12 March 2010

Market Conduct Policy Division
Capital Markets Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117

e-mail: investmentpdts_review@mas.gov.sg

Dear Sirs

MAS Consultation Paper on the Regulatory Regime for Listed and Unlisted Investment Products and the response to feedback on the MAS Consultation Paper on the Review of the Regulatory Regime Governing the Sale and Marketing of Unlisted Investment Products

Please find attached a joint letter which sets out the collective response by the International Swaps and Derivatives Association, Inc. ("ISDA") and the Securities Industry and Financial Markets Association ("SIFMA") to the new Consultation Paper and MAS response to the feedback on the original Consultation Paper.

MAS will recall that we had made a joint submission on the original Consultation Paper in April 2009 and our members reiterate their commitment to working with the Singapore government and regulators in their endeavour to help to re-build confidence in the structured products market in Singapore.

If you have any queries on this letter, please do not hesitate to contact:

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Yours sincerely

Timothy R Hailes
Chairman, Joint Associations Committee[1]

[1] For the purposes of this initiative, the Joint Associations Committee is sponsored by the International Swaps and Derivatives Association, Inc. (ISDA) and the Securities Industry and Financial Markets Association (SIFMA) only.

ISDA®

Comments by the International Swaps and Derivatives Association, Inc. (**ISDA**) and the Securities Industry and Financial Markets Association (**SIFMA**) on the Consultation Paper issued by the Monetary Authority of Singapore in January 2010 relating to the Regulatory Regime for Listed and Unlisted Investment Products and the response to feedback received to the Consultation Paper issued by the Monetary Authority of Singapore in March 2009 relating to the Review of the Regulatory Regime Governing the Sale and Marketing of Unlisted Investment Products

12 March 2010

The International Swaps and Derivatives Association, Inc. (ISDA) and the Securities Industry and Financial Markets Association (SIFMA)[2] appreciate the opportunity to collectively express our views on the Consultation Paper issued by the Monetary Authority of Singapore ("**MAS**") in January 2010 relating to the Regulatory Regime for Listed and Unlisted Investment Products (the "**Consultation Paper**") and the response to feedback received on the Consultation Paper issued by the MAS in March 2009 relating to the Review of the Regulatory Regime Governing the Sale and Marketing of Unlisted Investment Products (the "**March 2009 Consultation Paper**").

Please note that this letter only touches on certain of the items discussed in the Consultation Paper; individual members will have their own views on aspects of the Consultation Paper and may provide such comments independently.

Our members support MAS' review of the current regime for retail investment products and agree that MAS should insist on the implementation and maintenance of high standards of market practice, as this will lead to improved consumer confidence. We believe that the primary objectives should be:

(a) to ensure that investors are provided with sufficient information about investment products to enable them to evaluate those products and to determine what their risk exposure and expectations of investment returns should be; and

(b) to ensure that those selling investment products to retail investors should be subject to common regulatory-driven standards.

However, a rigorous cost-benefit analysis should be done to ensure that:

(i) any additional costs imposed on issuers and intermediaries as well as inconvenience to investors are commensurate with the corresponding benefits to such investors; and

(ii) the continued development and growth of the market - which benefits not only issuers and intermediaries, but also investors in providing them with an increasing array of products to choose from, as well as enhancing Singapore's standing as a regional (if not global) financial centre - is not adversely impacted.

Comments on specific proposals in the Consultation Paper

We set out below our comments in relation to a number of selected proposals from the Consultation Paper.

[2] Descriptions of these associations are provided in Appendix 1.

1. Current Regime to Continue to Apply to List of Excluded Investment Products

"Q1: MAS seeks views on the list of excluded investment products set out in Table 1 for which the existing regime under the FAA will continue to apply."

1.1 Members agree with MAS' decision not to proceed with an enhanced regime for "complex investment products" and to remove the distinction between listed and unlisted products. The Joint Associations Committee has, in its various representations to regulators, highlighted the risk of regulatory arbitrage.

1.2 We note that MAS has stated that the products proposed to be included on the excluded list are "already established in the market, and have terms and features generally understandable by retail investors". However, it is still not entirely clear to our members what principles were used by MAS to determine whether an investment product should be included in the list. In particular, a member noted that there was a difference in treatment between a structured deposit (which is an excluded investment product) and a principal protected structured note (which is covered under the new regime) yet both products have similar terms, features and risk profiles from a product payoff perspective. Similarly, a dual-currency investment is an excluded investment product yet an investor could lose a substantial portion of the principal amount invested in terms of its base currency.

1.3 With respect to the list of excluded investment products, members propose that MAS includes collective investment schemes that invest in excluded investment products (other than life insurance policies), exchange-traded funds ("**ETFs**") (or at least, non-synthetic ETFs), index-tracking exchange-traded notes and warrants (given that these products are no different from listed shares in terms of trading, price discovery and information disclosure).

1.4 Members propose that MAS set out a process by which applications can be made to MAS to include other products on the excluded list.

1.5 In addition, members seek confirmation that the new regime will not apply to offers made pursuant to an exemption from prospectus requirements under the Securities and Futures Act, Chapter 289 of Singapore. Members also seek clarification on whether the new regime will extend to non-natural persons (please also see paragraph 2.10 below).

"Q2: MAS seeks views on the proposal to require FAs to put in place formal policies and procedures setting out clearly the circumstances under which they would or would not permit the sale to a retail customer of an investment product they have assessed to be unsuitable for the customer."

