

23 May 2011

## **JOINT ASSOCIATIONS COMMITTEE COMBINED PRINCIPLES FOR RETAIL STRUCTURED PRODUCTS**

In July 2007, the Joint Associations Committee on Retail Structured Products (the **JAC**)<sup>1</sup> published a set of principles for managing the provider-distributor relationship in retail structured products (the **PD Principles**). This was followed in July 2008 by a set of principles for managing the distributor-individual investor relationship (the **DI Principles** and, together with the PD Principles, the **Principles**). The Principles were drafted with the intent of achieving fair treatment for individual investors and clarifying the respective roles and responsibilities of the various parties involved in the creation and distribution process.

The years since 2008 have seen increased recognition by governments and regulators of the importance of a vibrant and well-functioning retail structured products market. However, the financial crisis has also impaired investor confidence. Such considerations have led to regulatory initiatives designed to improve investor protection in multiple jurisdictions.

The JAC is extremely supportive of such initiatives and is fully committed to working with governments and regulators to facilitate positive consumer outcomes. As such, the JAC has been an active participant in the consultation process in multiple jurisdictions<sup>2</sup>.

**Although published before the financial crisis, the Principles address many of the same issues as those sought to be addressed by such initiatives. Given this, the JAC feels that now is an appropriate time to re-release the Principles in order to both encourage their usage and help inform the current debate.**

Accordingly, the PD Principles and DI Principles are restated in Annexes 1 and 2, respectively. The original sponsoring trade associations and their successors (the International Swaps and Derivatives Association (ISDA), the International Capital Market Association (ICMA), the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA)) have been joined by the British Bankers' Association (BBA), Associazione Italiana Intermediari Mobiliari (ASSOSIM), the Futures and Options Association (FOA), the Asia Securities Industry and Financial Markets Association (ASIFMA), the Institute of International Finance, Inc. (IIF) and the US Structured Products Association (SPA) in recognition of the importance of this work.

Although the Principles are non-binding (being intended primarily to help inform firms' thinking), the events of recent years have served only to increase their relevance. **As highlighted above, much of their conceptual rationale foreshadowed the themes of recent regulatory reform in this area.**

Such themes have a commonality across jurisdictions:

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<sup>1</sup> The JAC is sponsored by multiple associations with an interest in structured products. The members of the JAC comprise most of the major firms (both financial institutions and law firms) involved in the creation and, to some extent, distribution of structured securities which are distributed to retail investors.

<sup>2</sup> Since 2007, the JAC has been an active participant in the European Commission's initiative on Packaged Retail Investment Products and has also contributed to regulatory initiatives by - and engaged with - regulators globally, including the International Organization of Securities Organization (IOSCO), the Australian Securities & Investments Commission, the China Banking Regulatory Commission, the Hong Kong Monetary Authority, the Hong Kong Securities and Futures Commission, the Italian CONSOB, the Securities Commission in Malaysia, the Monetary Authority of Singapore, the Taiwan Financial Services Roundtable and the UK Financial Services Authority.

- first, there is a focus on the **interactions between individual investors and distributors** – on ensuring that conflicts of interest of distributors and providers are managed, that the risk of misselling is mitigated and that products are suitable for the specific needs of a particular investor.
- secondly, there is a focus on greater **pre-sale disclosure** – on reducing the asymmetry of information that exists between the provider/distributor on the one hand and the investor on the other, and on ensuring that investors receive information that is readily understandable and can be compared with other products in the market.
- finally, there is an increasing recognition that certain products might not be appropriate for certain target audiences and that some form of regulatory **product intervention** may be justifiable in those instances.

Such themes are consistent with those that underpin the Principles and their merit is fully recognised and endorsed by the JAC. For example, DI Principle 1 emphasises that disclosure documentation should enable investors to evaluate the investment from a risk/reward perspective and that distributors responsible for the creation of marketing materials should ensure that such marketing materials are appropriately tailored to the knowledge and sophistication of individual investors in the target market. DI Principles 3 and 4 stress the importance of full disclosure of fees and commissions payable to the distributor and the importance of distributors identifying potential conflicts and how to mitigate, manage or disclose such conflicts. DI Principle 6 holds that distributors need to assess whether products are generally appropriate for their intended target market and DI Principle 8 looks at the importance of assessing the suitability of a product for a particular investor.

The PD Principles take account of the many different routes by which investment exposures are mediated to customers and the various roles played by financial institutions in such process (whether in the design of an index, structuring an investment product, arranging for its issue, managing the portfolio of assets associated with it, assisting a person to acquire it or advising a person on whether to do so). The PD Principles aim to ensure a clear allocation of roles and responsibility between providers and distributors.

Through the application of the Principles, the JAC aims to support the following consumer outcomes:

- the recipient of a financial service or product should be in a position to understand the service or product in all material respects including its risk-reward profile or be represented by an agent who can understand the service or product.
- the decision to buy a financial service or product should not be influenced by a material conflict of interest on the part of the provider or distributor/advisor.
- a recipient of personal recommendations should expect the provider to take reasonable care in the provision of that investment advice.

