any of the below points if that would be of assistance and would welcome the opportunity to engage further with the Joint Forum on this topic.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Timothy R Hailes', with a large, sweeping flourish extending to the right.

Mr. Alderman Timothy R Hailes, JP

Chairman – Joint Associations Committee on Retail Structured Products

JAC contact - Fiona Taylor, ISDA
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Recommendation 1: Jurisdictions should consider implementing a concise written or electronic POS disclosure document, for the product sample identified in this report, taking into account the jurisdiction's regulatory regime.

Recommendation 2: The POS disclosure document should be provided to consumers free of charge, before the time of purchase.

Recommendation 3: A jurisdiction considering POS disclosure should consider requiring that a POS disclosure document disclose key characteristics including costs, risks and financial benefits or other features of a given product and any underlying or referenced assets, investments or indices, irrespective of the financial sector from which the products are derived.

1.1 Scope of Consultation

Following the IOSCO Report "Principle on Point of Sale Disclosure" (February 2011), it was put forward that further work should be undertaken in relation to POS disclosure for products similar to collective investment schemes ("CIS").

The JAC members note that the Joint Forum has responded to this request by selecting a sample of products from each of the insurance, banking and securities sectors that, in its opinion, and broadly confirmed by the Consultation participants, compete with CIS for consumer savings or investments. The sample included: structured notes, structured deposits, unit-linked life insurance, variable annuities and indexed annuities. The JAC members agree that there should be a level playing field in relation to the nature of the products covered whilst also allowing for differences in the product wrapper to ensure flexibility where there are benefits for the underlying investor.

1.2 Client Categorisation

We note that the Consultation is applicable to sales to "consumers" but that there is no clear definition of "consumer". It is noted in the Consultation that in many jurisdictions the term "consumer" broadly encompasses individuals and, in some cases, small or medium sized business consumers. For the purposes of the Consultation the term "consumer" is used as an overarching term to include different terms used to refer to the retail population who buys or may buy products covered in the sample, including retail investors, retail customers and clients, retail policyholders, and retail account holders.

The JAC members believe it would be helpful to develop common global standards on client categorisation and to harmonise and provide a clear definition of the scope and nature of retail investor.

The JAC members would support a more standardised approach which distinguishes between "true" retail investors (e.g. clients of high street retail banks), and sophisticated and/or high net worth individuals (e.g. clients of private wealth banks), and which provides appropriate and proportionate levels of protection for each. Individual retail investors will vary greatly in their level of understanding of markets, and there will be similar variations between individual non-retail investor. Some retail investors will have a high degree of sophistication, experience, knowledge and capability, whereas others will have a much lower degree. Investors of a similar level of actual sophistication of capability should afford a similar, appropriate minimum level of protection. The JAC members strongly believe that the Consultation's recommendations should only apply to retail investors and should not extend to non-retail investors and the wholesale market.

However, irrespective of the classification of the client, nothing should detract from the responsibility of all investors, once they have received suitable advice and appropriate disclosure from a distributor or have chosen not to seek advice, to evaluate any information provided to them, educate themselves about the products they undertake and ultimately take responsibility for the risks of their choices.

1.3 Disclosure of fees and costs

The JAC members fully support the view that investors should be informed of the existence of fees, costs, commissions, discounts, and any other sums paid to the distributor for acting as such over the life of that product. Distributors should have internal processes and controls in place to consider the appropriateness of fees and other incentives given local market conditions and regulatory requirements. A distributor's internal processes and controls should also consider the level of disclosure regarding such fees and costs in light of their possible impact on the secondary market of the structured product concerned.

If a structured product is packaged as an offer of a service for a fee and the fees charged for the provision of that service are generally absolute and not performance related, the investor needs to know the fees charged in order to work out what his investment return is likely to be. The issue for the investor is whether the price he is being charged for the return is cheap or expensive and he should be able to establish this by looking across the range of competing products and structures, if the fees for the service are disclosed. The JAC members agree that the ability to compare different products and to understand the costs and fees of the products is a very important element in the investment decision of an investor.

