22 September 2011

JAC Response to ESMA Discussion Paper on UCITS Exchange-Traded Funds and Structured UCITS

1. INTRODUCTION

1.1 This letter is a response to ESMA's discussion paper of 22 July 2011 on ESMA's policy orientations on guidelines for UCITS Exchange-Traded Funds and Structured UCITS (the ***Discussion Paper***).

1.2 The Joint Associations Committee on Retail Structured Products (the ***JAC***)[1] welcomes the opportunity for a public discussion of the matters raised in the Discussion Paper. The members of the JAC comprise most of the major firms (both financial institutions and law firms) involved in the creation within the EU of structured products that are distributed to retail investors. Many also deal with UCITS funds – both exchange-traded and traditional. While the main focus of the Discussion Paper is on UCITS funds, the members of the JAC note that there are also references to a wider category of investment products, including structured securities. Some of the proposals in the paper could have much wider implications beyond its immediate subject matter. It is therefore important to consider the proposals made in the Discussion Paper against that broader backdrop in order to avoid inappropriate rules and guidance and unintended consequences for parts of the non-UCITS investment market.

1.3 The Discussion Paper touches on a number of areas the JAC has commented upon at some length in recent regulatory consultations. In particular, we enclose our response to each of: (a) the EU Commission consultation on Packaged Retail Investment Products and the associated sections of its MiFID II consultation; and (b) FSA Discussion Paper 11/1 on Product Intervention, which we think are relevant to the current ESMA exercise. In addition, the JAC has also worked over a period of some years to help establish appropriate standards for business in the market for retail structured products and, as a result, has developed two sets of good practice standards to which its members are signatories: (a) "Retail Structured Products: Principles for managing the provider-distributor relationship" and (b) "Retail Structured Products: Principles for managing the distributor-individual investor relationship". The two sets of principles address issues relevant to proposals contained in the Discussion Paper. In view of that, a set of each is also appended to this response.

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

1.4 The JAC is aware that two broad objectives underpin the current regulatory interest in the ETF market: (a) systemic stability and the impact that products of this sort could have on that; and (b) investor protection. The Discussion Paper tends to focus on the second of these, as does this response.

Yours truly,

Timothy R Hailes

Chairman, Joint Associations Committee

Attachments:

1. **JAC response to the European Commission consultation on PRIPS and the associated sections of its MiFID II consultation**
2. **JAC response to the FSA's Discussion Paper on Product Intervention (DP 11/1)**
3. **JAC Combined Principles for Retail Structured Products**

OVERVIEW AND SUMMARY

3.1 Before addressing the specific questions posed in the Discussion Paper in Part 5 below, this response:

(a) highlights the wider implications for ESMA's consultation in light of some of the key characteristics of the current market for retail structured products, and particularly the diversity of products and distribution models in operation (see Part 3);

(b) considers which regulatory approaches are most likely to be effective in securing the policy objective under-pinning the Discussion Paper – helping to protect investors from acquiring investment products that will not help them to achieve their investment objectives (see Part 4).

3.2 We believe that it is important to address the issues covered by the Discussion Paper and ESMA's proposals in a way that takes full account of the above. We also consider that the consultation raises a deeper question as to the nature and purpose of the UCITS regime more specifically. UCITS IV has led to a much broader range of UCITS funds becoming available than was possible under the original UCITS Directive. The most innovative of these will generally have been discussed in some detail with EU Member State regulators prior to launch. It is therefore reasonable to suppose that those regulators were satisfied that the relevant funds were consistent with the UCITS label, yet there now seems to be regulatory anxiety about some of the funds that have emerged. It seems to the JAC that a key question is whether the UCITS label is intended to guarantee the "safety" of all UCITS for all retail investors, subject to the selection of a UCITS that is consistent with an investor's investment objective, or whether (as seems to be the case) it is accepted that some UCITS may only be suitable for more sophisticated categories of investor. Is the UCITS label now little more than an assurance to investors as to, broadly, the operating standards that will be applied in running the fund and the fact that the fund will comply with certain basic spread requirements? We think it is important that a clear consensus is developed on this, since different parts of the market may be operating by reference to different expectations and there is therefore a risk that this could lead to adverse investor outcomes.

3.3 **Diversity**: there is considerable diversity in (a) the products currently available in market for structured investments and (b) the nature of the production and distribution process for those products. The JAC considers it critical that this is properly understood and full allowance is made for it in the way in which regulatory policies are designed and in the drafting of any new rules and guidance. It is important to avoid forcing products or distribution channels into an inappropriate regulatory framework and posing a risk to positive innovation in future. In addition, UCITS products that have been launched following consultation with Member State regulators should not now be prejudiced as a result of the issue of new guidance; there is an important issue here about legal and commercial certainty and the rule of law.

3.4 In particular:

(a) In spite of the various legal "wrappers" used for investment products, different legal wrappers may nonetheless involve the same or similar underlying risk/reward profiles; while the Discussion Paper concentrates on ETFs and structured UCITS, the JAC considers that regulation in this area should look to the underlying substance of that risk/reward profile as much as the legal form. The prospect of regulatory arbitrage should be minimised by applying similar regulatory rules to product disclosure and the intermediation of products with equivalent risk/reward profiles.

(b) Equally, the legal substance of the arrangements cannot be ignored. It is important to create a regulatory regime that achieves similar investor outcomes in relation to similar risk/reward profiles, regardless of the legal form of the product through which those

exposures are assumed. However, due allowance does need to be made for the legal form of a product and the nature of the legal relationships it involves; in particular, we comment below on ESMA's proposal to treat a swap counterparty as if it were a discretionary investment manager, which appears to cut across current legal and regulatory understandings of the nature of the relationship between two parties to a swap in a way that could be disruptive and create wider uncertainty.

(c) Regulators should be alert to broader potential market impacts of a regulatory response. Given the equivalent risk/reward profiles across products classes, a general regulatory principle developed for one market may have much broader potential implications and "spill-over" into other markets. These implications should always be fully explored and understood to prevent unintended negative consequences.

3.5 What are the implications of this for the way in which the rules should be framed? The JAC fully supports a "coherent" approach to regulating the distribution of investment products, whether synthetic ETFs, structured UCITS or otherwise. However, coherence does not mean uniformity. The regulatory rules should be framed in a manner that supports a common policy outcome for investors, but in doing so, they should reflect the difference between investment product-types. Grouping "synthetic ETFs" and "structured UCITS" together, as in the Discussion Paper does, is a case in point and raises two basic issues.

(a) The first is definitional; it is not clear what sort of UCITS fall within each of these two categories. Each category could potentially embrace a range of fund types with broadly differing characteristics. It may be inappropriate or unnecessary to treat all of these in an identical manner.

(b) Secondly, whatever is meant by these two expressions, it is not clear why synthetic ETFs should be grouped together with structured UCITS in this way. While these two categories of product are likely to have some common characteristics, where a product in one of these categories is an ETF and a product in the other category is not they are likely to have very different characteristics.

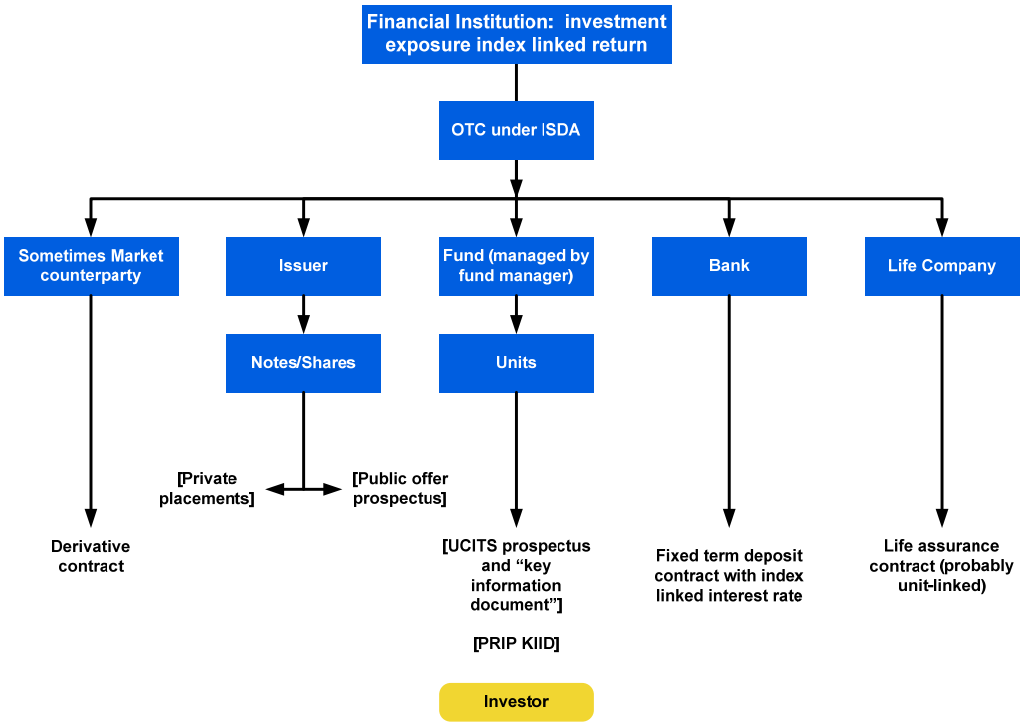
3.6 **Regulatory tools**: in terms of the regulatory tools available, the JAC believes that the best protection for investors is that they are put into a position where they are able to make informed decisions about whether or not to make a particular investment, given their particular circumstances. This would suggest that regulatory interventions to secure clear disclosure (facilitating informed decisions) and good operating standards in the interface between investors and intermediaries (who are best placed to understand their needs) are likely to be more effective than attempts to regulate the characteristics of investment products. On that basis, we would like to suggest that, in broad terms, the use of product bans (or bans on particular product characteristics) should generally only be deployed in the interests of investor protection where, assuming clear product disclosure to investors and intermediaries, intermediaries involved in the distribution of the product are unlikely to be capable of understanding it sufficiently to make that outcome reasonably likely.

3.7 JAC believes product intervention is a blunt tool. Where product intervention is a possibility, it is critical in the interests of legal and commercial certainty that the process by which a decision is taken and the intervention itself should be consistent with the rule of law. It should take place in accordance with an established framework that commands consensus, is transparent and supports a just outcome. If this is not the case, the possibility of product bans is likely to inhibit constructive innovation and distort the market.

4. THE CURRENT STRUCTURED PRODUCTS MARKET

Product diversity

4.1 The following diagram provides a high level overview of the range of structured products currently available the return on which depends upon an underlying OTC derivative contract, of which UCITS funds are only one:



4.2 Taking each in turn:-

(a) **OTC Derivatives** – an over-the-counter derivative (typically a total return swap) can be written giving a return to the counterparty based on, for example, the performance of an underlying index of assets or investment strategy.

(b) **Structured Notes** (which may sometimes be exchange traded and are sometimes confused with Exchange Traded Funds, below) – fixed income notes and certificates can be issued by a note issuer (sometimes a special purpose vehicle) which have an embedded derivative paying a similar return to the derivative at (a) above. Varying risk profiles can be written into the terms of the notes, for example by including principal protection.

(c) **Funds, including Exchange Traded Funds** – these may be UCITS, but may equally, as ESMA recognises, be in the form of other sorts of non-harmonised fund. UCITS can be established, in which there is a secondary market by way of exchange trading. The funds can take a number of forms including funds investing in a portfolio of assets linked to an underlying index or funds being actively managed by a third party manager. They may generate a return by entering into a derivative of the sort described at (a) above. The funds are typically UCITS compliant but need not be.

(d) **Structured Deposits –** typically structured deposits are a deposit made with a bank for a fixed period of time and which pay a return based on the performance of an underlying

index of assets or investment strategy, commonly hedged using OTC derivatives. We note in passing that work is currently under way in the context of the MiFID review to define what is caught by the concept of a "structured deposit". Our understanding of a deposit is that it should always be repayable in full, save in the event of the default of the relevant credit institution. We therefore think the focus of any definition of structured deposit should be on the basis upon which any return earned on the deposit is determined, distinguishing them from interest bearing "simple deposits"[1].

(e) **Life assurance contracts** – life assurance policies where the value of the policy at maturity varies according to the performance of an underlying index of assets or investment strategy, the relevant return being generated by use of an OTC derivative.

4.3 Any new regulatory rules need to take full account of:

(a) the considerable variety of structured investment products available within the EU (some offering similar returns, but through different legal structures) – see above; and

(b) the fact that it does not necessarily follow that an investment product with a relatively complex legal structure will also have a complex risk/reward profile or vice versa.

4.4 The JAC considers that the regulatory regime for structured products should operate principally (although not exclusively) by reference to the risk/reward profile rather than a product's legal structure.

(a) It should not be assumed that legal complexity equates to higher risk. Indeed, legal complexity is sometimes the result of steps taken to simplify or moderate the risk profile of a product; one of the most obvious examples of this is arrangements to provide some level of principal protection and another is the use of caps and floors on exposure. It is questionable to what extent investors need to understand the detailed mechanics by which a particular risk/reward exposure is provided as long as they understand the exposure they will undertake sufficiently to make an informed decision (and the KIID is the appropriate place to give investors that information). In part, it will depend on how far an investor takes exposure to the effectiveness and cost of a particular legal structure. It is certainly possible that a complex legal structure could affect an investor's ability to understand that risk profile, so that some discussion of the legal structure may be necessary. However, it should not be the default assumption that it is always necessary to describe the legal structure of a product; the emphasis should be on helping the client to understand the risk/reward profile so that he or she can determine whether it is likely to help in achieving the client's desired objective.

(b) That said, the legal form of a product through which a particular investment return is provided is not irrelevant. It can affect the outcome for the client; for example, the risk exposure involved in participation in an investment fund established as an FCP or a common law trust is quite different from that resulting from purchasing a debt security, even if both of them are intended to track the FTSE 100. Consequently, regulatory rules applicable to services provided in relation to structured products and product disclosure in relation to structured products need be sufficiently flexible to allow for the fact that products that take a different legal form do not necessarily behave in the same way simply because they purport to offer similar structured exposures or because they could be used for similar purposes.

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[1] The JAC has commented previously on a definition of "structured deposits" in its response to the EU Commission consultation on Packaged Retail Investment Products

Distribution Chain Diversity: the process by which retail investors obtain investment exposure using structured products – the roles of Product Producers and Distributors and the need for flexibility in the application of regulatory rules

4.5 In what follows, we refer to the firms that are involved in creating structured products as "Product Producers" and to the firms that are involved in enabling investors to acquire or enter into structured products as "Distributors". While JAC members do not generally have any direct relationship with the end investors in structured products they help to create, in other contexts, Product Producers (such as insurers) do sometimes have direct contact. In cases such as those, the comments below concerning the role of Distributors may be also relevant. In formulating its approach, the JAC considers that it is critical that ESMA takes full account of:

(a) the many different avenues by which investment products are mediated to investors; and

(b) the differing roles in each that can be played by Product Producers and Distributors.

4.6 There is no single framework for the process by which an investor will obtain an investment exposure in which Product Producers and Distributors always play the same roles; rather, the process commonly involves a series of stages, some of which will be the domain of the Product Producer and others that of the Distributor and, in some cases, both. For example, in some cases a Product Producer will sell products directly to investors, but in others it will have no contact with them at all. In addition, the market is dynamic – witness the emergence of on-line "investment supermarkets" and other forms of electronic platform. Failure to take this fully into account could result in an inappropriate allocation of regulatory responsibility between the various firms involved, with the result that rules do not achieve their intended result and need to be revised. To some extent this can be catered for by legislating for periodic reviews, as with the current MiFID review. However, it would be preferable if regulatory rules can be drafted in such a way as to allow for diversity and change.

4.7 Rules and guidance therefore need to be sufficiently flexible so that they can be applied appropriately to different frameworks. As with the treatment of the products themselves, avoiding over-prescription that assumes that a particular type of firm will be carrying on a particular type of activity is likely to help in achieving this outcome. The role of product regulation and the question of whether or not a client is prepared to pay for professional investment advice (and, if so, of what quality) are important elements in the likely outcome. However, putting those to one side, the basic objective should be that investors of a similar level of sophistication and size are afforded a similar minimum level of regulatory protection in relation to an investment exposure of a given sort regardless of the relative roles of Product Producers and Distributors in the process by which an exposure (having been put into a form whereby an investor can gain exposure to it) is mediated to the investor.

5. PRODUCT DISCLOSURE AND INTERMEDIARY REGULATION

5.1 The JAC recognises that various regulatory tools are available in seeking to achieve ESMA's investor protection policy objective in relation to exchange traded UCITS funds and structured UCITS. These range through the whole of the process whereby a potential investment exposure is identified, packaged into an investible form, described to investors and intermediaries and then advised upon or sold by an intermediary. The stages in that process and the different sorts of regulatory intervention available at each (together with some of the existing EU regulatory regimes relevant to each stage) can be illustrated using the following table:

Product provider regulation ↓	Finance Institution	MiFID/BCD/Life Directive Prudential and conduct of business rules
	Fund Manager	MiFID/UCITS Prudential and conduct of business rules
	Depositary	UCITS/BCD Prudential and conduct of business rules
Product regulation ↓	Fund (open-ended investment company, unit trust, FCP)	UCITS/company law Investment powers and operation
Disclosure regulation (point of sale and otherwise) ↓	Prospectus, key investor information document listing materials	UCITS/MiFID/PD/DMD/listing requirements Contents requirements and vocabulary
Intermediary/sales regulation	Intermediary	MiFID/IMD Prudential and conduct of business rules
	Investor	

5.2 While all of these tools are available, the JAC expresses the view below in response to a number of the policy orientations that the best protection for investors is that they are put into a position where they are able to make informed decisions about whether or not to make a particular investment, given their particular circumstances. This would suggest that regulatory interventions to secure clear disclosure to investors and their intermediaries (putting them in a decision to make informed decisions) and good operating standards in the interface between investors and intermediaries (who are best placed to understand their needs) are likely to be more effective than attempts to regulate the characteristics of investment products – the UCITS regime is arguably a

case in point, with attempts to regulate and provide guidance in relation to different aspects of the regime becoming increasingly complex and prolix, which, in turn, creates its own regulatory risks.

6. RESPONSES TO SPECIFIC QUESTIONS

■ Retailisation of complex products

1. Do you agree that ESMA should explore possible common approaches to the issue of marketing of synthetic ETFs and structured UCITS to retail investors, including potential limitations on the distribution of certain complex products to retail investors? If not, please give reasons.

6.1 This question focuses on the balance between three policy tools available in seeking to secure the investor protection outcome:

(a) Regulation of product disclosure;

(b) Regulation of product intermediation;

(c) Product bans.

6.2 Before considering the issues raised by the question, two broad points need to be made:-

(a) The balance between the above policy tools: the JAC considers that the first and second of the above policy tools are likely to be the most effective means of securing the most positive investor outcomes. Any rules should essentially facilitate good decision making; they should not introduce the judgement of the regulator into every investor relationship, supplant investor decision-making nor inappropriately restrict the sorts of products that investors can acquire or the types of business in which they can engage. In principle, the purpose of regulation in this area should be to put the investor in a position where they are able to make an informed decision as to whether or not to acquire a particular product, with professional support if needed. As product providers are likely to have limited if any control over the investor interface, it is not reasonable to expect them to assume responsibility for this. There is regulatory precedent for prohibiting the sale of certain products to retail clients, particularly in the case of unregulated funds. While this may be merited in certain cases, the JAC believes it is a blunt tool and should only be used sparingly and in a manner that provides the market with a high level of certainty as to when bans will be imposed – otherwise, the possibility of product bans is likely to inhibit constructive innovation and distort the market. By contrast, intermediaries are in a position both to understand the investment products available for sale to their clients and the circumstances of the relevant client; they are therefore best placed to marry up the two. On that basis, we would like to suggest that regulators should not consider any form of product ban (or product characteristic ban) in the interests of investor protection unless the product (or the relevant characteristic) is such that intermediaries that are likely to be involved in its distribution are not capable of understanding it sufficiently in order to do that.

(b) Defining "synthetic ETF" and "structured UCITS": it follows from what we say below, that if ESMA intends to develop regulatory rules specifically by reference to products falling within these categories, we think it is essential that it defines each category more clearly. While the concept of a UCITS ETF is tolerably easy to understand, there are questions as to what would make it "synthetic". Again, while the concept of a UCITS is straight forward, if rules are to be made by reference to whether a UCITS is "structured", greater clarity is needed as to what would make a UCITS "structured". JAC members would, of course, be happy to work with ESMA to seek to develop definitions.

Common approaches vs coherence

6.3 The JAC fully supports a "coherent" approach to the regulation of investment product marketing, whether synthetic ETFs, structured UCITS or any other type of investment product. This will be clear from the JAC's response to the consultation on the future EU regulatory regime for packaged retail investment products. However, it is important to distinguish between coherence and uniformity. The regulatory rules should be framed in a manner that supports a common policy outcome for investors, but in doing so, it is important that they reflect the difference between investment product-types. Grouping synthetic ETFs and structured UCITS together, as in this question, is a case in point and raises two basic issues.

(a) The first is definitional; it is not clear what sort of UCITS fall within each of these two categories, but each category could potentially embrace a range of fund types with broadly differing characteristics. It may be inappropriate or unnecessary to treat all of these in an identical manner.

(b) Secondly, whatever is meant by these two expressions, it is not clear why synthetic ETFs should be grouped together with structured UCITS in this way. It is true that these two categories of product are likely to have some common characteristics. However, an ETF is clearly very different from a non-ETF. A coherent approach to regulating the marketing of these products would involve being clear as to the policy outcome sought (in terms of investor protection), but flexibility in the means used to get there, so that any regulatory rules take account of product diversity. As we have affirmed in our work on PRIPs, a certain level of uniformity may facilitate comparability, but if pushed too far, can be counter-productive, for example, because it suggests a greater similarity between products than is in fact the case.

6.4 If this is what is meant by a "common approach" to the marketing of synthetic ETFs and structured UCITS, then the JAC agrees that ESMA should explore it. The JAC considers that the best place to do that is as part of the current PRIPs initiative, since that is likely to create the greatest prospect of a regulatory approach that is coherent across all product-types, including deposits and insurance contracts, so reducing the likelihood of regulatory arbitrage and confusion.

Regulation of marketing v limitations on distribution

6.5 The JAC supports the principle that the policy objective of investor protection can best be served by clear, effective disclosure as to the nature of a given product. The purpose of this should be to put investors into a position where they are in a position to make an informed decision whether or not to buy the product concerned. As we understand it, this is the purpose of the current work on Key Investor Information Documents in the context of the current PRIPs initiative, which the JAC supports.

6.6 The possibility of limiting distribution appears to raise a separate issue – whether there are cases where clear disclosure about the nature and characteristics of some products is not enough to achieve the desired policy outcome. In principle, the JAC agrees that there are.

6.7 The next question is how one covers that gap and, again, the JAC agrees with ESMA that the distribution process is critical in this. It is not clear what ESMA has in mind when it refers to "limitations" on the distribution of certain complex products to retail investors.

(a) If by "limitation" ESMA means that the sale of certain products to retail clients should be entirely banned, the JACs view is that this sort of regulatory intervention is merited only in very exceptional circumstances.

Since regulators are not in a position to review every product type and how it might usefully be deployed in assisting an investor to achieve his or her investment objectives, an outright ban on a particular category of products is likely to prove a blunt regulatory tool that risks putting products beyond the reach of those for whom they might potentially be useful.

In addition, were the use of product banning powers to become a serious prospect, it would be essential for ESMA to specify precisely when that power would be deployed and in what manner. Failure to do so would be likely to create considerable uncertainty in the market, potentially stifling constructive innovation and the generation of common goods in the form of new categories of investment product suited to the changing economic climate and changing investor needs.

The JAC does, however, accept that there is precedent for prohibiting the sale of certain categories of product to particular categories of investor. Given the concerns summarised above, we would like to suggest that regulators should not consider any form of product ban unless the product is such that intermediaries that are likely to be involved in is distribution are not capable of understanding it sufficiently in order to do that. This is because we consider that only the intermediary involved in the distribution of a product is sufficiently close both to the product and the client to be able to assess whether the two marry up. Intervention, then, should only be necessary where the product is of a sort where it is likely to be beyond the ability of an intermediary to do that.

However, in principle, we consider that the best person to assess whether or not an intermediary understands a product is the intermediary itself. It should be clear that they have that responsibility, something which is reflected in the JAC Principles (attached). This may be achieved through the materials provided by the product provider or generally through the product provider and distributor's communications.

(b) However, it is possible to impose limitations on the distribution of investment products without resorting to an outright ban, and this is the purpose of the MiFID "appropriateness" and "suitability" tests. The JAC fully supports the proposal that complex investment products should only be available to retail clients where they are sold by someone who applies one or other of these tests before any transaction takes place. Subject to the point above about definitions, the JAC also agrees that certain synthetic ETFs and structured UCITS should be regarded as complex for these purposes.

In assessing which products are "complex" the JAC considers that it is important not to confuse a complex legal structure with complexity of economic exposure. It does not necessarily follow that a product with a relatively complex legal structure will also have a complex risk/reward profile, or even that a complex risk/reward profile necessarily makes the product unsuitable even for those seeking low risk; indeed, complexity may be a means to controlling risk, for example, by providing a means by which investor loss can be subject to a "floor". As a result, it should not be assumed that complexity of a product equates to higher risk or to narrower suitability/appropriateness.

