May 21, 2012

Mohamed Ben Salem
General Secretariat
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Public Comment on Suitability Requirements with respect to the Distribution of Complex Financial Products

Dear Sir,

On behalf of the Institute of International Finance, the International Banking Federation, and the Joint Associations Committee on Retail Structured Products, (the JAC)[1] together 'the Associations', we welcome the opportunity to comment on the consultation report *"Suitability Requirements with respect to the Distribution of Complex Financial Products"* – henceforth "the draft Principles" - prepared by the Technical Committee of the International Organization of Securities Commissions (IOSCO) and issued for comment in February 2012.

On March 11th, 2011, the Associations wrote to IOSCO, welcoming the then-ongoing work on international principles on suitability requirements, and suggesting a number of principles. We argued that "*It is of absolute importance that investors of all levels of sophistication and capability be treated fairly, honestly, efficiently and professionally, and appropriate standards on suitability analysis are essential to the pursuit of those goals. […] We would argue however that there is a further public policy interest in addressing this issue: that of mitigating any potential damage to investor protection from different or divergent national or regional approaches on these issues. Indeed, the Associations would very much encourage further work on convergence in these areas, which will become increasingly important in the years to come as markets continue to globalize and investors of all levels of sophistication and capability seek investment opportunities both in their home jurisdictions and beyond.*"

We therefore welcome the efforts in this direction and are broadly supportive of the direction of the principles as currently drafted. The industry has long taken an interest in these

[1] The JAC is sponsored by multiple associations with an interest in structured products: the International Swaps and Derivatives Association (ISDA), the International Capital Markets Association (ICMA), and the Association for Financial Markets in Europe (AFME). In the first instance, queries on the JAC may be addressed to rmetcalfe@isda.org.

issues and was active before the financial crisis, notably through the publication by the Joint Associations Committee of principles for managing the provider-distributor relationship (PD Principles) in retail structured products and principles for managing the distributor-individual investor relationship (DI Principles), in July 2007 and July 2008 respectively.

Nevertheless, as we argued then, we believe that a focus on "complex" financial products rather than all financial products would be difficult to implement and administer for regulatory authorities, firms and customers and would ultimately lead to worse outcomes. For example, complexity does not always mean additional risk and conversely, some non-complex products may be higher risk. We strongly suggest that in adopting final principles, IOSCO adopt an approach that is applicable to all securities, collective investment schemes and related derivatives instruments and the balance of risk and reward associated with them and that the references to "complex" financial products be largely dropped from the principles and guidance. A further benefit of this would be that it would underline the fact that all customers deserve these standards of care and consistent, high standards of protection, rather than only those customers buying complex products, a sentiment with which you surely agree. We hope therefore that you will give this detailed consideration.

General Comments on the Draft Principles

In the annex attached to this letter, we have provided comments on the individual draft principles and guidance. Nevertheless, we felt that it would be beneficial to make a number of more general comments.

As noted above, with the exception of the word "complex", we are broadly supportive of the direction of the principles as currently drafted. Nevertheless, if you do not decide to go down this route, we think that the definition of "complex products" on page 10 should be completely revised and made far more detailed and specific. As drafted, it is extremely vague and confusing. Who for instance is "an average retail customer"? It is difficult to imagine that the current definition would lead to a common approach across IOSCO members.

Indeed, we have a number of problems with the definitions used. The definition of 'suitability' in particular is extremely widely defined. This has practical problems in the text, where a wide definition would create confusion, for instance in the application of Principle 5. We also find the definition of "distribution" far too widely drawn.

We recognize the difficulty of coming up with precise definitions and would be very happy to work with IOSCO and with other industry stakeholders on more precise and narrow definitions.

It is also unclear as to exactly which products the draft Principles would be applied to. We believe that the guidance should make it clear that it will only apply to investment products.

There is also confusion in the use of "customers", "investors" and "clients" throughout the text. We would suggest a consistent use of the term "customer".