1.6 Members agree in-principle, with the proposal that FAs put in place such formal policies. Typically, current sales processes would involve shortlisting suitable products for recommendation to the customer. If the customer requests for products which are not shortlisted (i.e. deemed not suitable), the customer is required to provide justification and the supervisor is

required to conduct validation to assess and ensure that the customer fully understands the features and risks of the product. Otherwise, the customer's application is rejected. In exceptional cases, where the customer insists on purchasing products assessed not to be suitable for him, senior management approval (after supervisor validation) will be sought. Members seek MAS' confirmation that such policies instituted by FAs would meet MAS' objectives for imposing this requirement.

2. Proposals for Unlisted and Listed Investment Products

Enhanced Safeguards for Retail Customers

> **"Q3: MAS seeks views on the proposals to require intermediaries:**
>
> **(a) to conduct a Customer Knowledge Assessment for a retail customer who wants to purchase unlisted non-excluded investment products; and**
>
> **(b) to have the Customer Knowledge Assessment performed or approved by a person independent of the financial advisory function."**

> **Q5: MAS seeks views on:**
>
> **(a) the proposal to require intermediaries to conduct a Customer Account Review for a retail customer who wants to trade listed non-excluded investment products; and**
>
> **(b) the safeguards proposed at paragraph 3.1.6."**

2.1 Members agree that the regimes applicable to listed and unlisted non-excluded investment products need to be different.

2.2 As MAS is aware, most member banks and financial institutions already have in place a process to assess (i) the level of understanding of a product by the customer; and (ii) the customer's existing asset exposure, investment objectives, risk tolerance and financial needs. The introduction of the Customer Knowledge Assessment framework appears somewhat prescriptive and rigid and a more useful approach may be for MAS to identify any perceived gaps in the current processes of the intermediaries. In particular, it appears that the assessment has to be repeated each time a product (even if it is the same as before) is being sold to the customer. Members expect that customers will find this unduly burdensome especially as they may well deal with more than one intermediary.

2.3 Members question whether the imposition of a Customer Account Review framework is the right approach for listed non-excluded investment products. Customers who trade in listed products

are typically self-directed investors who do not require advice and who would strongly object to being subjected to any kind of knowledge assessment test. We are not aware of any other jurisdiction which has mandated similar testing for listed products. We are of the view that the Customer Account Review framework is not required for listed products as the Singapore Exchange already has different listing requirements for different types of products. If any additional measures are required, a closer look at such listing requirements may be a better approach.

2.4 In addition, members would question the functionality of having an independent person perform Customer Knowledge Assessment. Singling out the knowledge and experience of the customer as a factor that must be assessed by an independent person to mitigate potential conflicts of interest appears arbitrary, as other factors to be assessed (such as the risk profile of the customer) arguably lead to similar conflicts of interest. This would apply in the context of the Customer Account Review framework as well (though admittedly to a lesser degree).

2.5 In light of this, members urge MAS to consider that fact-finding is an integral part of providing financial advice and the two processes must be viewed holistically. A fragmentary approach with multiple parties conducting different aspects of customer assessment increases the risk of inaccurate conclusions about customer-product suitability.

2.6 Members also seek clarification on what constitutes a person independent of the financial advisory/sales or dealing function for the purposes of conducting Customer Knowledge Assessment/Customer Account Review. Members query if the degree of independence is satisfied by independent reporting lines or if independence from the commission and fee or bonus pool structure of the financial advisory/sales or dealing function is also necessary. Members would note that increasing the number of persons involved in the assessment and sale processes necessarily increase operational costs and it may not be practicable unless these costs were passed to the customer.

2.7 Members seek to clarify whether distributors that operate on an "execution-only" model are entitled to refuse requests for advice from customers who have been assessed under the Customer Knowledge Assessment to have the relevant knowledge and experience.

2.8 With regard to paragraph 3.1.6 read with paragraph 3.1.7 of the Consultation Paper, MAS should consider more prescriptive guidance as to what would be considered appropriate circumstances under which intermediaries may open a trading account notwithstanding that they have assessed that the customer does not possess the relevant knowledge or experience and what would be considered appropriate safeguards.

2.9 Customers trading in listed products will, by and large, not request advice from the intermediaries before trading. However, as there may be instances where customers may request for advice before trading, members seek confirmation from MAS that they are entitled to refuse requests for advice from such customers.

"Q4: MAS seeks views and suggestions on the information proposed in paragraph 2.2.1 to be obtained from retail customers for the purposes of the Customer Knowledge Assessment."

“Q6: MAS seeks views and suggestions on the information proposed in paragraph 3.2.1 to be obtained from retail customers for the purposes of the Customer Account Review.”

2.10 (Depending on MAS’ response to paragraph 1.5 above), members seek confirmation that the Customer Knowledge Assessment framework and the Customer Account Review framework only applies to retail customers that are natural persons. Unless MAS specifies a separate set of guidelines for assessment at the corporate level, members understand that the Customer Knowledge Assessment framework and the Customer Account Review framework exclude corporate entities.

3. Proposed Requirements for Product Highlights Sheet

“Q9: MAS seeks views on the proposed requirements for the Product Highlights Sheet set out in paragraph 5.2.4.”

3.1 One approach that has been proposed by the Joint Associations Committee in November 2009, in its submission to the European Commission on its call for evidence relating to Packaged Retail Investment Products in the EU (“**PRIPS Submission**”)[3] is that proposed disclosure requirements for the Product Highlights Sheet may be established with reference to and sensitivity towards the particular characteristics of different product types which may be broadly categorised into two distinct structural types. These are:

3.1.1 Contractual investment products (“**Contractual IPs**”). Contractual IPs are products which entitle their owner to an amount of money calculated by reference to a formula. Contractual IPs include deposits, structured notes, warrants and certificates, annuities and some life insurance products. Contractual IPs are defined return investments.