Product providers are not generally able to apply these tests, which under MiFID rightly fall to the firm that has the client interface. Product providers can, however, consider generic appropriateness of products for particular parts of the investor market following confirmation from the distributor of the investor types that it intends to target. Indeed, this is reflected in JAC Principle 7 which provides that a product provider's assessment of a distributor should include consideration of their typical client type (i.e. the appropriateness of delivering a particular product through a given delivery channel).

6.8 Intermediaries and product providers have distinct, separate roles that need to be reflected in any new rules or guidance. Assuming a product has been properly described, we consider that product manufacturers should not be held responsible for consumer detriment where products are suitable for some investors but not suitable for others. It is the distributor's role to ensure that products are distributed to investors for whom they are suitable/appropriate. It is most unlikely that a product will be suitable/appropriate for all of a distributor's clients, even where it has been developed with a particular sector of the market in mind which is serviced by a given distributor. As it is the distributor that has the direct interface with the individual investor, investor suitability/appropriateness of a product is a matter for distributors and is not a role that the product provider can play.

2. Do you think that structured UCITS and other UCITS which employ complex portfolio management techniques should be considered as 'complex'? Which criteria could be used to determine which UCITS should be considered as 'complex'?

6.9 As indicated above, it is not entirely clear which UCITS ESMA considers to be "structured UCITS". Likewise, it is unclear what is meant by "complex portfolio management techniques". These concepts need greater definition if they are to be used as hooks for new regulatory rules. Subject to that, it is not presently clear to us that just because a UCITS is "structured" or employs "complex portfolio management techniques", interests in that UCITS should themselves necessarily be regarded as "complex" financial instruments. Any regulatory distinction between simple and complex should not be based on the assets of the fund or the way a UCITS is managed, but rather on the objectives and risk profile of the fund. A UCITS can be a very simple product for investors, but also use sophisticated techniques in order to improve the performance of the fund. For example, some very traditional equity funds also use relatively complex derivatives in order to manage their exposure to the market in the most efficient way.

6.10 However, in principle, the JAC agrees that there are likely to be some categories of UCITS that can be considered complex for the purposes of applying the MiFID appropriateness test in Article 19(6) of MiFID. Seeking to define the distinction between complex and non-complex products raises a number of issues on which the JAC has commented previously in the context of the EU Commission's work on PRIPs.

- In principle, the JAC considers that the distinction should operate by reference to the risk/reward profile rather than legal form. A product that is legally simple may nonetheless carry a complex risk profile whereas one that is legally complex may involve no greater risk than an investment in one of the leading benchmark equity indices.

- There is a need to strike a balance between: (a) creating sufficient certainty for firms so that it is reasonably possible to know which MiFID rules apply, while (b) recognising the considerable variety of investment products. Any standards need to be clear enough to be capable of being applied but not so overly prescriptive that they force an inappropriate treatment for a particular product.

6.11 We believe that the use of a safe-harbour[1] with associated guidance, along the lines of the present arrangement, is the best means of achieving this result, so that where services are provided in relation to a product that is not within the safe-harbour, a firm needs to consider whether the product is complex or non-complex by reference to the guidance. The effect of the rule should be no more than that; there should be no implication that a product is complex simply because it does not fall within the safe-harbour.

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[1] In other words, a list of products that will automatically be treated as non-complex.

6.12 With this in mind, as we have suggested previously, the drafting of the current 19(6) of MiFID could be usefully clarified. The exclusion should apply where execution-only services are provided in relation to "non-complex products". This should be accompanied by:

(i) a list of those products that will automatically be treated as "non-complex" – ie a "white list";

(ii) guidance that builds on Article 38 of the MiFID Level 2 Directive as to when products not included in the white list can nonetheless be treated as non-complex.

- As indicated above, it would be important for products included in a white list to be described in terms that do not imply that products that do not have the precise characteristics of those products should be regarded as complex, for example, simply because they "embed" a derivative. Once established, it would be preferable in the interests of certainty, for the categorisations not to be changed, or only to be changed in exceptional circumstances. If the new rules do allow for revision or guidance, we think it would be essential for that to be subject to an effective process and consultation.

- In addition, the description of products within the safe harbour and any associated guidance should be internally consistent in the way it addresses the question of complexity, operating by reference to the risk/reward profile over legal form. In particular, it should be made clear that where a product provides a return similar to that available through a category of UCITS that is treated as non-complex and has a similar issuer risk profile (for example, because the issuer of the instrument is subject to prudential regulation under one of the EU single market Directives), then it should also be treated as non-complex.

3. Do you have any specific suggestions on the measures that should be introduced to avoid inappropriate UCITS being bought by retail investors, such as potential limitations on distribution or issuing of warnings?

6.13 As indicated above, the JAC cautiously supports the introduction of powers to prohibit or limit distribution of investment products an appropriate tool in the regulatory tool box. However, for a number of reasons, it is important that they should be created within a framework that, among other things, ensures the following:

(a) They are exercised in a transparent way and in accordance with the rule of law – in particular, it is essential that the market should have sufficient certainty and that legitimate commercial interests are protected;

(b) They are only exercised after a careful analysis both (i) in order to test the proposal and (ii) to ensure that the power is used proportionately;

(c) Adequate account is taken of the impact of a ban or restriction on other product-types that are already in the market - we are particularly concerned about:

(i) the potential unintended consequences of product banning in causing spurious claims in relation to products which may have similar characteristics but which were not missold and were in fact suitable/appropriate at the point of sale;

(ii) the banning of a product where sales have already been made to investors which will lead to uncertainty for product providers and distributors in relation to such sales.

This uncertainty may have the unintended consequences of stifling constructive innovation and choice for consumers and increased costs of products to protect against the risk of a product being banned.

6.14 All this strongly suggests that any power to ban products:

(a) Should operate within a clear statutory framework, which embeds appropriate checks and balances, for example, by creating bodies that are capable of reviewing the use of the power and allowing for prompt and effective rights of appeal;

(b) Should be accompanied by clear guidance as to the circumstances in which the regulator is likely to exercise the power, which the regulator should be required by law to consult upon with all stakeholders;

(c) Should only be exercised following due consultation with all interested parties.

6.15 In the JAC's view, it would be more appropriate for such a framework to be considered as part of the on-going review of MiFID rather than in the context of a revision of the UCITS directive.

4. Do you consider that some of the characteristics of the funds discussed in this paper render them unsuitable for the UCITS label?

6.16 We would not rule out the possibility that funds could be launched under the UCITS label which are unsuitable for the class of investors for whom UCITS were originally designed. However, as things stand we think there is a need for a wider dialogue on precisely what is now the purpose of the UCITS label to achieve and we are doubtful whether it is possible to answer this question properly until that has happened.

6.17 UCITS IV has plainly led to a range of UCITS funds becoming available under the UCITS label that is much broader than what was possible under the original UCITS Directive. The most innovative of these will generally have been discussed in some detail with EU Member State regulators prior to launch. Consequently, it is reasonable to suppose that those regulators were satisfied that the relevant funds were also consistent with the UCITS label. It seems to the JAC that a key question is whether the UCITS label is intended to guarantee the "safety" of all UCITS for all retail investors, subject to selection of a UCITS that is consistent with the investor's investment objective, or whether (as seems to be the case) it is now accepted that some UCITS may only be suitable for more sophisticated categories of investor – in other words, is the UCITS label now little more than an assurance to investors as to, broadly, the operating standards that will be applied in running the fund and the fact that the fund will comply with certain basic spread requirements. We think it is important that a clear consensus is developed on this, since different parts of the market may be operating by reference to different expectations and there is therefore a risk that this could lead to adverse investor outcomes.

6.18 In terms of the characteristics discussed in the paper, even assuming greater clarity as to what is the purpose of the UCITS label, we think the treatment is too generic in order to comment meaningfully. A dialogue on this issue needs to be informed by more precise examples.

5. Do you agree that ESMA should give further consideration to the extent to which any of the guidelines agreed for UCITS could be applied to regulated non-UCITS funds established or sold within the European Union? If not, please give reasons.

6.19 The JAC agrees that ESMA should give further consideration to the extent to which any of the guidelines agreed for UCITS could be applied to regulated non-UCITS funds established or sold within the EU (including where the product producer is based outside the EU). As discussed

above, the form of "wrapper" used to produce an investment product should not necessarily attract a different regulatory treatment if the product creates the same risk/reward profile for an investor. There is a risk of regulatory arbitrage if ESMA does not consider how its policies on UCITS should be applied to equivalent non-UCITS products that have a similar risk profile.

6. Do you agree that ESMA should also discuss the above mentioned issues with a view of avoiding regulatory gaps that could harm European investors and markets? If not, please give reasons.

6.20 See answer to question 5.

7. Do you agree with the proposed approach for UCITS ETFs to use an identifier in their names, fund rules, prospectus and marketing material? If not, please give reasons.

6.21 The JAC believes that "labels" of products are generally not a helpful indicator of the inherent risk of a product. The name of a product is not necessarily indicative of the risk/reward profile of that product. Given the diversity of products in the market, the specific characteristics of a product would need to be examined to determine the potential for consumer detriment. The use of pre-defined labels, with associated regulatory treatments, may be a "blunt" tool to make a meaningful assessment of investor risk and could mislead investors as to level of risk associated with a particular product.

6.22 However, in the case of an exchange traded fund, we think it is reasonable that some means should be found of indicating clearly to investors that the fund cannot be bought and sold in the traditional way, but that they will need to transact through a broker. Any indicator should be "neutral" in the sense that it should not suggest that the product is any more or less risky or appropriate simply because it is an exchange traded fund.

8. Do you think that the identifier should further distinguish between synthetic and physical ETFs and actively-managed ETFs?

6.23 We have commented above on the need for greater clarity as to what is meant by "synthetic ETF". The same can be said of the expressions "physical ETFs" and "actively-managed ETFs". However, in principle, we do not believe these issues can be addressed properly in the form of a single "indicator". Indeed, to do so could be misleading:

(a) as the Discussion Paper makes clear, in practice, a "physical ETF" may in some cases be just as "synthetic" as a swap-based ETF;

(b) investors could be led to believe that a physical ETF simply holds the securities that constitute the index, when in fact the securities can be, and are normally, lent out. Investors could therefore be misled to believe that a physical ETF will never embed any counterparty risk;

(c) the identifier "synthetic" ETF would tell investors little about the scale of counterparty risk and level of collateralisation;

(d) investors might assume that synthetic ETFs are riskier than physical ETFs, but this is not always the case. In some cases the risk/reward profiles of physical and synthetic ETFs can be equivalent to each other;

(e) investors might assume that physical ETFs will only invest in the assets included in a reference index, or will not use derivatives, but this is not always the case;

(f) other factors may be more relevant to an investor's risk exposure than whether the ETF is synthetic or physical e.g. full or sample replication of an index; and

(g) some ETFs are a combination of both physical and synthetic strategies.

6.24 The JAC does, nonetheless very much support the principle of clear product disclosure so that investors are put in a proper position to assess the nature of the product and its risks. We therefore consider that the product characteristics to which these labels are being applied by ESMA need clear disclosure in the product documentation, including the KIID. Again, any rules in this area should be in neutral terms that do not imply that any one product characteristic is necessarily more risky than another.

9. Do you think that the identifier should also be used in the Key Investor Information Document of UCITS ETFs?

6.25 We think the KIID should make clear where a particular fund is exchange traded, and this could be done using an indicator. As explained above, we do not think that the other product characteristics identified by ESMA should be addressed by using "indicators", but the KIID should disclose all material product characteristics.

10. Do you agree with ESMA's analysis of index-tracking issues? If not, please explain your view.

6.26 The JAC makes no response to this question, although individual JAC member firms may wish to respond separately.

11. Do you agree with the policy orientations identified by ESMA for index-tracking issues? If not, please give reasons.

6.27 In principle, the JAC supports an approach that makes clear to investors what exposure they are undertaking by acquiring a particular investment product. The policy orientations are a helpful way of doing that.

12. Do you think that the information to be disclosed in the prospectus in relation to index-tracking issues should also be in the Key Investor Information Document of UCITS ETFs?

6.28 For the reason given in response to question 11, we do.

13. Are there any other index tracking issues that ESMA should consider?

6.29 The JAC has not identified any.

14. If yes, can you suggest possible actions or safeguards ESMA should adopt?

6.30 See response to question 13, above.

15. Do you support the disclosure proposals in relation to underlying exposure, counterparty(ies) and collateral? If not, please give reasons.

6.31 Yes, the JAC is in favour of disclosure to investors and intermediaries involved in the distribution process, thereby putting them in a position to make an informed investment decision.

16. For synthetic index-tracking UCITS ETFs, do you agree that provisions on the quality and the type of assets constituting the collateral should be further developed? In particular, should there be a requirement for the quality and type of assets constituting the collateral to match more closely the relevant index? Please provide reasons for your view.

6.32 The policy orientations relate specifically to synthetic index-tracking UCITS ETFs. It is not clear to the JAC that the current UCITS collateral rules are failing in relation to UCITS generally or index-tacking UCITS ETFs particularly. In principle, where a UCITS has entered into an index-tacking derivative and that position is collateralised in accordance with the existing provisions, our starting assumption is that the policy objectives of the UCITS Directive ought to be met so that it should not be necessary to revise these rules. In addition, imposing a further requirement on UCITS for them to ensure that the collateral they receive matches the index they are tracking more closely, would tend to erode the pricing benefit for the UCITS of entering into the swap transaction in the first place.

6.33 However, it would be helpful to understand more clearly whether ESMA has a particular policy objective in relation to index-tracking UCITS ETFs, different from UCITS generally. We note that ESMA states (at paragraph 28) that, in the event of a counterparty default, the ETF has to liquidate collateral, "for risk mitigation purposes and needs to conclude a new derivative transaction to ensure the continuity of the product". In relation to the second of these, as long as investors acquire the product in full knowledge that, in the event of a counterparty default, the counterparty's position will be fully collateralised, but their interests will be redeemed, then it is not entirely clear why the investor protection objective would not have been achieved.

17. In particular, do you think that the collateral received by synthetic ETFs should comply with UCITS diversification rules? Please give reasons for your view.

6.34 We have not undertaken an assessment of the extent to which collateral does not commonly satisfy the diversification rules in any event. However, since the UCITS will rely principally upon the swap transaction in pursuing its investment objective, as long as the collateral is sufficient to collateralise the fund's exposure under that in accordance with the existing guidelines, it is not clear why further requirements need to be imposed.

■ **Securities lending activities**

18. Do you agree with ESMA's analysis of the issues raised by securities lending activities? If not, please give reasons.

6.35 The JAC makes no response to this question, although individual JAC member firms may wish to respond separately.

19. Do you support the policy orientations identified by ESMA? If not, please give reasons.

6.36 The JAC makes no response to this question, although individual JAC member firms may wish to respond separately.

20. Concerning collateral received in the context of securities lending activities, do you think that further safeguards than the set of principles described above should be introduced? If yes, please specify.

6.37 The JAC has not identified any.

21. Do you support the proposal to apply the collateral criteria for OTC derivatives set out in CESR's Guidelines on Risk Measurement to securities lending collateral? If not, please give reasons.

6.38 The JAC considers that it would be logical to do so.

22. Do you consider that ESMA should set a limit on the amount of a UCITS portfolio which can be lent as part of securities lending transactions?

6.39 As long as the position is properly collateralised (as contemplated above) and the UCITS's use of stocklending and any associated risks is clearly disclosed to investors, the JAC does not consider that there is a need for a limit.

23. Are there any other issues in relation of securities lending activities that ESMA should consider?

6.40 The JAC has not identified any.

24. If yes, can you suggest possible actions or safeguards ESMA should adopt?

6.41 See response to question 23, above.

■ **Actively managed UCITS ETFs**

25. Do you agree with ESMA proposed policy orientations for actively managed UCITS ETFs? If not, please give reasons.

6.42 In principle, the JAC agrees that disclosure of the matters indentified in the policy orientations is likely to be the most effective means of addressing the investor protection concern, by putting investors and intermediaries into a position to make informed decisions.

26. Are there any other issues in relation to actively managed UCITS ETFs that ESMA should consider?

6.43 The JAC has not identified any.

27. If yes, can you suggest possible actions or safeguards ESMA should adopt?

6.44 See response to question 26, above.

■ **Leveraged UCITS ETFs**

28. Do you agree with ESMA analysis of the issues raised by leveraged UCITS ETFs? If not, please give reasons.

6.45 The JAC makes no response to this question, although individual JAC member firms may wish to respond separately.

29. Do you support the policy orientations identified by ESMA? If not, please give reasons.

6.46 Yes, the JAC is in favour of disclosure in the areas identified in the policy orientations for the reasons given in response to question 25.

30. Are there any other issues in relation leveraged UCITS ETFs that ESMA should consider?

6.47 The JAC has not identified any.

31. If yes, can you suggest possible actions or safeguards ESMA should adopt?

6.48 See response to question 30 above.

■ **Secondary market investors**

32. Do you support the policy orientations identified by ESMA? If not, please give reasons.

6.49 The JAC is in favour of the inclusion of a risk warning of the sort set out in paragraph 45 of the Discussion Paper.

33. Are there any other issues in relation to secondary market investors that ESMA should consider?

6.50 The JAC has not identified any.

34. If yes, can you suggest possible actions or safeguards ESMA should adopt?

6.51 See response to question 33, above.

35. In particular, do you think that secondary market investors should have a right to request direct redemption of their units from the UCITS ETF?

6.52 The JAC makes no response to this question, although individual JAC member firms may wish to respond separately.

36. If yes, should this right be limited to circumstances where market makers are no longer providing liquidity in the units of the ETF?

6.53 See response to question 35, above.

37. How can ETFs which are UCITS ensure that the stock exchange value of their units do not differ significantly from the net asset value per share?

6.54 The JAC makes no response to this question, although individual JAC member firms may wish to respond separately.

■ **Total return swaps**

38. Do you agree with ESMA analysis of the issues raised by the use of total return swaps by UCITS? If not, please give reasons.

6.55 We comment on a number of aspects of the analysis (particularly paragraphs 54-58) in response to ESMA's policy orientations at question 39, below.

39. Do you support the policy orientations identified by ESMA? If not, please give reasons.

6.56 We consider each of ESMA's policy orientations in turn, below.

Both the UCITS' investment portfolio that is swapped and underlying swap to comply with UCITS diversification rules

6.57 We agree that there appears to be some ambiguity on this point, but have not undertaken a survey to assess the extent to which swap portfolios do not currently comply with the UCITS diversification rules.

Extent to which swap counterparty has control over investment policy/limitations should be disclosed

6.58 We do not entirely understand the proposal being made. In principle, the investment policy of a UCITS and the limitations on investment of the portfolio are stipulated in the constitution and prospectus of the UCITS, not by the swap counterparty. Ultimately, therefore, it is for the directors of the relevant investment vehicle to determine these matters.

Discretion over composition or management of UCITS portfolio/discretionary decisions with respect to swap portfolio

6.59 The JAC considers that ESMA's proposed characterisation of a swap counterparty that has an element of discretion over the swap exposure as an investment manager is potentially problematic, not least, because it would appear to cut across existing legal and regulatory distinctions.

(a) The present EU regulatory framework (in MiIFD and the UCITS directive) sets out the boundaries of the activity of managing investments. "Portfolio management" is defined in MiFID as, *"managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments"*. This understanding will be reflected in national regulatory regimes. For example, in the United Kingdom, the activity of "managing investments" is defined as, *"managing assets belonging to another person, in circumstances involving the exercise of discretion … if – (a) the assets consist of or include any investment which is a security or a contractually based investment…"*. Both of these definitions are commonly understood to involve an agent manager with dispositive power over a portfolio of client assets. The position of a swap counterparty is quite different; much like an insurer operating various forms of investment-based life products, it has no more than a contractual obligation to pay a particular return in accordance with the terms of the contract and no dispositive power over the client's portfolio. This serves to emphasise that the activity of investment management is not just a regulatory categorisation, but reflects legal relationships that are quite different from those between a swap counterparty and the entity with which it contracts. It is also likely that this difference between the basic legal relationships involved is likely to be associated with a difference between the legal duties that attach to the respective roles. For example, under English law, an asset manager will owe fiduciary duties to funds to which it provides management services, whereas this is unlikely to be the case with a counterparty to a swap. It would be difficult for a swap counterparty to discharge the legal duties attached to acting as an investment manager in the context of acting as a swap counterparty. We are concerned that an attempt to characterise a purely contractual duty to swap a particular return into an investment fund as a form of

investment management could therefore create considerable uncertainty as to the legal and regulatory framework within which swap counterparties are supposed to operate. While we agree that it is right for regulatory regimes to address the substance of market activities, we nonetheless think it is important to avoid doing so by imposing an inappropriate legal and regulatory frame of reference.

(b) In any event, it has always been understood that a degree of discretion is inherent in even the simplest of derivative transaction which can affect the nature of the return received under the contract. Clearly, that discretion is not of the same as the sorts of discretion considered in the Discussion Paper, but it is there – especially in the role of the "calculation agent". The calculation agent will commonly be the counterparty wearing a different "hat" for the purposes of the operational mechanics of the transaction. In that capacity, the counterparty may, for example, have to exercise discretion on the occurrence of corporate actions or market disruption events that require adjustments to be made. Although there is clearly discretion, this does not involve a derivative counterparty being treated as a discretionary manager and we would suggest that it would be more appropriate for the discretions identified by ESMA to be treated as being an extension of these.

(c) Turning more specifically to the sort of swaps identified by ESMA, it is important to appreciate that they can involve varying levels of discretion, and that the discretion is not always exercised by the swap counterparty. The JAC considers that it is not appropriate to seek to approach all of these in an identical manner. Some swaps involve the exercise of discretion by the swap counterparty. Others may involve discretion being exercised by a business unit unconnected with the swap counterparty, or by a third party in circumstances where that affects the exposure provided through a swap. The intensity of the discretion may also vary between swaps. In some cases it can be very limited (even benchmark indices sometimes involve an element of discretion). In others the counterparty may have a more extensive discretion regularly to adjust the underlying of a swap at its discretion, albeit within certain parameters that have been fully disclosed to investors. Even in these cases, the swap counterparty might be exercising discretion within narrow, pre-determined and disclosed boundaries. In such cases the JAC does not consider that the level of reliance placed on the swap counterparty is comparable to that of a traditional asset manager or that, even if there are similarities, that merits applying the same legal and regulatory treatment in a manner that ignores the different basis for the relationships.

(d) As indicated above, it is also important to appreciate that UCITS are not the only products currently available in the market that sometimes involve the use of swaps similar to those described in the paper. Because of that, the regulatory approach taken in the context of UCITS could have wider implications. These need to be properly assessed and understood in deciding what, if any, regulatory intervention is needed. Determining product structures solely to avoid regulatory rules is not generally considered acceptable. However, failure to take account of this broader context, could provide an unintended incentive to do just that, thereby becoming a source of moral hazard.

Treatment as a delegation

6.60 The reference to the application of the UCITS delegation requirements should be considered in more detail. For example the requirement for the delegate to be authorised for the purpose of asset management and to be "qualified and capable" to perform the delegated management functions, will not always be compatible with the structure of swap transactions, particularly where the swap counterparty is simply swapping the exposure under an index or basket operated by an independent unit or third party. Some of the UCITS delegation requirements do not seem compatible with the role played by a swap counterparty. For example, the requirement that the delegate may not be any undertaking whose interests may conflict with those of the

management company or the unit-holders and the requirement that the management company must be able to monitor the business of the delegate and to give them further instructions (including withdrawing the mandate with immediate effect).

Prospectus disclosures and information in UCITS annual report

6.61 The JAC supports greater disclosure in relation to the matters identified by ESMA.

40. Are there any other issues in relation to the use of total return swaps by UCITS that ESMA should consider?

6.62 The JAC has not identified any.

41. If yes, can you suggest possible actions or safeguards ESMA should adopt?

6.63 See response to question 40 above.

■ **Strategy indices**

42. Do you agree with ESMA's policy orientations on strategy indices? If not, please give reasons.

Sufficiently diversified

6.64 The JAC supports the proposed disclosures described in paragraphs 65 and 66.

6.65 While the JAC agrees with the need for a "strategy index" to meet the UCITS diversification requirements, it would question whether the proposal on diversification discussed at paragraph 67 of the ESMA paper could impose an unnecessarily high standard – one which may in practice be higher than for funds providing a "physical" return where inadvertent breaches do sometimes take place.

6.66 While it is clear that a strategic index should be designed in a way that seeks to avoid "passive" breaches of the diversification limits, it may also be difficult to ensure that this never happens pending rebalancing – after all, one of the purposes of rebalancing is to ensure that the limits are respected. In principle, we would like to suggest that, provided there is appropriate rebalancing of the strategy with sufficient frequency (so that any passive breaches are promptly rectified), then this should be sufficient to achieve the underlying policy objective. Seeking to adjust the exposures within the index between those times would mean that the index rules are no longer respected and it may in practice be commercially difficult to operate an index on that basis.

Adequate benchmark

6.67 The JAC considers that the existing UCITS index rules should be sufficient and is not convinced of the need for further guidance in this area.

6.68 The second of the proposals in paragraph 68 (disclosure of the universe of index components) should enhance the information available to investors and thereby facilitate investor and intermediary decision making and the JAC is broadly supportive of this.