In finalizing the principles and guidance and deciding on the appropriate level of convergence and detail though, we believe that it is essential to be clear on the ultimate objective of the principles and their future use.

We suggest that the principles and guidance be drafted at a level of detail and convergence that would be a step along the road to mutual recognition or "substituted compliance" between IOSCO members. The 'litmus test' for whether draft principles or guidance would fully do this would be that if a national regulator or supervisor were to implement them in full and ensure that their intermediaries were in compliance with them, a host country regulator would feel comfortable in recognizing that other regulator's oversight as providing 'equivalent' or 'comparable' protections to customers for such products.

On the content of the draft principles and guidance, we support a general classification of customers, but within the retail category in particular as we argued last year, IOSCO should "*take account of the gradations in sophistication or capability of investors*". Individual retail investors will vary greatly in their level of understanding of markets, and there will be similar variations between individual non-retail investors. Some retail investors will in fact have a high degree of sophistication, experience, knowledge and capability, whereas others will have a much lower degree. Both market intermediaries and regulators should be attentive to this.

Investors of a similar level of actual sophistication or capability should be afforded a similar, appropriate minimum level of protection in taking on an investment exposure of a given sort regardless of the number and relative roles of the firms involved in the process by which an exposure (having been put into a investment form) is provided to the investor. However, this principle needs to be qualified by reference to the services a particular investor selects – in particular, the fact that some investors will not want investment advice or, where they do, will not seek to establish an ongoing relationship.

The guidance should also contain a firm statement to the effect that irrespective of the classification of the customer, nothing in the guidance should be read as detracting from the responsibility of all investors once they have received suitable advice and appropriate disclosures from an intermediary or have chosen not to seek advice, to evaluate any information provided to them, educate themselves about the products they undertake and ultimately take responsibility for the risks of their choices. Investors as well as intermediaries – and product providers – have responsibilities.

We also feel that the principles as drafted lose sight of the fact that the relationship between intermediaries and investors goes beyond the provision of advice at a fixed point of time. In our 2011 letter, we suggested that there were three basic phases for the distribution process: pre-sale (marketing, disclosure, information gathering on the investor); point of sale (advice, execution of orders); and post-sale/ongoing duties both with regard to the sale of an individual product and arising from an account relationship. There are also requirements or duties that should operate at all stages in the process. The principles would be stronger if more account was taken of these phases.

We fully agree that intermediaries should ensure that any financial products they intend to distribute are suitable for the type of customer they intend to solicit. However, we strongly feel that, there should be no regulatory obligation or limit to the sale of a product to particular categories of

clients. Nevertheless, intermediaries should be able to justify their decisions to the supervisor and show that it did not amount to misselling."

Whilst we agree that comprehensive and regularly updated Know Your Customer (KYC) requirements are necessary, we feel that ultimately the best way to protect consumers is to ensure that the advice and sale process is adequate.

We very much welcome though the 'business model-neutral' approach adopted in the guidance and hope that it will be maintained. It is important that customers understand the remuneration and incentives for intermediaries, rather than favoring one form over another.

We also welcome the recognition of the role of product providers and would support work on international principles for these and for their relationship with intermediaries. We note here that the Joint Associations Committee last year reaffirmed the set of principles for managing the provider-distributor relationship (PD Principles) in retail structured products and the principles for managing the distributor-individual investor relationship (DI Principles), originally published in July 2007 and July 2008 respectively and believe that the PD Principles could be a good starting point for this work.

Whilst the Associations recognize that the immediate focus is and should be on suitability requirements, as we argued last year, we believe that it will be important to proceed to develop common global standards on client categorization in relation to offering restrictions, conduct of business rules and licensing requirements. In this regard, the Associations recall that the IIF and the Securities Industry and Financial Markets Association (SIFMA) wrote to the then Chairman of the IOSCO Technical Committee, Michel Prada, in October 2007 calling, *inter alia*, for convergence of investor categorization regimes and believe that the arguments in that letter are still valid. This would also be very much in line with the G-20 mandate to IOSCO on business conduct standards.

