**Structured Products Compliance Checklist**

**Structured products and what to look out for when doing due diligence**

What is a structured product? ‘Structured retail products’ (SRPs) are compound financial instruments that have the characteristic of combining a base instrument (such as a note, fund or deposit) with an embedded derivative(s) that provides economic exposure to reference assets, indices or portfolios. In this form, they provide investors, at predetermined times, with pay-offs that are linked to the performance of (those) reference assets, indices or other economic values.

No matter what proceeds this, the big rule with due diligence is don’t try to de-risk it – just understand and deal with the risk as it is.

It is important that you understand what the intended outcome is of due diligence – I suggest it is simply to understand any potential source of investor detriment and ensure that due consideration is given to the interest of investors.

**Due diligence could therefore include the following headline considerations:**

1. General organisation of the product manufacturer’s governance arrangements including product design and product testing;
2. Target market and resultant distribution strategy (ie what clients the product suits and how to target only them – considerations can include things like the market(s) to which the client will be exposed, and the duration before results are delivered); The key to the target market question however is to ensure the clients have sufficient knowledge and experience to understand the structure, and payoff function in order to be able to make an informed investment decision:
3. The value at the date of issuance and transparency of costs;
4. The exit strategy - secondary market and redemption;
5. The review process;
6. When providing manufacturers’ materials to clients, whether they understand the information included, asking the manufacturer to supply additional information or training where that seems necessary to understand the product adequately; and not to distribute the SRP understanding is lacking.

**It is also useful to inwardly reflect with cost related questions like**

1. Would a professional client buy the product at the price at which it is being offered to retail investors?
2. Are all cost and price calculation principles clear and transparent?
3. What costs and fees for the retail investor are associated with the product?
4. Are all charges and fees transparent to the investor?
5. How are the interim / annual reported values established?
6. Are the same pricing model and valuation techniques as at the time of the original pricing when the terms of the product were fixed, being applied?

**In order to be able to deliver a compliant suitability letter, the following information on risk should be ascertained**

1. The conditions of trading on the secondary market
2. The methods used to determine the secondary market price of the product;
3. The means used to inform investors about the secondary market price of the SRP they hold; and
4. Possible costs associated with the clients’ market transactions and with the making of the secondary market. As well as appropriate information on costs associated with redemption from the SRP.

**Systems and controls around structured products should be clear,**

**written and auditable. They should**

1. Define the steps to be followed before ANY structured product can be sold
2. Describe the records that must be kept supporting the research
3. Define the roles, powers and responsibility of those conducting the due diligence and those selling the product – it is good practice to have at least 2 un-conflicted people involved (e.g. a researcher and a compliance manager)
4. Have a review process – is the procedure working?
5. Collect relevant MI on the product (complaints, performance, secondary market efficiency etc)
6. Define a performance measure that will trigger a freeze on distribution

**The following is a list of due diligence questions an IFA may legitimately ask of a manufacturer – it is not an all-inclusive list**

1. For each SRP manufactured and/or distributed, does a key decision function or committee take responsibility for the product governance arrangements within the firm?
2. How are investors’ interests taken into account?
3. How is the consumer protected from the risk of offloading assets or liabilities from the manufacturer’s own balance sheet / trading book?
4. Are the necessary financial engineering aspects of the product clearly set out in the KFD?
5. What back testing procedures are in place to ascertain how the product may have performed in the past – what were the results and how are they disclosed?
6. This Checklist is derived from the IOSCO, regulation of retail structured products Consultation Report, April 2013, p. 6-7 (IOSCO CR 05/13, 18 April 2013).