6.69 However, the JAC is not entirely convinced that it is necessary for an index to have an objective beyond simply benchmarking the performance of the universe of index constituents mentioned above. In principle, members consider that as long as there is effective disclosure of

those constituents, it ought not to be necessary to overlay a further "objective" on top of benchmarking their performance.

Rebalancing

6.70 The JAC agrees with ESMA's comments on the importance of transparency as to index constituents and that details of rebalancing arrangements should be explained in the prospectus.

6.71 However, on the assumption that there is transparency, it is not clear to members why rebalancing on a daily basis or even more frequently should be problematic and consequently the JAC does not agree that further guidance is needed on this point.

Publication in appropriate manner

6.72 The JAC agrees that it is important for investors to be able to understand and assess the nature of the exposure they will undertake by acquiring a particular investment product. It also agrees that, in the case of what ESMA has identified as "strategy indices" this is likely to involve a description of the areas identified by ESMA. However, where that is achieved, it is not clear to the JAC what purpose would be served by publishing a detailed description of the full calculation methodology or why investors would need to replicate the strategy if they are already gaining exposure to it through a holding in a UCITS. Indeed, there could be risks for investors and swap counterparties in providing such a thorough-going disclosure.

(a) The JAC does not believe that in most cases retail investors would be likely to have any greater understanding of the risks associated with a product if the proprietary calculation model were to be disclosed. There is therefore a risk that it could result in an onerous and costly disclosure process that is ultimately unlikely to result in any appreciable benefit to investors.

(b) In the paper ESMA seeks to draw parallels between traditional investment managers and providers of swaps that provide a synthetic return involving an element of discretion on the part of the swap counterparty or a third party. As indicated above, the JAC does not accept that this parallel is appropriate. However, we would question whether requiring the proposed level of disclosure is consistent with the level of transparency required under the rules in relation to an investment manager in performing its investment management mandate on the part of the fund (for example, a manager running a quantitative strategy).

(c) The JAC is also concerned that detailed disclosure of the sort suggested in the paper could unintentionally put swap counterparties providing exposure to this sort of index at a commercial disadvantage as against the market. Among other things, there could be a risk that it could in some cases enable the market to second-guess how a given strategy will need to rebalance and then use that information to front-run trading connected with index hedging by the swap counterparty or otherwise enhance their position at the expense of the swap counterparty.

Conflicts of interest

6.73 JAC members agree that where an index is provided by the same legal entity that is the counterparty to a swap transaction which swaps the return on the index into the UCITS, there should be appropriate arrangements in place to manage any potential conflicts of interest between the unit which maintains and operates the index and the relevant dealing desk. They further agree that the nature of the relationship between the two units may need to be disclosed in the prospectus of the relevant UICTS.

43. How can an index of interest rates or FX rates comply with the diversification requirements?

44. Are there any other issues in relation to the use of total return swaps by UCITS that ESMA should consider?

6.74 The JAC has not identified any.

45. If yes, can you suggest possible actions or safeguards ESMA should adopt?

6.75 See response to question 44 above.

ABOUT THE ASSOCIATIONS

The **BBA** is the leading association for the UK banking and financial services sector, speaking for 201 banking members from 50 countries on the full range of UK and international banking issues and engaging with 55 associated professional firms. Collectively providing the full range of services, our member banks make up the world's largest international banking centre, operating some 150 million accounts for UK customers and contributing £50 billion annually to UK economic growth.

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 counties 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.

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

The **UK Structured Products Association** (UK SPA) is an organisation established by companies that create and distribute structured products to the UK financial services market in order to provide a useful and responsive source of information, education and comment on structured products by promoting their contribution to effective financial planning.

The Association's formation is a direct response to the members' belief that structured products are sometimes misunderstood and misrepresented and that this lack of understanding can prevent structured products forming an integral part of financial planning for investors.

The UK SPA is committed to publishing research, information and educational material about structured products and so create greater acceptance about their potential.

The UK SPA is not a commercial organisation and education and research are its core activities.

ATTACHMENT 1

01 February 2011

Dear Sir/Madam

JAC response to current consultations on the Packaged Retail Investment Products Initiative

This paper responds to the current EU Commission work on its Packaged Retail Investment Products ("PRIPs") initiative and, in particular, the following recent consultation documents:

- The consultation by the Commission Services on legislative steps for the Packaged Retail Investment Products initiative (the "PRIPs Consultation Paper");
- The Commission consultation paper on the MiFID Review (the "MiFID Consultation Paper"); and
- The consultation paper on the Review of the Insurance Mediation Directive (the "IMD Consultation Paper").

The Joint Associations Committee on Retail Structured Products (the **JAC**)[4] welcomes the opportunity to comment on the proposals in these consultation papers. We start by setting out in the **General Comments** section, below, a number of key considerations that we believe are of fundamental importance in deciding on:

- the design of the new regime; and
- how to legislate for it.

We then move on, in **Appendix 1**, to provide our response to the questions in the PRIPS Consultation Paper and, in **Appendix 2**, to provide our response to the relevant questions in the MiFID Consultation Paper and our thoughts on the IMD Consultation Paper.

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[5] within the EU of structured securities which are distributed to retail investors. The exposures available through the securities may also be made available through all of the other product-types covered by the PRIPs initiative, including investment funds, insurance products and structured deposits. The PRIPs initiative is therefore of prime relevance to the members of the JAC and their position in the market gives them a unique perspective on it.

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4 The JAC is sponsored by multiple associations with an interest in structured products. In the first instance, queries may be addressed to rmetcalfe@isda.org. For the purposes of this submission, ASSOSIM co-signs only the position regarding PRIPs. ASSOSIM will submit a separate position dealing with the MiFID review.

5 This is notably true of co-signatory, ASSOSIM

The members of the JAC have done their best to respond fully to the Commission's proposals. However, we do wish to highlight a concern to the Commission as to the period given for the consultation process. As the Commission is aware, this is a time of very considerable regulatory change for the financial services sector. That change is being driven not just by EU, but also international and national regulatory initiatives. Most of the firms who have helped to prepare this response are assisting with numerous regulatory consultations at all of those levels, frequently involving the same individuals. For entirely understandable reasons, there is a desire to press ahead expeditiously with the reform agenda. However, the process is now intense and is rendered more so by the need to try to understand the inter-relationships between national, regional and international initiatives. That is now creating a risk that regulatory proposals will not receive adequate consideration from those who are sometimes best placed to assess whether they will achieve their intended effect and whether they could create legal or regulatory uncertainty. The concern is general but, of the papers covered by this response, is particularly pronounced in relation to the MiFID Consultation Paper. The JAC fully agrees with principle 9 of the OECD reference checklist for regulatory decision making – that regulations should be developed in an open and transparent fashion, with appropriate procedures for effective and timely input from interested parties such as affected businesses and trade unions, other interest groups or other levels of government. We also welcome the Commission's commitment in its Communication on Smart Regulation of 8 October 2010 that, in the interests of smart regulation, it will lengthen the period for its consultations. We would like to think that in setting the timetable for future consultations the Commission will seek to make greater allowance for the context referred to above. Similarly, it would be helpful if the Commission could provide greater clarity as to the nature and extent of the regulatory impact assessments on which proposals are based.

GENERAL COMMENTS

The market for PRIPs exists for a reason; it provides for the needs of investors for long-term financial security and, in particular, retirement funding. If it was failing in that, investors would have given up on it long ago. But that is far from being the case. The fact that the market is as large, vigorous and resilient as it is should be regarded as a sign of success; indeed it should be celebrated. Firms engaged in this market perform a critical social function. That does not, of course, mean that it has no short-comings and, in view of the nature of the products and the importance of the PRIPs market for society as a whole, these cannot always be left buyers and sellers to sort out between themselves. However, where regulatory action is needed, it is important for it to be placed in context so that it enhances something that is fundamentally sound, rather than damaging it.

The Commission's objective is to secure a coordinated regulatory approach to and enhanced outcomes for retail clients gaining investment exposure through PRIPs: (a) by bringing greater standardisation to pre-contract disclosures to retail clients; and (b) by harmonising the rules for firms that help investors in their decision to take on that exposure such as investment advisers and those dealing with or on behalf of clients without advice. The JAC wholeheartedly supports these objectives. We consider it essential that European investors can confidently access good quality investment products which they can use in seeking to meet their investment needs and that those products are distributed in a way that means they can be clearly understood and compared. Indeed, the JAC was originally established and has worked over some years to promote a co-ordinated industry approach to improving consumer outcomes, both within the EU and internationally; it is hoped that the presence of such an active industry group pursuing this objective will be taken into account by the Commission in calibrating any new rules. In particular, the JAC has worked with the industry to produce a set of good practice principles for managing the relationship between product

providers and distributors (see Annex 1[6]) and a further set of principles for managing the relationship between distributors and individuals (see Annex 2[7]). More recently, the JAC has been actively involved in responding to both CESR and the Commission consultation processes on the UCITS key investor information document and earlier phases of the Commission's PRIPs initiative.

The JAC fully agrees with comments in the consultation papers which indicate that a "one size fits all" approach to regulating the PRIPs market is unlikely to achieve the Commission's objectives, and could be counter-productive. While some areas of the market are largely commoditised, at the other end of the spectrum there is considerable diversity. This is noticeable at two levels:

- First, in the different ways in which an investment exposure can be put into a form in which a retail investor can access it in seeking to achieve a given investment objective – ie through an investment product (see "**Product Diversity**" at 1 below); and

- Secondly, in the variety of channels through which retail investors can come to acquire or enter into those investment products (see "**Distribution Chain Diversity**" at 2 below).

The JAC considers it critical that full allowance is made for this diversity in the way in which the new regime is designed and in the drafting of any new rules. It is important to avoid forcing products or distribution channels into an inappropriate regulatory framework and posing a risk to positive innovation in future.

While the main focus of the PRIPs initiative is on the regulation of financial services providers, the JAC also highlights below its belief that investors should be encouraged to approach savings and investment of their assets in a responsible manner and that financial services providers should be able to assume that they will; regulation and supervisory practice should be calibrated by reference to that principle.

In what follows, we refer to the firms that are involved in creating PRIPs as "Product Producers" and to the firms that are involved in enabling investors to acquire or enter into PRIPs as "Distributors". While JAC members do not generally have any direct relationship with the end investors in PRIPs they help to create, in other contexts, Product Producers (such as insurers) do sometimes have direct contact. In cases such as those, the comments below concerning the role of Distributors may be also relevant.

The JAC's comments at this stage relate mainly to policy questions, but the ultimate success of the PRIPS initiative will depend on effective translation of the adopted policy objectives (which will presumably be published by the Commission) into a specific legislative proposal. The JAC would be able and would be happy to put its members' technical expertise at the Commission's disposal to assist in this respect.

1. Product Diversity: risk/reward profile of investment products as compared with their legal form

Any new regulatory rules need to take full account of:

(a) the considerable variety of structured investment products available within the EU (some offering similar returns, but through different legal structures); and

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[6] This annex was deleted due to repetition. Please find appended to Attachment 3.

[7] As above.

(b) the fact that it does not necessarily follow that an investment product with a relatively complex legal structure will also have a complex risk/reward profile or vice versa.

The JAC considers that the regulatory regime for PRIPs should operate principally (although not exclusively) by reference to the risk/reward profile rather than a product's legal structure.

- It should not be assumed that legal complexity equates to higher risk. Indeed, legal complexity is sometimes the result of steps taken to simplify or moderate the risk profile of a product; one of the most obvious examples of this is arrangements to provide some level of principal protection and another is the use of caps and floors on exposure. It is questionable to what extent investors need to understand the detailed mechanics by which a particular risk/reward exposure is provided as long as they understand the exposure they will undertake sufficiently to make an informed decision. In part, it will depend on how far an investor takes exposure to the effectiveness and cost of a particular legal structure. It is certainly possible that a complex legal structure could affect an investor's ability to understand that risk profile, so that some discussion of the legal structure may be necessary. However, it should not be the default assumption that it is always necessary to describe the legal structure of a product; the emphasis should be on helping the client to understand the risk/reward profile so that he or she can determine whether it is likely to help in achieving the client's desired objective.

- That said, the legal form of a product through which a particular investment return is provided is not irrelevant. It can affect the outcome for the client; for example, the risk exposure involved in participation in an investment fund established as an FCP or a trust is quite different from that resulting from purchasing a debt security, even if both of them are intended to track the FTSE 100. Consequently, regulatory rules applicable to services provided in relation to PRIPs and product disclosure in relation to PRIPs need be sufficiently flexible to allow for the fact that products that take a different legal form do not necessarily behave in the same way simply because they purport to offer similar structured exposures or because they could be used for similar purposes.

For these reasons, in a number of cases in this Paper, the JAC indicates its view that where further rules are introduced for PRIPs, broad principles, prompts and optionality are preferable to overly detailed or prescriptive rules that seek to cover every eventuality.

2. Distribution Chain Diversity: the process by which retail investors obtain investment exposure using PRIPs – the roles of Product Producers and Distributors and the need for flexibility in the application of regulatory rules

In formulating its approach to PRIPs, the JAC considers that it is critical that the Commission takes full account of:

(a) the many different avenues by which investment products are mediated to investors; and

(b) the differing roles in each that can be played by Product Producers and Distributors.

There is no single framework for the process by which an investor will obtain an investment exposure in which Product Producers and Distributors always play the same roles; rather, the process commonly involves a series of stages, some of which will be the domain of the Product Producer and others that of the Distributor and, in some cases, both. For example, as the Commission recognises, in some cases a Product Producer will sell products directly to investors, but in others it will have no contact with them at all. In addition, the market is dynamic – witness the emergence of on-line "investment supermarkets" and other

forms of electronic platform. Failure to take this diversity and dynamism fully into account could result in an inappropriate allocation of regulatory responsibility between the various firms involved, with the result that rules do not achieve their intended result and need to be revised. To some extent this can be catered for by legislating for periodic reviews, as with the current MiFID review. However, it would be preferable if regulatory rules can be drafted in such a way as to allow for diversity and change.

The rules for PRIPs therefore need to be drafted in sufficiently flexible terms so that they can be applied appropriately to different frameworks. As with the treatment of the products themselves, avoiding over-prescription that assumes that a particular type of firm will be carrying on a particular type of activity is likely to help in achieving this outcome. The role of product regulation and the question of whether or not a client is prepared to pay for professional investment advice (and, if so, of what quality) are important elements in the likely outcome. However, putting those to one side, the basic objective should be that investors of a similar level of sophistication and size are afforded a similar minimum level of regulatory protection in relation to an investment exposure of a given sort regardless of the relative roles of Product Producers and Distributors in the process by which an exposure (having been put into a form whereby an investor can gain exposure to it) is mediated to the investor.

It is, perhaps, helpful to look at the role of JAC financial firm members as Product Producers, in order to draw out what this means in practice.

- The financial firm members of the JAC are all Product Producers although many are in groups that also have a distribution function. They rarely have contact with the underlying retail clients or have detailed information about those to whom their products are ultimately sold – that is the case even in those groups that have private or retail client advisory or brokerage arms since there would normally be a clear functional separation between the two. Product Producers in that position are generally not able to assess whether a product is suitable or appropriate for a particular investor that may ultimately acquire it; a direct relationship with the investor is needed to do that. In a context such as this, the JAC therefore agrees that regulation of (a) those that do have a direct relationship with the investor and (b) the disclosure process, is key in achieving the Commission's objectives. Product Producers nonetheless recognise that they need to give information about their products to those who have the client relationship, to assist them in providing their services to their clients.

- Some Product Producers do have a direct relationship with the investor – for example, the MiFID Consultation Paper addresses the position of a credit institution which has a direct contractual relationship with its client, and the IMD Consultation Paper the position of insurers. Where JAC members are involved in products of this sort, it is because the Product Producer wishes to hedge its exposure in relation to a product by entering into transactions with a JAC member; in other words, JAC members would more usually be entering into derivative contracts as hedge providers to enable a Product Producer to provide PRIPs, rather than carrying on the banking or insurance activities themselves. Likewise, investment funds are often in the form of vehicles with independent boards and regulatory responsibilities, with assets managed by an investment manager; JAC members may sometimes do little more than provide investment exposure to the fund through derivative instruments and associated transactions. Even where a hedge provider is more directly involved in structuring an investment product, in particular, by arranging for the issue of structured securities, it would be unusual for it to have direct contact with investors, any sale being mediated through a separate financial institution. In these cases, the hedge provider simply helps to create an investment product that behaves in a particular way and provides an explanation of that, notably in the prospectus. It is ultimately for the investor and whichever intermediary they choose to determine whether the resulting exposure is something that will help that investor meet a particular investment objective.

- There appear to be three basic phases for the distribution process, and the JAC agrees with the current focus of the PRIPs initiative on these:

    - **A 'pre-sale' phase** in which products are marketed to Distributors and/or investors and in which (depending on the service sought by the investor) Distributors may acquire information on the sophistication, knowledge and/or financial resources and capability of the investor;

    - **A 'point of sale' phase** in which the investor and Distributor actively discuss the possible purchase of a particular product or products or a dealing instruction is given and following which, the Distributor executes the sale;

    - **A 'post-sale' phase** - the period in which the investor holds the product.

  In the pre-sale phase, there are at least three types of activity:

    - The general marketing of products;

    - The disclosure of information on those products; and

    - The acquisition of information about the investor by the Distributor to allow it to subsequently assess the suitability or appropriateness of particular products (where those duties arise).

  The point of sale phase involves two basic types of activity:

    - The provision of investment advice (or suitability/appropriateness assessments and related explanations of risks);

    - The execution of client orders.

  The post-sale phase covers the lifetime in which the product is held by the investor. It may or may not be associated with an ongoing client relationship between the investor and the Distributor. In the absence of such a relationship, a Distributor may have no on-going duties to the investor. The JAC agrees with the public policy objective that the firms involved in each of these phases should discharge their duties in such a way that, taken together, clients purchasing a similar product get the same basic level of protection, albeit that in practice they receive something more than that.

- For structures where Product Producers have no direct client relationship, it is important to maintain a clear distinction between regulatory rules that are designed to address the way in which investment services and activities in relation to PRIPs are provided to and carried on with clients – the area covered by MiFID – and the activity of creating investment products. MiFID does not generally address product creation. Rather it regulates the provision of "investment services" and the conduct of "investment activities".[8] Product creation often does not involve investment services or activities with the underlying investors. There are separate Directives that regulate the creation itself of investment products in the interests of achieving positive investor outcomes (distinctly from regulating related disclosure). The most important example of this is the UCITS Directive, regulating the creation of fund participations by UCITS and/or their managers. However,

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[8] The position is the same under the Insurance Mediation Directive.

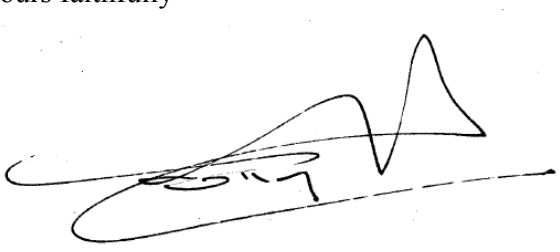
the Commission has concluded (quite rightly) over the years that it is neither appropriate nor realistic to regulate the structure and operation of every investment product-type issued by or available through EU vehicles. The JAC therefore has a concern that attempts to use a Directive such as MiFID to address the role of firms in structuring or creating investment products could involve trying to make the Directive do something that it was not designed for and would, in any event, simply catch those firms that happen to be EU investment firms or EU credit institutions. The result could be rules that do not sit well with their intended object and an unlevel playing-field between different firms. In a similar vein, some PRIPs (particularly for those available in the high net worth market) will, in any event, emanate from outside the EU. Once again, seeking to impose duties on Product Producers using a Directive such as MiFID could result in an uneven playing field.

3. Investor responsibility

As indicated above, the process by which an investor decides to take on a particular investment exposure often involves a number of different actors in different roles and with different responsibilities. This paper concentrates on the roles of Product Producers and Distributors. Taking due account of the investor-protection regime outlined in the MiFID directive, it is important to recognise that investors also have a responsibility for ensuring an appropriate outcome, in particular, by not investing in something until they are satisfied that they understand the risk/reward exposure they will be taking on and, if they do not, seeking appropriate advice.

The JAC notes that the consultation papers covered by this response and the Directives to which they relate do not address the need for an investor to take responsibility for his or her decisions. That assumption may underlie all of the relevant regimes, but is nowhere expressly stated. It is an important principle that should apply to any new rules in this area (and to associated supervisory activities) that no regulatory regime can or should seek to protect investors if they suffer loss as a result of an insufficiently responsible approach on their part.

Yours faithfully



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PARTICIPATING ASSOCIATIONS

ISDA®

ISDA, which represents participants in the privately negotiated derivatives industry, is among the world's largest global financial trade associations as measured by number of member firms. ISDA was chartered in 1985, and today has 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.

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

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

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 sector.

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

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.

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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

Response to questions in the PRIPS Consultation Paper

We set out below our responses to the questions raised in the PRIPs Consultation Paper which are relevant for JAC members. As noted above, the PRIPS initiative deals with a wide range of products and it is essential that the new regime is crafted appropriately to deal with that. In particular, we note that some (but by no means all) structured PRIPS have considerably more detailed disclosure documentation than that used, for example, for non-structured UCITS. For this reason the process of identifying an appropriate harmonised set of contents requirements for the preparation of KIIDs in respect of all types of structured PRIPS is likely to be much more challenging than for a non-structured UCITS.

The Commission does not raise for consideration in the PRIPs Consultation Paper the relationship between the proposed new KIID and any documents separately required by individual Member States in order to sell PRIPs to clients in their jurisdiction. However, the JAC would like to suggest that where, in future, a KIID is required in relation to the distribution of a particular product-type, that obligation should replace any requirements of individual Member States to provide documentation which is intended to have a similar purpose.

CONSULTATION RESPONSES

EXECUTIVE SUMMARY

The Commission's attempt to enhance investor understanding and the quality of investor decision making by establishing a harmonised regime for a PRIPs, including a Key Investor Information Document, is welcome. Indeed, the JAC has been actively involved in Commission consultations and industry workshops from the earliest stages of the "substitutable investment products" initiative. As the Commission is aware, we have also given considerable thought to the question of KIIDs both in the context of the development of KIIDs for UCITS and in earlier stages of the PRIPs review. In particular, on 19 November 2009 we made a submission to the Commission in relation to its PRIPs initiative and followed that on 30 June 2010 with a supplementary submission (the "Supplementary Submission") providing our suggestions specifically on the content and format of a KIID for PRIPs. Since the second of these documents considers some of the issues raised by the PRIPS Consultation Paper in some detail it is attached to this submission as Annex 3 after the JAC statements of good practice referred to above.

As a result of that work, we think it is important that the following broad principles are reflected in the scope and structure of the new regime:

- To the extent possible, any vocabulary prescribed for use in KIIDs by the new rules should be sufficiently generic so that it can be used for KIIDs for products of any sort. Where that is not possible one or more alternatives should be provided for, or the relevant content requirement addressed by reference to a prompt indicating that the firm creating the KIID is to formulate the relevant disclosure in an appropriate manner.

- Although a level of prescription in respect of KIID content aids comparability and ensures that key messages are communicated in a consistent manner, an overly prescriptive approach could risk detracting from clear and effective disclosure. There will therefore need to be sufficient flexibility to allow disclosures to be appropriately tailored to the relevant type of product.

- Brevity will not necessarily aid investor understanding if it acts as a constraint on a clear description of key characteristics of the product. There is therefore an important balance to be struck between length and intelligibility which, given the variety of products involved, may not be the same for every product-type. Possible strategies for dealing with this include the use of glossaries, targeted cross-reference to other documents or allowance for appendices on an incremental basis to address the characteristics of particular product-types.

In addition, a number of national and international bodies have been undertaking work on pre-contract disclosure in the context of investment product distribution, for example, work by IOSCO[1] and the Hong Kong and Singapore regulators. As far as possible, the EU PRIPS regime should be consistent with international standards for pre-contract disclosure so that firms and investors are not confronted by the cost and potential risks that could arise from having to take different approaches in different jurisdictions. See also our proposal in the introduction to this Appendix, above, regarding the relationship between the KIID and individual Member State documentation requirements.

In a similar vein, most EU jurisdictions will presumably require retail disclosure in the local language. For international firms making pan-European offers the burden of translating all of this information will be considerable. If there is to be an obligation to translate KIIDs into the language of individual Member States (and ensure accuracy of translation) responsibility for that should lie with whoever is best placed to do this. In view of that, we think it would be preferable not to seek to legislate about whether Product Producers or Distributors should arrange for a translation, leaving it to the firms involved to determine that between themselves.

Q. 1: Should the PRIPs initiative focus on packaged investments? Please justify or explain your answer.

The answer to this question depends upon the definition of "packaged investments", as to which see Qs.2-14 below. However, we agree that the initiative should focus on investments of a sort that seems to be suggested by the draft definition included in the PRIPS Consultation Paper. We believe "vanilla" products should be strictly out of scope together with any other categories of product that are simple enough to be excluded, including shares and fixed or floating rate bonds issued by trading companies. The regime would seem both inappropriate and unnecessary for such products with no discernible public policy benefit.