One major omission though, which we hope will be addressed, is on the topic of product governance. Whilst we recognise that the principles are intended to apply to intermediaries there is an important inter-relationship between the product origination, structuring and governance process and the selection and delivery process; indeed the PD Principles and DI Principles reflect this connectivity and the JAC has undertaken some work in this area already through its response to the UK FSA consultation on this topic. We believe that the guidance should make clear, for example, that intermediaries should satisfy themselves that the product provider has in place effective procedures to ensure strong governance of the product and to avoid conflicts of interest; in framing these suitability requirements IOSCO should have due regard for the overall chain of relationships involved, ensure that each component is calibrated to the respective roles performed and, critically, informed by the connections between each of them rather than considered in isolation of each other.

The Associations would welcome the opportunity to engage further with IOSCO on this area."

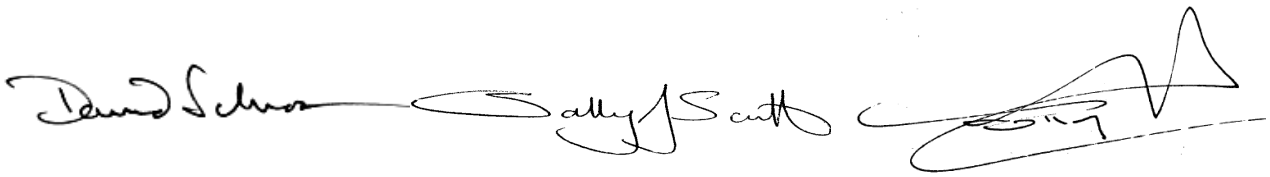
Conclusion

The Associations welcome the chance to comment on the draft Principles and guidance and support IOSCO's engagement in this area. Global standards both here and on the linked issue of

client categorization would be in the interests of investor protection and financial market integrity. Such standards will be far more meaningful and effective though if they apply to all securities, collective investment schemes and related derivatives instruments, so we urge you to reconsider the focus on "complex" products.

If you have any questions do not hesitate to contact Crispin Waymouth – cwaymouth@iif.com.

Yours faithfully,



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Annexes

1. Detailed Comments on Principles
2. Joint Associations Letter and Principles of March 2011
3. JAC Principles

Response to IOSCO Consultation Report: "*Suitability Requirements with respect to the Distribution of Complex Financial Products*": Detailed Comments on Principles

Principle 1

Intermediaries should be required to adopt and apply appropriate policies and procedures to distinguish between retail and non-retail customers when distributing complex financial products. The classification of customers should be based on a reasonable assessment of the customer concerned, taking into account the complexity and riskiness of different products and services. The regulator should consider providing guidance to intermediaries in relation to customer classification.

We agree with the distinction between retail and non-retail customers, which reflects policy and existing regulation in a large number of jurisdictions. This principle though should operate irrespective of the complexity and riskiness of the products. What counts is the assessment of the sophistication and ability of the customer.

We would therefore recommend amending this principle to read:

"Intermediaries should be required to adopt and apply appropriate policies and procedures to distinguish between retail and non-retail customers when distributing ~~complex~~ financial products. The classification of customers should be based on a reasonable assessment of the customer concerned~~, taking into account the complexity and riskiness of different products and services~~. The regulator should consider providing guidance to intermediaries in relation to customer classification.

While we do not favor going into the details of the classification, there should at least be a sufficient level of commonality that retail customers in one jurisdiction can feel confident in their treatment as retail customers in another jurisdiction. This will be important in future moves to mutual recognition/ substituted compliance. As such, we would suggest dropping the word "Possible" from the second paragraph of the guidance on this principle.

