



March 11th, 2011

Stephen Po
Senior Director, Intermediaries Supervision
Securities and Futures Commission
8th Floor, Chater House,
8 Connaught Road Central,
Hong Kong

Dear Stephen,

Joint Industry Written Contribution on Suitability Requirements for Market Intermediaries in Relation to Investors

At the meeting between IOSCO Standing Committee 3 – henceforth ‘SC3’ - and interested parties on December 3, 2010, you said that ahead of the next meeting of the Standing Committee (now scheduled for late March as we understand), it would be helpful to have a written contribution from the industry on the issues raised.

This letter and attached annexes constitute the written contribution of the Institute of International Finance, the International Banking Federation, and the Joint Associations Committee on Retail Structured Products, (the JAC)¹ together ‘the Associations’.

General Approach

The work of SC3 in this area stems largely from concerns over misselling of financial products, highlighted by the Joint Forum in its survey of suitability standards; the G-20 mandate to IOSCO to promote financial market integrity by reviewing business conduct rules; and IOSCO’s 2009 report on *Unregulated Financial Markets and Products* recommendation that IOSCO should review investor suitability requirements as well as the definition of sophisticated investors and strengthen these requirements as appropriate. The Associations note that SC3 has therefore been examining the issue of suitability standards for the sale of complex financial products both with regard to retail and non-retail investors.

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

The Associations both understand these concerns on investment protection and financial market integrity and support work on international principles to address them. It is of absolute importance that investors of all levels of sophistication and capability be treated fairly, honestly, efficiently and professionally, and appropriate standards on suitability analysis are essential to the pursuit of those goals.

The Associations therefore very much welcome IOSCO's engagement on this important issue. We would argue however that there is a further public policy interest in addressing this issue: that of mitigating any potential damage to investor protection from different or divergent national or regional approaches on these issues. Indeed, the Associations would very much encourage further work on convergence in these areas, which will become increasingly important in the years to come as markets continue to globalize and investors of all levels of sophistication and capability seek investment opportunities both in their home jurisdictions and beyond.

The Associations are therefore determined to engage in the most constructive and reasonable way possible on the issue both in offering observations to IOSCO and in acting to promote industry sound practice. We hope therefore that this initial contribution will be seen in this regard.

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

The Lessons of the Crisis

Whilst the Associations recognize the concerns of SC3 members over complaints from investors in certain jurisdictions since the financial crisis, the evidence available suggests that what actually happened was more complex and varied than simple misselling of products to investors (although that occurred in certain instances) and analysis of the issues must include consideration of a number of factors including:

- i. Instances where there was indeed misselling in the sense that products were inappropriately or inadvertently **marketed** to investors without due regard to their level of sophistication or capability, leading them to believe that particular products were suitable;
- ii. Instances of **inadequate disclosure** by either product originators or market intermediaries to investors, including where the disclosure did not fully cover the market risk and default risk and more generally failed to set out the worst-case scenario;
- iii. Instances where, despite requirements, the intermediary did not obtain **sufficient or updated information** about the knowledge, experience, or investment time horizon of investment of the client to enable it to give sufficient advice on the suitability of a potential investment;

- iv. Cases where there were adequate rules but where **enforcement** was lax or did not pick up breaches by individual intermediaries or providers;
- v. Cases, particularly for more sophisticated or capable investors, where marketing and disclosure was adequate, where the investor did not receive misleading or inappropriate advice, but where the investor either did not carry out **sufficient due diligence** with regard to the risks that they were undertaking or consciously made a decision to overlook the risk of default or weaker performance even though they were in a position to do so;
- vi. Cases where a client involved in an **execution-only** relationship with a broker ordered the purchase of an instrument, in a context where the broker did not have any duty of advice to the client, and did not make any assessment of the suitability of the particular product for the client, not being required to do so; and
- vii. There were cases where the **credit ratings** attached to certain products may have given an incomplete or possibly misleading picture of the risk of a particular product and where investors did not carry out an independent assessment and diligence, relying on the rating alone. We note that concerns were highlighted even before the height of the financial crisis, including in the *Final Report of the IIF Committee on Market Best Practices: Principles of Conduct and Best Practice Recommendations* of July 2008.

Moving Forward

In adopting a common approach therefore, the Associations believe that IOSCO should be mindful of this complexity and should take a **careful, targeted and proportionate** approach in developing common standards on suitability requirements.

