

Legal & Regulatory Developments in Structured Retail Products

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Agenda

- Options for Retail Structuring
- International Focus on Structured Products
- Relevant EU Issues
- FSA Initiatives
- Recent Cases
- Themes for the Future

Issues in UK Retail Structuring

- Securities Regulation
- Conduct of Business Regulation
- Consumer Protection Law

Scope of Securities Regulation

- Retail Bonds & Warrants
- Listed Wholesale Bonds & Warrants
- Highly Structured Notes
- Closed Ended Investment Companies

Conduct of Business Regulation of Securities Offerings in the UK

- Effective ban on direct offers of derivatives
- Derivatives may only be the subject of an advised sale, or bought on a discretionary basis, where a full suitability fact-find has been done on the client
- Derivatives includes most structured bonds, warrants and notes but not shares in closed-ended investment companies

Avoidance of Securities Regulation – UCITS Regulated Funds as Repackaging Vehicles

- Public offerings of open-ended fund units fall outside securities regulation and bars on derivative distribution
- S.238 FSMA prohibits the public offering of unregulated fund units in the UK
- Public offering of UCITS must be done using a prospectus in the form required by the FSA CIS Sourcebook
- Liability for UCITS prospectus
 - Strict liability subject to due diligence
 - Directly actionable only by private person

Retail Repackaging – Other Products

- Structured Deposits
- Life Policies
- Retail OTC Derivatives

International Focus on Retail Distribution of Structured Products

- CRMPG II
 - Identifies sales of complex products to retail investors as an issue of “heightened reputational risk”
 - Recommends “know your distributor” procedures

- NASD Guidance
 - Product disclosure and fair advertising
 - Suitability
 - Risk control systems
 - Training

EU Issues

- Prospectus Directive
 - Requires consolidation of the distribution chain for public securities into a single “offer”

- Markets in Financial Instruments Directive
 - Draft conduct of business rules
 - Art 10(1)(c) – a distributor who has done suitability on a client may not recommend to that client a product which he does not believe that the client understands
 - Art 11- a distributor may not provide an execution-only service in a complex product (including any derivative)
 - Art 19(3) – all clients must be provided with information as to financial products, including appropriate risk warnings, in a form comprehensible to them

FSA Treating Customers Fairly (TCF) Initiative

- Expansion of Principle 6
“A firm must pay due regard to the interests of its customers and treat them fairly”
- TCF addresses the whole sales cycle, from structuring to complaints handling
- Applies the same test to steps which take place between institutions as to those which take place within them
- Is being implemented this year through ARROW review

Obligations of Product Structurers and Designers under TCF

- Product provider must consider
 - How the product would perform in different market scenarios – stress-testing
 - Which target groups of customers is the product suitable for – and which not
 - How can the products features and risks be made comprehensible to customers
 - Will the product material enable intermediaries to understand and explain it
 - Whether there is a requirement for infrastructure (valuation, reporting, complaint handling) after sale

FSA Identified Problem Areas

- Handover between technical and sales people
- Provision of information to distributors
- Relying “excessively” on distributors having specialist knowledge
- Inadequate training of service staff to handle queries from distributors after product launch
- Inadequate post-sale systems and complaints handling

Recent UK Litigation

- Seymour v Ockwell
 - Liability of a product provider for activities of intermediary

- Peekay v ANZ
 - Liability of a distributor for inaccurate marketing

Common Elements of Regulators' Concerns

- Accurate information about the product
 - Information provided to sales staff
 - Control and training of sales staff
- Adequate, balanced risk disclosure
- Class based suitability analysis
- Risk assessment and control systems by appropriately senior management
- Liability for activities of third parties

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