Once this distinction between these two broad categories of customers has been made though, regulators should acknowledge and the guidance should reflect that even within these categories there will be variations in the sophistication and capability of customers, particularly retail customers. Individual retail customers will vary greatly in their level of understanding of markets.

On the one hand, as the fourth paragraph of the guidance on this principle states "*Intermediaries should be required to make their own assessments on the level of expertise and knowledge of the customer*". On the other, just because a customer is classified as retail, it does not detract from their responsibilities in the conduct of their own investment. The more sophisticated and capable a retail customer is, the more that they should be expected to carry out their own sufficient due diligence or as the IOSCO guidance says "*assess independently, or through a disinterested advisor, the value and risks of the transactions.*"

We therefore recommend that a further paragraph be added at the end of the guidance:

"Irrespective of the classification of the customer, nothing in this guidance should be read as detracting from the responsibilities of all customers once they have received suitable advice and appropriate disclosures from an

intermediary or have chosen not to seek advice, to evaluate any information provided to them, educate themselves about the products they undertake and ultimately take responsibility for the risks of their choices."

This would seem to us to be a more practical way of dealing with the kinds of issues with public entities explored in the third paragraph of the guidance than automatically including them as retail customers or extending additional protections. We therefore think that the guidance should be amended here.

We welcome the guidance that where the classification of customers is not determined by statute or regulation, the customer should be informed by the intermediary at the outset, which is very much in line with what we suggested.

Whilst we agree with paragraph 6 that jurisdictions may allow customers who qualify as non-retail customers to be treated as a retail customer, we feel that the guidance should be amended to include the following:

Customers treated as retail, or wishing to be treated as retail, should recognize: (i) that it may have cost implications; (ii) that the customer may need to provide more information to the intermediary; and (iii) that it may mean that the range of investments available to the customer is more restricted.

At the start of the final sentence of paragraph 6, the following should be added for clarification:

"*Depending on the nature of the service and what has been agreed with the customer*"

Unless agreed otherwise, the onus will be on the customer to alert the intermediary to any changes that might affect their treatment.

Principle 2

Irrespective of the classification of a customer as retail or non-retail, intermediaries should be required to act honestly, fairly and professionally and take reasonable steps to manage conflicts of interest that arise in the distribution of complex financial products, including through disclosure, where appropriate.

We agree strongly with this principle and with the guidance as drafted. It is of fundamental importance that market intermediaries act honestly, fairly and professionally irrespective of the level of sophistication and capability of the customer.

Principle 3

Investors should receive or have access to material information to evaluate the nature, costs and specific risks of the complex financial product. Any information communicated by intermediaries to their customers regarding a complex financial product should be communicated in a fair, comprehensible and balanced manner.

We agree strongly with this principle and with most of the guidance as drafted subject to the replacement of the word "Investors" with "Customers" and the deletion of the word "complex" throughout. It would though be useful for the guidance to clarify whose responsibility it is to provide customers with information, as there will be cases where the responsibility is with the product provider to produce the information and where the role of the intermediary is to disseminate it.

In the Associations' Principles, we called for the intermediary to "*make adequate disclosure of relevant material information in its dealings with its customers. All communications should be clear, fair and not misleading.*"[1] Further, we called for intermediaries to "*take all reasonable steps to satisfy themselves that the customer has sufficient information on the investment in a form the customer is reasonably likely to understand so that the customer has had an adequate opportunity to understand the risk/reward profile and other material characteristics of the relevant investment before making any decision whether to enter into the relevant transaction.*"

In particular, we very much support the third and sixth paragraphs of the draft guidance on the need for special care to be given to assist customers in making an informed investment decision, and the need for proper disclosure to include any compensation and/or fee that the intermediary may earn. We are happy to see that the draft Principles do not create any presumption in favor of a particular model of compensation, provided that this compensation is properly disclosed.