However, the fact that one institution has a different trading strategy from another, with a higher toleration of risk and therefore a higher prospect of return, is irrelevant to an investor choosing between the products of the two institutions. The key point being that the investor is unaffected by losses made on the hedge, in the same way and for the same reason that he does not participate in the gains. Consequently, disclosure of profit margins or losses on hedging is irrelevant.

Reflecting the assumption of risk by the product provider, and the value add provided by the product provider, a retail structured product will typically include an embedded margin. This embedded margin on a retail structured product is not, therefore, the same as the profit to be made on a retail structured product because it is at risk, and may not be reached over the life of the product, being dependent on the characteristics of the product, hedging and its pricing model. In addition, the risk/reward to the investor is not affected by whether or not the product provider reaches, exceeds or falls short of the embedded margin (including where the provider ultimately suffers an economic loss on the product). The margin made (or lost) on a retail structured product is not comparable to, for example, an asset management fee in the context of a CIS as such a fee is deducted from the net asset value of the product by way of fixed percentage cost and regardless of investment performance.

In relation to a defined return product (i.e. a product where the pay-off is described at the outset by reference to a specific asset, index or other value), an investor will receive at the pre-defined times (e.g. coupon payment dates, maturity) what the product documentation states the return will be. These are marketed as "hold to maturity" products. As an accommodation to the needs of consumers, there may be a secondary market in the product.

The basis on which the secondary market is provided should be made clear to investors: prior to the maturity of the product, the price an investor may receive for their product on the secondary market may not be the price the investor paid for the product (or price payable at maturity). It is, therefore, essential to ensure that investors understand the secondary market.

The assumption of risk and accordingly reward for the product provider is intrinsic to the delivery of retail structured products and does not represent or give rise to consumer detriment provided that clear and broad disclosure is made as to the existence of the embedded product provider margin and its potential impact on secondary market pricing.

In addition, the overall price of a retail structured product should be a factor that is taken into account by distributors in their product selection and point of sale responsibilities when considering whether and how a product should be made available to their investor clients. It is important to delineate the responsibilities of a product provider and distributor when considering the appropriateness of the overall charge for a retail structured product.

Recommendation 4: The POS disclosure document should be clear, fair, not misleading and written in a plain language designed to be understandable by the consumer.

- 2.1 The JAC members agree with the overall aim of enhancing the transparency of retail structured products in order to seek to ensure that retail investors have a greater understanding of complex structured products and the risks associated with each product. The JAC members agree that information about financial products in the POS disclosure document should be clear, fair and not misleading.
- 2.2 However, the JAC members wish to re-iterate that it is the distributor who has the direct interface with the individual investor and it is the responsibility of the distributor to ensure that the investor has all the requisite information in order to make an informed decision. The product provider is not likely to have sufficient information in order to make disclosures which are consistent with the investors' capacity to understand such disclosures.
- 2.3 In addition, we would point out in relation to the reference to plain language designed to be understandable by the consumer, that in many instances the product provided to an end-investor is necessarily complex and the key disclosures required are not necessarily a simplification of a complex strategy but a clear outline in plain language of the risks inherent in the product.

Recommendation 5: The POS disclosures should include the same type of information to facilitate comparison of competing products.

- 3.1 Whilst it may be helpful to have a POS disclosure document to compare different product wrappers offering the same economic exposure, we would urge regulators to acknowledge that different wrappers provide investors with choice and may be subject to different tax treatment, thereby making a meaningful comparison difficult. The overriding principle should be to ensure that any information included in the POS disclosure document is meaningful in the context of the product, even if this may be at the expense of absolute comparability across products.

3.2 Any framework will need to reflect the basic division of CIS and certain products which are akin to CIS into two distinct structural types as follows:

- CIS: CIS are products which entitle their owner to the return on a pool of assets in which his initial contribution has been invested less fees. CIS are variable return investments.
- Contractual packaged retail investment products (PRIPs): Contractual PRIPs are products which entitle their owner to an amount of money calculated by reference to a formula. Contractual PRIPs include deposits, structured bonds, warrants and certificates, annuities and some life insurance policies. Contractual PRIPs are defined return investments.

3.3 We believe that this division will be required to be embedded in any regime, since it drives a number of important distinctions between the regulatory disclosures which are appropriate to the type of product concerned. This will be essential in order to ensure customer understanding of differing product types and to ensure that customer benefit is maximised.