Q. 2: Should a definition of PRIPs focus on fluctuations in investment values? Please justify or explain your answer.

In principle, we agree that it should capture some form of uncertainty and fluctuation in payments or returns by reference to a factor that is separate from the "wrapper" through or as a result of which they are provided, but please also see also responses to Qs. 5, 6, 8 and 13 below. In particular, we consider that fixed return investment products, such as fixed rate bonds, and simple floating rate deposits and bonds should be out of the scope of the definition as we think it is unlikely that investors will have comprehension issues with these products and many simple syndicated corporate bond issues would otherwise be caught.

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[1] We note that IOSCO Standing Committee 3 is currently undertaking work in the area of product distribution under the chairmanship of Stephen Po, in particular, in the area of suitability. ISDA, the IIF and other industry associations and members are supportive of that work and are engaging in the agenda.

Q. 3: Does a reference to indirectness of exposure capture the 'packaging' of investments? Please justify or explain your answer.

In broad terms, we agree that some form of 'packaging' or 'indirectness' of the exposure is a good starting point for the definition. However, we believe there could be some scope for interpretation and potentially regulatory arbitrage around what constitutes a "direct holding" for this purpose and a clear definition of "direct holding" would therefore be important. Please also see our responses to Qs. 5, 6, 8 and 13 below.

Q. 4: Do you think it is necessary to explicitly clarify that the definition applies to fluctuations in 'reference values' more generally, given some financial products provide payouts that do not appear to be linked to specific or tangible assets themselves, e.g. payouts linked to certain financial indices, the rate of inflation, or the overall value of a fund or business?

We believe clarification of this sort would be consistent with the Commission's objectives for the PRIPs regime. The reference to "assets" could be replaced with "reference values", which could then be defined broadly to include values derived from, for example, credit, equity, commodity or other financial or non-financial assets, interest rates (in products that do not fall outside the PRIP definition), FX rates, indices or inflation.

Q. 5: Do you have any other comments on the proposed definition? If you consider it ineffective in some regard, please provide alternatives and explain your rationale in relation to the criteria for a successful definition outlined above.

Basic definition

In essence, we understand from the PRIPs Consultation Paper that the Commission is effectively suggesting a definition of "PIP" rather than "PRIP" – in other words, the definition does not seem to operate by reference to whether the product is of a sort that is commonly acquired by retail investors, but rather whether it is a "packaged investment product". The regime obligations, such as the provision of a KIID, would then only apply to 'retail' sales of PIPS. We believe that this approach could be effective if correctly drafted. It would need to be clear that the obligation to produce a KIID (and any other similar rules) only arises where the product is actually sold to a retail investor regardless of whether it was designed for retail investment. The firm involved in deciding to sell the product to a retail client would therefore be an important "gate-keeper" under this regime.

A further area for attention is the potential for regulatory arbitrage. This tends to support the Commission's proposed approach in suggesting that the basic definition needs to be drafted in sufficiently broad terms. If certain substitutable products fall outside the PRIPs regime this could lead to movements in the market away from products captured by the PRIPs regime towards the exempt products.

In terms of more detailed drafting, certain of the expressions used in the definition could be clarified. In particular, we note the following:

- The "amount payable" could be defined as including a periodic payment or redemption, sale or surrender value, but excluding payments from non-investment products (e.g. general insurance).

- If the term "assets" is replaced with "reference values" or, alternatively, "reference factors", then this could be defined broadly as mentioned in Q. 4 above.

- "Direct holding" will need to be carefully defined to include, for example, shares in trading companies and holding companies, but excluding shares in an SPV which holds or repackages PRIPs.

- It may be more appropriate to replace the words, "is exposed to" with the words "is primarily defined by reference to", at least in relation to structured securities.

Treatment of wholesale products

We do nonetheless want to stress, as we have done previously, the importance of a definition that does not encompass products of a sort that ought not to create the kind of policy issues that the Commission is seeking to address. A significant concern is that wholesale institutional market products are inadvertently captured. The PRIPs Consultation Paper suggests that the Commission Services currently intend that the definition should be broad with a number of exemptions taking certain products out of the regime. The scope of these exemptions would need to be considered carefully to ensure that all products that should be exempt benefit from a clear exemption or are included in a "white list" or are otherwise dealt with in an 'indicative list'. Where wholesale market products are inappropriately caught by the regime, this could result in significant upheaval from an organisational and documentation perspective with little or no benefit for the end investor– and even in some cases product discontinuation. For the markets to continue to function effectively, the exemptions need to be capable of being easily applied by market participants in a manner that does not create legal and regulatory uncertainty.

In addition, we think there is considerable merit in the Commission considering the introduction of a safe-harbour exemption for wholesale products where the contractual terms and/or principal disclosure document contain a legend stating that the product is not suitable for retail investors and should not be sold to or invested in by retail investors. Firms should then be prohibited from offering or selling such products to retail investors. Clearing and trading systems could be required to tag such products as "EU non-retail". Such an approach would be similar to that adopted for Rule 144A securities in DTC. In relation to the definition of what is a "retail investor" or "retail client", please see our comments at Q.104 in Appendix 2 of this response.

Q. 6: Should simple (non-structured) deposits be excluded from the scope of the initiative? Please justify or explain your answer.

We agree that simple fixed and floating deposits should not be caught by the regime. They are not regarded as packaged products and we do not see any investor comprehension or comparability issues in relation to the risk/return on these products. Indeed, it is not presently clear why simple deposits would be caught by the current definition of "PRIP" as currently formulated (as the references to 'assets' and 'wrapping' etc do not seem relevant). However, that could turn upon precisely how the word "deposit" is ultimately defined for these purposes. We would therefore query whether there is a need for a specific exclusion.

More generally, we note that having a specific exclusion of a product that does not apparently fall within the definition of a PRIP in any event could create uncertainty (by implication) as to what other products are intended to be covered by the definition. It may therefore also be desirable to address areas such as this (if at all) in the context of the proposed 'indicative list' (see Qs. 13 and 14 below).

Q. 7: Do you consider option 1 or option 2 preferable for achieving this? Please explain your preference, and set out an alternative if necessary, with supporting evidence.

It may be helpful to clarify the precise meaning of a "deposit" for these purposes. However, our understanding of a deposit is that it should always be repayable in full, save in the event of the

default of the relevant credit institution. Rather than referring to principal (or repayment at "par"), the definition should therefore focus on the basis upon which any return earned on the deposit is determined. This is closer to Option 1. However, we would query whether the approach in Option 1 could be simplified by stipulating those bases of calculating a return that are not "structured" (and that are therefore "simple deposits"), ie interest rates, rather than seeking to specify all of the other bases of calculating the return that could result in the deposit being "structured". Subject to our comments in response to Q.6 regarding the risks of creating an "exclusion" for simple deposits, a structured deposit would then be within the regime if it falls within the definition of a PRIP and is not a "simple deposit". Such structured deposits could be included in the indicative list as being within the scope of the PRIPs initiative.

Q. 8: Should such an exclusion be extended to financial instruments which might raise similar issues as deposits (e.g. bonds), and if so, how might these be defined? Please justify or explain your answer.

We think that fixed and simple floating rate bonds should be out of scope. A similar method to that suggested for deposits in response to Q. 7 may be used so that "structured bonds" are stated in the indicative list to be within the scope of the PRIPs initiative if they fall within the definition of a PRIP and are not "simple bonds" (which could be defined as bonds, the return on which is expressed either as a fixed or floating rate interest – a definition would need to be developed for the latter).

We do not see why simple non-structured products in general should not be excluded from the initiative. Other candidates for consideration include, (i) vanilla market access products and (ii) certain types of covered bonds and asset backed securities with full recourse to the issuer (since any element of structuring in (ii) is intended to support the basic payment obligation, not produce a structured return).

In view of the breadth of the current definition we would therefore welcome further clarity by the use of an 'indicative list' of products so as to provide the sufficient legal certainty required for market participants. This is especially the case if the concept of 'offered to retail' is not included in the definition of what is a PRIP.

Q. 13: Do you see benefits from such an indicative list being developed? If not, please provide alternative proposals and evidence for why these might be effective.

The JAC agrees that an indicative list would be beneficial to provide legal certainty, though it will not be a substitute for a clear PRIP definition. In addition, the Commission should consider whether to create a "white" list setting out (on a non-exhaustive basis) financial instruments that should never be treated as a PRIP in any circumstances. Products that could also be considered for inclusion in this list are certain simpler products such as vanilla market access and p-note type products. We would be happy to work with the Commission to support the development of any such lists.

The indicative list should be sufficiently comprehensive to provide effective guidance to the industry as to the appropriate classification of each product-type available in the market. This is particularly important for those products that could fall on the threshold of the definition of "PRIP". The list should only be indicative; it needs to be drafted in terms that do not imply that a particular product is necessarily a PRIP simply because it has some of the characteristics of instruments included in the list.

Updating the list

The JAC notes that the Commission considers that the list should be "relatively open to revision and update". It is clearly important that any indicative list keeps pace with the development of new products; it should be periodically refreshed to cater for product evolution and to avoid regulatory arbitrage opportunities. However, any arrangements for updating the list need to be subject to a rigorous objective and transparent process and appropriate consultation. In the interests of certainty, it would be preferable for reviews generally to take place in accordance with a public pre-set timetable.

A good example of the sort of area where, we believe, developing product design makes it important for the Commission to retain the flexibility to exclude products from the ambit of the PRIPs regime is the current work on high quality securitisation products. As the Commission will be aware, the industry is exploring the idea of a securitisation "quality label", which is intended to expand investor interest in high quality securitisations. This would be an important means of supporting European real economy growth and increasing access by banks to long-term institutional investor funding. If it proceeds, an objective would be to create a more level playing field between investment regulations that exist for covered bonds and high quality securitisations, including potentially the distribution of certain types of securitisations, on a highly qualified basis, to retail investors in a similar way as are certain covered bonds. At this early stage, it is important that the PRIPS regime should allow for a suitably graduated regulatory approach to retail investment in these types of high quality securitisations – and in a manner that does not result in unnecessarily onerous regulatory treatment for the issuers. The use of indicative and white lists could be an important means of achieving this. We assume that lists such as these would be developed and maintained by ESMA and would be happy to make the knowledge of our members available to ESMA to assist in that process.

Legal and regulatory impact of changes to the list

It should be a basic principle that any change to the list should not result in a need to re-classify as PRIPs products that were generally in existence at the time of the previous review and which have not commonly been categorised as PRIPs in the light of the previous version of the indicative list. This may mean that it is necessary to consider the use of grandfathering arrangements, for example, in relation to products that are already in client portfolios at the time of reclassification (so that they are not subject to retrospective treatment) and products that are subject to an on-going offer.

Q. 14: Do you have any suggestions on the possible contents for such a list, including on how to define items placed on the list?

As indicated above, we would suggest that simple deposits and various non-structured products are included to make it clear that these are not intended to be within the regime (rather than as separate exclusions). In the interest of market certainty, it is important that the list should be used only to clarify and provide carve outs from the PRIPs definition, but not to expand the scope of the definition.

We think it is important that the Commission should continue to move towards a greater harmonisation in the expressions used to refer to financial instruments and products in all EU financial services legislation and, consequently, would favour definitions that are consistent with and/or build on those used elsewhere within the EU regulatory regime.

Q. 17: Should the design of the KIID be focused on delivering on the objective of aiding retail investment decision making? If you disagree, please justify or explain your answer.

Before responding to any of the questions in the PRIPs Consultation Paper that relate to KIIDs, we need to make a general point; the answers to many of the questions posed are heavily contingent on a more precise understanding of the intended purpose of the document. While we understand that its general purpose is to assist in the investment decision making process, until there is greater clarity about the way in which it is intended to do that, it is difficult to be definitive in our response to a number of the questions. We consider that it is important to be clear about whether the document is intended to be entirely "stand alone" (which we do not think the Commission intends), or whether it is to be an introduction - a reading aid - to assist navigation and comprehension of the other disclosure materials or, alternatively, a form of aide memoire? Our responses below are therefore subject to further clarification from the Commission in this area.

Subject to that, we agree with the broad objective that the KIID should be focussed on aiding retail investment decision-making. We welcome the recognition by the Commission that this does not mean that 'one size fits all' and that it will be necessary to have different forms of KIID for different PRIPs. On that basis, we also agree that providing key information in a clear and transparent, standardised, format could help to enhance investment decisions in conjunction with product materials in the current format familiar to the market.

The inter-play between the KIID and contractual documentation and other disclosure documentation (such as the prospectus) is important. A short-form document such as the proposed KIID is unlikely, on its own, to form a sufficient basis for investment decision-making. The contents requirements mandated for other pieces of documentation concerning investment products that are commonly provided to investors (for example, under the Prospectus Directive) have been established over the years by reference to what legislators and courts have considered investors should know before making a decision. In view of that, it is important for investors to be aware of and understand the wider characteristics and material legal terms and conditions of the product which they wish to buy. It should not be the case that an investor solely bases an investment decision on the KIID; that would undermine the rationale for the law applicable to the creation and sale of each product-type and would raise questions as to the point of regimes such as the Prospectus Directive which already provides for a developed disclosure regime aimed at protecting retail investors, either directly or through intermediaries. The introduction of the KIID should not be seen to diminish the important role intermediaries have to play in aiding investor understanding, notably in discharging MiFID appropriateness or suitability and risk explanation obligations.

Q. 18: Should the KIID be a separate or 'stand alone' document compared with other information that might be necessary, e.g. background information, other disclosures, or contractual information? Please justify or explain your answer.

As indicated in our response to Q.17, the extent to which the KIID should be a 'stand alone' document, which is capable of informing an investment decision without reference to other material, turns on what the KIID will contain and the role it is intended to play in the investment decision-making process. If it is a short-form summary, the idea that a review of the KIID in isolation would be sufficient to enable an informed investment decision would seem to ignore the important role of other documentation developed to comply with legal and regulatory standards which are designed to facilitate effective investor decision-making. It cannot be expected that a two page document can serve the purpose of giving important information to consumers on a 'stand alone' basis. The KIID also needs to be seen in the context of the role that investment advice or suitability/appropriateness assessments (where applicable) should play in investor decision making. While it may well be appropriate for the KIID to be a separate document, operating as an 'aid' to investment decision-making, it should not be the sole source of

information upon which an investment decision is made. As indicated above, a clear understanding of the purpose of the KIID is therefore essential in terms of defining investors' legitimate expectations (and, consequently, the issue of liability discussed below). Consequently, we believe the Commission should therefore consider requiring the purpose of the KIID to be made clear – in particular, through endorsement of a statement of purpose (possibly linked-in with a responsibility statement) on the face of the KIID.

Against that background, we suggest that the role of the KIID should be to act as a useful summary of key information, to highlight particularly important issues for consideration and to facilitate comparability between products, similar in some ways to the Prospectus Directive summary prospectus. However, as mentioned in respect of Q. 17 above, for retail investors to make an informed choice, they would still need to have access to all necessary information. In respect of credit risk, for example, we do not believe it would be workable for an investor to make a decision without reference to other material.

To enhance the investor's understanding of key points (and to assist in containing the length of the KIID), we would suggest the use of a glossary of key terms and targeted cross-references to specific sections of the relevant offering/contractual document, which contain more comprehensive information in relation to certain prescribed areas. Cross-referencing would allow the KIID to give the investor a flavour of the issues that should be considered whilst at the same time directly assisting the investor in locating further information on specific product characteristics where desired. We refer to Sections A.1 and A.2.1 of the Supplementary Submission, which provide some further comments on the use of cross-references and a glossary.

The KIID could also helpfully include a section on "Documents Available to You", detailing where an investor can go for further comprehensive information to which prospectus liability attaches. The KIID itself should not carry this liability.

The question of liability for the PRIPs KIID will need also to be addressed specifically. As highlighted above, the issue of liability is directly related to the stated purpose of the KIID which needs further definition. However, in addition, as mentioned in Section B.4 of the Supplementary Submission, we would suggest defining the level of liability attaching to the KIID; we believe that it would be appropriate to stipulate that the level of liability attaching to KIIDs is similar to, and consistent with, that for the prospectus summary under the Prospectus Directive regime, i.e. that no civil liability should attach in respect of the KIID unless: (i) it is misleading, inaccurate or inconsistent, when read together with the other parts of the relevant offering document, or (ii) it does not provide, when read together with the other parts of the offering document, key information in order to aid investors when considering whether to invest in such securities. A higher level of liability is unnecessary and would likely result in an over-cautious approach being taken by the party compiling the KIID. A higher liability standard, and strict limits on length, would also place unacceptable risk on the party preparing the KIID and is likely to result in a decision not to offer certain products to retail investors, thereby reducing competition and investor choice.

The PRIPs Consultation Paper also provides that the introduction of a pre-contractual disclosure requirement is without prejudice to national legal systems' definitions and treatment of pre-contractual or contractual legal relationships. However, this point is not really developed further. As this is relevant to other questions (such as the objective of the KIID and also whether or not it should be a stand alone document) we think further clarification will be needed.

Q. 19: What measures do you think will be necessary to ensure KIID remain streamlined and focused solely on key information?

Please refer to our response to Q. 18 above and in particular the references to the use of a glossary and cross-references.

Standard form definitions could be developed for certain common terms. As mentioned previously in our Supplementary Submission, the JAC would be happy to work with the Commission and/or ESMA on any such project. A market standard glossary of terms would have several advantages:

- it would keep the KIID free of definitions and explanatory text which would otherwise serve to clutter and lengthen the document;
- it would ensure consistency of terminology, which would aid comparability and investor comprehension;
- there would be a reduction of legal and other drafting costs for the person producing the KIID.

As indicated in the response to Q.18 above, in order to reduce the need for a KIID to disclose all foreseeable risks, we feel that it is also crucial that the liability standards attaching to the KIID are no stricter than those attaching to the prospectus summary.

Q. 20: While the same broad principles should be applied to all PRIPs, should detailed implementations of some of these principles be tailored for different types of PRIP? Please justify or explain your answer, and provide examples, where relevant, of the kinds of tailoring you might envisage.

We agree with the objective of a harmonised approach to disclosure. However, given the diversity of products involved, it is also important to appreciate that harmonisation can only go so far without resulting in a regime that does not fit the products concerned. The balance between principle and detailed prescription is a fine one. However, we agree that the use of broad principles over precise prescription would be helpful in addressing this tension since it allows flexibility for detailed implementation to be tailored for different types of PRIPs, facilitating accurate representation of key features. With that in mind, the JAC has previously proposed a draft template form of KIID which seeks to ensure that the structure and language in the template can be applied across different types of PRIPs, noting nevertheless that there are fundamental differences the relevant product-types.[1] In the light of our work on that, we believe there are particular difficulties in seeking to standardise disclosure in relation to areas such as costs, performance, risks and guarantees and also in addressing the inter-play between the wrapper and its underlying.

We agree that the UCITS KIID provides a useful starting point for developing the KIID. However, any use of the UCITS KIID needs to recognise that it is highly UCITS-specific and will require considerable modification. We welcome the apparent recognition in the current PRIPs Consultation Paper that KIIDs for PRIPs more generally will need to be tailored for certain products – that shoehorning everything into the UCITS framework will not work.

We also note that it may make sense to allow optional tailoring for the client's personal situation, which would seem appropriate if the Distributor is to produce the KIID.

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[1] See the JAC Supplementary Submission in relation to the EU Commission's Packaged Retail Investment Products initiative of 30 June 2010 - attached.

Q. 21: Do you foresee any difficulties in requiring the KIID to always follow the same broad structure (sequence of items, labelling of items)? Please justify or explain your answer.

We do not foresee any particular difficulties with this – to some extent, it turns upon how broadly the function of each element in the structure is described. Please also refer to the Supplementary Submission, in which we have previously suggested a broad structure that could be used across different products, including the use of general terminology and harmonised section headings (Section A.1 of the Supplementary Submission). However, it may be necessary to provide for an element of incrementalism to address particular product characteristics that are not shared across all products in the PRIPs fold – for example, by means of optional appendices.

Q. 22: Do you foresee any difficulties in requiring certain parts of the key information and its presentation (e.g. on costs, performance, risks, and guarantees) to be standardised and consistent as possible, irrespective of tailoring otherwise allowed? Please justify or explain your answer.

As we have confirmed previously in our Supplementary Submission, we believe a level of prescription (particularly in relation to structure) aids comparability and ensures that key messages are communicated in a consistent manner. We can therefore see that there is scope for some standardisation. However, as mentioned above there may be difficulties in requiring certain parts of the information to be standardised without obscuring the very important differences between the different products. Too much prescribed content may risk detracting from clear and effective disclosure. We have provided further detail on this in the questions below.

Q. 23: Can you provide examples and evidence of the costs and benefits from your experience that might be expected from greater standardisation of the presentation and content in the KIID?

We do not have examples. However, we note that if the costs or resourcing requirements of the new rules are too high, there is a risk that firms could decide to limit their offerings to retail investors only to those products which can absorb high production costs; that would result in reduced product selection competition and in all likelihood raising the costs for investors.

Q. 24: Should the content of the KIID be controlled so that there is no possibility for firms to add additional information unless expressly allowed for?

The answer to this question depends to some extent on its purpose, as to which, see our response to Q.17, above. If it is to be little more than an "aide memoire", then a higher level of prescription may be realistic. Even if it is to be more than that, then a reasonable level of standardisation is still important in achieving the objective of comparability. For example, we think the KIID could usefully include a section on "Reasons to Invest". Nonetheless, we feel that there needs to be some flexibility to include other relevant information, whether directly or by reference, in order to allow the disclosure to be appropriately tailored. We believe that the current format of the UCITS KIID may be too prescriptive in this respect for the broader range of products that will be covered by the PRIPs regime. Please see Section A.1 of the Supplementary Submission relating to 'Principles v Prescription' for our further views on this. An ability to add information above and beyond what the prescribed KIID form expressly allows for may be an advantage for the investor where, for example, new and different features that are important for the investment decision do not fit within the prescribed form.

We also think it important that firms are permitted to exclude or decline to populate sections (e.g. past performance, scenario analyses) that would not be meaningful or could be misleading in the context of each product.

Q. 25: Do you foresee and difficulties in applying these broad principles to the KIID for all PRIPs, as the building blocks on content and format for a 'level 1' instrument? Please justify or explain your answer.

In the Supplementary Submission, we have previously noted that the following principles – that disclosure should:

- be fair, clear and not misleading;
- be expressed in short, simple and plain language;
- follow a harmonised structure and sequence of sections; and
- contain common disclosure elements and key points of comparison that must be included in all PRIPs disclosure.

We refer to Section A.1 of the Supplementary Submission for further detail. In addition, we have the following observations:

- **'KIID must be short - 2 pages where possible'**:

We feel that restricting the KIID to two pages could be at the cost of providing relevant information in a clear format. An arbitrary page limit which necessitates removal of important disclosures or constrains the options for presentation could therefore turn out to be counterproductive. This could result (particularly if there is no further statement of the purpose of the KIID as noted in relation to Q.18 above) in misunderstanding, the potential for investor loss (and related litigation) and/or some products being discontinued.

We believe that there are particular considerations in relation to structured securities. As noted in the Supplementary Submission, given the additional disclosure necessary in a KIID for structured securities (e.g. more detailed disclosure in relation to return and risk), members feel that a target of four pages might be more appropriate, but with flexibility for more complex products, particularly where more extensive disclosure in relation to the underlying(s) is essential to investor comprehension. This needs careful review by reference to the full range of potentially affected products since, in some cases, there may be compelling reasons for allowing a materially longer document.

We also suggest that it would be appropriate to allow for a relaxation of page limits to permit certain information to be presented in alternative formats which improve investor understanding but take up more space (e.g. graphically). (Hong Kong's "Key Facts Statement" regime allows for this.)

As noted above, targeted cross-referencing and use of a glossary may also be important tools in ensuring the document is as concise as possible while avoiding it becoming misleading.

- **'KIID must be kept 'up to date' and accurate, so that investors can rely on it without reference to other information'**:

This gives rise to a number of important questions. In particular, it would be necessary to determine who would be responsible for updating the information and how frequently and what use would be made of the updated KIID; if the proposal is to send it to all of those who have acquired PRIPs using the previous KIID, that could be costly and may not be possible (not least because the person responsible for producing the KIID will not necessarily know who they are).

A further question arises in relation to changes in the period between updates – whether these would need to be communicated to anyone, how and to whom. Product Producers will often have no idea who KIIDs have been provided to; if there is to be a requirement to update those who have received it, this tends to emphasise the importance of not being over-prescriptive as to who should be responsible for KIID production and updating.

A duty to keep the KIID up to date on a continuous basis could potentially represent an onerous requirement, though this will partly depend on how much prescribed KIID content will consist of information that is 'dynamic' (such as historical performance data or changeable initial underlyings) as opposed to 'static' (fixed structures and underlyings, issuer name etc.). In the context of a stated KIID purpose to aid, and be part of, a wider decision making process (including MiFID advice or suitability/appropriateness assessments), some dynamic information could be subjected to updating that is periodic only (as under the TD) – so past performance data could for example be provided in full year increments only.

However, we believe it would be more appropriate to think in terms of a maximum duration for the KIID used specifically as part of the sales process – creation and 'sell by' dates could be chosen by the KIID preparer and endorsed on the face of the KIID, potentially as part of the responsibility statement. After that, any further sales would need to be made using a new KIID reflecting changes (if any) that have occurred in the intervening period.