In particular, the Associations do not believe that IOSCO should define its analysis of suitability issues around **complex products**. Such an approach would be difficult to implement and administer for regulatory authorities, firms and customers. For example, complexity does not always mean additional risk and conversely, some non-complex products may be higher risk. We believe that a more effective approach would be to look at all securities, collective investment schemes and related derivatives instruments and the balance of risk and reward associated with them.

The Associations also believe that any IOSCO approach should be ‘business model-neutral’ in that it should not prohibit, mandate or promote particular types of products or business models. We note that the US Securities and Exchange Commission (SEC) in its recently published ‘*Study on Investment Advisers and Broker-Dealers*’ endorsed this neutrality.

In moving to such a common approach, the Associations feel that it is useful to go beyond addressing the concerns on investor protection, financial market integrity and regulatory fragmentation and make clear the **outcomes** that international standards and industry practices should achieve. We would suggest the following:

- 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 advisor.
- A recipient of personal recommendations should expect the provider to take reasonable care in the provision of that investment advice.

The Associations believe that any approach should take account of the diversity and dynamism of the market for investment products. It should also take account of the gradations in sophistication or capability of investors and strike the right balance between adequate investor protections and the recognition of the duties of investors in the conduct of their own investment.

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

The Associations also believe that, in defining appropriate levels of protection, IOSCO should be mindful of a number of different factors:

- **Diversity of products:** there is a considerable variety of investment products, some offering similar returns, but through different legal structures. 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.
- **Diversity in the ways in which an investment exposure is assumed:** any approach should take full account of the many different avenues by which investment exposures are mediated to customers and the differing roles played by financial institutions in each - 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. In some cases, only one firm is involved in an “end-to-end” process (for example, this more likely with life assurance or structured deposit products). In others there could be many firms involved, and not all of them will necessarily be subject to the regulatory oversight of a single regulator or even located in the same jurisdiction. Among other things, it cannot be assumed: (a) that a firm engaged in product design necessarily knows who will ultimately acquire the product or have any direct relationship with investors; or (b) that a firm that sells a product will necessarily be appointed to give advice or have any continuing relationship with the investor – the investor may appoint it to do these things, but equally the firm may only be asked to execute a trade.
- **Phases in the distribution process:** in spite of the diversity highlighted above, from the point at which a product has been created, there appear to be three basic phases for the

distribution process: **pre-sale** (marketing, disclosure, information gathering on the investor); **point of sale** (advice, execution of orders); and **post-sale/ongoing duties** both with regard to the sale of an individual product and arising from an account relationship. There are also requirements or duties that should operate at all stages in the process.

- **The fact that there are different types of participant:** not only investors and market intermediaries but also product originators, packagers and issuers.

Looking at each of these factors in a sequential way can however lead to a great deal of confusion and a loss of perspective. Instead the factors need to be seen as gradations within an overall framework. A possible way of looking at this is set out in Annex 1.

Whilst the central focus of IOSCO's suitability work is clearly the point-of-sale phase and to a lesser extent, the ongoing obligations of market intermediaries in respect of changes in the performance or value of the product, as indicated above, the Associations believe that the broader context is critical in calibrating the intensity of regulation required.

Principles

In looking at how best to respond constructively to IOSCO on this issue, the Associations concluded that there would be value in suggesting principles to capture this complexity and in particular the different duties of different participants. Such principles could guide both conduct by market intermediaries towards investors and the aims of regulation in this area.

We attach such a set of possible principles in Annex 2, prepared with the input of industry experts from around the world and constituting some initial thinking to assist IOSCO in its deliberations on suitability requirements. These are very much preliminary suggestions but should help address the concerns of investors and IOSCO members, leading to improved investor protection.

The Associations believe that the Principles could apply to all forms of securities, collective investment schemes and related derivatives instruments referred to in the Principles as "investments". They should apply whenever a firm deals or provides services in relation to investments with or for a person on whose behalf it is acting.

The Principles should be applied in a way that recognizes the relative sophistication, capability and ability of the customer concerned to bear investment loss. However in doing so, there must be recognition (i) that customers' investment decisions are dependent on a range of factors, not all of which are within the sphere of influence of intermediaries; and (ii) that customers have ultimate responsibility for their own investment decisions.