3.4 The JAC members strongly agree that as outlined in Principle 4 of the G20 High-Level Principles on Financial Consumer Protection the requirement for financial services providers and distributors to provide POS disclosure documents should be balanced against the requirement for consumers to be made aware of the importance of providing financial services providers with relevant, accurate and available information.

Recommendation 6: The POS disclosures should be concise, set out key information about a product and may include, as appropriate, links or refer to other information. It should make clear that it does not provide exhaustive information.

4.1 The JAC members take the view that the following points should be considered when deciding what information should be included in a POS disclosure document:

- Objective parameters to allow investment product providers to be confident that they have satisfied their obligations;
- Clear scope of what is, and is not, considered "key information", including clarification as to whether product obligor disclosure is required and if so, to what extent;
- If the investment product provider is to be liable for the POS disclosure document, content requirements must be limited to information within the knowledge and control of the investment product provider;
- Development of a glossary would be beneficial to both investors and the industry;
- Review and revision requirements must reflect the pre-contractual nature of the POS disclosure document. Information which is potentially subject to constant change should be subject to periodic rather than continuous review;
- Length requirements should consider the space that will be required to provide high quality summary disclosure. Too short a document will result in over simplified disclosure which will reduce the utility of the document to investors. Requirements to be clear and concise are preferable to arbitrary length restrictions;
- A synthetic risk reward indicator should not be included on the basis it is likely to mislead investors and discourages investor engagement with the full risk profile of the product; and

- A non-prescriptive approach to presentation of past performance.

4.2 POS Disclosure Standards

We agree with the introduction of a POS disclosure document as we believe it would be of assistance to retail investors embarking upon their decision-making process, and as such will act as a further important risk mitigant against mis-selling of products.

However, the focus must be on ensuring that this POS disclosure document is designed to provide a high standard of summary disclosure, and does not inadvertently undermine other product literature which retail investors already find useful. Regulators should bear in mind that attempting to oversimplify product information, focusing on brevity at the expense of quality, and attempting to put disclosure into an inappropriate framework will severely limit the usefulness of the disclosure and is likely to result in the document misleading investors. The interplay between any POS disclosure document and other contractual/disclosure documentation (e.g. a prospectus) is very important. Any POS disclosure document will not, on its own, form a sufficient basis for investor decision-making and should cross-refer to other contractual/disclosure documentation.

Any POS disclosure document should be designed to assist an investor in engaging with and understanding the legal terms and conditions of the products and the implications of the terms and conditions in terms of investment proposition, risk, reward and charges. Investors would still be expected to read the other documentation provided to them when making their investment decision (or be advised by someone who has) and be bound by their terms.

It is important that there is consistency across jurisdictions where possible and we note the PRIPS regime (as discussed above) under which a harmonised disclosure regime is proposed, although much refining is yet needed to make it fit for purpose.

Recommendation 7: Allocation of responsibility for preparing, making available and/or delivering the POS disclosure document should be clearly established, and the POS disclosure document should identify which entity is responsible for its content.

5.1 As products may be sold either through a fragmented distribution chain (i.e. where the product provider and the distributor are different, unconnected persons (e.g. an investment bank which issues a note which is then sold through a financial adviser)) or through an integrated distribution chain (e.g. an insurance company which sells its own products through its own sales force), it will be necessary for the rules made in respect of POS disclosure to be applicable to both of these models.

5.2 The JAC members welcome the Consultation's recommendation for regulators to clearly establish who has the responsibility for preparing and providing the POS disclosure document and its relevant content. The delivery of an appropriate outcome for the investor is generally a result of appropriate co-operation and interaction between the distributor and product provider. Distribution chains vary considerably across product types and industry segments and the exact responsibilities must flow from the specific roles of the product provider and the distributor. It will, therefore, be necessary to distinguish between issues that relate to the conduct of business of the relevant distributor (e.g. conflicts, inducements, and suitability) and those which relate to the product itself. Product providers cannot deliver requirements which relate to the conduct of the distributor selling the product and it is

important that any such approach does not impose such obligations. The ultimate aim is to ensure that the customer is not treated differently in dealing with the fragmented distribution chain than he would be if he were dealing with an integrated producer/distributor. The JAC Principles were formulated in order to clarify the roles and responsibilities of product providers and intermediaries.