This is particularly important in the case of structured products sold during a short window of just several weeks. Any subsequent activity is then limited to secondary market purchases. This is very different from open ended funds with a constant offering period, such as UCITS. In cases where there is a defined offer period, we would therefore suggest that there should be no obligation to update the KIID after admission to trading, if relevant, or at the end of the relevant offer period, whichever is later) to avoid an undue administrative burden on the party preparing the KIID. Any post-sales obligations could then be dealt with elsewhere, e.g. MiFID. Where, on the other hand, there is a continuous offer period, a continuous duty to update the KIID would be more appropriate. However, any updating obligations should in all cases be restricted to significant changes only.

Any updating obligations need to be seen in the context of the KIID's form/content and related questions of liability. There is also a question as to who would need to receive an updated version and for what purpose. Given the potential risks involved, the producer of the KIID (whether Distributor or Product Producer) might wish to endorse on the KIID (as part of the responsibility statement) a limitation on third party Distributors using the KIID. This could, for example, be a limitation to those Distributors it has approved and so has contact with (and so is able to warn of any update/correction). An option also to consider is for the KIID to include a weblink to where the KIID producer published the KIID on its own website, so that any update to it could be checked prior to sale (and KIID producer liability would be accordingly limited). If KIIDs are generally limited to static information, then the number of KIIDs needing updating within the sell-by period will be relatively limited and a market wide warning service might be conceivable (e.g. involving ESMA or regulatory information service providers).

See also the responses above in relation to whether the KIID should be a stand-alone document; this is relevant in respect of the reference to investors being able to rely on it 'without reference to other information', which we do not think is realistic.

- **'KIID must focus on key information, as necessary for the average investor to make an informed decision on the PRIP in question'**:

As to whether a KIID would be sufficient, on its own, to enable an investor to make an informed decision, see our comments above. Subject to those, for the reasons explained in the general

section of this paper, we note that it may be difficult for those Product Producers that do not have a direct relationship with investors to determine what an 'average investor' might be. In these circumstances, intermediaries may be best placed to judge what information is likely to be key from the perspective of their clients.

Q. 26: Are there any other broad principles that should be considered on content and format?

See our comments at Q.25 above and in the Supplementary Submission.

Q. 27: Should product manufacturers be made generally responsible for preparing a KIID? Please justify or explain your answer.

In view of the factors outlined in the general section above (and, in particular, the varying levels of contact that Product Producers may have with investors depending on the distribution chain and the variety of uses that Distributors may wish to make of their products in assisting their client), we believe that it is not appropriate to be prescriptive on this point. It is worth bearing in mind that, whilst most Product Producers are financial firms, they could also be non-financial firms (e.g. an oil company issuing an oil-linked bond designed by a third party bank), sovereigns or others. In addition, it may not always be clear who the Product Producer is in some structures, e.g. structures where there is an SPV issuer. Frequently, the Distributor will be better placed to determine what key information is 'necessary for the average investor' and to tailor information received from the Product Producer accordingly or obtain further information where needed. A Distributor is also likely to be sensitive to risks that are particularly relevant for its customers, e.g. FX risk may be a concern for some clients, but not others.

We expect that certain of the information required for the KIID will in any event need to come from the Distributor and, depending on the precise purpose and contents, it may well be in the interest of clients to ensure that their Distributor, who may be more sensitive to their requirements and risk appetite, would be in charge of the KIID. In addition, sales made without a KIID would need to be the responsibility of the Distributor as the Product Producer would not be able to control this.

Responsibility for preparation of the KIID should therefore be left open and subject to agreement between Product Producers and Distributors, with liability for the KIID resting with whoever is contractually responsible. The most important objective would be to provide clarity to the investor as to who has produced the document (e.g. by including a responsibility statement on the face of the KIID as previously discussed) rather than attempting to specify in advance who is responsible in a given distribution scenario.

We also refer to Section B.3 of the Supplementary Submission for our previous comments in this area.

Q. 28: Are you aware of any problems that might arise in the distribution of particular products should responsibilities for producing the KIID be solely placed on the product manufacturer?

See our response to Qs. 25 and 27 above. Placing responsibility for producing the KIID exclusively with the Product Producer may not represent the most practical outcome. In particular, Product Producers will not necessarily be in a position to undertake client classification for all those who might purchase a given product in order to determine whether any are retail clients. In addition, it may limit the extent to which a document can be tailored to the specific target investor or investors and/or contain useful disclosure relating to the Distributor which may also be relevant to an investor's decision.

Q. 29: If intermediaries or distributors might be permitted to prepare the documents in some cases, how would these cases be defined?

We would propose that responsibility for preparation of the KIID could be determined on a case-by-case basis by agreement between the Product Producers and Distributors**.**

Q. 30: What detailed steps might be taken to improve the transparency of the social and environmental impacts of investments in the KIID for PRIPs?

This is a highly complex area with implications well beyond the PRIPs initiative and, in view of that, we question whether it would be more appropriate to address it by way of a separate workstream. That should also take account of the numerous existing initiatives, for example, among providers of ethical investment funds. However, our initial thoughts in the context of PRIPs are that it would necessitate developing greater consensus as to the concepts of "social impacts" and "environmental impacts" (and which are positive and which negative) and how one would rate PRIPs by reference to them. In developing any standards, it would clearly be important for there to be a reasonable level of consensus as to their merit and effectiveness in measuring the relevant "impacts" among investors and the industry. If the Commission's objective is to influence behaviour within the single market, that consensus would need to be EU-wide.

Rather than requiring every PRIP to be rated by reference to whatever criteria were established (something that could be very onerous and expensive), it may be more fruitful for the Commission to consider allowing firms to include some form of EU-endorsed "kite mark" rating where they wish to distinguish a particular product by reference to its social or environmental credentials.

Q. 31: How might greater comparability and consistency in product labelling be addressed?

We refer to the Supplementary Submission (Sections A.1 and A.2.2) where, among other things, we suggested that terminology could be drafted to be as general as possible to allow the same headings to be used for a broad range of PRIPs, in addition to the harmonisation of headings and the order of sections for all PRIPs KIIDs. As referred to above, the development of a market standardised glossary of defined terms may also help ensure correct use of labelling and standardised classification of terms.

Q. 32: Should the summary prospectus be replaced by the KIID for PRIPs? Please outline the benefits and disadvantages you see with respect to such an approach.

The JAC does not consider that it should; the two regimes should operate side-by-side.

Questions remain as to whether (particularly in the context of programme-based issuances) the concept of the summary and a KIID as currently applied can be interchangeable. The person responsible for producing a PRIPs KIID might be a different person from the issuer and it may be difficult in practice to square the two different responsibility regimes.

In addition, the purpose of the two documents is not identical. Hence, the contents requirements for KIIDs and prospectus summaries are also likely to differ substantially, with prospectus summaries containing more information relating to the business of the issuer and also being longer (up to 2,500 words rather than two pages). It is very unlikely that the key information required for a prospectus summary could fit into two pages.

Q. 34: Do you agree with the suggested approach for UCITS KIIDs?

This seems to represent a pragmatic approach.

Q. 35: Are there any disclosures, e.g. required by the existing regimes, which you believe the PRIPs KIID should not include, but which should still be disclosed, e.g. separately to the KIID? Do you have any practical examples for such elements?

While we understand the desire to have a simple short-form disclosure document that is consistent across all product-types, as indicated above, we do not think it is feasible for the KIID to be entirely free-standing in relation to all categories of PRIP. As we explained in our Supplementary Submission, we think there is a balance to be struck between: (a) ensuring that the KIID contains all of the information that a person needs to consider in deciding whether or not to invest; and (b) the Commission's objective of keeping the document to a certain length and not over-burdening it with information.

We therefore think it is important in ensuring appropriate customer outcomes that the KIID regime should make adequate allowance for targeted cross-references to the sections of the relevant PRIP Offering Document that set out additional information of a sort required to be headlined in the KIID so that the investor can consider the risk/reward profile of a given product fully before investing. We agree that the relevant rules would need to drafted in such a way as to avoid lengthy cross-references.

Q. 36: What in your view will be the main challenges that will need to be addressed if a single risk rating approach is to work for all PRIPs?

We think it is important to distinguish between a "single risk rating approach" and the use of a "single risk rating indicator". While in principle, we approach a harmonised approach across investment products, we believe an attempt to reduce representation of the risks involved in those products to a single risk indicator is fraught with difficulty with material potential for investors being misled about the risk profile of what they are buying.

As noted in the PRIPs Consultation Paper, the inclusion of a risk indicator for UCITS reflects consumer testing in the UCITS space which suggested that it improved investors' ability to understand the level of risk inherent in a given product. However, in the PRIPs context, we think the use of a single risk rating raises several issues:

- Investors may place undue emphasis on risk indicators, which could discourage them from engaging fully with the risk profile of the investment. This could pose a significant concern particularly in the context of more complex PRIPs.

- Investor testing demonstrates that investors do not place adequate emphasis on methodology explanation and caveats, even when highlighted as important. There is also a question as to whether the caveats required to accompany a risk rating can be justified in a document in which space is at a premium.

- PRIPs can carry diverse risk profiles - structured securities in particular. In the context of more straight-forward investment funds, a volatility-based approach may help to provide an indication of the risks of different "delta-1" exposures. However, we doubt whether it is possible to develop a single risk calculation methodology (whether using volatility or otherwise) that is capable of producing a consolidated risk indicator that is equally reliable for all categories of PRIP; the result could therefore be materially misleading and inconsistent with the Commission's objectives for this project. One of the most obvious ways of allowing for the diversity of risks between products and within a single product (for example, in relation to leverage and capital protection) is to use several indicators for different products or risks based on different methodologies. We appreciate that this could detract from comparability. However, a single rating cannot distinguish between the

different types of risk and could well lead investors to assume for products with the same risk weighting that the nature of the risk is the same. Consequently, in our view, the use of volatility bands as the only risk measure is not sufficient. We include some examples by way of a footnote to this paragraph which help to show why in the context of a 1-year low-strike reverse convertible on Eurostoxx50 and a capital protected note linked to global emerging markets.[1] Against this background, if a single risk methodology were to be formulated, there is also a danger that this could create bias in favour of certain types of products by reference to whether they could technically be brought within one or another risk-band.

- Note also that risks can also be investor-specific, e.g. FX risk. What is a risk for one person is not necessarily a risk for another.

- There is also the concern that, in the context of capital protected products which are highly complex but relatively low risk, an inappropriately designed indicator may incorrectly score these products as higher risk due to their legal complexity – as indicated above, legal complexity does not necessarily involve a complex risk profile. Principal protected products may be legally complex precisely because they have been structured to reduce risk. As discussed above, we believe the objective should be to facilitate investors' understanding of the risk/return profile of a given product rather than the legal engineering required to put it together.

We would also refer you to the detailed comments we provided in Section A.2.4 of the Supplementary Submission on this issue.

As a result, we feel that applying a single risk indicator carries significant danger of misleading rather than assisting investors, implying a much higher level of objectivity than is appropriate. We also wonder whether the introduction of a single risk indicator could be somewhat at odds with Commission's approach in the wholesale markets of discouraging excessive or exclusive reliance on other types of risk indicators, such as credit ratings (which we support).

Whereas a single risk indicator for all products may be difficult to implement, a series of risk indicators or other symbols might be more appropriate. There is, for example, some support among our members for representing risk by standardised symbols.

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1 (a) 1 year low-strike reverse convertible on Eurostoxx50:- there is a fixed coupon of 3% payable after 1 year; the principal payable at redemption is 100% if SX5E has never traded below 40% of spot at start; if it has traded through this barrier on any one day, then the amount payable at redemption is expressed by reference to the following formula: SX5E(final)/SX5E(initial). A historical backtest of annual returns on this product is available if the Commission would find it helpful: since January 1987, there has not been a single instance (computing products starting on every business day in this period) where the product has not redeemed at 100% + 3% coupon – in other words, the volatility of returns is 0.00% and, on a volatility measure, the product would therefore be in risk category 1. However, this fails to capture the fact that the investor could lose substantial amounts of capital if the Eurostoxx ever went down by 60% or more during the period. Obviously this has a very low probability, but risk category 1 fails to capture the fundamental risk to investors in this product.

(b) Capital protected note linked to Global Emerging Markets:- a 1-year product with 75% capital protection and providing 100% upside to the MSCI Emerging Markets index (MXEF). The amount payable on redemption after 1 year is an amount equal to 100% + 100%*(-25%, MXEF(Final)/MXEF(Initial)-1). Again, historical simulations can be provided if that would be helpful. The volatility of annual returns is equal to ~21%, hence putting this product into risk category 6. That might seem appropriate until you compare the product with (a), above, where you can lose up to 100% of capital, whereas here you can lose only 25%.

Alternatively, narrative risk explanations are likely to be more useful to investors, allowing them to assess the relevance of each risk factor in the context of their specific objectives and portfolio.

Retail investors also buy different products for different reasons. Whether to buy a particular product is a subjective assessment which for more complex products is better dealt with at the Distributor/investor level and through appropriateness assessments rather than by assigning a rating to a product in the KIID.

Q. 37: Do you consider there are any other techniques that might be used to help retail investors compare risks?

On the basis of the issues outlined under Q. 36 above, we would propose that there should be a degree of discretion in the way risks are presented, with the overriding requirement being to do so in a fair and clear manner. Detailed requirements may superficially appear to aid comparability, but could do so at the risk of shoe-horning risk disclosures into an inappropriate or misleading framework or inhibiting risk disclosure. In principle, we think it is more important for an investor to have a clear idea of the risks of a particular product than to be able to compare documents if the comparison would be potentially misleading.

As mentioned in Section A.2.4 of the Supplementary Submission, we suggest that the preferred approach should be to frame the disclosure as questions to which an investor could easily relate. Alternatively, simple standardised key risk statements may be considered. The KIID should also only contain "key risks" specific to that product. Risks that would relate to all products of the relevant product category should not be included. Instead cross-references could be incorporated referring investors to the disclosure relating to those more general risks set out in the relevant offering document.

The Commission may also wish to consider other simpler mechanisms for reflecting risks, such as the use of colour coding or the development of other standardised symbols. This is an area where practice is currently developing so that examples are now in use.

Where used, synthetic risk indicators should reflect principal protection and credit strength. We would suggest that the lowest risk indicator is reserved for principal protected products issued by issuers with low credit risk: prime or high grade.

Q. 38: What in your view will be the main challenges that will need to be addressed in developing common cost metrics for PRIPs?

The issue here relates to comparability of costs and charges between products with an entirely different legal profile and based on different charging structures. We think there is an important distinction to be made between different types of products. In particular, there is a distinction between: (a) packaged products based on collective management of a pool of assets for which a fee is charged pro rata between those whose assets are being managed, which would include some forms of life assurance product; and (b) those products which simply operate by reference to a payout formula or which pay a form of fixed return:

- In the context of a product with a simple charges profile (for example, a set management fee), the question of what should be disclosed may be relatively straightforward. Fees are deducted from the performance of the underlying assets and charged directly to the customer, so the customer cannot calculate expected returns unless he knows the level of such costs. It is right that investments of this sort should therefore be subject to a fee disclosure regime.

- For defined return products the investor's key interest is in receiving the promised pay out. Fees and costs are built in to the payout formula and the profit made by the manufacturer may vary depending on market conditions. However, the investor's interest is in a specified return rather than in the expertise of a manager in managing a pool of assets with a view to achieving a given objective. Comparison with investments where fees are subtracted from investment management performance is therefore inappropriate. Profits or losses made on a hedge cannot be compared with management fees derived by a fund manager. A more appropriate comparison would be with a deposit paying a fixed return - the investor should be interested in the defined return and the credit risk of the deposit taking institution, not its funding cost.

In short, we think only those costs which serve to reduce the payout to the investor such as management fees charged by an asset manager, distribution fees or product entry or redemption fees may be of use to an investor and should be disclosed in the KIID.

Q. 39: How can retail investors be aided in making 'value for money' comparisons between different PRIPs?

There is clearly a subjective aspect to "value for money" (in light of accessibility/liquidity, tax efficiency of the delivery mechanism, etc), which makes comparisons difficult. It should not be assumed that legal complexity has a positive or negative impact. A comparison based on likely return may be more useful together with information on those real costs or fees which may reduce that return on inception of the product, during its life and on maturity (akin to the UCITS KIID model). "Profitability" should not be relevant for this purpose. We also consider that "value for money" comparisons would be assisted by the Commission's objective of providing greater transparency in the context of commissions and distribution fees paid out of the amount invested in a product to those who intermediate their sale.

Q. 40: Do you consider that performance information should always be included in a KIID?

For defined return PRIPs, you may expect information on expected returns in detail, but for other types of PRIPs it may be unusual for there to be information about future returns and performance – particularly those involving a return that depends upon a dynamic pool of assets. We therefore do not think that it would be appropriate to stipulate that performance information should always be included. Those that have a direct investor interface may be best placed to gauge their investor's level of understanding and requirements for performance information and may include such information in any advice, educational or other materials they provide to their clients. What is more important is to seek to ensure that investors understand what are the key factors that will generate the investment performance and how much risk they involve.

Please also refer to Section A.2.9 of the Supplementary Submission, which contains our previous comments on historical performance information and scenario analysis.

Q. 41: What in your view will be the main challenges that will need to be addressed in ensuring performance information can be compared between different PRIPs?

We think the overriding principle should be to ensure that any performance information included in the KIID is meaningful in the context of the product. A degree of flexibility for the KIID producer is key here even though this may be at the expense of absolute comparability of performance data across PRIPs.

Q. 42: Do you agree that a consistent approach to the description of guarantees and capital protection in the KIID should be sought, e.g. through detailed implementing measures, for different PRIPs?

The KIID should have to clearly state on the front page whether principal protection is provided and, if so, by whom and in what circumstances. We think that a consistent and standardised approach to the use of these and other key terms is desirable and could, for example, be achieved through the development of a glossary of approved standard terms, as mentioned above. However, it is important to appreciate that the ways in which guarantees and capital protection are provided can vary between different types of products and may therefore be difficult to compare.

Q. 43: What information should be provided to retail investors on the cost of guarantees?

We do not think the costs of the guarantee portion of the product should be isolated from the costs of the rest of the product (nor may it be technically feasible to isolate these costs in all cases).

APPENDIX 2

Response to relevant questions in the MiFID Consultation Paper and to the IMD Consultation Paper

A. The MiFID Consultation Paper

This section focuses on the questions raised in section 7 of the MiFID Consultation Paper – "Investor Protection and the Provision of Investment Services". In responding to these questions, we concentrate on the implications of the proposals for those firms involved in producing retail structured products of a sort produced by our members. While the focus of these questions is on the role of those investment firms that "own" the client interface, such as investment advisers and those dealing with or on behalf of clients without advice (ie Distributors), some of the issues raised also touch on matters that are relevant to the role of Product Producers. We only respond to those questions in section 7 that raise issues relevant to the production of retail structured products or to the Product Producers. We have not therefore responded to all of the questions. In addition, we do not address questions that raise broader issues for the financial services industry generally or parts of the consultation that are materially broader than just those businesses engaged in product manufacture. An example of this would be the proposal to introduce a civil liability regime in relation to MiFID standards. Given the potential for duplication of existing national standards and the considerable long-term legal uncertainty it could create in the financial markets, the issues it raises merit separate treatment that goes well beyond the ambit of this paper and we have assumed that it will be the subject of considerable discussion.

The following comments should be read together with those in the general section above. The concern expressed in the general section about short consultation periods is particularly pertinent in the case of the MiFID review. The Commission's proposals on PRIPs generally and in relation to the KIID have been developed over a long period and so the issue is not quite so pronounced. However, that has not been the case with the MiFID proposals and we believe the quality of comment on the MiFID review proposals may have suffered as a result of the very tight deadline.

Qs. 39-41: Post-trade transparency

Where an offer of retail structured securities with a fixed maturity date has been made using a prospectus, but the securities are not admitted to trading, we would question whether it is appropriate to subject them to the post-trade transparency regime.

Q. 84: What is your opinion about limiting the optional exemptions under Article 3 of MiFID? What is your opinion about obliging Member States to apply to the exempted entities requirements analogous to the MiFID conduct of business rules for the provision of investment advice and fit and proper criteria? Please explain the reasons for your views.

Article 3 enables Member States to exempt certain advisory firms from the application of MiFID provided that those firms are regulated by the Member State concerned. Many of the entities that benefit from this exemption are small and medium-sized firms and do not wish to be able to take advantage of the MiFID passport – other Member States do not therefore need to rely upon the fact that a harmonised regulatory regime is being applied to those firms.

The JAC supports the principle on which this exemption is based - that unnecessarily onerous regulation is counter-productive and should be avoided. Nonetheless, it seems appropriate that where a Member State makes the exemption available, the regulatory rules that apply ought to ensure that MiFID exempt firms offering investment advice on instruments covered by MiFID should meet certain basic standards that are consistent with those applied by firms that are regulated under MiFID. This is justified both in terms of investor protection and creating a level playing field. We suspect that many Member State regulatory regimes already do this in any event.

Q. 85: What is your opinion on extending MiFID to cover the sale of structured deposits by credit institutions? Do you consider that other categories of products could be covered? Please explain the reasons for your views.

We comment in Appendix 1, above, on the definition of "structured deposits". The JAC supports the extension of MiFID to the provision of advice on and the sale of structured deposits since these are used to produce investor returns that can be similar to other categories of structured products and they can be used for similar purposes. The approach taken in MiFID to other categories of retail structured products should also be consistent with that taken in the context of the PRIPS Consultation Paper save to the extent the products are insurance products, subject to equivalent regulation under the Insurance Mediation Directive. Other than insurance, we believe that all of the other proposed categories of PRIP are likely already to be MiFID instruments and, on that basis, we do not consider that any further categories of product should be included.

While the MiFID Consultation Paper refers to the sale and non-advised sale of structured deposits by "credit institutions", it is assumed that the rules would apply to any form of Distributor in carrying on MiFID services or activities in relation to these products, save to the extent the activity is subject to equivalent regulation under another EU Directive. It will be necessary to address how MiFID should be extended to cover structured deposits, since the existing regime has been drafted by reference to financial instruments and does not always sit well with services and activities conducted in relation to deposits.

Q. 87: What is your opinion of the suggested modifications of certain categories of instruments (notably shares, money market instruments, bonds and securitised debt), in the context of so-called "execution only" services? Please explain the reasons for your views.

Future of execution-only

The JAC considers that the Commission's objectives would be best met by seeking to refine the distinction between complex and non-complex products, rather than abolishing the concept of "execution only" services. Abolishing execution-only services would subject a broad range of activities in relation to non-complex products to additional regulation (and hence investor cost) and, as far as the JAC is aware, there is little evidence of market failure. Adjusting the definition of what is a complex product as the Commission suggests should be sufficient to address investor protection concerns.

Defining the distinction between complex/non-complex

Seeking to define the distinction between complex and non-complex products raises a number of issues.

- In principle, the JAC considers that the distinction should operate by reference to the risk/reward profile rather than legal form. The assessment of complexity should take

account of the risk characteristics of a particular product rather than its legal form. As indicated above, a product that is legally simple may nonetheless carry a complex risk profile whereas one that is legally complex may involve no greater risk than an investment in one of the leading benchmark equity indices.

- Much as with the definition of "PRIP", there is a need to strike a balance between (i) creating sufficient certainty for firms so that it is reasonably possible to know which MiFID rules apply, while (ii) recognising the considerable variety of investment products. Any standards need to be clear enough to be capable of being applied but not so overly prescriptive that they force an inappropriate treatment for a particular product.

- We do not think it follows that just because a particular investment is classified as a PRIP that it should also be regarded as complex.

We believe that the use of a safe-harbour with associated guidance, along the lines of the present arrangement, is the best means of achieving this result, so that where services are provided in relation to a product that is not within the safe-harbour, a firm needs to consider whether the product is complex or non-complex by reference to the guidance. The effect of the rule should be no more than that; there should be no implication that a product is complex simply because it does not fall within the safe-harbour.

With this in mind, the drafting of the current 19(6) could be usefully clarified. The exclusion should apply where execution-only services are provided in relation to "non-complex products". This should be accompanied by:

(i) a list of those products that will automatically be treated as "non-complex" – ie a "white list";

(ii) guidance that builds on Article 38 of the MiFID Level 2 Directive as to when products not included in the white list can nonetheless be treated as non-complex.

- As indicated above, it would be important for products included in a white list to be described in terms that do not imply that products that do not have the precise characteristics of those products should be regarded as complex, for example, simply because they "embed" a derivative. Once established, it would be preferable in the interests of certainty, for the categorisations not to be changed, or only to be changed in exceptional circumstances. If the new rules do allow for revision or guidance, we think it would be essential for that to be subject to an effective process and consultation in much the same way as discussed in Appendix 1 above at Q. 13 in relation to the definition of "PRIP".

- In addition, the description of products within the safe harbour and any associated guidance should be internally consistent in the way it addresses the question of complexity, operating by reference to the risk/reward profile over legal form. In particular, it should be made clear that where a product provides a return similar to that available through a category of UCITS that is treated as non-complex and has a similar issuer risk profile (for example, because the issuer of the instrument is subject to prudential regulation under one of the EU single market Directives), then it should also be treated as non-complex.

Descriptions of individual products

As indicated above, we think that distinction between complex and non-complex products should be based on risk/reward profile over the legal form of the product. Consequently, we also agree

that it is not sustainable for all shares admitted to a regulated market, money market instruments and bonds automatically to be treated as non-complex. On that basis further thought is needed as to how best to reflect the complexity of the risk/reward profile in the context of the complex/non-complex distinction. Subject to that, we had the following comments on the proposed product descriptions:

- In the description of "bonds" and "money market instruments", it was unclear to us what is meant by the words, "or incorporating a structure which makes it difficult for the client to understand the risk involved".