Conclusion

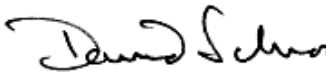
The Associations both welcome and support IOSCO's engagement in this area. Global standards both here and on the linked issue of client categorization would be in the interests of investor protection and financial market integrity. As noted above, it is of absolute importance that investors

of all levels of sophistication and capability be treated fairly, honestly, professionally and efficiently. Appropriate standards on suitability analysis are essential to the pursuit of that goal.

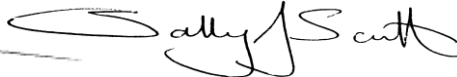
The Associations have therefore been determined to engage in the most constructive and reasonable way possible, whilst reflecting the complexity of the issue and promoting a careful, targeted and proportionate approach. We hope that the attached Principles and Framework Matrix will assist in delivering this and with achieving the desired outcomes set out above.

We would be very happy to discuss with SC3 if desired and to explain further the Principles, Framework Matrix and underlying approach. If you have any questions do not hesitate to contact either Richard Rosenthal – Richard.Rosenthal@morganstanley.com – or Crispin Waymouth – cwaymouth@iif.com.

Yours faithfully,



Mr. David Schraa
Director, Regulatory Affairs
Institute of International Finance



Mrs. Sally J. Scutt
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Mr. Timothy J. Hailes
Chairman
Joint Associations Committee

cc: Raffaella Pantano, CONSOB, Chair of Suitability Working Group, IOSCO

Greg Tanzer, Secretary-General, IOSCO

Hans Hoogervorst, AFM, Chair, IOSCO Technical Committee

Steven Maijoor, Chairman, ESMA

Maria Velentza, Head of Unit, Securities Markets, European Commission

Ethiopsis Tafara, Director, Office of International Affairs, Securities and Exchange Commission

Jacqueline Mesa, Director, Office of International Affairs, Commodities Futures Trading Commission

Attachments:

Annex 1: Framework Matrix

Annex 2: Principles

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Framework Matrix

The matrix below attempts to provide clarity on the options and issues by looking it in terms of two axes:

- The point in the process of advising and selling the product, broken down into four broad time frames: principles operating at all stages; principles operating before an investment is recommended or sold; principles applying at the point of transacting; principles applying post-transaction/ on an ongoing basis.
- The extent of the duty of the market intermediary at a particular point in the process, operating along a spectrum from a very high degree of care for the client at one extreme to *caveat emptor* (subject to a duty of honesty and fairness) at the other.

It should be noted that the matrix does not look at the additional dimension of the relationship between the intermediary and the originator/ manufacturer. This is though important and should not be lost in the approach. If the table were '3D', this would be the third axis.¹

Point in Time		Extent of Sophistication and Capability of the Investor		
		Low	Medium	High
All stages	Handling Conflicts			
	Communications with customers			
Before an investment is recommended or sold	Pre-service information			
	Product assessment			
	Understanding the customer			
At the point of transacting	Suitability of investment recommendations			

	Information before transacting with or for a customer	
	Dealing where the investment does not involve assessment of suitability	
	Dealing	
Post-transaction/ Ongoing	Information once a customer has acquired an investment	
	Ongoing suitability assessments	

Note that the Joint Associations Committee has issued two sets of Principles that are relevant here: “*Retail Structured Products: Principles for managing the provider-distributor relationship*” and “*Structured Products: Principles for Managing the Distributor-Individual Investor Relationship*”. These are available on ISDA’s website.

Principles

Outcomes the Principles should help to support

- The purchaser 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 advisor.
- A recipient of personal investment recommendations should expect the provider to take reasonable care in the provision of that investment advice.

Principles

1. Principles applying in all stages of the distribution process

1.1 Relevant financial instruments

Consideration a. The Principles should apply to all forms of securities, collective investment schemes and related derivatives instruments referred to in these Principles as “investments”.

Discussion: The Associations have limited their focus to instruments that are covered under the scope of IOSCO’s remit rather than to all investment products (e.g. insurance products). This is not to ignore the wider international discussion on the distribution standards for other categories of product (and within the EU in the context of the Packaged Retail Investment Product (PRIIPs) consultation) but we felt that attempting to address it here would go beyond SC3’s mandate and requires further consideration. The Associations also do not believe that IOSCO should define its analysis of suitability issues around a category of complex products. Complexity does not always mean additional risk and conversely, some supposedly non-complex products can be very risky. We believe that a more effective approach would be to look at all products and types of securities investments and the balance of risk and reward associated with them.