- 5.3 The JAC members believe that more clarity from regulators/supervisors around the roles and responsibilities of product providers and intermediaries for the key information disclosures is imperative. In many cases, the delineation of responsibilities between product provider and intermediary has been blurred and we would urge regulators/supervisors to provide additional guidance to encourage better consistency in implementation.
- 5.4 The JAC members take the view that whilst a product provider should bear responsibility for ensuring that the product “does what it says on the tin” (i.e. performs in accordance with the methodology and formulae outlined in the documentation), it is the distributor who should take responsibility for the wider product governance. Ultimately it remains the case that it will be for the distributor to determine whether a product is suitable for an end investor, following the product provider’s general assessment of the product against the target market. It is the distributor rather than the product provider who can control who a product is distributed to.
- 5.5 We would therefore urge the regulators to bear in mind the method of origination for determining product features when creating and allocating regulatory obligations, and also when exercising supervisory and enforcement powers; the person or persons who undertake product design should bear responsibility in relation to the design of the product to meet identified consumer needs and the distributor should continue to bear POS responsibilities.
- 5.6 The responsibility to provide any POS disclosure document to an investor should lie with the distributor. A coherent civil liability regime should support, rather than detract from, the desired focus on consumer friendly disclosure. Fundamental to this is ensuring that the requirements are structured in a way that product providers and distributors can be satisfied that they are capable of objectively demonstrating compliance with their obligations. Unless this prerequisite is met, many product providers and distributors may feel unable to manage their disclosure risk in relation to retail structured products. This is likely to result in some product providers and distributors exiting the market and reducing the range of products that are offered. This will result in a reduction in consumer choice and competition and an increase in the costs of products to consumers. It may also reduce the quality of products available.
- 5.7 For the disclosure of product charges and intermediation charges, see section 1.3 above.

<p>Recommendation 8: A jurisdiction considering POS disclosure should consider how to use its capabilities and powers to implement these POS recommendations, taking into account the jurisdiction’s regulatory regime.</p>
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6.1 Jurisdictional Arbitrage

Whilst differing regulatory regimes continue, there is a risk that they may be arbitrated, with certain market participants potentially seeking to structure products so as to minimise their regulatory obligations. In order to ensure consistency in relation to the sale of structured products, the JAC members would welcome the introduction of standards determined at an international level to facilitate the development of a level playing field across jurisdictions.

In particular, the JAC members would welcome a harmonised approach across, for example, the EU to avoid cross border arbitrage and/or gold plating by individual countries. Even where there is not an integrated market, where institutions are operating on a global basis and originating products for a number of jurisdictions, it would be helpful to have a consistent set of provisions which regulators could apply and JAC members would urge regulators to adhere to such standards and avoid imposing additional, national regulations which potentially lead to market participants exiting the market and reducing the range of products that are offered.

6.2 Regulatory pre-approval of a POS disclosure document

The JAC members are of the view that there should not be a regulatory pre-approval process for POS disclosure documents. We believe that this would present moral hazard for the regulators as well as creating unnecessary inefficiencies.

There is a risk that a pre-approval process may mean retail investors capable of understanding the relevant investment risks will miss relevant investment opportunities. Investors may also assume that if the regulator has 'signed-off' a product, they have less responsibility in informing themselves about a proposed investment. We believe that a market-wide pre-approval approach may stifle innovation and restrict customer choice by too great a degree.

Were pre-approval processes introduced, we agree that they would need to be administered by individuals who understand how structured products work from a financial perspective and the requirements the products need to comply with. Given the number of products in the market and the frequency of product changes and variations, this would have massive resourcing implications for the regulators, and as a consequence, costs which are likely to be passed back to firms and ultimately consumers.

In addition, it should be noted that structured products are already regulated in the EU (under the Prospectus Directive and the UCITS Directive), or other analogous regimes in other jurisdictions in relation to disclosure, form and content.

6.3 Flexibility of content

Given the differing nature of the products covered by the Consultation, we would urge regulators to encourage flexibility in terms of content and presentation in order to acknowledge the different nature of the wrappers and ultimate benefits to investors.