- In terms of distinguishing between those UCITS funds that can automatically be treated as non-complex and those that cannot, one approach might be to align the rule with that in relation to KIIDs for UCITS funds by treating all UCITS funds that are not "structured UCITS" as non-complex.

Q. 88: What is your opinion about the exclusion of the provision of "execution-only" services when the ancillary service of granting credits or loans to the client (Annex I, section B (2) of MiFID) is also provided? Please explain the reasons for your views.

In relation to 7.2.1(c) of the Commission consultation (ie the proposal that a product would not be a non-complex product (and so not available in relation to execution only services) if the granting of credit or loans to the client to allow them to carry out the transaction in one or more financial instruments), it may be more appropriate to address this through the combination of consumer credit legislation and reliance on existing MiFID standards, such as Article 19. The fact that credit has been provided in relation to a given transaction does not alter the risk characteristics of the product itself. If, however, this is addressed by way of an express provision in MiFID rather than, for example, the Consumer Credit Directive, then the impact of any new rules should be limited to retail clients.

Q. 89: Do you consider that all or some UCITS could be excluded from the list of non-complex financial instruments? In the case of a partial exclusion of certain UCITS, what criteria could be adopted to identify more complex UCITS within the overall population of UCITS? Please explain the reasons for your views.

See response to Q.87 above.

Q. 90: Do you consider that, in the light of the intrinsic complexity of investment services, the "execution-only" regime should be abolished? Please explain the reasons for your views.

See response to Q.87 above.

Q. 93: What is your opinion about obliging intermediaries to inform the clients about any relevant modifications in the situation of the financial instruments pertaining to them? Please explain the reasons for your views.

As indicated in its PRIPs submission to the Commission of 17 November 2009, in principle, the JAC agrees that the regime should address the provision of post-sale information to investors so that they are able to keep their financial position under review. This should be limited to retail clients that have acquired complex products. It also agrees that where the Product Producer has no direct contractual relationship with the investor, the intermediary is best placed to provide the information concerned. However, any new rules need to address the possibility:

- that the client will not have a continuing relationship with any investment firm or credit institution - in particular, if there is no on-going relationship, it may not be easy for either

a Product Producer or Distributor that has been involved in some way to determine what might be a "relevant" modification; how would this be defined or assessed?

- that if it becomes necessary for a credit institution or investment firm to maintain a continuing relationship with an investor, that will create costs which may make some services uneconomic resulting in a move towards (and need for) cheaper "simplified advice" services and execution-only dealing arrangements.

We note that this obligation to inform clients about relevant modifications overlaps partially, but is not necessarily aligned, with the triggers and content of the KIID updating obligation considered in the PRIPs Consultation. The obligations imposed by the PRIPs and MIFID regimes to provide post sale information in relation to the product, including the triggers for such information to be updated and communicated, as well as the person responsible for providing and communicating the updated information, should be considered by the Commission so as to avoid any potential duplication and inconsistencies between the two regimes.

Q. 94: What is your opinion about introducing an obligation for intermediaries providing advice to keep the situation of clients and financial instruments under review in order to confirm the continued suitability of the investments? Do you consider this obligation be limited to longer term investments? Do you consider this could be applied to all situations where advice has been provided or could the intermediary maintain the possibility not to offer this additional service? Please explain the reasons for your views.

See answer to Q.93 above.

Q. 95: What is your opinion about obliging intermediaries to provide clients, prior to the transaction, with a risk/gain and valuation profile of the instrument in different market conditions? Please explain the reasons for your views.

The nature of the Commission's proposal is unclear since, section 7.2.3 of the MiFID Consultation Paper refers variously to "customised", "structured finance" and "tailor-made" products and seems to equate these with "structured products". It would be helpful to understand whether all of the proposals in this section only apply to a particular category of financial products or, in some cases, financial products more generally.

However, in relation to pre-contract information the JAC agrees with the Commission's comment in footnote 188, that it is important to ensure that the MiFID rules on what information must be provided to investors concerning investments in respect of which a firm provides its services are properly aligned with those on KIIDs considered above.

Whether, more specifically, clients should be given a "risk/gain and valuation profile of the instrument in different market conditions", again, it would be helpful to understand what Commission has in mind. However, subject to that our initial view is that it could be very challenging in the case of some products to produce a statement of this sort given the range of variables – particularly where the product does not operate by reference to a simple pre-set formula or variations a single factor. In addition, the output could be challenging for investors to understand given the number of assumptions and qualifications that firms would need to communicate in order for the resulting output not to be misleading – we are mindful of the fact that MiFID itself requires information on future performance to contain a prominent warning that forecasts are not a reliable indicator of future performance.[1]

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[1] Article 27(6) of the Level 2 Directive.

If the Commission is nonetheless minded to introduce a standard along these lines, we would suggest: (i) that it is included, not as a rigid stipulation, but rather as a factor that an intermediary should take into account in assessing whether its communication with a given client satisfies the requirement of being fair, clear and not misleading in Article 19(2) of the Level 1 Directive; (ii) that there should be greater clarity as to the sort of products in respect of which it may be appropriate.

Q. 96: What is your opinion about obliging intermediaries also to provide clients with independent quarterly valuations of such complex products? In that case, what criteria should be adopted to ensure the independence and the integrity of the valuations?

While it is important for clients to have access to reliable information about their investments, we have the following comments:

- Not all investment products (or the products by reference to which they pay a return) are valued on a quarterly basis; for example, some forms of investment fund might only be properly valued once a year; we think any rules would need to make adequate provision for this since the consequences of not doing so could be to create a new category of costs which investors would ultimately have to bear.

- On the face of it, the proposal for "independent" valuations would also, if implemented, introduce considerable additional cost into the investment process and it is unclear how it would work in practice. In some cases, investment vehicles that issue participations to investors do produce annual audited figures. However, the introduction of quarterly independent valuations across the spectrum of "complex" products would appear to go well beyond that.

Q.97: What is your opinion about obliging intermediaries also to provide clients with quarterly reporting on the evolution of the underlying assets of structured finance products? Please explain the reasons for your views.

See response to Q.96.

Q.98: What is your opinion about introducing an obligation to inform clients about any material modification in the situation of the financial instruments held by firms on their behalf? Please explain the reasons for your views.

See response to Q.93. The reference to instruments held by firms should be clarified to ensure that it does not apply to firms that provide purely custodial services to a client.

Q. 99: What is your opinion about applying the information and reporting requirements concerning complex products and material modifications in the situation of financial instruments also to the relationship with eligible counterparties? Please explain the reasons for your views.

See response to Qs 104 and 105 below. Eligible counterparties are in a position to request and make use of such information about the instruments in which they invest as they consider appropriate. In view of the underlying rationale for the eligible counterparty regime, we see no compelling case for additional regulatory rules in this area.

Q. 100: What is your opinion of, in the case of products adopting ethical or socially oriented investment criteria, obliging investment firms to inform clients thereof?

See our comments in response to Q.30 in Appendix 1 of this response.

Q. 104: What is your opinion about retaining the current client classification regime in its general approach involving three categories of clients (eligible counterparties, professional and retail clients)? Please explain the reasons for your views.

The JAC believes that the current client classification regime has worked well and, subject to our comments below, should be retained without adjustment. While no regulatory regime is perfect, in practice it seems to have allowed for a suitably graduated approach to applying regulatory rules (and hence the associated costs), tailored to the sophistication of the clients concerned, while at the same time allowing for adjustments to classification where appropriate in reliance on the ability to opt "up" and "down".

Where a client is not confident that it understands a particular financial instrument or course of action proposed, it is open to that client to seek investment advice – as would be reasonable and prudent in those circumstances. Where that happens, even if the firm with which the client is to deal wishes to treat the client as an eligible counterparty, the firm providing the advice must treat the client as a professional client so that an enhanced level of protection applies.

It is therefore not clear what benefit any change would achieve at this stage and, in view of the experience of the industry at the time MiFID was introduced, it could be an expensive exercise to introduce. The only area that may be worth some consideration is the classification of private individuals that are sophisticated investors with high net worth and who frequently want access to products more commonly available in the professional market place. While the existing regime recognises that it is appropriate to allow for this class of client to be "opted up" from retail to professional status, in practice, the rules governing that process make it virtually impossible as a result of the requirement that the client must have carried out transactions in significant size on the relevant market at an average frequency of 10 per quarter over the previous four quarters; many categories of investment product simply do not get used or dealt with in that way, such that even if the client satisfies the "opt up" criteria in all other respects, the fact that the relevant market for a particular investment does not operate in the manner that the rule contemplates means that the client cannot be re-classified.

Q. 105: What are your suggestions for modification in the following areas:

(a) ***Introduce, for eligible counterparties, the high level principle to act honestly, fairly and professionally and the obligation to be fair, clear and not misleading when informing the client;***

(b) ***Introduce some limitations in the eligible counterparties regime. Limitations may refer to entities covered (such as non-financial undertakings and/or certain financial institutions) or financial instruments traded (such as asset backed securities and nonstandard OTC derivatives); and/or***

(c) ***Clarify the list of eligible counterparties and professional clients per se in order to exclude local public authorities/municipalities?***

Please explain the reasons for your views.

See our answer to Q104 above in relation to client categorisation under the existing regime.

In relation to the application of high level principles to dealings with eligible counterparties, an important principle underlying the eligible counterparty regime is that the entities concerned are sufficiently sophisticated to look after their own interests. We believe that principle should continue to apply. The high level principles mentioned in part (a) of the question above are integral to healthy, long-lasting, commercial relationships in any event and do not need to be legislated for.

Q. 106: Do you consider that the current presumption covering the professional clients' knowledge and experience, for the purpose of the appropriateness and suitability test, could be retained? Please explain the reasons for your views.

The JAC considers that the current presumption should be retained. This is an integral part of the graduated approach of adopted the MiFID regime by which the level of protection provided to clients is balanced against the cost to those clients of providing it by reference to their level of sophistication. The rules allow for flexibility of application because they use the mechanism of a presumption rather than disapplying the requirement altogether. In addition, it is always open to a professional client to require that it is treated as a retail client or to agree that a higher level of protection will apply to the relationship as a contractual matter.

Q. 107 What is your opinion on introducing a principle of civil liability applicable to investment firms? Please explain the reasons for your views.

Subject to further clarification from the Commission as to what is proposed, we believe that, if this measure is introduced, it could create material levels of legal and regulatory uncertainty; it would effectively bring into play the views of regulators and courts in 27 different Member States as to the meaning of the MiFID provisions and raise questions as to the relationship between this and existing protections under Member State regimes. Uncertainty can carry a material cost, both in terms of business not written as a result of an overly conservative approach (because of nervousness as to what standards apply) and litigation. The proposal should therefore be subjected to rigorous and transparent cost-benefit analysis. The JAC has not undertaken a review. However, we anticipate that such a cost-benefit analysis will reveal that it is a basic feature of all Member State legal regimes that a person suffering damage at the hands of another as a result of the other's failure to take reasonable care should be appropriately compensated. If so, we do not see a compelling case for the introduction of a further civil liability regime.

Q.108: What is your opinion of the following list of areas to be covered: information and reporting to clients, suitability and appropriateness test, best execution, client order handling? Please explain the reasons for your views.

See answer to Q.107, above.

Q. 115: Do you consider that organisational requirements in the implementing directive could be further detailed in order to specifically cover and address the launch of new products, operations and services? Please explain the reasons for your views.

We respond to this question in the context of structured product launches.

JAC member firms already have a strong commercial incentive to ensure that the products they create work as represented. Building on that, as indicated in our general section above, the JAC has also been working with firms over the few years to define and foster good practice in the area of product creation and distribution. We would therefore question whether further regulatory intervention is necessary.

To the extent the Commission concludes that it is necessary, the JAC has misgivings about the proposed approach.

- First, we consider that it would be inappropriate to use MiFID to regulate the product creation process. As indicated in the general section above, product creation is not necessarily a MiFID activity and the firms that engage in it will not always be MiFID firms or even located in the EU. We are concerned that using a Directive that is essentially designed to regulate investment services and activities to regulate the product creation process could lead to inappropriate regulation and an unlevel playing field.

- Further, we have highlighted in the general section above, the considerable diversity to be found in the market for investment products. The product creation process is no exception to this. In some cases, the creation of a financial product could involve a variety of firms playing different roles, including where a Distributor participates in the product design process with a Product Producer. Attempts to regulate in this area would therefore need to be sufficiently principles-based to reflect the multitude of possible scenarios.

- In particular, we note the fact that some of the Commission's proposals appear to assume greater contact between Product Producers and investors than is actually the case leading to the suggestion that Product Producers should assume a greater level of responsibility for investor outcomes than is feasible or appropriate.

    - A key example of this is the reference in the proposal to requiring investment firms to run an assessment of the compatibility of a product with "the characteristics and needs of the clients to whom these products would be offered". As noted above, the firms represented in the JAC generally have no contact at all with those who invest in the investment products which they design or produce. Their activities are restricted to identifying an investment exposure that investors are likely to want to access and then package it in forms in which they can do so. The product provider is not close enough to the clients to whom the products are ultimately offered to make a meaningful assessment of their characteristics or needs, except in general terms. The process of marrying a particular investment product with the characteristics and needs of the client is one for which either the client or the person advising the client on how to meet those needs is responsible. Where a client is not satisfied that he or she is in a position to make their own assessment, it is open to them to obtain investment advice.

    - Another example is the suggestion that the compliance function should "ensure that the product … complies with all applicable rules including those in relation to disclosure, suitability/appropriateness…." These are matters that need to be addressed by the firms that "own" the client relationship.

Q.116: Do you consider that this would imply modifying the general organisational requirements, the duties of the compliance function, the management of risks, the role of governing body members, the reporting to senior management and possibly to supervisors?

See answer to Q.115 above.

B. The IMD Consultation Paper

We had few comments on the IMD Consultation Paper at this stage. We note that the Commission broadly intends to reflect the rules and standards that will apply to non-insurance products to the distribution of insurance products and agree that this is the most appropriate approach in ensuring consistent treatment for investors and a level playing field. The new regime for PRIPs does not adopt a harmonised approach across all classes of PRIP, there is a risk of regulatory arbitrage which is unlikely to be beneficial to investors/

Consequently, our comments above in relation to the proposed MiFID standards apply equally to proposals to apply equivalent standards in the context of the IMD.

ANNEX 3

JAC Supplementary Submission

30 June 2010

Dear Sir/Madam,

The Joint Associations Committee[1] welcomes the opportunity to make a supplementary submission in relation to the EU Commission's Packaged Retail Investment Products (**PRIPs**) initiative. This submission is supplementary to our earlier submission dated 19 November 2009 (the **JAC November Submission**[2]) and focuses specifically on the content and format of a short form disclosure Key Investor Information Document (**KID**) for PRIPs.

This submission takes the form of a pro forma template KID (the **Template KID**) with accompanying commentary and is the result of several months' collaborative work amongst JAC members. As with our earlier submission, the principal focus of our work has been in relation to the sale of structured securities to retail investors but attempts have been made to ensure that the structure and language used in the template produced could be applied across both other Contractual PRIPs and Collective Investment PRIPs. We note, however, that there are fundamental differences in the nature of the investment being offered in a Contractual PRIP as compared to a Collective Investment PRIP. As such, the KID regime in respect of these two families of PRIPs will need to be different in some respects to ensure that in each case the correct emphasis is placed on the various elements of disclosure[3]. If appropriately structured, this need not detract from the product comparison objective. Furthermore, such differences will help in emphasising to investors the distinguishing features of these families of products.

The Template KID aims to build on the work of the Commission and CESR in respect of the UCITS KID. It represents an attempt to transpose this work into the broader PRIPs field, in particular seeking to identify areas in which we feel that the UCITS proposals will require modification to work effectively with this wider range of products. In completing this work, we have also drawn on (i) the work of the Commission, the Council and the Parliament in respect of the review of Directive 2003/71/EC (the **Prospectus Directive**), (ii) the work of the regulators in Hong Kong and Singapore in relation to the short form disclosure initiatives under consideration in those jurisdictions and (iii) useful concepts raised in the Barclays Capital submission to the Commission in relation to KID of 18 December 2009 (the **Barclays Capital KID**). We hope that the Template KID will provide a useful basis for ongoing discussions between the industry and the Commission in relation to the key issues arising in respect of the PRIPs disclosure initiative.

We would very much welcome the views of Commission Services in relation to this Template KID and would be happy to meet with Commission Services to discuss these matters further.

Structure of this submission:

Error! Reference source not found. introduces and provides explanatory commentary on the Template KID (attached as a separate document). **Section** Error! Reference source not found.

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

[2] Please see www.isda.org/c_and_a/pdf/PRIPS_JAC_Response_Updated.pdf

[3] In this regard, please see paragraphs 8, 9, 16 to 18 and 33 to 37 of the JAC November Submission.

covers the general drafting principles applied and **Section** Error! Reference source not found. provides section by section commentary.

Error! Reference source not found. discusses other essential issues which we feel will need to be addressed under a PRIPs short form disclosure regime, namely:

Scope, Purpose, Responsibility, Liability, Relationship with the Prospectus Summary, Relationship with MiFID and Delivery.

SECTION A

A.1 General drafting principles

In preparing the Template KID we have sought to adhere to a number of the core principles as set out in the Issues Paper published by the Commission in relation to the PRIPs Workshop held in October of last year. Most notably, the principles that disclosure should:

- be fair, clear and not misleading;
- be expressed in short, simple and plain language;
- follow a harmonised structure and sequence of sections; and
- contain common disclosure elements and key points of comparison that must be included in all PRIPs disclosures.

Further points of note in respect of our approach are:

- **Terminology:** Terminology has been drafted to be as general as possible. This is to allow the same headings to be used for as broad a range of "PRIPs" products as possible, thereby acknowledging the PRIPs initiative's harmonisation agenda. Examples of such language include: Product Producer, Product Start Date/End Date and Final/Periodic Return.

- **Section headings:** Additional section headings have been added, or proposed UCITS headings reformulated, where this is felt to be either necessary to introduce additional disclosure required in the context of securities products or helpful to facilitate better investor understanding. The intention remains that the headings and the order of sections would be harmonised for all PRIPs KIDs. Observing UK FSA guidance in relation to investor-friendly key features disclosure, where appropriate, headings have been phrased in the form of questions that investors are likely to ask.

- **Principles v Prescription:** The template seeks to strike a balance between prescribed content and principles based prompts. A level of prescription (particularly in relation to structure) aids comparability and ensures that key messages are communicated in a consistent manner. Too much prescribed content risks detracting from clear and effective disclosure. Members agree that a harmonised structure and a requirement that certain key questions are addressed are important to facilitate comparability, but also feel that the flexibility to include certain other relevant questions, where appropriate, allows disclosure to be appropriately tailored. Where additional disclosure is included this would be subject to the overriding requirement that it should be fair, clear and not misleading.

- **Cross references to other documents:** We feel that in the structured securities sphere there is also a balance to be struck between ensuring that the KID is sufficiently comprehensive to aid an investor when considering whether to invest, while at the same time ensuring that the KID does not become over-burdened with detail which is easily accessible elsewhere. This is particularly important if the KID is to remain accessible for investors. We welcome the provisions in the draft UCITS Regulation which permit limited cross-references to the relevant Offering Document. We agree that the party compiling the KID should not use numerous lengthy and non-specific cross references as this will detract from the value of the KID and reduce accessibility. We feel, however, that targeted cross references to specific sections of the Offering Document which contain more comprehensive disclosure in relation to certain

prescribed areas is a very positive development. This approach allows the KID to give the investor a flavour of the issues that should be considered whilst at the same time directly assisting the investor in locating specific and appropriate further reading. This would be of particular benefit in relation to disclosure of risk, charges and (in context of structured securities) relating to the Product Producer which are all already disclosed in an accessible format in the relevant Offering Document. To ensure optimum effectiveness, cross references should be to specific pages or sections in the relevant Offering Document.

- **Length:** We note the requirement proposed in respect of the UCITS KID that the KID be no longer than two pages for standard UCITS and three pages for structured UCITS. Members acknowledge the importance of ensuring that the KID remains a concise document but are of the opinion that an arbitrary page limit which necessitates the removal of important and useful disclosure would be counterproductive. Given the additional disclosure necessary in a KID for structured securities (e.g. more detailed disclosure in relation to return and risk and additional obligor disclosure) members feel that a target of four pages might be appropriate, but that flexibility should be allowed in the context of more complex products, particularly where more extensive disclosure in relation to the Underlying(s) of such product is essential to investor comprehension. As above, appropriate use of cross referencing (and indeed the use of a Glossary) will also be important in ensuring that the document is as concise as possible.

  We also note that the Hong Kong "Key Facts Statement" regime allows page limits to be relaxed to permit certain information to be presented in alternative formats which improve investor understanding but take up more space (e.g. graphically). IOSCO's work in this field also supports the use of alternative formats to assist investor comprehension. We feel that it would benefit investors if a similar flexibility were permitted under the PRIPs regime.

A.2 Section commentary

The commentary below is intended to explain any key drafting features and raise any conceptual issues identified in the course of drafting. It is set out on a section by section basis.

A.2.1 Header and "Purpose" Section

This initial information sets out the product in question and the status of the KID. We note that clear signposting of this nature has been found to assist retail investor comprehension. In respect of specific content:

Product Reference Code: Any standard product identification code (for example, in the case of debt securities, this would be the ISIN and Valor/WKN/Common Code).

Glossary: A prompt has been included to allow for the use of a Glossary document to supplement the KID. Members were generally supportive of the suggestion that, for certain products, an optional Glossary document, in similar format to that proposed for the Barclays Capital KID, might be useful in assisting readability. It would allow for explanation of more specialist terms in the Glossary. This would reduce "clutter" in the KID itself and in allowing for more detailed, retail friendly explanations to be offered, it would also assist in improving the understanding of less sophisticated investors (in line with the Commission's wider investor education goals).

Such a Glossary could be prepared by Product Producers/Distributors on a house-by-house basis or subject to some form of Commission-led standardisation where appropriate. Standard form definitions could be developed for certain common terms. The JAC would be happy to work with the Commission and/or CESR on any such project.

KID validity period: To avoid an undue administrative burden being placed on the party charged with preparation of the KID, it is proposed that the duty to update the KID should be consistent with the current Prospectus Directive regime (i.e. there should be no obligation to update the KID after admission to trading, if relevant, or the end of the relevant offer period, whichever is later). Wording has been inserted in this section of the Template KID making this clear to investors.

A.2.2 Quick Facts

This section is designed to address the product comparison function of the KID. It is a feature used in both the Hong Kong SFC template Key Facts Statement and the Barclays Capital KID. The aim has been to choose headings that are generic, allowing the same headings to be used across the range of both Contractual and Collective Investment PRIPs products and thereby facilitate comparison between them. Comparability is also assisted by the easily accessible “line item” format. The intention would be that investors would become familiar with these commonly used headings which, in turn, would improve their confidence when analysing and comparing different products. There will necessarily be some overlap between this section and the following sections.

The Commission may wish to consider whether this section could be modular. For example, a series of different Quick Facts section templates might be available (one for each Product Category). Whilst the majority of headings could be common to all templates, a modular structure would allow additional headings (which apply exclusively to Contractual PRIPs or Collective Investment PRIPs or indeed only to an individual Product Category) to be included in the relevant module for the relevant Product Categories only (e.g. in the case of securities, whether or not the product is listed). This would be more efficient because where a key point of comparison applies

only to certain Product Categories it need only appear in the Quick Facts section for those Product Categories to which it relates.

In respect of specific headings in the Quick Facts section:

Product Category: This is designed to place the product in a category according to its wrapper (e.g. a "structured security"). This could work alongside investor education initiatives to improve investor understanding by making clear the distinction between different product wrappers.

Product Type: This describes the more specific nature of the products within the generic "Product Category" (e.g. a note as opposed to a warrant or certificate). This may not be relevant in relation to products where the Product Category is not subdivided.

Product Start Date/Product End Date: As above, general language has been used to attempt to ensure applicability to a range of PRIPs. For example, in the context of an offering of Notes these terms would relate to the Issue Date and Maturity Date respectively.

Final Return/Periodic Return: This is a further example of using general language. In completing these prompts, the party completing the KID would stipulate the nature of the payment (e.g. "Redemption Amount" or "Interest"/"Coupon" and briefly explain how the payment is calculated (e.g. "linked to the performance of [●]").

A.2.3 Product Description

This section would contain a more detailed narrative description of the product to assist comparability and accessibility. This section has a standardised structure using a series of prescribed headings (framed as questions). As above, the phrasing of information as questions an investor might ask is in accordance with UK FSA guidance on the preparation of key features documents, reflecting findings that this aids investor understanding. We have also provided for the inclusion of standardised prominent warnings cross-referring to the key risks section to ensure that the disclosure is suitably balanced in terms of risk and return.

A.2.4 Key Risks

In line with the desire to focus on key product specific information only, we would propose that this section contains only disclosure relating to the "key risks" of the product. Risks that would relate to all products of the relevant product category would not be included. Instead cross references would be incorporated referring investors to the disclosure relating to those more general risks set out in the relevant Offering Document. In this regard, please see our comments in relation to the use of cross references in Section A.1 above. The risk headings included are by means of example only and would be deleted (and/or additional headings added) as appropriate.