Whilst we support the broad approach of the fourth paragraph, we think that the guidance should refer to a "*description of the risk characteristics of the product*" rather than a "*description of the different components of the product and how these components interact.*" It is the risk characteristics that will be important to the customer rather than the different components *per se.*

However, in line with our general comments on the draft Principles, we think that making a distinction between complex and non-complex products would be an artificial one and not one that would help the investor. In the second paragraph, the draft guidance states that "*Complex financial products may have features and pose investment risks that are difficult for many customers, even non-retail customers, to appreciate fully.*" This is misleading: all financial products may have features that are difficult to understand. The duty of the intermediary is to explain those features, and as the guidance suggests, to present a "*fair, comprehensible and balanced picture regarding both the risks and potential benefits*". We would therefore suggest dropping the word "Complex" at the start of this paragraph.

In the same vein, we disagree with the argument in the fifth paragraph that "*Stricter disclosure requirements should apply whenever the intermediary advises or otherwise recommends the purchase of a complex financial product to retail customers.*" If the intermediary has provided a fair, comprehensible and balanced picture to the customer and if they have carried out a proper analysis of the suitability of such a product to the investor, such disclosure should already have been carried out. There would be no need for a further standard, and once again, it runs the risk of creating incentives against the use of more complex products even when they may be more suitable and less risky for the retail customer. We therefore recommend that you drop this paragraph.

[1] Associations' Principles, Principle 3

We have two further comments on the wording of the draft guidance:

- Paragraph seven states that "*Consumers should have reasonable access to information that fosters their ability to track costs and charges*". We agree with this, but think that it would be useful to define "*reasonable*" with as much clarity as possible. The phrase "*if practical and feasible, on an unbundled basis*" is also confusing and should be clarified.

- Paragraph eight argues that "*Moreover, where practical and feasible, intermediaries should seek to provide customers with comparative information.*" Whilst we think that the phrase "*where practical and feasible*" is essential, it would be helpful if there could be more narrative in the guidance on how this should be understood. In particular, the guidance could usefully make it clear that in some cases, there may not be a comparable product. Equally, the guidance could make it clear that intermediaries would not be expected to know about all the products and options viable in the marketplace, but to make a reasonable assessment of whether there are similar structured products based on reference securities that possess substantially similar volatility characteristics, but which offer materially different rates of return.

Principle 4

Even when an intermediary sells to a customer a complex financial product on an unsolicited basis (no management, advice or recommendation), the regulatory system should provide for adequate means to protect customers from associated risks.

The underlying idea of this draft principle appears to be that intermediaries should not attempt to evade their duties to customers by claiming that they were not giving them advice. We would agree with this idea, as simple and as obvious as it is. It is vital that if non-advice services are offered, customers should still benefit from protection and should not be exposed to misleading conduct.

However, as drafted, both the principle and guidance are ambiguous and would not promote a sufficiently common international approach.

We would therefore recommend that the principle and guidance be extensively revised so that, to the extent practicable, jurisdictions take similar approaches here. The principle and guidance should also consider the nature of the responsibilities of the intermediary in the case of a request for execution on an unsolicited basis, rather than automatically seeking recourse to regulatory safeguards.

In particular, what the guidance appears to miss is that even before an intermediary and customer reach the stage where a customer might buy a product on an unsolicited basis, they should already have reached a clear understanding of the nature of the services that the intermediary should provide. In the Associations' Principles, we suggested two Principles that should apply at the pre-service stage before an investment is recommended or sold:

"Principle 6. *An intermediary should disclose clearly and in sufficient detail for the customer to make an informed decision about whether to proceed:*

(a) the nature of the services it will provide, particularly whether it is restricted to executing an investment transaction or will include the provision of personal investment recommendations or discretionary investment management services;

(b) the nature of the investments covered by the service and whether or not the service will be provided by reference to substantially the whole of the market for investments of that sort; and

(c) the basis of its remuneration.