3.1.2 Collective investment products (“**Collective investment IPs**”). Collective investment IPs are products which entitle their owner to the return on a pool of assets in which his initial contribution has been invested less fees. Collective investment IPs include collective investment schemes, units in business trusts or real estate investment trusts and some life insurance policies. Collective investment IPs are variable return investments.

3.2 The elements required to give an investor a clear understanding of the risks associated with an investment will differ significantly according to whether the product described is a Contractual IP or a Collective Investment IP.

3.2.1 For Contractual IPs, it is usual for the terms of the product and its expected return to be spelt out in considerable detail, and this can be disclosed. However, the essence of the contractual commitment which the product embodies is the credit risk on the counterparty to that credit. In general, counterparty risk is disclosed through the publication of accounts, but this is unlikely to be satisfactory for a document intended to

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[3] Copy of the submission reproduced in Appendix 2.

be capable of being easily understood. Where issuers (and/or counterparties to whom investors are exposed) are rated, disclosure of the relevant rating may suffice. However, the majority of issuers and counterparties are likely to be unrated, and it is very unclear whether retail investors understand ratings sufficiently for the information to be meaningful.

3.2.2 For Collective Investment IPs, it is unusual for such investment to provide any meaningful information about their likely future returns, and even more unusual for them to be marketed on the basis of firm estimates of future performance. The essence of what the investor is offered is participation in the investment performance of the relevant manager. The most important things for the investor to understand are therefore the level of expertise of the manager and the price which he will be charged for that expertise.

3.3 No matter how flexibly the templates are constructed, authors of the Product Highlights Sheet should be given a degree of discretion in the way in which they present risks; subject to an overriding requirement to do so in a fair and clear manner, a principles-based approach is therefore desirable. An over-detailed prescription of content is not likely to deliver the best outcomes for investors.

3.4 In particular, members are concerned that a prescribed page limit for the Product Highlights Sheet may be unrealistic given the potentially unlimited diversity of "underliers". The number of pages required for presentation of disclosures may escalate due to the complexity of the product or the type and number of asset classes referenced. The constraints of a page limit would also eliminate the use of charts and pictorial illustrations yet these tools assist in making information more accessible to investors. If a page limit is required by MAS, members propose that there should be variable page limit requirements depending on the attributes of the product such as the number of asset classes referenced, with more complex products being allowed higher page limits. In any case, MAS should have the right to waive the page limit requirement, on a case-by-case basis, for a particular product offering.

3.5 Members seek to clarify the scope and extent of liability arising from the Product Highlights Sheet, especially in relation to content requirements. Further thought should be given to the level of legal liability which attaches to the Product Highlights Sheet – a high level of legal liability would generally result in documents drawn up with the primary aim of protecting the issuer rather than informing the investor.

3.6 In particular, members would like to have MAS' specific prescriptions on the extent and type of the information disclosed in the prospectus that must be included in the Product Highlights Sheet. Please also confirm that inclusion of cross-references to specific pages in the prospectus would be allowed. Members would also seek to understand if liability on the Product Highlights Sheet would only arise if considered with the prospectus as a whole, or if liability can arise independently on the Product Highlights Sheet itself. In the latter case, it is suggested that a strict page limit would severely impugn on the issuer's need to meet its obligations in relation to making sufficient disclosures unless it is expressly stipulated that no liability will arise in respect of any omissions in the Products Highlights Sheet.

3.7 Members also propose adding a threshold of materiality to the requirement that the information contained in the Product Highlights Sheet must not be false or misleading.

3.8 Members also note that liability for the Product Highlights Sheet will be imposed on issuers and issue managers. We assume that this follows from the essence of the Product Highlights Sheet as currently conceived being that it should be specific to a particular product.

3.9 There may be some merit in allowing distributors to include a supplement to the Product Highlights Sheet which will contain customer-specific information. In the case of some products, such specification may be inherent, and without information which is specific to the individual investor, the document is unlikely to be informative. It should be open to distributors and product providers to agree that, where appropriate, the distributor may supplement the Product Highlights Sheet with customised information applicable to the individual investor or to a class of targeted investors. It follows that liability for the contents of the supplement should rest with the distributor and that it should be made clear to the investor that his recourse with respect to the contents of such a supplement rests solely with the distributor.

3.10 Members note that the proposed questions in the Product Highlights Sheet set out in the March 2009 Consultation Paper included a requirement to disclose the fees and charges of distributors and product providers. Members seek clarification on the types of fees and charges that require disclosure.

3.11 The PRIPS Submission also highlights that Contractual IPs and Collective Investment IPs are priced differently. A Collective Investment IP is a packaged offer of a service for a fee, and the fees charged for the provision of that service are generally absolute and not performance related. Thus, what the investor will get as his investment return will be the investment performance less the management fees charged. He therefore needs to know the management fees charged in order to be able to work out what his investment return is likely to be. A Contractual IP, by contrast, will pay the defined return – fees and costs are already taken into account in the calculation of the return which is defined. The issue for the investor as to whether the price which he is being charged for that return is cheap or dear, and he – or, usually, his investment adviser or broker – can establish this by looking across the range of competing products and structures. A useful comparison can be made with bank deposits – an investor is not told, and does not need to know, the return which the bank hopes to make over its funding costs on the particular deposit.