1.2 Customers and firms

Consideration b. The Principles should apply whenever a firm deals or provides services in relation to investments with or for a person on whose behalf it is acting (referred to in these Principles as a “customer”). In these Principles, a firm acting in that capacity is referred to as an “intermediary”. Where a firm is responsible for structuring and issuing or arranging for the issue of an investment, it is referred to in these Principles as a “product producer”.

Discussion: There is recognition that there are different classifications and categorizations around the definition of customers/clients/counterparties, etc across the world. For the sake of simplicity, we have used the expression “customer” in these principles to cover those persons on whose behalf the firm is acting (while recognising that a firm may have relationships with counterparties who will not be customers because the firm will be dealing with them at arm's length, for example in a dealer-to-dealer relationship). There is also recognition that a single firm may act only as a distributor of financial products, or only as a

product producer, or in both capacities. We have attempted to address these differing capacities in the Principles.

Consideration c. The Principles should be applied in a way that recognizes the relative sophistication, capability and ability to bear investment loss of the customer concerned.

Consideration d. In applying the Principles, there must be recognition (i) that customers' investment decisions are dependent on a range of factors, not all of which are within the sphere of influence of intermediaries; and (ii) that customers have ultimate responsibility for their own investment decisions.

Means for Implementation:

An intermediary should assume that natural persons have the least sophistication, capability and ability to bear investment loss and large institutions the most. However, this is only a starting point so that, for example, high net worth customers with sophistication in the relevant investments or access to additional support, might be treated more like institutions.

An intermediary should make clear to its customer at the outset what assessment it has made and the implications of that for how it will treat the customer.

Customers should be able to agree a different approach with the intermediary, recognizing: (i) that it may have cost implications; (ii) that the customer may need to provide more information to the intermediary; and (iii) that it may mean that the range of investments available to the customer is more restricted.

In line with Considerations b and c, where an intermediary deals with institutional customers as its equals, and they are not relying upon it for the provision of personal investment recommendations or the exercise of discretion on their behalf, the duty of that intermediary towards such customers will necessarily be very limited.

Discussion:

(a) The reference above to firms with whom an intermediary deals as its equal is intended to reflect the sort of situation contemplated, for example, in the EU regulatory rules in relation to eligible counterparties and thus to apply to inter-dealer relationships. In such cases, whilst the firm will still owe the counterparty a minimum duty (e.g. around disclosure of conflicts of interest), its duties will be very limited on the basis that the counterparty is in a position to adequately protect its own interests.

(b) A number of regulatory regimes specifically distinguish between retail and institutional customers. In addition, the EU regime, for example, also contemplates that a customer can move up the ladder if certain sophistication criteria are satisfied and that firms and customers can also agree a higher level of protection. We believe that customer categorization is an important part of the overall framework which needs to be acknowledged within the Principles. While we do not believe that the Principles should focus on the details of this

categorization, we do believe that there is a compelling case for developing a non-exhaustive international understanding as to those categories of customers who can always be treated as falling within the “professional/institutional” category, for all purposes and wherever located. In addition, where national regulators make more detailed rules, they should be encouraged to introduce a distinction between retail/institutional customers (with the ability for customers to opt to move between the two), only applying the full regime to the former. In order to assist certainty (and therefore avoid potential costs) the tests for distinguishing between the two need to be as objective as possible (for example, using indicators such as regulatory status and size).

(c) In the Principles below and in line with the approach being taken by IOSCO, reference is made to ‘suitability’ obligations and assessments. It should be understood though that the Principles are consistent in approach and intended effect not only with those jurisdictions that apply or seek to apply a ‘suitability’ requirement but also with those jurisdictions or regulatory authorities that apply a ‘fiduciary’ duty.

1.3 Dealings with customers – handling conflicts

Principle 1. *An intermediary should ensure that its customers are fairly treated. In doing so, it should try to avoid conflicts of interest that could have a material adverse effect on their customers and, when they cannot reasonably be avoided, mitigate them, including through disclosure to the customer.*

Principle 2. *An intermediary should not in relation to any service provided to a customer receive a payment or benefit from any person or provide any payment or benefit to any person other than the customer unless: (i) its receipt will not have a significant adverse effect on the discharge of the intermediary’s duties to the customer (for example, by creating commission bias); and (ii) its nature and amount is clearly disclosed to the customer before the service is provided. Where it cannot be ascertained before provision of the service, the basis upon which any amount will be determined should be disclosed and the market intermediary should provide further details once they are available if the customer requests it.*

Discussion: The Associations are aware that there is a wider debate as to the future role of product provider commissions. The underlying principle is that the quality and outcome of a service to a customer should not be undermined by these commissions regardless of the business model being used by the intermediary.