PARTICIPATING ASSOCIATIONS



Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

ISDA is listed on the EU Register of Interest Representatives, registration number: 46643241096-93



ICMA represents financial institutions active in the international capital market worldwide. ICMA's members are located in 47 countries, including all the world's main financial centres. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years, providing the framework of rules governing market practice which facilitate the orderly functioning of the market. ICMA actively promotes the efficiency and cost effectiveness of the capital markets by bringing together market participants including regulatory authorities and governments. See: www.icmagroup.org.

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ANNEX 1

PRINCIPLES FOR MANAGING THE PROVIDER-DISTRIBUTOR RELATIONSHIP

(Published in July 2007)

A. Introduction

These PD Principles seek to address issues that financial services firms have in practice found helpful to consider when performing the function of either provider or distributor in connection with the process of delivering structured products to retail investors.

It should be noted that **the PD Principles are non-binding and, as such, intended purely to help inform firms' thinking**. The sponsoring associations believe market participants should be free to agree their relationships and relative responsibilities on a case-by-case basis, to the extent these are not prescribed by local law or regulation. The PD Principles are intended to be sufficiently broad in their applicability to provide a reference framework for managing the provider-distributor relationship in retail structured products markets globally.

The PD Principles are the product of a global working group of firms, taking in the views of both distributors and providers and supported by a coalition of trade associations. Furthermore, the associations issued the PD Principles for public comment, obtaining constructive feedback from other trade associations and market participants.

Structured products include a variety of financial instruments that combine various cash assets and/or derivatives to provide a particular risk-reward profile that would not otherwise be available in the market. The exact risk-reward profile varies from instrument to instrument.

The arrangements between the parties, the applicable regulatory regime and the fact that structured products combine various components may in practice result in different financial services parties being responsible for different aspects of the related regulatory obligations (even though the universal-bank model may entail a 'proprietary product distribution' arrangement). In particular, it is common for the distributor to have a direct interface with the retail investor while the provider does not. These PD Principles therefore particularly focus on how to address this issue, wherever it arises, given that all parties within this distribution 'chain' have a common interest in ensuring that investors obtain satisfaction with regards to their legitimate expectations as to the nature of the investment.

Retail investors in this context will mean natural persons and may include high-net-worth individuals. The PD Principles do not, unless otherwise indicated, address the role of entities acting solely as issuer of a product.

The PD Principles are drafted with no single jurisdiction in mind; they are, on the contrary, intended for global use, at a high level. The specific and possibly more detailed procedures that any firm might in practice (and subject to appropriate cost-benefit analysis) adopt to help it manage provider-distributor relationships with regards to retail structured products will be a function of factors such as the jurisdiction or jurisdictions involved, the distribution channel(s) utilised, the precise nature of the products and the nature of the relationship between the parties.

Regulatory treatment may depend on the nature of the component instruments; for instance, depending on the jurisdiction, structured deposits or exchange-traded notes acquired by investors via brokers on a 'reverse-enquiry' basis may each require separate analysis. Among other matters, due consideration will need to be given to post-sale arrangements such as secondary market-making activity and information

provision. The sponsoring associations invite industry to consider adapting the PD Principles, as appropriate, to take account of such specific factors.

B. PD Principles

These PD Principles should be read in conjunction with the Introduction above, which contains important overarching comments on the nature and scope of the PD Principles. Moreover, the PD Principles are to be taken collectively, rather than viewing any one PD Principle in isolation from the others.