3.12 What follows from this is that the profit or loss which may be made by the provider of the product is not analogous to the fees charged by a manager, since management fees are deducted from the return which the investor would otherwise have received, whereas product profits made or losses suffered are not. The key point is that the investor is unaffected by losses made on the hedge by the product provider, 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 to Contractual IPs.

3.13 There is, however, a considerable difference between profit margins made by distributors and inducements paid to distributors. This is because the latter are capable of creating conflict or bias, and the possibility of such bias should be disclosed to the client. Members therefore seek confirmation that the fee disclosure requirements of the new regime will be in line with what we have outlined above. In addition, members wish to confirm that the disclosure of a range or a cap for commissions or inducements paid to distributors would be sufficient for the purpose of complying with this requirement.

3.14 Members respectfully submit that MAS agree, as part of the approval process, to informal preliminary reviews of the Product Highlights Sheet in order that potential concerns can be identified and addressed prior to launch, reducing the necessity for regulatory intervention down the road.

3.15 Members also understand that MAS has developed samples of Product Highlights Sheets which are being consumer-tested. Members would be grateful if MAS could release these samples for consultation and look forward to the opportunity to present their views. This consultation process will be instrumental in developing a workable and effective disclosure document. Members would like to highlight the developments in other jurisdictions such as the key facts statement in Hong Kong and the key investor disclosure document in Europe which may serve as useful comparisons to the Product Highlights Sheet.

4. Further Comments on MAS' response to feedback received on the March 2009 Consultation Paper

4.1 Introduction of Seven Day Cooling-off Period

Members seek to clarify (i) that, in the event where an investor exercises the right to withdraw his subscription during the cooling-off period, unwinding costs associated with the movement of underlying markets can be passed on to the investor; and (ii) the extent to which this proposal differs from the cooling-off period in the present collective investment scheme regime. The members propose that if such investors are entitled to a full refund of subscription monies without deduction of unwinding costs, the option to withdraw would be tantamount to a "free put option", the costs of which would be priced into the product and ultimately borne by those investors who chose not to exit their investment. This would lead to an inequitable result.

4.2 Appointment of Approved Trustee

4.2.1 Members note that MAS is proceeding with the requirement for issuers of unlisted debentures to appoint a trustee where the offers of such debentures require a prospectus to be issued. The requirement for a trustee has significant cost implications not only in terms of trustee fees, but also the need to establish a new standalone programme for Singapore offerings. Such cost implications could deter potential issuers from issuing retail debentures thereby stultifying any revival of the retail structured note market in Singapore and curtailing the range of investment options available to retail investors.

4.2.2 The empowerment of MAS to issue directions to the trustee to "act in the public interest" also causes concern. A trustee will owe a fiduciary duty to its noteholders alone, but the broad powers given to MAS may lead to directions being issued to the trustee which may conflict with such fiduciary duty to its noteholders.

4.2.3 Members have also observed that there may be a shortage of trust companies in Singapore which would be willing to take on the role of a trustee in a retail issuance of debentures.

4.2.4 Foreign trustees who will not be familiar with Singapore law will be even more reluctant to take on the appointment given the above-mentioned power of MAS to issue directions to trustees and further, given that specific statutory duties will also be imposed on them.

Members would also highlight in relation to foreign trustees that it will be difficult for the issuer to be satisfied that the "trustee is obliged to take timely and appropriate action on behalf of debtholders in the event of a default" without obtaining an express undertaking from the trustee. Trustees would understandably refuse to provide such an undertaking given that what would be "timely and appropriate action" is imprecise. This also requests in an uneven playing field between local and foreign trustees as local trustees will not need to provide such an undertaking. In fact, past experience has shown that trustees are often not able to take timely action as many considerations need to be taken into account while the trustee seeks legal and other professional advice to determine the most appropriate course of action which may in turn be dependent on several outcomes that are not within the trustee's control. Delays also often result from the trustee's reasonable insistence on being sufficiently indemnified for any action it undertakes. In addition, Singapore statutory protections that may be made available for trustees would not provide immunity from legal proceedings in other jurisdictions. In any event, members seek MAS' clarification on its expectations as to the actions required to be taken by trustees in an event of default. While this requires further thought, an alternative may be to require the appointment of an agent instead of a trustee for noteholders. This may make it more palatable for appointees to agree to such an appointment as they will then only have the statutory duties and be subject to directions from MAS, without having to weigh this against the fiduciary duties imposed on trustees by centuries of common law.

4.2.5 Members seek to clarify whether the trustee may be an affiliate or related party of the issuer. With respect to the requirement for a local trustee, members would like to confirm that an offshore trustee with a Singapore branch would also qualify as a local trustee (i.e., it is not only Singapore-incorporated trustees which would qualify).

<u>Appendix 1</u>

The International Swaps and Derivatives Association, Inc. (**ISDA**) has over 810 member institutions from 57 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end-users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. As such, we believe that ISDA brings a unique and broad perspective, both in terms of the depth of representation across the derivatives industry and in terms of international representation and understanding of the regulatory arrangements in other jurisdictions.

The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). The Asia Securities Industry and Financial Markets Association (ASIFMA), with offices in Hong Kong, is the Asia regional member of the GFMA.

Appendix 1

17 November 2009

Dear Sir/Madam,

We welcome the Commission's invitation to express our views on the opportunity and need for a harmonised legal framework regarding product transparency and distribution requirements for 'substitute' retail investment products.

1. The Joint Associations Committee (JAC)[1] is grateful for the opportunity to respond to the commission's call for evidence on the need for a coherent approach to product transparency and distribution requirements for "substitute" retail investment products. 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 committee therefore does not focus exclusively on one product type. However, it is felt that whereas the commission is likely to be provided with information from other sources on fund and insurance products, it is 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.