1.4 Communications with customers

Principle 3. *An intermediary should make adequate disclosure of relevant material information in its dealings with its customers. All communications should be clear, fair and not misleading.*

Means for Implementation:

An intermediary should also respond appropriately to customers’ requests for information, bearing in mind that this may have a cost for the customer.

An intermediary should avoid making a communication in relation to investments that could lead customers to believe that the intermediary is

making an investment recommendation to them unless that is the intermediary's intention and its intention is made clear in the communication.

Discussion: The Associations believe that this Principle is fundamental and is relevant regardless of the level of sophistication or capability of the investor

1.5 Culture and capability

Principle 4. An intermediary should:

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

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

Means for Implementation:

An intermediary should take reasonable steps:

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

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

Discussion: The Associations recognize that the objective of building the right culture is critical and believe that it deserves greater attention in international standards of good practice than it has hitherto received. It would be possible to draft ever more detailed sets of rules and to require staff to memorize them. However, even with the best rules in the world, if culture is weak, they will provide only limited protection against the "wrong" decisions being made in the heat of the moment, or even in the ordinary course.

Principle 5. Firms should take appropriate steps to manage their relationships with other firms in the investment distribution chain.

Means for Implementation:

Where a firm is one of two or more firms involved in the process whereby an investment exposure is assumed by a customer it should consider the following:

(a) Whether the others are appropriate for their role including, where necessary, undertaking due diligence in order to assess whether the standards and processes of another firm in the chain are sufficiently robust.

(b) Where law and regulation do not distinguish sufficiently between the roles and duties of those involved, whether this could create legal or regulatory

uncertainty and the possible consequences. Where necessary, it should take steps to reduce or eliminate uncertainty, including by defining its relationship contractually or otherwise in writing.

Product producers should ensure that materials they produce or for which they are responsible, such as term sheets, which are to be used in the distribution process are fair, balanced and clear (respecting, as appropriate, jurisdiction-specific regulation to this effect) and are presented in a way which is consistent with their agreed obligations to the intermediary. Where product producers agree to provide an intermediary with information to enable the intermediary to create its own customer materials, this should be clear and of the kind requested by the distributor.

Discussion: Three years ago, a number of industry associations (including the ESF, ICMA, ISDA, AFME and SIFMA) – collectively the Joint Associations Committee - developed with their members and have since sponsored two sets of principles designed specifically for firms acting as product producers and distributors in the structured products market: *Retail Structured Products: Principles for managing the provider-distributor relationship*, and *Principles for managing the distributor-client relationship*. Both are available on the ISDA website. A number of the Principles reflect those documents, particularly this Principle 5.

2. Principles that are relevant before an investment is recommended or sold

2.1 Pre-service information to customers

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

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

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

(c) the basis of its remuneration.

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

Means for Implementation:

The nature and level of disclosure should be commensurate with the service to be provided. However, where the service involves the provision of personal investment recommendations or discretionary management, the intermediary should make clear whether the service is independent or provided on some other basis. The intermediary should explain how the basis on which the

service is provided could affect the recommendations given or decisions taken on behalf of the customer. For intermediaries operating exclusively on an 'execution-only' basis, their clients should understand that they will not receive any investment advice for any transaction.

2.2 Product assessment by market intermediary

Principle 8. *An intermediary that markets investments or provides personal recommendations or discretionary management in relation to investments must understand the features and characteristics of the investments concerned and their risk/reward profile and material risk attributes. In assessing any investment, an intermediary should exercise its own judgment in a manner consistent with responsible professional opinion.*

Means for Implementation:

An intermediary providing personal recommendations or discretionary management will be unable to ascertain the suitability of the investment for a customer's needs unless it performs this assessment. It should not place undue reliance upon statistical modeling tools and should assess any tools used sufficiently to understand their shortcomings.

In assessing the suitability (as referred to in Principles 10 and 11) of an investment for a particular use, intermediaries can take into account whether a particular investment is subject to product or transparency regulation since these are relevant to whether it is likely to be suitable for investors of a particular class.