1. Distribution to the retail investor in structured products in many, though not all markets, is effected through intermediaries, e.g. private banks, rather than directly by the product ‘provider’ (sometimes referred to as ‘manufacturer’).
2. Where a product provider and a private bank (or other retail-facing business) operate within the same institution, they may operate quite distinctly; they may even be subject to different regulation; or have different reporting and management structures. Any such formal separation is generally robust and will be driven by legal, compliance, confidentiality and other requirements. Thus, even where a product is originated and distributed by the same institution, there can, in practice, be a separation between the manufacturing and distribution functions to which these PD Principles refer.
3. Product providers should consider what internal approval processes are appropriate for retail structured products; any such processes might address such issues as sign-off, product structuring, risk-reward and distribution.
4. The distribution structure means that it is often the distributor who interfaces with the individual investor and whose client that investor is. In such circumstances, investor suitability (as determined in the local market) is accordingly exclusively an issue for distributors, since it must be considered in the context of confidential information provided by the client to the distributor.
5. Distributors must understand the products they distribute. In jurisdictions where distributors provide not only the issuer’s prospectus document but also term-sheets or other marketing material (such as brochures) to their clients, the distributors take responsibility for the accuracy and completeness of those marketing materials, even if they incorporate material provided by the product provider; in these circumstances, a distributor must be satisfied with and take responsibility for such materials and their compliance with local law and regulation.
6. Product providers should ensure that their term-sheets are accurate, fair, balanced and clear (respecting, as appropriate, jurisdiction-specific regulation to this effect); and that they are presented in a way which is consistent with their agreed obligations to the distributor. (For example, where the parties understand that the product will be distributed by the distributor to high net worth individuals, the term-sheet should not contain rubric that the product is not suitable for retail investors.) Where providers agree to assist the distributor by supplying information, this should be clear and of the kind requested by the distributor in preparing its own term-sheet or product description for its client; this may include scenario analyses and relevant-to-product risk factors.
7. When commencing dealings with a distributor, product providers should consider whether the distributor is an appropriate distributor for the placing of particular types of products and, where they consider it necessary, practical and appropriate to do so, should conduct a "know your distributor" approval process. There is no fixed form for this process, which can vary according to the circumstances, and there are a number of means by which a provider can gain comfort as to the

integrity of a distributor's processes. Issues which may typically be considered include a distributor's typical client type (and whether the distributor deals directly with them or via sub-distributors), suitability determination processes, regulatory status, reputation and compliance with selling laws; though the specific details considered will vary widely depending on the distribution, the particular product and the relevant jurisdiction or jurisdictions. Each party does, in any case, retain its own regulatory obligations; no party takes on the regulatory obligations of another or the oversight of that other party's compliance with those obligations.

8. Distributors should also evaluate product provider counterparties ("know your product provider"), particularly as regards the product provider's performance with respect to those items mentioned in 6 above.
9. To the extent that law and regulation may not distinguish sufficiently between the roles of product providers and distributors, this may create points of uncertainty as to where legal or regulatory liabilities may fall. Providers and distributors should be aware of this and its consequences.
10. Product providers and distributors should seek to agree and record their respective roles and responsibilities towards investors.

ANNEX 2

PRINCIPLES FOR MANAGING THE DISTRIBUTOR-INDIVIDUAL INVESTOR RELATIONSHIP (Published in July 2008)

The distributor-individual investor relationship should deliver fair treatment of the individual investor. Individual investors need to take responsibility for their investment goals and to stay informed about the risks and rewards of their investments. Distributors can play a key role in helping them achieve these objectives. In this document, an "investor" means a retail investor who is not an institution, a professional, or a sophisticated investor, and a "distributor" refers to any institution or entity that markets or sells retail structured products directly to an individual investor. This will include an issuer of a retail structured product that markets or sells the same directly to individual investors.

In light of the increased interest in structured products as part of individual investors' investment and asset allocation strategies, it is important for firms to keep these DI Principles in mind in their dealings with individual investors in structured products. These DI Principles complement and should be read in conjunction with the "Principles for Managing the Provider-Distributor Relationship" (or PD Principles) set out in Annex 1 hereto, which focus on the relationship between manufacturers and distributors. These principles apply to the relationship between the distributor and the individual investor.

Although these DI Principles are non-binding (being intended primarily to help inform firms' thinking) and do not create enforceable obligations or duties, firms involved in the distribution of structured products to individual investors are encouraged to reflect these principles in their policies and procedures. Further, each firm is encouraged, given differing regulatory environments and both cultural and client base differences, to consider the extent to which the firm should adapt these principles to its particular circumstances. As stated in the related PD Principles noted above (PD Principle 7), "no party takes on the regulatory obligations of another or the oversight of that other party's compliance with those obligations."