2. The JAC wholly supports the objectives of the Commission in introducing the PRIPS proposals. We believe that it is essential for the success of retail financial services in Europe that investors have access to high quality products which meet their

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[1] The JAC is sponsored by: European Securitisation Forum (ESF), International Capital Market Association (ICMA), International Swaps and Derivatives Association (ISDA), [Association for Financial markets in Europe (AFME)] and Securities Industry and Financial Markets Association (SIFMA). Fuller descriptions of the associations appear within Annexe 3. In the first instance, any queries may be addressed to rmetcalfe@isda.org

investment needs and which are marketed in such a way that they can be easily understood and compared. We support the introduction of proper regulatory standards at an EU level, since it is appropriate that regulators should maintain high standards of market practice across the Community, and the maintenance of such high standards improves consumer confidence. We believe that these objectives should drive the PRIPS legislative process.

3. The primary objectives of the process should therefore be

   (a) 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 expectations of investment return should be.

   (b) 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

   (c) To facilitate the comparison of products across different product types, whilst ensuring that such comparisons emphasise the substantive differences as well as the similarities between different types of investments.

Scope of PRIPs framework

4. We believe that the discussion about the classification of PRIPs is based on a false premise; that being that it is possible to deduce from the legal form of a product whether it is to be offered to retail investors. This is clearly incorrect. We believe that the correct test of whether a product is a retail product is whether it is in fact sold to retail investors. We therefore believe that the PRIPs regime should apply to any of the products identified in the Commission paper where they are in fact marketed to retail investors in the EU as medium or long-term investment products but not otherwise. There are three primary drivers for this view

   (a) The creation of a list of PRIPs based on legal characterisation may result in regulatory arbitrage; e.g. avoidance through repackaging;

   (b) There is no benefit – but potentially significant unnecessary cost - in forcing products which are in fact offered only to wholesale investors to comply with retail disclosure requirements; and

   (c) The interests of consumers will not be advanced – and may be adversely affected – by the diversion of resources to non-consumer products

5. There is no merit in establishing arbitrary benchmarks such as the EUR 50,000 denomination used in the Prospectus Directive (2003/71/EC). The effect of these is to include in the definition of "retail" a large number of offerings which are not offered to retail investors – thereby creating considerable cost – but to present a relatively easy challenge to those who actively wish to circumvent the law. We regard both of these outcomes as highly undesirable.

6. The creation of a workable definition of a retail product is relatively straightforward – a retail offering would for this purpose be a directed offering of a product made

primarily or exclusively to persons in the EU who are (or would be) classified as retail clients for the purposes of MiFID.

7. Because the proposed PRIPs regime is multi-product, and covers products which are currently subject to different disclosure standards, it will overlap with some parts of some of these regimes. It will therefore be necessary for the interaction between the two regimes to be determined in legislation. We believe that the optimal approach would be for the PRIPs regime to pre-empt the relevant provisions of other regimes. Thus, for example, the requirement to produce a (KID- inspired) summary in the Prospectus Directive should be replaced by the PRIPs obligation to produce a disclosure document when securities are actually offered retail.

8. We also believe that the PRIPs framework will need to reflect the basic division of PRIPs into two distinct structural types. These are:-

   (a) **Contractual 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.

   (b) **Collective Investment PRIPs.** Collective investment PRIPs are products which entitle their owner to the return on a pool of assets in which his initial contribution has been invested less fees. Collective Investment PRIPs include UCITS, shares in investment companies and some life insurance policies. Collective Investment PRIPs are variable return investments.

9. We believe that this division will be required to be embedded in the PRIPs 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 from the PRIPs project.

Product Disclosure

10. One of the bases of the PRIPs proposal is the creation of a mandatory retail disclosure document to be used for all retail sales which will set out the key features of the relevant product. This document is referred to by the commission as the KID, and we will follow that usage in this letter. We note that since the rules relating to the PRIPs KID will be considerably more complex than those which currently apply to the UCITS KID, there is the possibility for confusion, but in the interests of avoiding a multiplicity of terms we will refer to the KID as the generic PRIPs document.

11. We agree that the UCITS KID format forms a useful basis for the development of the KID, but we also agree that it is highly UCITS-specific, and will require considerable modification before a genuinely cross-product format can be developed.

12. Different product types will require different issues to be raised, and it is unlikely to be possible to create a common detailed template for all products. We may therefore end up with two derivative forms of the base template, one for each type of product.

In many respects this is desirable – an investor contemplating a choice between a UCITS and a market-linked structured note should clearly understand the differences between the two, that they have different risk characteristics, and the different presentations used for the two different types of product should emphasise that distinction. We accept that differences in presentation may make comparison more challenging, but this seems to us to be preferable to creating confusion amongst consumers by concealing the inherently different risk characteristics of different products.

13. No matter how flexibly the templates are constructed, authors of KIDs should be given a degree of discretion in the way in which they present risks; subject to an overriding requirement to do so in a fair and clear manner, a principles based approach is therefore desirable. We do not believe that over-detailed prescription of content is likely to deliver the best outcomes for consumers. Such detailed requirement aids comparability at the cost of inhibiting risk disclosure, and it is more important that consumers should have a clear idea of the risks inherent in a product than that they should be able to compare documents.

14. Thought should be given to the level of legal liability which attaches to the KID – the higher the level of liability, the more constrained the producer of the document will be as to what can be said about the likely performance and future returns of the product. Also, it is notorious that high levels of legal liability result in documents drawn up with the primary aim of protecting the issuer rather than informing the investor.