We are aware that this section is relatively "text heavy" but feel that the approach elected would offer optimum disclosure for investors, again based on a question and answer format to aid comprehension. Each risk should be explained in full in retail friendly language in the KID.

Other formulations considered include:

(i) the approach adopted in the Barclays Capital KID of a headings based risk section linking to/supported by an explanation of the relevant risk factors in an accompanying Glossary; and

(ii) a hybrid approach of disclosure based on one or two word "risk tags" (e.g. "Credit Risk"), in line with the Barclays Capital approach, but with the explanation of the tag appearing adjacent to it in the KID itself.

Both of these approaches have their merits. In particular, approach (i), which allows for a "cleaner" document which would be visually easier for investors. However, on balance, members felt that the "risk tags", whilst easily identifiable to those with investment knowledge, may not be intuitive for retail investors. As such, the preferred approach is to frame the disclosure as questions to which an investor could easily relate. We would nonetheless be happy to discuss further the most appropriate format for this section.

Further to member comment, a Synthetic Risk Reward Indicator (**SRRI**) has not been incorporated. Members strongly supported the arguments against the inclusion of such an indicator as expressed in the Barclays Capital submission to the Commission, namely that:

> *"(i) in the context of retail structured securities it would be very difficult (if not impossible) to formulate an indicator calculation methodology which would allow a meaningful comparison between such a broad range of products;*
>
> *(ii) the use of a single figure score would anyway detract from the wider risk disclosure in this section as retail investors are likely to place undue emphasis on the indicator (a similar weakness to credit ratings). This is of greater concern where the indicator is of questionable validity;*
>
> *(iii) where a risk indicator is used in respect of a retail structured security, significant space would be required to set out the explanation of the indicator, the score and the warnings in relation to its reliability. This would reduce the space available for more meaningful disclosure of the actual risks involved in the product and add unnecessary clutter to the document; …*

In addition:

(iii) Investors tend to place undue emphasis on a risk indicator. This is a particular concern in the context of structured securities since the risk profile is generally more diverse than that involved in a UCITS (in particular, given the additional obligor credit risk dimension). A single figure rating discourages investors from fully engaging with the detail of this risk profile. This must surely detract from the value of the KID as an investor education document.

(iv) Diverse risk profiles often apply to structured securities and risk is often investor specific. For example, an investor investing in a product denominated in a currency other than that of his home member state takes significant foreign exchange risk which may not be factored into the indicator. Consequently, narrative risk explanations are far more useful to investors allowing them to assess the relevance of each risk factor identified in the context of their specific portfolio. As above, the incorporation of a SRRI would require reasonably significant explanatory narrative which would reduce the space available for explanation of the actual risks involved.

(v) Computing a calculation basis for a risk indicator for products for which there is no (or limited) past performance data presents significant challenges. Given the Commission's

work in the Rating Agencies sphere, it would seem odd to move towards a formulation that introduces significant new subjectivity and is more conflicted than the existing Rating Agency regime. Furthermore, any element of subjectivity introduced (as may be unavoidable), would open the party calculating the rating to liability risk in respect of investors subsequently seeking to challenge an assumption made in the course of such calculation.

(vi) Finding a common calculation methodology that could be used across the full range of PRIPs would represent an even greater challenge. The nature of structured securities (and indeed a number of the other Contractual PRIPs products) is fundamentally different to UCITS. For example, no "strategy" applies and collateral arrangements (if indeed these apply at all) are arranged on a different basis. As such, the regime applying to UCITS would not easily be transposed to other PRIPs products in a way that would allow for reliable or meaningful ratings to be produced.

Were different methodologies to be applied to different product categories, there is a significant risk that investors would nonetheless regard the index scores as comparable across product categories. This could offer an unfair advantage for certain products for which the categorisation framework was more favourable.

(vii) There are concerns that, in the context of capital protected products which are highly complex but relatively low risk (e.g. complex structuring might be used to reduce risk), an inappropriately designed indicator may incorrectly score these products as higher risk due to their complexity. This potential asymmetry between complexity and risk was a theme discussed in the JAC November Submission at paragraphs 23 to 29.

We note further that it is reported that the numeric indicator was considered but then rejected by the Monetary Authority of Singapore in relation to their proposed Product Highlights Sheet.

In relation to the calculation methodologies considered by CESR in relation to the UCITS KID we note the more detailed analysis included in the JAC's response dated 10 September 2009 to the CESR Consultation Paper (09-552), together with Addendum on technical advice at level 2 on the format and content of Key Information Document (KID) disclosures for UCITS of 8 July 2009, available at www.isda.org/c_and_a/pdf/KID-disclosures-for-UCITS-JACresponse.pdf.

A.2.5 Charges and Taxes

Members were generally supportive of the approach taken to charges disclosure in the Barclays Capital KID and the rationale provided in the accompanying submission.

Excerpt from the Barclays Capital submission:

> "***2.6 Charges***
>
> - *For clarity we have split the charges up into categories.*
> - *To facilitate comparison between products, the format of this section could be retained for all products. Hence where no charge relating to a particular category applies in relation to this product we have not removed the category but simply stated that no such charge applies.*
> - *For transparency we have:*

(i) disclosed the deduction of all Issuer costs as charges; and

(ii) disclosed the existence of a bid/offer spread for any secondary market sales. Even though this is not strictly a product charge, it will nonetheless act to reduce the potential return that an investor would receive.

- *In contrast to the CESR Advice in relation to UCITs, we have not included an illustration of charges in numerical tabular format. We appreciate the rationale for this requirement. However, the costs payable in respect of many retail structured securities are often based on less predictable components (for example, variable funding costs) and as such we feel the number of assumptions that are required to produce numerical data renders the data unreliable from an investor perspective. In the context of retail structured securities, such a numerical illustration of data is, therefore, more likely to mislead investors than provide useful insight. This is of particular concern given the findings of the consumer testing conducted by IFF Research and YouGov in respect of the UCITs KID (the **UCITS Consumer Testing**) that retail investors often treat such illustrative data as fact (i.e. a conclusive list of the actual amount of charges that they will be expected to pay).*"

In terms of the nature of Product Producer fees that should be disclosed, we refer to the JAC November Submission and in particular paragraphs 33-37 thereof which contain more detailed commentary in this regard.

A.2.6 Further Information Available To You

This section mirrors the "Documents Available To You" section incorporated into the Barclays Capital KID. Members generally agreed that a section setting out clearly what other materials were available would be very helpful in improving investors' understanding of the full range of disclosure materials available to them and in that way also further contextualising the KID.

It was felt that this section might also usefully contain reference sources for post-issuance information.

A.2.7 "How do I purchase this product….."

It is intended that this section would provide information in relation to how a prospective investor might purchase the product. It was felt that the KID was not the appropriate forum to disclose full details of the terms and conditions of the offer but that this question should be addressed in outline.

A.2.8 "Who is the Product Producer?"

In the context of structured securities specifically, and Contractual PRIPs generally, obligor credit risk is an important investment consideration. As such, it was felt that a distinct section containing stipulated Product Producer disclosure would assist with clarity. However, members would emphasise that the KID should not be required to contain detailed Product Producer disclosure. This is already set out in an accessible format in the Offering Document. As such cross-references directing investors to the specific pages of those Offering Documents upon which such information can be found would be the most effective way of ensuring that such information is

made available to investors. Incorporation of such information into the KID itself would significantly lengthen the document with no apparent additional benefit to investors. Clearly, this section may not be appropriate in the context of Collective Investment PRIPs. For further discussion of the differing disclosure requirements for Collective Investment PRIPs as compared to Contractual PRIPs, please see paragraphs 16 and 17 of the JAC November Submission.

A.2.9 Annex 1 - Scenario Analysis/Historical Performance

In line with the Commission's work in relation to the UCITS KID, a Past Performance section has not been incorporated. Historical performance information is not generally available in relation to structured securities products. Instead, a prompt has been included to allow for the annexing of a scenario analysis/historical performance section.

In this regard please note:

(viii) Members are generally supportive of the Commission's proposal that a low, medium and high return scenario should be included, along with appropriate warnings regarding limitations of the data used and that the scenarios were not equally probable.

(ix) This section has been included as an Annex to allow the KID producer to incorporate varying formats of information at their election without disrupting the flow, and preserving the uniformity, of the core document. Members felt that allowing the KID producer the flexibility to present scenario analyses in a variety of flexible formats would assist accessibility (e.g. numerically, graphically and/or in a chart format). Product Producers are often used to preparing marketing materials for products of this nature on a regular basis and are, therefore, familiar with what presentational approaches are generally best suited to particular product types and are expected and valued by distributors and end investors. In this regard we note that the Hong Kong SFC has allowed for flexibility to be applied to the length of its Key Facts Statement document where this would allow for the incorporation of information in alternative "investor friendly" formats.

(x) Members feel that a degree of flexibility with regards the approach taken for the preparation of scenario analyses would improve the utility of the data prepared. However, prescribing rigid calculation methodologies may risk generating inappropriate results for certain products. A general requirement that the scenario analyses provided are prepared and presented in a manner which is fair, clear and not misleading should ensure appropriate standards are maintained.

A.2.10 Annex 2 – Information relating to the Underlying(s)

For certain structured securities an understanding of the nature and likely performance of the underlying or underlying(s) will be important to an investor’s ability to understand his possible return. Therefore, a separate Annex has been incorporated allowing for disclosure in this regard. This has been incorporated as an Annex because such disclosure will not be appropriate in relation to every product (for example, if the underlying is a specific share, this can adequately disclosed in the Quick Facts section of the KID). Using an Annex for this disclosure allows the uniformity of sections in the core document to be maintained in respect of all products, with an Annex relating to the Underlying only added where appropriate.

SECTION B

FURTHER KEY ISSUES

B.1 Scope

As set out in the JAC November Submission, the KID should only be required for products actually sold to "retail" investors (see paragraphs 4 to 6 of that document). The regime will need to be carefully crafted to ensure that products sold to "wholesale" investors are not unintentionally caught by the PRIPs KID regime. The KID document provides no investor/public policy benefit in the "wholesale" space and, as such, the significant additional cost to the KID producer cannot be justified.

Similar concerns apply in relation to "vanilla" products. We note that the currently proposed economic definition of PRIPs (as per the Commission's Update of 16 December 2009) requires that a PRIP will necessarily contain an "element of packaging". We assume that this reflects the Commission's intention that "vanilla" products will be strictly out of scope. We believe that this must be the correct outcome. The regime would seem both inappropriate and unnecessary for such products with no discernible public policy benefit.

B.2 Purpose

The purpose should be to set out certain ***key*** information in relation to the product with the goal of "aiding" a prospective investor when considering whether to invest. In this way, consistency would be ensured with the analogous Prospectus summary regime (as set out in the recently approved Directive amending the Prospectus Directive). We note further that the "key information" definition now incorporated into the Prospectus Directive is broader than the information we would expect to be required in a KID document (both in terms of content and the level of detail required, e.g. more detailed issuer disclosure and information regarding use of proceeds). We note that this definition of "key information" would only be appropriate if, in line with the Prospectus summary, the KID is only expected to provide all "key information" when read together with the Prospectus document. In this regard, please see our comments in relation to the use of cross referencing above.

The KID should not be required to contain "all" information that an investor might reasonably require. That is both unnecessary from an investor protection perspective and unrealistic from a disclosure perspective. The role of disclosing "all" information that an investor requires should remain that of the relevant Offering Document.

B.3 Responsibility for preparation

The Commission, in its December communication relating to the PRIPs initiative, discussed two possible approaches:

(i) Detailed rules setting out responsibilities for preparation of document, to generally sit with Product Producer, but, given the role of Product Distributors in relation to bringing certain PRIPs into the retail market, responsibilities also placed on Product Distributors.

(ii) A more flexible approach relying on the cooperation between Product Producer and Product Distributor.

Members feel that option (ii) must be the better approach for the reasons set out at paragraphs 19 to 21 of the JAC November Submission. Arguably, the correct approach to responsibility can only

be determined once a clearer picture of required content for the document emerges. Whilst some sections of the Template KID are better suited to being completed by the Product Producer, (e.g. Quick Facts and Key Risks), others would need to be completed by the Product Distributor (e.g. Product Distributor Charges, Further Information, How do I purchase this product, Product Distributor disclosure and elements of the Product Description). More specifically, members are concerned that the extent of the information to be provided under any Product Description section is clearly limited to statements of fact. If it is not, Product Producers may find themselves in a position where the information they are required to provide risks being characterised as investment advice.

Furthermore, the Commission should consider whether the Product Description section is in fact better prepared by the Product Distributor. Product Distributor's often already prepare retail investor friendly Product Description-style summaries as part of their marketing material. As the party directly engaged with the investor, and indeed paid to manage the investor relationship, the Product Distributor is arguably better placed to understand the nature of material that investors require.

B.4 Liability

We note our comments at paragraph 14 of the JAC November Submission. We would suggest that the same level of liability as applies to the Prospectus summary under the revised Prospectus Directive regime should also apply to the KID, i.e. that that no civil liability should attach in respect of the KID unless it is misleading, inaccurate or inconsistent, when read together with the other parts of the relevant Offering Document, or it does not provide, when read together with the other parts of that Offering Document, key information in order to aid investors when considering whether to invest in such securities.

A higher level of liability is unnecessary and would likely result in an over-cautious approach being taken by the party charged with compiling the KID. Having a higher liability standard and placing strict limits on the length of the KID would also place an unacceptable risk on the party charged with preparation and is likely to result in a number of Product Producers and Product Distributors electing not to offer certain products to retail investors. This would reduce competition and investor choice.

B.5 Relationship with the Prospectus Summary

The debate as to how the requirement to produce a KID should interact with the requirement to produce a Prospectus Summary is important and a duplication of information should be avoided. We would suggest that, in the context of relevant products sold to "retail" investors, the requirement to produce a Summary should be replaced with a requirement to produce a KID. Alternatively, the two regimes could be harmonised such that the form of Summary required to be produced in these circumstances under the Prospectus Directive regime mirrors the requirements under the PRIPs KID regime. We assume that this may be the intention of Recital 19 to the amending Directive in respect of the PD (A7-0102/2010). Whilst we would welcome this outcome, further aspects which it will be important to consider are:

(iii) how information that it is currently required under the Summary regime but may not be required in such detail under the KID regime should be treated (for example, Product Producer/Issuer disclosure); and

(iv) the approach that should be taken in the context of "retail" debt issuance programmes, or debt issuance programmes allowing for the issuance of securities to both "retail" and "wholesale" investors. The summary disclosure currently seen in base prospectuses for

programmes is generic in nature, referring to types of issuance contemplated under the programme rather than specific issuances. This would not seem to be compatible with the product specific approach likely to be required in relation to KID. A number of suggestions have been made in relation to how this issue could be addressed. We would be happy to discuss this in more detail with the Commission if that would be of assistance.

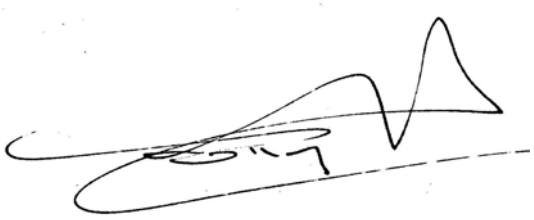
B.6 Relationship with MiFID

Whilst it would be desirable for a common approach to be taken to retail classification under the MiFID and PRIPs regimes, the current MiFID approach requires refinement. In considering any proposals for reform of the investor categorisation regime under the MiFID we would urge the Commission to consider carefully how any such changes would work in context of a future PRIPs regime. As in "Scope" above, it will be important to ensure that the scope of any definition of "retail" for investor classification purposes is carefully considered to avoid products that are essentially "wholesale" being unintentionally caught in the PRIPs regime. We would be very happy to engage in discussions on this important point.

B.7 Delivery

The KID should be designed to work equally effectively in both soft and hard copy. There should be an obligation to deliver the KID in sufficient time to allow it to inform investment decisions.

Yours sincerely,



Timothy R Hailes

Chairman – Joint Associations Committee on Retail Structured Products

JAC contact - Richard Metcalfe, ISDA

rmetcalfe@isda.org, 0044 20 3088 3552

FORM OF TEMPLATE KIID

What is the purpose of this Key Investor Information Document?
This document sets out certain key information relating to the [Insert product name]. Details of further product information are set out in "Further Information Available To You" below. The full legal terms and conditions can be found in [Insert details of relevant offering document]. [Insert if a Glossary is to be used (optional): Highlighted terms are explained in the Glossary.] IF YOU DO NOT UNDERSTAND ANY FEATURE OF THIS PRODUCT OR ARE UNSURE AS TO WHETHER IT IS SUITABLE FOR YOU, YOU SHOULD OBTAIN INDEPENDENT ADVICE BEFORE INVESTING This document was published on [Insert date] and is accurate only as at that date. This document was produced by [Insert name of party responsible for the KID].

Quick Facts	
Product Category: [Structured [Debt] Security][Structured Deposit][Insurance]. **Product Type:** [Note][Certificate][Warrant] [linked to [Underlying Asset]] **Product Producer:** [*Insert the full name and title (e.g. "Issuer") and specify the Product Producer's business sector (e.g. Banking, Insurance) and jurisdiction of registration*] **Product Distributor:** [*Distributor to insert the full name of the Product Distributor or, in the case of affiliate Distributors, the name of the relevant group*] **Product Currency:** [●] [**Listing:** [●]] **Offer Price:** [●] [per Security][per Unit]	**Product Start Date:** **Product End Date:** **Early Withdrawal:** [Available [(with charge)][(without charge)]][Not Available] **Early Termination:** [*If applicable (e.g. a Knock-out feature), insert a brief statement to this effect*][Not applicable] [**Form of Return:** [Cash][Physical Delivery]] **Final Return:** [*Insert brief description of return*] **Periodic Return:** [Nature of payment] payable on [●] **Underlying:** [*Insert name and type of Underlying (e.g. Share, Index, Basket of Shares)*]. [*Optional:* For further details please see Annex [1][2]].

Product Description	[*Option to insert symbols here with*

***explanation*]**

What is the aim of this product?

[*Insert a brief synopsis of the product*]

Why might I buy this product?

[*Insert a generic description of the product objective*]

What return could I receive under this product?

[*Complete in accordance with Completion Note 1 below*]

How and when will I normally receive this return?

[*Complete in accordance with Completion Note 2 below*]

What are the Key Risks involved in this Product? [*Complete in accordance with Completion Note 3 below*]

AN INVESTMENT IN THIS PRODUCT INVOLVES RISK. THE LIST BELOW HIGHLIGHTS ONLY CERTAIN KEY RISKS. A DISCUSSION OF FURTHER RISKS WHICH MAY BE ASSOCIATED WITH AN INVESTMENT IN THIS PRODUCT CAN BE FOUND AT PAGES [●]-[●] OF [*INSERT DETAILS OF RELEVANT OFFERING DOCUMENT*].]

The risk profile of the product may change through its lifetime. The key risks listed below represent the [Product Producer/Product Distributor]'s assessment of the key risks as of the date of this document.

What is the risk that I may lose some or all of the money that I invest?

[*Complete in accordance with Completion Note 4 below*]

Can the Product Producer adjust the product or my return without my consent?

[*Complete in accordance with Completion Note 5 below*]

Can the Product Producer terminate the product before the Product End Date, extend the product or delay payment of my return?

[*Complete in accordance with Completion Note 6 below*]

Can I withdraw my money from the product, or otherwise sell the product, at any time?

[*Complete in accordance with Completion Note 7 below*]

How might movements or disruptions in financial markets affect my return?

[*Complete in accordance with Completion Note 8 below*]

Will other business activities of the Product Producer affect the value of my investment?

[*Complete in accordance with Completion Note 9 below*]

What Charges and Taxes might I have to pay in relation to this product?

The following charges apply. Overall, they reduce your return.

[See Completion Note 10 and the prompts below]

Product Producer charges:

- **One-off charges on purchase:** [Insert details or if no such charge applies state "Not applicable"]
- **Charges over the product lifetime:** [Insert details or if no such charge applies state "Not applicable"]
- **One-off charges at the end of the product term:** [Insert details or if no such charge applies state "Not applicable"]
- **One-off charges on early withdrawal:** [Insert details or if no such charge applies state "Not applicable"]

[N.B. In each case charges stated should be the maximum possible charge that may apply]

Product Distributor charges: *[To be completed by the Product Distributor]*

[Where a bid/offer spread may apply in relation to the Secondary Market insert: **Bid/offer spread:** If you wish to sell the product before the Product End Date the price at which a buyer may be willing to buy the product from you may be less than the price at which they may offer to sell the product to you or someone else.]

Taxes: The tax laws of [Insert relevant jurisdictions], your own country and other countries may affect your investment in this product. For further information, please speak to an adviser.

Further Information Available To You [To be completed by the Product Distributor]

You should also refer to the following documents which are available free of charge both online at [web address] and in hard copy on request from [address]:

[Complete in accordance with Completion Note 11 below]

How do I purchase this product and who should I contact for more information? [To be completed by the Product Distributor]

The period during which this product is initially being offered to you by the [Product Distributor] is [Insert details of the [Offer Period]]. [The product is subject to a minimum investment of [●]]. The product is available for purchase in minimum units [(denominations)] of [●].

For more information or to purchase the [Insert product name] please contact the [[Product Producer][Product Distributor] at: [Insert contact details]][your financial advisor].

Who is the Product Producer?

[Insert Product Producer's name] is [authorised and] regulated by the [Regulatory Authority]. [Insert Product Producer's name] is registered in [Country] [Registration Details (e.g. Company Number)]. Registered Office: [Insert address].

[Insert brief description of the nature of the Product Producer's business to include a prominent statement as to whether or not investments issued by the Product Producer are covered by any investment protection scheme][Insert a cross reference to any more detailed Product Producer disclosure in the relevant Offering Document]

Who is the Product Distributor?

[To be completed by the Product Distributor]

[Scenario Analysis][Historical Performance Data] (Optional)

[Include appropriate prominent warnings regarding the limitations of any data included, including whether the scenarios reflect output at maturity only and clarification that the scenarios do not represent a forecast of expected performance. It should be made clear that the scenarios shown may not have an equal probability of occurrence]

[Appropriate scenarios shall be chosen to show the circumstances in which the product may generate a low, a medium and a high return, including, where applicable, an investment loss for the investor]

Information relating to the Underlying (Optional)

[*Insert a brief description of the Underlying where required to supplement the information in the Quick Facts section*]

COMPLETION NOTES

PRODUCT DESCRIPTION

COMPLETION NOTE 1:

What return could I receive under this product?

Explain the basis of calculation of the return in plain English. Formulae may be included if this will aid investor understanding. If scenario analyses/historical performance data are to be included, these should be incorporated in Annex 1 as prompted. Return for this purpose should include both the return (if any) of the investor's capital or upfront premium and the return on that capital or upfront premium. Details of any capital protection should be included but with corresponding prominent warnings (cross referring to the risk section below) as to limits to such capital protection.

[*Insert if appropriate:* The return (if any) that you receive under this product is linked to the performance of the Underlying specified above. Before investing you should ensure that you understand the nature of the Underlying.]

[*If scenario analyses/historical performance data are to be included insert:* Examples of possible payouts for this product can be found in Annex 1 on page [●] below]

[*Insert for all products, including capital protected products:* **YOUR INVESTMENT MAY GO DOWN AS WELL AS UP AND YOU MAY LOSE ALL OF THE MONEY THAT YOU INVEST.**]

[*Where the product contains adjustment provisions insert:* **IN CERTAIN CIRCUMSTANCES THE [*INSERT RELEVANT PARTY*] MAY HAVE A RIGHT TO ADJUST THIS PRODUCT AND YOUR RETURN. FOR FURTHER DETAILS SEE THE "KEY RISKS" SECTION BELOW**]

COMPLETION NOTE 2:

How and when will I normally receive this return?

Insert relevant details. Include details of whether the product return is received in cash or by physical delivery and scheduled payment date.

[*Where the product contains early termination or payment deferral provisions insert:* **IN CERTAIN CIRCUMSTANCES THE [*INSERT RELEVANT PARTY*] MAY HAVE A RIGHT TO [TERMINATE THE PRODUCT BEFORE THE PRODUCT END DATE] [OR] [DELAY YOUR RETURN]. FOR FURTHER DETAILS SEE THE "KEY RISKS" SECTION BELOW**]

KEY RISKS

COMPLETION NOTE 3:

General approach

Questions listed in this section are by means of example only - delete and/or reorder as appropriate. Consider whether any additional product/structure specific questions or risks (e.g. knock out provisions) should be added and, if so, set out when the consequences of such features may be most evident.

COMPLETION NOTE 4:

What is the risk that I may lose some or all of the money that I invest?

> Include appropriate explanation of Product Producer and any other relevant counterparty credit risk. Consider including a cross reference to the "Who is the Product Producer?" section below.

> Include a statement as to whether or not the product is capital protected and, if so, setting out and appropriately explaining any limitations on this protection.

> Where the product does not have the benefit of a guarantee and/or any government investor/depositor protection scheme, include a specific statement to this effect.

> Where appropriate, include a statement clarifying that the investor does not have recourse to the underlying asset/assets and an appropriate explanation of the consequences of this from an investor perspective in a default scenario.