For the avoidance of doubt, these DI Principles are intended primarily to apply in the context where structured products are actively marketed and/or recommended by distributors to individual investors, and not where distributors are merely executing transactions for investors on a non-advised, non-discretionary basis. Where distributors are executing on this basis, those parts of these DI Principles that are not appropriate to such relationships (for example, those relating to secondary market making and client appropriateness and suitability) shall not apply.

Overview

The term "structured products" refers to a variety of financial instruments that combine various cash assets and/or derivatives to provide a particular risk/reward profile that allows investors access to broader investment opportunities. The return of a structured product is usually derived from the performance of one or more underlying assets. Examples of underlying assets include, but are not limited to: interest rates; a particular equity or debt instrument; a basket of securities; a securities index or indices; an individual commodity or commodities; a commodities index; an individual currency or currency basket; creditworthiness of a security or basket of securities; or any combination thereof.

Some structured products offer full or partial principal protection, while others have no principal protection. Some offer a yield; others do not. It is possible that the value of an individual structured product may not increase as much as the underlying asset, or may decrease more than the underlying asset. Some structured

products offer individual investors access to new asset classes that may otherwise be difficult to access through other investment alternatives and which can help with portfolio diversification.

Structured products can be more or less risky than other investment products such as equities, fixed income products, or mutual funds: there is no necessary link between product complexity and investment risk - complex products may be low risk, and non-complex products may entail high risk. It is important that an investor understands the role in an investment strategy that can be played by any particular structured product in light of the investor's specific investment objectives, risk tolerance, and investment horizons.

DI Principles

These DI Principles should be read in conjunction with the Overview and Introduction section set out above, which contains important overarching comments to the nature and scope of the DI Principles. Moreover, the DI Principles are to be taken collectively, rather than viewing any one DI Principle in isolation from the others.

1. Product Transparency

The party who is primarily responsible for the creation of marketing materials, or is responsible for a prospectus, or other offering memorandum, should, to the extent permitted by applicable laws and regulations, use reasonable efforts to ensure that the material features of the particular structured product are clearly articulated and delineated in such marketing materials or prospectus in a way that enables individual investors to evaluate the investment from a risk/reward perspective. Such party should also ensure that structured product descriptions in client materials and prospectuses are clear and not misleading. This will be helpful to both individual investors' and financial advisors' understanding of the product. Further, to the extent that a distributor is primarily responsible for the creation of marketing materials, such materials should be adapted to, and reflective of, the knowledge and sophistication of individual investors in the target market. For example, it should be clearly disclosed how returns on a structured product are linked to an underlying asset.

Marketing materials that are distributed to, or intended for distribution to, individual investors should be subject to review by the distributor's appropriate supervisory staff, as well as other internal processes, such as compliance or legal, as appropriate.

2. Risk Disclosure

Risk disclosure is important to an investor's understanding of structured products and should be made available to investors before a decision to invest is made. Investors should understand the risks inherent in the product before investing in it. Investors should be informed of the general types of risks associated with structured products, subject to individual regulatory standards as to the specific language required. Particular prominence should be given to any risk not usually associated with a given product, for example, risk of loss due to any sale of the product before maturity, as well as any material product-specific risk that may apply, such as risks arising from the underlying asset, liquidity and market risks in relation to the product itself, or specific tax considerations. Where information on past performance is given, the presentation should be fair and not misleading, and, in particular, should acknowledge any limitations in available data.

3. Fees and Costs

Investors in a structured product should be informed of the existence of fees, costs, commissions, discounts, and any other sums paid to the distributor for acting as such over the life of that product.

Distributors should have internal processes and controls in place to consider the appropriateness of fees and other incentives given local market conditions and regulatory requirements. A distributor's internal processes and controls should also consider the level of disclosure regarding such fees and costs in light of their possible impact on the secondary market of the structured product concerned.

4. Potential Conflicts Management

Distributors should have internal processes and controls in place to consider potential conflicts issues and identify measures designed to mitigate, manage, or disclose material conflicts of interest arising from the sale of structured products. Such processes should, where necessary or appropriate, provide timely, adequate, and clear disclosure related to conflicts of interest or potential conflicts of interest that may exist or arise in connection with the distributor's sale of the structured product, or as a result of the business they conduct.