Principle 7. *An intermediary should consider whether it is appropriate to tell customers that do not seek investment advice (including via discretionary management) that it may be in their interests to do so."*

Whilst there is some overlap between (c) in Associations' Principle 6 and draft IOSCO Principle 3, we hope that you will consider making this distinction between the phases of the service and adopting these principles at least in the guidance. In addition, in Associations Principle 15, we covered the case of purchase on an unsolicited basis:

Principle 15. *Where a customer asks an intermediary to undertake a transaction in relation to an investment other than on the personal recommendation of the intermediary, the intermediary should consider whether, from what it knows of the customer, there is anything that clearly suggests the customer does not have a sufficient level of knowledge or experience to assess the merits of that transaction for the customer. However, if the customer still decides to proceed, having been given sufficient time to consider the issue properly, the intermediary can execute the transaction and is not under a duty to prevent it.*

Means for Implementation:

Where the intermediary reasonably believes that the customer may not have a sufficient level of knowledge or experience it should (but is not obliged to) consider whether to notify the customer that it would be prudent for the customer to take professional investment advice.

We think that this would provide more clarity than the existing text and would actually provide greater consumer protection, so would encourage you to adopt it or similar wording in the text.

Furthermore the guidance does not get across the point that when a client delegates its asset management through a discretionary mandate, it is vital that the service be understood and the risk/reward profile respected. This does not mean per se that more complex strategies or riskier products cannot be used in reasonable proportion (i.e. limiting risk or hedging). We think that wording clarifying should be integrated into the text.

Principle 5

Whenever an intermediary recommends to a customer that it purchase a particular complex financial product, including where the intermediary advises or otherwise exercises investment management discretion, the intermediary should be required to take reasonable steps to ensure that recommendations, advice or decisions to trade on behalf of such customer are based upon a reasonable assessment that the structure and risk-reward profile of the financial product is consistent with such customer's experience, knowledge, investment objectives, risk appetite and capacity for loss.

We support this principle as currently drafted. It very much echoes Associations' Principles 10 and 11:

Principle 10. *An intermediary must take reasonable steps to ensure that a personal recommendation or decision in the exercise of investment management discretion to trade on behalf of a customer is suitable for its customer.*

Means for Implementation:

An exchange of trading views between a firm and another participant in the market which can be treated as an equal should not be regarded as a personal recommendation.

Principle 11. *In determining whether a particular investment is suitable under Principle 10, the intermediary should satisfy itself on the basis of the information obtained from the client under Principle 9, that:*

(a) The relevant investment transaction is consistent with the customer's investment objective;

(b) The relevant investment transaction will not expose the customer to a loss that is greater than the customer is able to bear consistent with the customer's financial situation and the customer's investment objective; and

(c) The customer has the knowledge and experience to understand the features, characteristics and risks of the particular investment.

The intermediary should not make a personal recommendation of an investment transaction to a customer or enter a transaction in the exercise of its discretion unless it reasonably believes that (a)-(c) above will be satisfied.

Nevertheless, in line with our general comments, we think that the term "suitability" has been insufficiently defined. This creates problems for the guidance on this principle as it is unclear for instance in the second paragraph of the guidance as to what the term "suitability" would mean.

There should also be greater clarity on how the distinction is made between "advice" and "investment management" vis-à-vis the client. The wording of the Principle is rather vague here.

Further, there are a few sentences in the guidance which we found difficult to understand.

The first paragraph of the guidance: "*In light of the greater reliance of customers on the recommendations and advice provided, or on the exercise investment discretion by the intermediary, the provision of such advisory or discretionary services calls for stricter protections.*" is difficult to understand. The sentence is confusing and unnecessary and we would recommend that you drop it.

Whilst we believe that we understand the underlying motivation behind the final sentence of the second paragraph: "*Moreover, if an intermediary's behavior amounts to making a recommendation to a customer, it cannot avoid its suitability obligations by claiming that it has not made any recommendations to such customer*", we think that "amounts" is potentially ambiguous and should be further defined or clarified.