COMPLETION NOTE 5:

Can the Product Producer adjust the product or my return without my consent?

> Include details and appropriate explanations of any adjustment provisions.

COMPLETION NOTE 6:

Can the Product Producer terminate the product before the Product End Date, extend the product or delay payment of my return?

> Include details of any Product Producer call, early termination or deferral provisions.

COMPLETION NOTE 7:

Can I withdraw my money from the product, or otherwise sell the product, at any time?

> Include appropriate explanation of any restrictions/charges on early withdrawal, to include appropriate warnings in relation to any charges or restrictions on early withdrawal. Where appropriate, include a warning that the product value may be lower during the term of the product than at the Product End Date.

> Include contact details for secondary market pricing and sales and, where appropriate, include warning relating to the lack of or limited secondary market for the product and a warning that the return received through a sale in the secondary market may be lower than if the product was held to term.

COMPLETION NOTE 8:

How might movements or disruptions in financial markets affect my return?

> Include appropriate explanation of market exposure risks, to include warnings relating to any potential volatility and any leverage employed and any specific market or asset class risk related to the Underlying.

> Include appropriate explanation of any currency risk.

> Include appropriate plain English explanation of any market disruption risk and the consequences of a market disruption for the investor.

> Where hedging may be directly relevant to the investor's return, include a brief plain English explanation that the Product Producer has hedged or may hedge its exposure to the product and include an explanation of how this may affect investors, e.g. consequences of hedging disruption events.

COMPLETION NOTE 9:

Will other business activities of the Product Producer affect the value of my investment?

> Include appropriate explanation of any conflicts of interest the Product Producer may have.

CHARGES AND TAXES

COMPLETION NOTE 10:

The Product Producer and Product Distributor should ensure that all contemplated charges are covered including, for example, custodian charges and platform execution charges. Where charges are investor specific, investors should be prompted to confirm these with the Product Producer/Product Distributor as appropriate prior to purchase.

FURTHER INFORMATION

COMPLETION NOTE 11:

Insert in bullet point format:

- details of relevant Offering Document and useful ancillary materials including the languages in which such information is available; and
- details of where information in relation to any underlying assets (both pre and, if applicable, post-issuance) are/will be available and the languages in which such information is available.

ATTACHMENT 2

Jason Pope
Conduct Policy Division
Financial Services Authority
25 The North Colonnade
London
E14 5HS
Email: dp11_01@fsa.gov.uk

21 April 2011

Dear Mr Pope

JAC Response to FSA Discussion Paper DP11/1: Product Intervention

Introduction

This paper responds to FSA Discussion Paper DP11/1: Product Intervention (**DP11/1**). The Joint Associations Committee on Retail Structured Products (the **JAC**)[1] welcomes the opportunity to comment on the proposals set out in DP11/1. We agree with the objective of consumer protection and fully support an appropriate and proportionate regulatory approach to product intervention to achieve this objective.

We start our response by setting out the product design process generally adopted by product providers (in order to provide context to the earlier intervention proposals set out in DP11/1) and have also set out our general observations in the General Comments section below and responses to specific proposals in DP11/1; both sections include a number of key considerations that we believe are important in considering the appropriateness of the proposals set out in DP11/1 in achieving the objective of consumer protection.

The members of the JAC comprise a large proportion of the major firms involved in the creation and distribution within the EU of retail structured products. DP11/1 covers a wide range of financial products used by retail consumers, including deposits, insurance policies, investment products and mortgages. Of most relevant to the JAC are structured securities, structured funds and structured deposits (**Products**): our response is focussed on these Products.

The JAC members are signatories to the JAC Principles "Retail Structured Products: Principles for managing the provider-distributor relationship" (**JAC Principles**). The JAC Principles seek to address issues that firms have in practice found helpful to consider to ensure good consumer outcomes when performing the function of either provider or distributor in connection with the process of delivering structured products to retail

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

investors. The JAC has also developed principles that apply to the distributor-individual investor relationship, i.e. the Structured Products: Principles for Managing the Distributor-Individual Investor Relationship (**JAC Distributor Principles**). These are both highly relevant to the proposals set out in DP11/1 and we refer to the JAC Principles and JAC Distributor Principles where appropriate in this response. The JAC Principles and JAC Distributor Principles are set out in the Annex to this response.[1]

We have not responded to each question raised in DP11/1 but have, instead, sought to address, at a high level, the proposals set out in DP11/1. We consider that the proposals set out in DP11/1 must also be considered in light of the European Commission consultation paper on the review of the Markets in Financial Instruments Directive (December 2010) (**MiFID Review**), and proposals on Packaged Retail Investment Products (we have included in the Annex to this response the JAC supplementary submission to the EU Commission on the PRIPS Consultation), and the proposed intervention powers of the Financial Conduct Authority (**FCA**) set out in the HM Treasury consultation paper: A new approach to financial regulation: building a stronger system (February 2011) (**HMT Consultation**). These will reshape consumer protection and improve consumer outcomes: this should be taken into account in formulating any change to rules or supervisory or enforcement practice.

Process and responsibility for product design

Before responding to the proposals set out in DP11/1, we thought it would be helpful to summarise the product design process that is generally applicable to the launch of a Product by a product provider. We consider that it is important to highlight and explain this process in order to put the proposals set out in DP11/1 in context and to be able to evaluate their appropriateness in meeting the consumer protection objective.

The market for retail structured products is highly competitive, with a number of product provider financial institutions competing for business from retail intermediaries. Providers compete on price and client service, which includes sharing information and ideas with their clients.

The vast majority of Products are capable of being provided by a variety of providers. In relation to these, product providers may be approached by a distributor, who will often determine what characteristics a product should have (this is the 'pure manufacturer' role referred to in the Responsibilities of Product Providers and Distributors for the Fair Treatment of Customers (**RPPD**)). There will be a competitive process between different product providers to design a Product that meets the distributor's requirements. Therefore, there is input from distributors at the product design stage and creation of Products is often driven by the needs of the distributors, as well as their clients.

In other cases, the product provider designs a new Product on its own initiative or together with one or more distributors, for example following internal research and development.

The key point to note is that the design of the product and determination of its terms will often fall to the distributor: in the remaining cases it will fall to the distributor and the provider, or to the provider alone.

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[1] This Annex has been deleted due to repetition in this document. Please find the Principles appended to Attachment 3.

Regulators need to take into account the heterogeneity of origination processes and in particular responsibility for determining product features when creating and allocating regulatory obligations around product origination, and also when exercising supervisory and enforcement powers. A manufacturer of a product should bear responsibility for ensuring the product 'does what it says on the tin' (i.e. performs in accordance with the reasonable expectations of end investors) and that it complies with product regulation and applicable requirements of the Prospectus Directive; the person or persons who undertake product design should bear responsibility in relation to the design of the product to meet identified consumer needs: and the distributor should continue to bear point of sale responsibilities.

It is key that intervention is proportionate and targeted appropriately to follow these responsibilities, as to do otherwise risks penalising manufacturers for the failings of their distributors or *vice versa*. The reputational implications for a product provider of being involved in disciplinary action as a result of distribution failures are very substantial: it is important that action be targeted at the party responsible for any failings.

General comments

Interrelationship with point of sale regulation

Although the focus of DP11/1 is on earlier intervention in product design before the point of sale, we consider that the role of the distributor is fundamental to the consumer protection objective and we must not lose sight of this in the proposals outlined in DP11/1.

Under point of sale obligations, distributors of retail structured products must assess client needs and determine the appropriateness or suitability of a Product for each client. As a result of the client's best interests rule, the distributor is a quasi-fiduciary of the end investor. (Often it is also a fiduciary of the end investor.)

Product providers consider generic appropriateness of Products for the target market of the distributor following confirmation from the distributor of the investor types that it intends to target. This reflects JAC Principle 7 which provides that a product provider's assessment of a distributor should include consideration of their typical client type. This is good practice not least because of the reputational impact of failing to do so.

We therefore consider that the point of sale obligations are important to the fair treatment of consumers and that, even with a more interventionist approach in relation to product design, ultimately it remains the case that it will be for the distributor to determine whether a Product is suitable (or appropriate, as relevant) for an end investor, following the product provider's general assessment of the Product against the target market. It is the distributor rather than the product provider that can control who a Product is distributed to. However, the question of the allocation of responsibility between product providers and distributors is complex – and cannot rest on the labels for the roles provided by each. It is, therefore, essential to consider the role of each of the product provider and distributor in relation to the distribution of a Product and apply the responsibilities to the right role in the distribution chain. This will ensure that the person best placed to meet the applicable requirements is responsible for them.

We believe that product manufacturers should not be held responsible for consumer detriment where they are suitable for some investors but not suitable for others – it is the distributor's role to ensure that Products are distributed to investors for whom they are suitable/appropriate. It is extremely unlikely that a Product will be suitable/appropriate for all of a distributor's

clients. As it is the distributor that interfaces with the individual investor, investor suitability/appropriateness of a product is exclusively a matter for distributors and is not a role that the product provider can play. The distributor and product provider, therefore, have distinct, separate roles which must be recognised. This is emphasised in JAC Principle 4 which provides that "*the distribution structure means that is it 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*".

We also believe that a distributor must understand the products that it distributes to ensure that the consumer is not misled and is treated fairly. This is built into JAC Principle 5 (which provides that distributors must understand the products they distribute) and JAC Distributor Principle 6 and is also reflected in the RPPD. This may be achieved through the materials provided by the product provider or generally through the product provider and distributor's communications.

Regulatory requirements applicable to product providers

Chapter 5 of DP11/1 (Possible Development of the Regulatory Framework) sets out proposals to include greater prescription in the current regulatory framework.

Product providers and distributors must already comply with the FSA's Principles for Businesses (particularly Principles 1, 2, 3, 6, 7 and 8). In addition, the RPPD guidance for the fair treatment of customers sets out guidance for product providers and distributors in treating end investors fairly. As a result, we do not disagree, in principle, with the proposal (set out in chapter 5 of DP11/1) to turn some of the RPPD guidance into rules and consolidating existing rules into a single section of the Handbook, subject to consultation. There is considerable common ground between the RPPD requirements and the JAC Principles, with which members already comply: to that extent the RPPD requirements merely reflect existing good practice. In addition, any conversion of the RPPD requirements into FSA rules would need to be subject to an Article 4 notification to the European Commission under MiFID. As a result, the creation of such rules will need to be justified before implementation in the UK.

Competition

Product providers exist in a highly competitive market. As a result, in relation to the design of a Product there is strong competition between product providers to design a Product that best meets the demands of distributors and end investors. As discussed above, product providers will often be approached by a distributor (who will often determine the characteristics of the relevant product) and product providers will each be competing against each other. This competitive process should result in benefits for consumers in terms of pricing and choice and fosters innovation.

Competition in the market also incentivises good behaviour from product providers. The proposals for earlier intervention in DP11/1 may also lead to less choice for consumers and may also increase costs for consumers because the competitiveness between the product providers would be reduced. It is recognised in chapter 1 of DP11/1 that improved consumer protection must be balanced with competition considerations (*the key theme is how improved consumer protection should be balanced with a healthy level of choice and competition in the market)*; we fully support this.

We also note that the FSA acknowledges that where the product intervention proposals implement super-equivalent requirements, those requirements may not apply to firms passporting into the UK (but would apply to UK firms passporting into other EEA states). As a result, FSA regulated firms/firms operating from the UK will be disadvantaged, for example when exercising passporting rights, compared to non-UK based firms passporting from a different jurisdiction.

Responses to specific proposals in DP11/1

Chapter 2 (Our new approach)

Consumer detriment

Further to the proposals set out in chapter 2 of DP11/1 in relation to the new approach to prevent detriment before it occurs, we consider that the applicable regulatory regime must be calibrated to the sophistication of clients. We believe that it is appropriate for the proposals set out in DP11/1 to apply to retail clients only (and not extend to the wholesale market and to investors that may be categorised as professional clients). There are indications in the HMT Consultation that product intervention powers may extend to the wholesale market: we do not consider this appropriate. We, therefore, do not support the proposal that certain categories of Product may be limited to professional clients only. As discussed above, as part of a distributor's point of sale obligations a distributor must consider whether a particular Product is suitable or appropriate for a particular client.

As discussed above, the suitability/appropriateness assessment conducted by distributors are important to ensure that a consumer does not suffer detriment by purchasing an unsuitable product. Although some products may be complex, they will be suitable for some investors. It does not follow that a Product with a relatively complex legal structure will also have a complex risk/reward profile (or *vice versa*). As a result, it should not be assumed that complexity of a Product equates to higher risk or to narrower suitability/appropriateness.

Chapter 3 (The rationale for product intervention)

In relation to the problematic product feature indicators set out in chapter 3 of DP11/1, it must be noted that the presence of one or more of the factors is not inherently indicative of consumer detriment. There is a danger that the indicators would stigmatise products and would be likely to stifle competition where products are legitimate but have certain of these characteristics. On the specific indicators of problematic product features set out in DP11/1 we have the following points:

- "*Exit charges or other features which act as a material barrier to exiting*" – in relation to this indicator it must be acknowledged that there is no obligation of a product provider to provide a secondary market in a Product for hold to maturity products;

- We are concerned that the indicators "*Complex products, including bundled products or those with opaque structures*" and "*Layers of charging due to multiple products or services included in the package*" can be read widely to catch indices where (i) the end investor is not expected to know exactly how the algorithm works but invests as a result of the investment strategy (for example, this may include the Dow Jones Industrial Average) and (ii) baskets of indices where index fees are paid to each index provider;

- We are also concerned that the "*Use of non-standard assets for investment purposes*" could be read widely so that Products which provide access to assets which otherwise would not have been available to the end investors directly would be included within this indicator, for example we query whether emerging market equities (including Brazil, India and China) would constitute non-standard assets for the purposes of this indicator;

- We query whether "*Products where the customer is attracted by a teaser rate and then tied in*" and "*Products with features outside the core range (e.g. "bells and whistles" or "gimmicks" of little use to most customers or at significantly higher margin)*" may catch common Products such as bonus certificates.

Chapter 4 (The emerging supervisory approach)

Effective product governance processes

We fully support the need to have effective product governance processes in place within product providers and recognise the FSA's desire to scrutinise these processes (as set out in chapter 4 of DP11/1).

We believe that an important element of achieving the FSA's aims of preventing significant consumer detriment is the effectiveness of a product provider's internal product governance processes. Such processes ensure that controls are in place to consider a number of characteristics in relation to a Product that may raise concerns, e.g. design of the product, distribution strategy (including consideration of the target market) and approval of the product.

JAC Principle 3 recognises the importance of product governance processes of product providers and states that such processes must be appropriate for retail structured products. This JAC Principle suggests that the following issues may be addressed in an approval process: sign off, product structuring, risk-reward and distribution. We believe that compliance with this JAC Principle helps to ensure effective processes are put in place by firms.

The assessment approach set out in DP11/1 to the risks posed to consumers includes reviews of a firm's policies and procedures relating to product development and their effectiveness. We agree that this is an important element of the FSA's assessment approach and that compliance with the guidance set out in the RPPD and JAC Principles seeks to encourage effective governance processes.

An important element of the pre-sale stage of a Product (and so a firm's product governance processes), is the assessment of the distributor. In ensuring that appropriate distributors are appointed, product providers seek to ensure that Products will be distributed responsibly. JAC Principle 7 provides for the use of a "know your distributor" approval process (e.g. on the basis of typical client type, use of sub-distributors, suitability assessment processes, regulatory status, reputation and compliance with selling laws) to ensure that appropriate distributors are appointed. We, therefore, agree with the inclusion of distribution strategy in the assessment approach factors (subject to our comments below) and believe that this is already covered by the JAC Principles. The extent of any assessment should also be tailored to the roles performed by the parties. This will primarily turn on the question of who is responsible for product design: where the distributor is responsible, then it seems inappropriate to have the

manufacturer of the product be responsible for dictating the target market (as is implied by paragraphs 3.44 and 4.25 of DP11/1).

A key part of preventing consumer detriment is the use of appropriate disclosures in product documentation. We, therefore, believe that in seeking to meet the consumer protection objective, firms should ensure that clear, plain language is used when describing the product, including its risks when developing a product. This, again, is emphasised in the JAC Principles, at JAC Principle 6 which requires that term sheets should be accurate, fair, balanced and clear and presented in a way that is consistent with their agreed obligations to the distributor. However, in relation to the proposals set out in chapter 6 of DP11/1 in relation to mandated risk warnings, we consider that it would be extremely difficult, and possibly dangerous, to provide for mandated risk warnings, as such risk warnings would be dependent on the characteristics of a particular Product.

Chapter 6 (Additional product intervention options)

Banning products

Chapter 6 of DP11/1 sets out the proposal that the FCA may be able to ban products. We agree that harmful products should not be available to investors (considered in light of whether the product is, in fact, harmful or whether it could be sold in compliance with suitability obligations to certain investors).

This proposal must be considered in light of the MiFID Review proposals to enable national regulators and the EU to ban certain high risk products. In addition, the HMT Consultation also proposes powers of intervention of the FCA in relation to the ban of a product. Product banning is fraught with risks, and should occur only following consultation on detailed rules governing the basis of product bans, appeal rights and due process.

We consider that an extremely careful analysis will need to be conducted before a proposal to ban a product is effected and so such power would need to be used proportionately. In relation to the proposal to introduce minimum criteria for products and banning certain features are also envisaged. We consider that it would be difficult to specify such criteria or features in isolation. We are particularly concerned about the penumbra effect that product banning could have – whereby banning a particular missold product on particular grounds causes a spate of spurious claims in relation to products which may have similar characteristics but which were not missold and were in fact suitable/appropriate at the point of sale.

In addition, there are timing considerations for the regulator in exercising any banning powers. Following intervention by the FCA, there may be a perception that the FCA has acted too late in circumstances where detriment has already been caused to some investors. This presents moral hazard for the regulator in determining when to ban a product at a time when the product has already been made available to some investors, which risks knee-jerk responses to emerging issues. In addition, the banning of a product where sales have already been made to investors will lead to uncertainty for product providers and distributors in relation to such sales. This uncertainty may have the unintended consequences of stifling innovation and choice for consumers and increased costs of Products to protect against the risk of a Product being banned.

Pricing

Chapter 6 of DP11/1 provides for a more interventionist approach in relation to the pricing of products.

We believe that the potential for consumer detriment arises in relation to pricing where a Product and its documentation does not reflect the time/value of the Product. This means that the product documentation does not reflect the value of the product across the life of the product. We have set out below relevant considerations in relation to Products which are "buy to hold" and also utilising a secondary market in a Product. We do not agree that the appropriate response is for the FCA to necessarily be involved in the pricing of products – instead, a product provider's effective product governance process should govern the pricing of a product.

A Product involves the assumption of risk by the product provider. Reflecting this risk, and also the value add provided by the product provider, the Product will typically include an embedded margin. That margin of a Product is not therefore the same as the profit to be made on a Product because it is at risk, being dependent on the characteristics of the Product and its pricing model. The margin made (or lost) on a Product is not comparable to an asset management fee, for example, for the product provider.

In relation to distribution fees, such fees must be disclosed to investors by the distributors (where they are subject to MiFID). We note that the Retail Distribution Review will also impact the payment, and disclosure to investors, of fees. This may rectify the perceived market failings around pricing and disclosure of commissions.

In relation to a defined return Product, an investor will receive what the Product documentation states the return on the Product will be. These are marketed as "hold to maturity" Products. As an accommodation to the needs of consumers, there may be a secondary market in the Product. The basis on which the secondary market is provided should be made clear to investors. In relation to the availability of the secondary market, it also is generally made clear that, prior to the maturity of the Product, the price an investor may receive for their Product on the secondary market may not be the price the investor paid for the Product (or price payable at maturity). It is, therefore, essential to ensure that investors understand the secondary market. This is reflected in JAC Distributor Principle 7 which provides that investors should be informed before investing of the likelihood of their being able to sell a particular structured product prior to maturity and the ways that this might be done. In addition, this Principle states that investors should be made aware that sales in the secondary market may be at prices that are below the amount payable on the product at maturity, the original offer price or price that they acquired a Product at.

Defined return Products are capable of meeting consumer needs that may not be met as effectively (or at all) by other investment products. The assumption of risk and accordingly reward for the product provider is intrinsic to the delivery of the Products and does not represent or give rise to consumer detriment provided that clear disclosure is made as to the effect of margin on secondary market pricing.

DP11/1 proposes that the product provider has a duty to consider the appropriate overall charge for Products, this being particularly relevant where there is a risk that the total charge is at a level that undermines the possibility of achieving a reasonable return. However, while we agree the product provider should consider the provider's overall charge for a Product, the product provider may not have knowledge of all layers of charges that the end investor will

incur when buying a Product, e.g. the costs imposed by the distributor and/or custodian the investor chooses to hold that Product with. The overall price of a Product should, therefore, be a factor that is taken into account by a distributor in their point-of-sale responsibilities when considering whether a Product is suitable or appropriate for a particular investor. It is therefore, important to delineate the responsibilities of a product provider and distributor when considering the appropriateness of the overall charge for a Product.

DP11/1 also considers the option of finding suitable benchmarks for Products in relation to pricing. We are concerned that this may inadvertently lead, even with the best of intentions and care, to potentially inappropriate benchmarks because of the inherent difficulties in identifying an appropriate benchmark, compounded further by situations where even a slight difference in the characteristics of a Product compared to the benchmark may render any comparison with the benchmark inappropriate for investors, even if the benchmark is the closest comparative Product.

Warnings about products

Chapter 6 of DP11/1 proposes the publication of a list of products that the FSA considers to be generally unsuitable for the mainstream retail market, e.g. leveraged ETFs. DP11/1 provides that this list is intended to act as a signal that the product is likely to only be suitable for certain segments of the retail market. However, we consider that the specific characteristics of each product would need to be considered, including the product documentation and information set out for the investor, before publishing a warning about an entire group of products.

We believe that labels of Products, for example, as leveraged ETFs, are no reflection of the inherent risk of a Product. As a result, the name of a Product is not necessarily indicative of the risk profile of that Product. It is, instead, the characteristics of the Product that determine the potential for consumer detriment. As a result, we do not consider that it would be helpful to have a list of products that are considered to be generally unsuitable for the mainstream retail market (with no reference to the characteristics that raise concerns). DP11/1 already provides a list of problematic product features (in chapter 3) which we consider is the better approach to identifying products that may cause significant consumer detriment.

Preventing non-advised sales

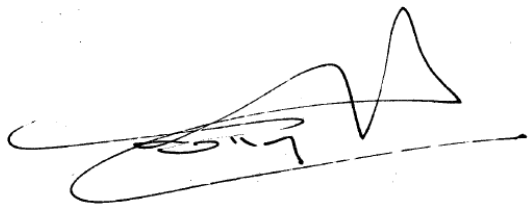
Chapter 6 of DP11/1 also proposes that the FCA may direct advised sales only of certain Products. We believe that this would result in restricted choice for a consumer where there is demand for the non-advised sale of a product (and, again, it would be difficult to provide a list of the products that would be subject to this requirement (for the reasons set out in the section above)). There are also point of sale appropriateness assessments that would need to be undertaken.

Investors should have the choice as to the basis on which services are provided, i.e. whether on an advised or non-advised basis. An investor's choice should, not, therefore, be limited by preventing execution only services in relation to certain Products and will depend on the sophistication of the client.

Pre-approval

We agree with the FSA's proposals, in chapter 6, that the FSA (or FCA) should not pre-approve Products. We believe that this would result in a potentially significant delay to the launch of a new Product and present moral hazard for the FSA.

Yours faithfully



Timothy R Hailes
Chairman, Joint Associations Committee

JAC contact – Richard Metcalfe, ISDA
rmetcalfe@isda.org, 020 3088 3552

Participating Associations

Since its founding in 1985, the International Swaps and Derivatives Association has worked to make over-the-counter (OTC) derivatives markets safe and efficient.

ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool.

Today, the Association has more than 800 members from 55 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 efficiently manage the financial market risks inherent in their core economic activities.

ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework.

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

The International Capital Market Association (ICMA) is a unique self regulatory organisation and an influential voice for the global capital market. It represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges, central banks, law firms and other professional advisers. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years. See: www.icmagroup.org.

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

AFME (Association for Financial Markets in Europe) promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association).

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76. For more information please visit the AFME website, www.AFME.eu

ATTACHMENT 3

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**)[1] 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[2].

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.

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[1] 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.

[2] 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.

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:

- 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 counties 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.

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

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.

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.

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[1]. 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

[1] 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).

jurisdiction or jurisdictions involved, the distribution channel(s) utilised, the precise nature of the products and the nature of the relationship between the parties.

Regulatory treatment may depend on the nature of the component instruments; for instance, depending on the jurisdiction, structured deposits or exchange-traded notes acquired by investors via brokers on a 'reverse-enquiry' basis may each require separate analysis. Among other matters, due consideration will need to be given to post-sale arrangements such as secondary market-making activity and information provision. The sponsoring associations invite industry to consider adapting the PD Principles, as appropriate, to take account of such specific factors.

B. PD Principles

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

1. Distribution to the retail investor in structured products in many, though not all markets, is effected through intermediaries, 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[21], or is responsible for a prospectus, or other offering memorandum, should, to the extent permitted by applicable laws and regulations[22], 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'[23] 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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[21] 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.

[22] 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.

[23] "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[24].

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

[24] 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[25], and other pertinent information.

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