15. The elements required to give an investor a clear understanding of the risks associated with an investment will differ significantly according to whether the product described is a Contractual PRIP or a Collective Investment PRIP.

16. For Contractual PRIPs, it is usual for the terms of the product and its expected return to be spelt out in considerable detail, and this can be disclosed. However the essence of the contractual commitment which the product embodies is the credit risk on the counterparty to that credit. In general counterparty risk is disclosed through the publication of accounts, but this is unlikely to be satisfactory for a document intended to be capable of being easily understood. Where issuers (and/or counterparties to whom investors are exposed) are rated disclosure of the relevant rating may suffice. However the majority of issuers and counterparties are likely to be unrated, and it is very unclear whether retail investors understand ratings sufficiently for the information to be meaningful.

17. For Collective Investment PRIPs, it is unusual for such investments to provide any meaningful information about their likely future returns, and even more unusual for them to be marketed on the basis of firm estimates of future performance. The essence of what the investor is offered is participation in the investment performance of the relevant manager. The most important things for the investor to understand are therefore the level of expertise of the manager and the price which he will be charged for that expertise.

18. It appears to us that any attempt to standardise KID formats across these two product types would have the effect of potentially misleading customers about the extent of the differences between the two.

Tailoring Disclosure for particular products

19. The essence of the KID as currently conceived is that it should be specific to a particular product. The idea of requiring the KID to be "tailored" to the individual customer is – broadly - incompatible with this concept.

20. We agree that it may well be desirable for a KID to be customer specific. In the case of some products – such as annuities – such specification may be inherent, since without information which is specific to the individual customer the document is unlikely to be informative.

21. We do not see why distributors should not be permitted to compile client-specific KIDs and, as a result of this, we do not see why distributors should not be permitted to prepare KIDs for all products which they wish to distribute. We note that a rule which required all KIDs to be prepared by product providers would effectively prohibit such customisation, since the product provider is not in direct contact with the client and would be unable to provide a customised KID. If a distributor wishes to prepare a KID (or a customised KID), he should be free to do so. It follows from this that liability for the KID should rest with the person who prepared it – a rule that product providers always had liability for KIDs would, again, effectively prohibit the preparation of KIDs by anyone other than providers and in consequence operate as a ban on personalised KIDs. Consequently we believe that it should be open to product distributors and product providers to agree between themselves who should prepare the KID and where liability for that KID should lie. Provided that the result of this agreement is made very clear to the investor, there is no reason why the investor should not be bound by this. Thus if an investor has been made aware that a particular KID is prepared solely by the product provider, he should only be entitled to remedies against that product provider. Conversely, if the investor has been made aware that a particular KID has been prepared solely by a distributor, his recourse should be solely against that distributor.

22. We agree that a wrapper is not itself a PRIP, and that the fact that a non-PRIP product is offered in a wrapper should not itself trigger the preparation of a KID. We also agree that where a PRIP product is offered in a wrapper, the relevant significant information about the wrapper should be disclosed in the KID.

Suitability and Appropriateness

23. We agree that the MiFID rules form the best base from which to work to develop a PRIPs distribution regime. The basis of the MiFID distribution regime is the suitability obligation which is imposed on any financial intermediary which advises or recommends a client to make an investment. MiFID also permits an alternative, lower, standard of care - appropriateness - where a retail customer does not seek advice from the intermediary. Securities may be sold to retail investors outside the scope of these protections, but this is only permissible for "non-complex" products.

24. The appropriateness standard may not be relevant in this context. The objective of the KID is precisely to disclose to investors the risks inherent in the product. The existence of the KID requirement should put PRIPs on the same footing as UCITS, where the fact of the existence of the simplified prospectus results in the

disapplication of the appropriateness rule through the deeming of the product as being non-complex. It seems to us that the simplest method of dealing with this would be to provide that the existence of a KID satisfies the appropriateness requirement for non-UCITS products, and that for non-MiFID products the extension of the suitability regime should not be accompanied by any extension of the appropriateness regime to products which are covered by the KID requirement. Furthermore, not putting PRIPs on the same footing as UCITS in this regard would not satisfy the public policy objectives of the PRIPs project. We also note that, given that the recent CESR paper on complex and non-complex products (CESR 09/558) does not reach a firm conclusion on whether all UCITS should automatically be considered non-complex regardless of their complexity, it may be a better approach to use the PRIPs legislation to place UCITS and non-UCITS on a similar basis in this regard.

25. If the appropriateness standard were to be applied across the universe of PRIPs, it would be necessary to make some difficult determinations as to "complex" versus "non-complex" status – how, for example, would an annuity be categorised for this purpose? It is also notable that the MiFID standard is not in fact a simple measure of product complexity – UCITS, no matter how complex, are deemed to be non-complex for this purpose.

26. A false link is sometimes made between product complexity and product risk, which leads to the illusion that complexity and risk are synonymous. This is clearly not the case - for example principal protected products may be highly complex precisely because they are structured to reduce risk. It is also sometimes suggested that complex structures are unsuitable because they cannot be easily understood. This is based on another fallacy - what investors need to understand is not the underlying structure of an investment, but the risks inherent in it. In the retail markets product complexity is often the result of products being structured to create more precisely defined investment outcomes. The complexity of many defined return investments delivers a simplified and more easily understandable risk exposure than does a conventional variable return investment.

