

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.



The European Securitisation Forum is the voice of the securitisation and CDO market place in Europe, with the purpose of promoting efficient growth and continued development of securitisation throughout Europe. Its membership is comprised of over 160 institutions involved with all aspects of the securitisation and CDO business, including issuers, investors, arrangers, rating agencies, legal and accounting advisors, stock exchanges, trustees, IT service providers and others. The Forum is affiliated with the Securities Industry and Financial Markets Association (SIFMA).



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



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 London Investment Banking Association (**LIBA**) is the principal trade association in the United Kingdom for firms active in the investment banking and securities industry. The Association represents the interests of its Members on all aspects of their business and promotes their views to the authorities in the United Kingdom, the European Union and elsewhere. For more information, please visit www.liba.org.uk.



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.

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.