Given the above, the JAC strongly encourages providers and distributors to consider how best to reflect the Principles in their policies and procedures, and believes that the adoption of the Principles greatly assists in allowing investors to confidently access good quality and appropriate investment products. In addition, adoption of the Principles serves a public policy interest in that it mitigates potential damage to investor protection from different or divergent national or regional approaches on these issues. This will be of ever increasing importance as markets continue to globalise and investors of all levels of sophistication and capability seek investment opportunities both in their home jurisdictions and beyond.

## PARTICIPATING ASSOCIATIONS



Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA is one of the world's largest global financial trade associations, with over 800 members institutions from 56 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. Information about ISDA and its activities is available on the Association's website: [www.isda.org](http://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](http://www.icmagroup.org)

ICMA is listed on the EU Register of Interest Representatives, registration number 0223480577-59.



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 was formed on 1st November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and 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. AFME is the European regional member of the Global Financial Markets Association (GFMA) and is an affiliate of the US Securities Industry and Financial Markets Association (SIFMA) and the Asian Securities Industry and Financial Markets Association (ASIFMA). For more information, visit the AFME website, [www.AFME.eu](http://www.AFME.eu).

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76

The British Bankers' Association (BBA) is the leading association for the UK banking and financial services sector, speaking for over 220 banking members from 60 countries on the full range of UK and international banking issues. All the major banking players headquartered in the UK are members of the association, as are the large international European Union banks with operations in the UK, the US banks operating in the UK and many other financial entities from around the world. The integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum encompassing services and products as diverse as primary and secondary securities trading, insurance, investment banking and wealth management, as well as deposit-taking and other retail/commercial banking activities.



The voice of banking  
& financial services



ASSOSIM (Associazione Italiana Intermediari Mobiliari) is the Italian Association of Financial Intermediaries, which represents the majority of financial intermediaries acting in the Italian Markets. ASSOSIM has nearly 80 members represented by banks, investment firms, branches of foreign brokerage houses, active in the Investment Services Industry, mostly in primary and secondary markets of equities, bonds and derivatives, for some 82% of the total trading volume.

ASSOSIM is listed on the EU Register of Interest Representatives, registration number 48038551498-21.



The Futures and Options Association (FOA) is the industry association for some 170 international firms and institutions that engage in the carrying on of derivatives business, particularly in relation to exchange traded transactions. The FOA's membership includes banks, brokerage houses and other financial institutions, commodity trade houses, power and energy companies, exchanges and clearing houses, as well as a number of firms and organisations supplying services into the futures and options section.

FOA is listed on the EU Register of Interest Representatives, registration number 2992254367-88.



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 Asia Securities Industry & Financial Markets Association (ASIFMA) is an independent association whose mission is to promote the development of liquid, efficient and transparent capital markets in Asia and facilitate their orderly integration into the global financial system.

Association priorities are driven by the active participation of over 40 member companies, including global and regional banks, securities dealers, brokers, asset managers, credit rating agencies, law firms, trading and analytic platforms, and clearance and settlement providers involved in Asian capital markets.

ASIFMA is located in Hong Kong and works closely with global alliance partners: the Global Financial Markets Association (GFMA), the Securities Industry and Financial Markets Association (SIFMA) and the Association for Financial Markets in Europe (AFME).



The Institute of International Finance, Inc. (IIF), is the world's only global association of financial institutions. Created in 1983 in response to the international debt crisis, the IIF has evolved to meet the changing needs of the financial community. Members include most of the world's largest commercial banks and investment banks, as well as a growing number of insurance companies and investment management firms. Among the Institute's Associate members are multinational corporations, trading companies, export credit agencies, and multilateral agencies. Approximately half of the Institute's members are European-based financial institutions, and representation from the leading financial institutions in emerging market countries is also increasing steadily. Today the Institute has more than 400 members headquartered in more than 70 countries.



The Structured Products Association (U.S.) is the trade association for the American structured investments industry. Comprised of nearly 12,000 professionals, the SPA advocates for the structured products investment class among regulators, media, advisors and investors. The SPA promotes investor education as a core mission of the industry.

## 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<sup>1</sup>. 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.

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<sup>1</sup> International Swaps and Derivatives Association (ISDA), International Capital Market Association (ICMA), previously London Investment Banking Association (LIBA) and European Securitisation Forum (ESF) (now Association for Financial Markets in Europe (AFME)), British Bankers' Association (BBA), Associazione Italiana Intermediari Mobiliari (ASSOSIM), Futures and Options Association (FOA), Securities Industry and Financial Markets Association (SIFMA), Asia Securities Industry and Financial Markets Association (ASIFMA), Institute of International Finance, Inc. (IIF) and US Structured Products Association (SPA).

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, 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 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<sup>1</sup>, or is responsible for a prospectus, or other offering memorandum, should, to the extent permitted by applicable laws and regulations<sup>2</sup>, 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'<sup>3</sup> 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.

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<sup>1</sup> The relationship between providers and distributors is specifically addressed in "Principles for Managing the Provider-Distributor Relationship" PD Principle 5 set out at Annex 1 hereto.

<sup>2</sup> 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.

<sup>3</sup> "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.

## **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<sup>4</sup>.

## **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

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<sup>4</sup> Insofar as a secondary market exists for the product. See DI Principle 7.

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<sup>5</sup>, and other pertinent information.

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<sup>5</sup> Insofar as a secondary market exists for the product. See DI Principle 7.