2.3 Understanding the individual customer

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

Means for Implementation:

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

3. Principles applying at the point of transacting

3.1 Suitability of personal investment recommendations or investment management decisions

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

Means for Implementation:

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

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

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

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

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

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

Discussion: Consistent with our comments on Considerations (c) and (d) above, it is important that the application of Principles 9-11 takes full account of the sophistication and circumstances of the customer receiving the service. For example, it is likely to be inappropriate for a firm to have to gather the same amount of information about a sophisticated institutional client as it would a private individual in order to advise on an identical type of transaction. The application of the Principles also needs to take account of the circumstances in which any recommendation is made; it should not catch, for example, the exchange of trading views. In the case of portfolio management rather than *ad hoc* investment services, the client would not necessarily need to understand any particular investment, but should understand the overall investment strategy, objectives and risks related to the portfolio managed on his behalf.

3.2 Information before transacting with or for a customer

Principle 12. *Subject to Principle 13 and to Section 3.3 below, before transacting in an investment with or for a customer (or upon recommending the transaction to the customer) intermediaries should take all reasonable steps to satisfy themselves that the customer has sufficient information on the investment in a form the customer is reasonably likely to understand so that the customer*

has had an adequate opportunity to understand the risk/reward profile and other material characteristics of the relevant investment before making any decision whether to enter into the relevant transaction. Where the customer subsequently decides to proceed, the intermediary is entitled to assume that the customer has properly considered the transaction and its risks.

Means for Implementation:

In deciding what information needs to be provided, how and when, intermediaries should have regard to the IOSCO Principles for Disclosure of Key Information in regard to CIS Prior to the Point of Sale, as appropriate to the type of customer concerned.

Principle 13. ***The information requirements in Principle 12 do not apply where the decision to transact is made in the ordinary course of performing a discretionary investment management mandate in accordance with its terms.***

Principle 14. ***Where the market intermediary makes a personal investment recommendation to the customer, it should communicate clearly to the customer the basis of the recommendation and retain a record.***

Discussion: As reflected in Principle 5, product producers also have an important role to play in ensuring that product information provided by intermediaries to customers (whether prepared by the product producer or the intermediary) is of an appropriate quality.

3.3 Dealing where the service does not involve an assessment of suitability

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

Means for Implementation:

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

Discussion: Principle 15 applies in relation to a proposed transaction in an investment of a sort on which customers of the sort concerned would commonly take advice where there is no indication that customer has received professional investment advice from elsewhere.

3.4 Dealing

Principle 16. *Subject to complying with a customer's express instructions, when executing an order for a customer, an intermediary should take all reasonable steps to achieve "best execution".*

Discussion: The concept of "best execution" has received considerable regulatory and industry attention and has been subject to detailed definition, with regional variations. It is not feasible to capture all of that in high level principles of this sort. By including the expression in quotation marks, we have sought to reflect the fact that it should be understood as a term of art, by reference to local usage of that expression or other expressions designed to describe a similar concept.

4. Principles applying post-transaction/ on an ongoing basis

4.1 Information once a customer has acquired an investment

Principle 17. *The intermediary should provide information on the performance and value of the investment (and where it is comprised in a portfolio, on the portfolio) which is appropriate in frequency and detail in the context of the services the intermediary has agreed to provide on an ongoing basis.*

Means for Implementation:

There is no on-going duty to assess the suitability of any investment except as contemplated in Principle 18.

A firm that provides no more than a custody service should account regularly to the customer for the investments it holds, but is not required to provide performance information.

Discussion: Where such a service is being provided, the intermediary should also respond appropriately to customers' information requests, bearing in mind that providing additional information may have a cost for the customer.

4.2 Ongoing suitability assessments

Principle 18. *Where the intermediary and customer expressly agree, an intermediary should assess the suitability of an investment the customer has acquired as a result of its personal investment recommendation or the exercise of its discretion on behalf of the customer at such intervals as the customer and intermediary may agree.*

Means for Implementation:

This is most likely to be the case in relation to the provision of a discretionary investment management service where the suitability assessment is generally likely to be on-going. However, it may also be the case in relation to an advisory service if, for example, the intermediary and the customer agree that the intermediary that gave the original advice will also provide a periodic

review. The factors relevant to the original assessment will generally be the same for any subsequent assessment. However, information obtained about the customer for the purposes of the original suitability assessment should be revised as appropriate by reference to the on-going service to be provided.

Discussion: It is critical that this Principle should only apply where there is an express agreement between the intermediary and the customer providing for an on-going service of this sort post-transaction.