Dear all,

I am sharing these comments on my personal account, and not the one of my employer.

If I fully understand, what you are trying to do is to make sure that any distributor of product has a full knowledge of what it is distributing and therefore can inform the final investor adequately of what investment he is acquiring. The paper then goes one step further in making sure that the issuer/sponsor of the product has some feedback on what the investors thinks, and who is looking to acquire the issuer’s/sponsor’s product, so it can adapt its offering / product positioning.

On a purely philosophical point of view, you are trying to write a marketing training book. The main risk with putting these philosophical questions into a rule book is that it risks freezing an industry and eventually moves it away to other jurisdictions. You can then create more barriers, and you will then engage in a legal down spiral. So, it is very important that such regulation is limited to what is really necessary to protect the customers and does not try to define and regulate everything.

Your proposed regulation is asking product issuers to define within a given framework where their product stands in the risk reward scale. The risk is forcing them to over describe the product, which will just lead to the creation of a large volume of disclaimers that nobody will read, and then you might as well not have anything to read. Adapting simplified descriptions like beta, volatility, daily NAV risk’s distribution, etc. requires advanced financial market knowledge. So, where do you find the right balance, and is it possible to regulate it? My view is no, but more of that later.

Before going further, let’s go back to basics. Where does this all attention come from? It originated in the fact that some US real-estate linked structured products were sold on a large scale to unsuspicious investors who did not realize that they were buying highly structured mortgage back instruments linked to US private home mortgages, and that US borrower could walk away from their mortgages Scott free. They thought in terms of European mortgages, where in the ‘70s you went to jail and were ostracized from society for not paying back your debt/mortgage. In the US, it was common to have Facebook discussion as to whether one should just default on his mortgage to save some money.

Now, putting the blame on distributors, imposing a whole regulation on every single asset distributor just because a few US based entities did not explain the US mortgage law to European investors, and because the European investors did not inform themselves about the risk linked to these investments, is an overkill. Does it mean we need to do nothing, no, but certainly not what this paper does, which is to handcuff a whole industry to prevent a few rogues people to go around miss-selling.

What is required is:

* To make sure that the product describes properly the investment process of the investment vehicle, which is what a fund prospectus should do, and what the fund authorities already verify;
* To make sure that any structured product sold as a certificate or through any other legal vehicle than a fund structure, has the same level of underlying investment process description and risk description; that needs to be enacted;
* That, when sold to a target investor which is not deemed to have the knowledge of the underlying assets, a proper description of these assets and their risk is given to that investors; that is regulated by the sale’s person regulator;
* That the ultimate sales person (would it be the discretionary asset manager or the electronic platform) has an acknowledgement from the investor that he understands what he is buying.

But, what should not be regulated is:

* The fact that the ultimate sales person needs to understand the product itself: that is already covered by the sales people’s regulators;
* The fact that the sales people need to ask for the relevant documentation from the issuer: given the rules that regulates a sale person, he should know he can’t sell something he does not fully understand and is already responsible under these rules for understanding what he sells;
* The fact that the sale person needs to give some feedback to the issuer: that is a basic distribution practice that does not require a law and that has not penal logic,
* The fact that an investor can fully rely on the sales person to decide what he can/should invest in: an investor who does not trust his investment advisor should change advisor, or should impose to the sales person/investment advisor a remunerations structure linked to the performance of the assets he acquired through him, this is much more effective than volumes of regulations.

So, to me, this regulation is the wrong solution to the wrong problem. The real question to address is: what drove US sales people to sell to European investors assets they did not understand? What drove European institutional investors to acquire assets they did not understand? Mainly two reasons:

* The US sales people were remunerated on volume, not the underlying asset’s performance
* The European investors were ignorant of the US mortgage bankruptcy laws and
  + at the retail level, believed sales people who were remunerated on volume,
  + at the institutional level, had no link between their remuneration and the performance of the assets they acquired, and thus no reason to do their homework.

Once you accept these facts, you realize that the solution is not to overregulate the sales process, but to change the decision process of the actors.

If you regulate the industry processes, you force the company employing the sales people to monitor them; if you change the sales people / institutional investors’ remuneration process, you force these actors to change their behavior, regardless of how rogue/riskless their employer might push them to be.

NB: I have worked for twenty years on a trading floor in different banks across various regions and have seen various sales people’s behavior in various cultures, geographic, ethnic or corporate specific. Any miss-selling had always its origin, not in the regulation trying to rein sales practices, but in the remuneration structure of the sales people and its over-head structure.

Change these remuneration structures from a volume driven fee to an underlying assets’ performance driven fee (for sale people and assets managers alike), and the whole industry will change by itself, without need of further regulation. If the actors suffer when the end customer suffers, and thrive when they thrive, they will make sure the end customers do not suffer but thrive. This current regulation does not create this dynamic.

NB: As a background, I have worked for twenty years in various main stream international bank’s trading floors in different sales, product structuring and trader capacity, and for several years as an asset manager. I worked in Asia, Middle-East, Europe and the US, thereby gaining abroad view on the whole industry.