The seventh paragraph "*Suitability obligations should apply to both the intermediary and the employees working within the firm*" is also ambiguous. Whilst we agree that the intermediary is not the only person in the firm with a duty towards the investor, the wording could be read as implying that the full panoply of suitability regulations would apply to all employees irrespective of their roles. We think that this wording could usefully revised to the effect that any employee whose actions will impact materially on either the quality of the investment product, the investment decisions, or on that of the advice to the investor should meet the highest standards of integrity and professional conduct. Given the overlap with Principle 7 below, though, we would recommend that any wording in this area be inserted into the guidance on that draft principle.

As with our comments throughout, we recommend that you drop the word "*complex*" throughout the guidance.

Further, while we agree that intermediaries should develop a thorough understanding of the features of the relevant financial product and that this would normally mean carrying out their own analysis, there will be cases where the product provider has already carried out that analysis and has provided it to the intermediary. In such cases, the intermediary would reasonably be expected to verify the analysis rather than to repeat it.

Principle 6

An intermediary should have sufficient information in order to have a reasonable basis for any recommendation, advice or exercise of investment discretion made to a customer in connection with the distribution of a complex financial product.

We support the principle and the basic thrust of the guidance. In the Associations' Principles, in addition to Principles 10 and 11 quoted in the discussion of Principle 5 above, we also had Principle 9:

Principle 9. *Unless operating on an exclusively execution-only basis and likely to be understood as such, an intermediary should seek from its customers information about their financial situation, investment experience and investment objectives relevant to the services to be provided.*

Means for Implementation:

When entering into a relationship which will involve the provision of personal investment recommendations or the exercise of investment discretion, intermediaries should make reasonable efforts to understand the needs and circumstances of their customer and to obtain information on, for example, the investor's financial situation and needs, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the intermediary considers to be necessary to enable it to advise unless the intermediary can reasonably satisfy itself that the customer is capable of evaluating risks independently, and doing so in practice.

We therefore agree that "*The goal is to reduce inducements to purchase a financial product where the customer neither understands the product, nor is capable of assuming the financial risks.*"

However we have significant concerns with a number of aspects of the drafting of the guidance:

i. As with all the principles, we believe that it should apply in relation to all financial products rather than solely complex ones. We therefore recommend deleting the word "complex" throughout.

ii. Given the overlap with Principle 5, we think that you should consider merging the two principles.

iii. We agree with the underlying philosophy of the second paragraph of the guidance that there will be cases where the intermediary has insufficient information to make a reasonably based recommendation. However we think that after "*should be required to consider whether it has sufficient information to make a reasonably based recommendation*", the words "*and should have the flexibility to decide whether or not to proceed.*" This would clarify the meaning rather than change it.

iv. Whilst we sincerely welcome the attempt to clarify "*in the best interests of the customer*" through the footnote applied to paragraph 3 of the guidance and completely agree that the intermediary should always provide advice that is suitable for the customer, we still have concerns with the phrase itself. Despite the guidance, it would be very difficult to implement as it would mean very different things in different jurisdictions. The footnote helpfully suggests that it need not amount to a fiduciary standard but does not provide sufficient detail on what it should mean instead. We believe that a better approach that would avoid this confusion would be to amend the first sentence of the third paragraph of the guidance to read "*In either case, the intermediary should provide advice that is reasonable and relevant in the circumstances*". The second sentence would be retained.

v. Whilst we recognize that in certain cases, the regulator may be given the power to, and choose to prohibit or restrict automatically the recommendations of certain categories of products, we believe that paragraph 4 as drafted is both too vague and is likely to lead to an expansive interpretation. We remain concerned that restrictions on the availability of a range of investment products could adversely affect investor

choice if such discretion is exercised with broad bans rather than by defining clearly the segment for which the prohibition is aimed. For example, as noted above, some retail investors, such as certain high net worth individuals, may have far higher levels of financial knowledge, experience and resources than other retail investors and may, therefore, be interested in and find more sophisticated products of great value to their investment planning. Restricting a recommendation to retail customers broadly may thus be too blunt a tool. We would therefore recommend redrafting it to read as follows:

"*In certain limited cases, where the regulator judges that that the recommendation of a particular financial product or group of products is inherently likely to lead to a situation where customers of a particular level of experience, knowledge, investment objectives, risk appetite and capacity for loss would neither understand the product, nor be capable of assuming the financial risks, the regulator may be given the power and choose to prohibit or restrict the recommendation to customers with a given set of characteristics."*

Principle 7

Intermediaries should establish a compliance function and develop appropriate internal policies and procedures that support compliance with suitability obligations, including when developing or selecting new complex financial products for customers.

We very much support this principle and the basic thrust of the accompanying guidance, subject of course to the deletion of the word "complex" throughout. Indeed, should IOSCO still want to retain specific references in the Principles and guidance to complex products rather than taking the more general approach to all financial products that we have suggested, the wording in paragraph 2 of the guidance "*including in the distribution of complex products*" could be used in other principles and guidance.

If anything, we would actually support the guidance going further. In the Associations' Principles,

Principle 4. ***An intermediary should:***

a) foster a culture in which its staff are likely to act in accordance with these Principles;

b) have and employ effectively the resources and procedures which are needed for the proper performance of its business activities.

Means for Implementation:

An intermediary should take reasonable steps:

(a) to put in place (i) training that is appropriate to the role of the staff concerned; and (ii) an independent compliance function. In each case, these should support a culture consistent with these Principles rather than just a "compliance culture"; and

(b) to ensure that its management receive sufficient information as to any activities it undertakes of a sort covered by these Principles to enable them to assess whether the intermediary has acted in a manner consistent with the Principles.

We suggest that you consider adopting some of this wording, particularly on the duties of management to receive sufficient information and on the need for a compliance culture.

As we have suggested in our response to draft Principle 5, this might be a more appropriate place to address the issue of the duties of employees in the firm as a whole.

One major omission though, which we hope will be addressed, is on product governance. The design of the product is touched on in the fifth paragraph but there is no reference to its ongoing governance. Whilst we recognise that the principles are intended to apply to intermediaries there is an important inter-relationship between the product origination, structuring and governance process and the selection and delivery process; indeed the Joint Associations Committee (JAC) principles for managing the provider-distributor relationship (PD Principles) in retail structured products and principles for managing the distributor-individual investor relationship (DI Principles), reflect this connectivity and the JAC has undertaken some work in this area already through its response to the UK FSA consultation on this topic. We believe that the guidance should make clear, for example, that intermediaries should satisfy themselves that the product provider has in place effective procedures to ensure strong governance of the product and to avoid conflicts of interest; in framing these suitability requirements IOSCO should have due regard for the overall chain of relationships involved, ensure that each component is calibrated to the respective roles performed and, critically, informed by the connections between each of them rather than considered in isolation of each other.

Principle 8

Intermediaries should be required to develop and apply proper policies that seek to eliminate any incentives for staff to recommend unsuitable complex financial products.

We agree with this principle as drafted, subject to the dropping of the word "*complex*". We also strongly agree with the second paragraph of the guidance, once again subject to the dropping of "*complex*". Nevertheless, we feel that the first sentence of the first paragraph is very subjective and is not based on facts. We therefore suggest dropping it, and the word "*Moreover*" at the start of the next sentence.

Principle 9

Regulators and self-regulatory organizations should supervise and examine intermediaries on a regular and ongoing basis to help ensure firm compliance with suitability and other customer protection requirements relating to the distribution of complex financial products. Enforcement actions should be taken by the competent

authority, as appropriate. Regulators should consider the value of making enforcement actions public in order to protect investors and enhance market integrity.

We agree with this principle and guidance as drafted, subject to the dropping of the word "*complex*".