27. This is particularly important in the context of defined return investments. Many structured products are structured specifically to provide the investor with protection – that is, the investor gives up some part of his potential return in order to increase the predictability of his final return. Products of this kind are optimised for investors with lower risk tolerances, and are likely to be unsuitable for investors who are actively seeking higher levels of risk. Thus for these products there a strong inverse relationship between complexity and risk – the more complex the product, the less risk it is likely to embed.

28. The suitability of a particular product for a particular investor is a function of the investor's existing asset exposure, investment objectives, risk tolerance and financial needs. The complexity or otherwise of a product is not a relevant characteristic in the making of this determination – what matters is whether the investor understands what the risks are and what the returns are likely to be.

29. It is arguable that if the PRIPs proposals were to adopt the MiFID appropriateness standard it would be beneficial for a more rational classification than "complexity" to be applied.

Satisfying Client Obligations

30. PRIPs may be sold either through a fragmented distribution chain (i.e. where the product producer 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 PRIPs sales to be applicable across both of these models. For this purpose, it will therefore be necessary to distinguish between those proposed rules which relate to the conduct of business of the relevant intermediary (conflicts, inducements, suitability, reason why requirements) and those which relate to the product itself (product design, risk identification and return modelling). Product producers cannot deliver requirements which relate to the conduct of the intermediary selling the product, and it is important that the rules do not impose such obligations.

31. The suitability obligation necessarily rests on the distributor. However, the delivery of an appropriate outcome for the investor is generally a result of appropriate co-operation and interaction between the distributor and the product provider. The Joint Associations Committee has therefore focused on this area, and in particular has produced the July 2007 Provider-Distributor Principles (Annexe 1 to this letter) and the Distributor-Investor principles (Annexe 2). Distribution chains vary considerably across product types and industry segments, and the exact responsibilities of a firm must flow from the role it plays in the product delivery and lifecycle chain. Consequently we do not believe that it is likely to be possible to generalise about liability and responsibility for KIDs and/or the provision of suitable or appropriate services. What is important is to ensure that the distribution process is regulated as a whole in such a fashion as to ensure that there are no lacunae. The ultimate aim is to ensure that the customer is not treated differently in dealing with a fragmented distribution chain than he would be if he were dealing with an integrated producer/distributor.

32. The imposition of MiFID conduct of business rules on non-MiFID distributors is likely to pose a major supervisory challenge for national regulators – for example, few national regulators impose obligations on firms which arrange deposits, and the creation of mechanisms to supervise such firms may be difficult unless those firms were to be "deemed" into MiFID for the purpose of their PRIPs activities. However, in many member states this would lead to multiple regulation of the same or similar activities.

Fee Disclosure

33. Collective Investment PRIPs must be subject to a fee disclosure regime. This is because the fees concerned are deducted from the performance of the underlying assets , and are therefore charged directly to the customer. For products of this kind,

a customer cannot calculate his expected return on his investment unless he knows the level of such costs.

34. This is not generally true of Contractual PRIPs. A Contractual PRIP is a product which specifies to the investor exactly what he will receive at a future time. For such products there are no "costs" in the sense given above. For example, a deposit account customer has no need to know what happens to his money once it is deposited – his entitlement to the return specified when he made the deposit is not affected by the question of what the bank concerned did with his money once it received it and whether such bank made or lost money with the proceeds of the deposit. The same is true for structured bonds.

35. Contractual PRIPs and Collective Investment PRIPs are priced differently. A Collective Investment PRIP is a packaged offer of a service for a fee, and the fees charged for the provision of that service are generally absolute and not performance related. Thus what the investor will get as his investment return will be the investment performance less the management fees charged. He therefore needs to know the management fees charged in order to be able to work out what his investment return is likely to be. A Contractual PRIP, by contrast, will pay the defined return - fees and costs are already taken into account in the calculation of the return which is defined. The issue for the investor is as to whether the price which he is being charged for that return is cheap or dear, and he - or, usually, his investment adviser or broker - can establish this by looking across the range of competing products and structures. A useful comparison can be made with bank deposits - an investor is not told, and does not need to know, the return which the bank hopes to make over its funding costs on the particular deposit.

36. What follows from this is that it is incorrect to regard a Contractual PRIP as a species of managed fund. The investor pays a price to receive a structured return, and the return he receives will be the return specified in the documentation. The profit or loss which may be made by the producer of the product is not analogous to the fees charged by a manager, since management fees are deducted from the return which the investor would otherwise have received, whereas product profits made or losses suffered are not. Consequently, disclosure of profit margins or losses on hedging is irrelevant to Contractual PRIPs.

37. This is a manifestation of the fact that it makes little sense to speak of comparing profitability even between different PRIPS. 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 is 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. It is therefore seriously misleading to compare the profit made on hedging retail products with the management fee derived by a fund manager from his management activities. One is disclosed to the customer because it comes out of his pocket. The other is not because it does not.

Commission Disclosure

38. There is, however, a considerable difference between profit margins made by distributors and inducements paid to distributors. This is because the latter are capable of creating conflict or bias, and the possibility of such bias should be disclosed to the client. We believe that the disclosure-based approach adopted in MiFID is effective, and is sufficient to deal with this issue.

Post-sale Obligations

39. One of the most important structural distinctions between securities on the one hand and deposits, funds and life policies on the other is that the latter all give rise to a continuing contractual nexus between the product provider and the investor, which impose obligations to provide post-sale information. In the securities market the equivalent obligations of a securities issuer to a holder of securities are not contractual but arise exclusively from regulation. Securities issuers have therefore been obliged to develop mechanisms for providing post-sale information and secondary market liquidity, and these mechanisms frequently go well beyond the requirements imposed by the relevant regulatory framework. The reason for this development is partially to service investors, but partly also to ensure that securities can be offered on terms that are not materially worse than those of competing products. We believe that the PRIPs proposals should address post-sale disclosure requirements. However, here again, it is important to recognize that for some types of products (such as deposits and insurance policies) a continuing legal relationship between the product provider and the ultimate customer is an essential feature of the product, whereas for others (such as securities) the nature of the distribution chain may be such that the product provider may neither know nor be able to find out the identity of the ultimate client. All of these situations should be catered for in addressing post-sale disclosure issues.