5. Credit Ratings

Credit ratings of issuers or, where applicable, guarantors, may not represent a rating of the potential investment performance of the individual structured product itself. Credit ratings, however, should be taken into account to the extent that they affect the terms of the product. If credit ratings are provided, the related disclosure should make clear the significance of the rating. Distributors should use credit ratings accordingly.

6. New Product Review

Distributors should understand the products they distribute. New structured products, whether developed by the distributor or developed by a third-party provider or manufacturer, should be subject to the distributor's product review and assessment process. This process should take into account the nature of the new structured product, the target investors, and an assessment as to whether the product is appropriate for its intended target market. Distributors should also have a process for determining what generally constitutes a "new product". It is not sufficient for a distributor to accept a third-party manufacturer's assessment regarding appropriateness of structured products for individual investors who are ultimately customers of the distributor and not the manufacturer. Distributing firms should conduct an independent assessment.

7. Liquidity/Secondary Market

Investors should be informed before investing of the likelihood of their being able to sell a particular structured product prior to maturity, and of the ways in which this might be done. Any secondary market to be provided by the distributor itself or through an exchange, or otherwise, should be disclosed. If there is little likelihood of such sale or other liquidation being possible, that fact should be clearly disclosed. Investors should be made aware that sales in the secondary markets, even where possible, may be at prices that are below the amount payable on the product at maturity, the original offering price, or the price at which they acquired the product. In addition, distributors should make a clear distinction between an investment in the structured product and a direct investment in the underlying asset, and that the return on the structured product may not reflect the return of a direct investment in the underlying asset, noting in particular that these respective returns may not necessarily move in tandem. For principal-protected products, it should be made clear to investors that the principal protection applies only at maturity, and the costs of unwinding the product mean that an earlier redemption value may differ materially from the potential value at maturity.

7a. Client Valuations

Structured products should be valued on a regular basis and disclosed to the investor through the distributor's normal client statement process or otherwise.

8. Client Appropriateness and Suitability

Where a firm actively markets a particular product, as opposed to merely executing transactions on clients' instructions, it should determine which particular types of clients the product could properly be sold to (appropriateness) and may also be required to determine whether the particular product is right for a particular client (suitability). Methodologies and standards for making these determinations should be developed by the distributor and adequately communicated to the distributor's financial advisors. Liquid net worth, degree of sophistication, risk profile, age, and investment experience are several variables that may be relevant to such an assessment. Also, financial advisors should consider how a specific structured product would fit into an individual's portfolio. These standards should be reviewed periodically and amended, as needed.

9. Financial Advisor and Supervisor Training

Structured products vary a great deal as to their terms, risk/reward profile, liquidity/availability of a secondary market, underlying asset, and a variety of other factors. As such, it is important that financial advisors interacting with individual investors have an adequate understanding of structured products in general as well as an understanding of the characteristics of the individual structured products being offered. The financial advisor should be able to clearly explain the product's features to an individual investor. Distributors should provide their financial advisors with the necessary training, or access to training, in structured products, including both the benefits and risks of the products, and should consider providing educational materials on structured products generally, in a suitable form (including one-on-one meetings, written materials, class-based training, desktop training, or other forms, as appropriate). Such training should also be provided to those responsible for supervising financial advisors.

10. Oversight and Compliance

Structured product sales to individual investors should be subject to the distributor's internal legal, compliance, and supervisory review processes, policies, and procedures. Distributors should have such supervisory procedures in place covering transactions in structured products, which should involve supervisory staff of appropriate seniority in light of the nature of the particular product and investor target market. Supervisory responsibilities may encompass sales practices, reasonableness of profit/loss potential, fees, and adequacy of training. Managers performing such supervision should have access to appropriate legal and compliance department support.

11. Tax Implications

Investments in structured products may have tax consequences for individual investors depending on their personal circumstances and jurisdiction of residence. Although certain tax implications may be highlighted in product documents, investors should be encouraged to discuss the specific tax implications of structured products with their accountant, tax attorney, or other tax professional.

12. Post-Trade Follow-up/Product Life Cycle Issues

Distributors should provide financial advisors with the necessary information to help their clients monitor performance of any structured product in which they have invested, and provide access to information regarding the terms of that structured product, including its maturity, pay-out details, secondary market price, and other pertinent information.