40. It is also important to ensure that investors are clearly informed about their ability to liquidate their investments early, and the price at which they may expect to do so. There are two different mechanisms by which this may be achieved; either through a contract with the issuer by which the issuer undertakes to repurchase the investment, or through an arrangement by which the investor may sell the investment through a dealing mechanism. In the latter case, we note that product providers are frequently prevented from making robust arrangements for the secondary marketing of securities products by EU regulatory concerns[2]. Such barriers are not in the interests of consumers, and should be removed.

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[2] See for example Art 1(2) of the UCITS directive (85/611/EEC), which suggests that where arrangements are made to ensure that the market price of securities remains close to asset value, that this may have the effect of causing the securities to be treated as units in a collective investment undertaking.

Secondary Markets in Securities

41. One of the issues which is likely to arise in the construction of the PRIPS regime is the distinction between the making available to investors of securities dealing facilities and the marketing of PRIPS. It is clearly undesirable (if not impossible) to require a KID for every security admitted to trading on an exchange, neither should it be possible to construe the making available of securities dealing facilities as PRIPs marketing. However this interaction is not satisfactorarily dealt with in the Prospectus Directive, and the PRIPs legislation provides an opportunity to address the issue in a coherent fashion. This opportunity should be taken.

Yours sincerely,

Timothy R Hailes
Chairman – Joint Associations Committee on Structured Products

ISDA.

ISDA, which represents participants in the privately negotiated derivatives industry, is the largest global financial trade association, by number of member firms. ISDA (the International Swaps and Derivatives Association) was chartered in 1985, and today has over 800 member institutions from 54 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

The International Capital Market Association is the self-regulatory organisation and trade association representing constituents and practitioners in the international capital market worldwide. ICMA's members are located in 48 countries across the globe, including all the world's main financial centres, and currently number some 400 firms in total. ICMA performs a crucial central role in the market by providing and enforcing a self-regulatory code of industry-driven rules and recommendations which regulate issuance, trading and settlement in international fixed income and related instruments. ICMA liaises closely with regulatory and governmental authorities, both at the national and supranational level, to ensure that financial regulation promotes the efficiency and cost effectiveness of the capital market. www.icmagroup.org

AFME (Association for Financial Markets in Europe) was formed on 1 November 2009 following the merger of LIBA (the London Investment Banking Association) and the European operations of SIFMA (the Securities Industry and Financial Markets Association). AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with SIFMA in the US, and the ASIFMA (Asian Securities Industry and Financial Markets Association) through the GFMA (Global Financial Markets Association). AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. For more information please visit the AFME website, www.AFME.eu.

ANNEX 1

Retail Structured Products: Principles for managing the provider-distributor relationship

A. Introduction

These 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 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 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 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: European Securitisation Forum (ESF), International Capital Market Association (ICMA), International Swaps and Derivatives Association (ISDA), London Investment Banking Association (LIBA) and Securities Industry and Financial Markets Association (SIFMA). Furthermore, the associations issued the 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 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 Principles do not, unless otherwise indicated, address the role of entities acting solely as issuer of a product.

The 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 Principles, as appropriate, to take account of such specific factors.

B. Principles

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

Structured Products: Principles for Managing the Distributor-Individual Investor Relationship

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 principles in mind in their dealings with individual investors in structured products. These principles complement and should be read in conjunction with our recently released, "Retail Structured Products: Principles for Managing the Provider-Distributor Relationship," available at the websites of the five sponsoring associations[3], which focus on the relationship between manufacturers and distributors. These principles apply to the relationship between the distributor and the individual investor.

Although these 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 Provider-Distributor Relationship Principles noted above (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 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 principles that are not appropriate to such relationships (for example, those relating to secondary market making and client appropriateness and suitability) shall not apply.

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[3] European Securitisation Forum, International Capital Market Association, International Swaps and Derivatives Association, London Investment Banking Association, Securities Industry and Financial Markets Association

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.

Principles

These 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 Principles. Moreover, the Principles are to be taken collectively, rather than viewing any one Principle in isolation from the others.

1. Product Transparency

The party who is primarily responsible for the creation of marketing materials,[4] or is responsible for a prospectus, or other offering memorandum, should, to the extent permitted by applicable laws and regulations[5], 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

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[4] The relationship between providers and distributors is specifically addressed in "Retail Structured Products: Principles for Managing the Provider-Distributor Relationship," Principle 5, Joint Trade Associations, July 2007.

[5] In some jurisdictions, law and regulation may specify or limit the form, the content or the presentation of material which may be given to investors. These principles do not require such rules to be disregarded.

will be helpful to both individual investors' and financial advisors'[6] 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.[7]

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.

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[6] "Financial advisor" refers to the firm's employees, or independent contractors, who interact directly with individual investors and who are registered to solicit trades and effect transactions. The formal term may vary significantly by firm and/or jurisdiction.

[7] Insofar as a secondary market exists for the product. See Principle 7.

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 it affects 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,[8] and other pertinent information.

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[8] Insofar as a secondary market exists for the product. See Principle 7.