

# Structured investment products suitability assessment template – FAQs



The following frequently asked questions (FAQs) are to help firms understand and interpret the **structured investment products suitability assessment template**, which we published on 27 October 2009. The FAQs should be read in conjunction with the **explanatory note** that accompanies the template. They do not replace that explanatory note, but provide further clarification on key areas.

The FAQs, template and explanatory note:

- are relevant to all business types providing advice or investment management services on structured investment products, including private banking and discretionary portfolio management services;
- are limited to sales where the suitability test applies; and
- apply to a wide range of structured investment products, including capital protected plans, collateralised plans and Structured Capital at Risk Products (SCARPs) – further information on the scope of the template is provided in the explanatory note.

The FAQs focus on specific aspects of risk that are particularly pertinent to structured investment products (e.g. loss of capital arising from counterparty risk) where the industry has requested further clarification. Other risks associated with structured investment products that are not covered in the FAQs (e.g. market risk) must still be considered when providing advice or investment management services on structured investment products.

## Important legal note

These FAQs do not constitute Handbook guidance: They do not define the suitability standards for structured product investment advice. Firms should consider this communication as ‘FSA supporting material’, which is intended to help firms comply with the FSA’s rules and Principles.

## FAQs

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- Q16: The template and explanatory note do not refer to the MiFID Connect guidance on assessing suitability. Are they consistent?
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- Q20: Why do you say that we should consider the customer's individual investment portfolio? Many couples prefer to think of their finances as joint holdings.
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**Q1: Do we have to follow this template?**

The template and explanatory note are grounded in our COBS rules and high-level Principles and they form the methodology by which we will assess suitability. Firms should consider the implications of the publications and how they might apply to their own business model. However, the template and the explanatory note accompanying the template are not Handbook **guidance** and are not binding on those to whom our rules apply.

The template is a suitability assessment methodology for structured investment products focused on customer outcomes. It is not designed to deal with procedural or process requirements, so it should complement, rather than replace, existing compliance arrangements that firms have in place. The intention of publishing the template is to help firms provide suitable advice, to help compliance functions develop an outcome-focused approach to their business monitoring and to help firms assess suitability in the event that they receive complaints (in particular, complaints relating to products that were backed by Lehman Brothers). <back>

**Q2: What if we think it does not entirely suit our business model?**

You should consider the implications of the publications and their key elements and consider how you might apply them to your own business model. You are not obliged to use them or to use particular aspects of them, but we expect you to have appropriate systems and controls in place to ensure that customers achieve good outcomes.

The template is intended to provide a basis for the assessment of suitability across the whole of the industry (including private banking and wealth management firms). Even though specific references may not appear fully relevant for your processes, it is likely that the principles of our approach and the desired outcomes are relevant. <back>

**Q3: Why have you said that structured investment products are not suitable for customers who do not want to take any risk with their capital or have no capacity for loss?**

We consider structured investment products to carry a greater risk of capital loss than deposits. The Financial Services Compensation Scheme (FSCS) covers deposits up to £50,000. Most structured investment products do not have FSCS coverage, and while the probability of counterparty failure may be low, this means the impact of a default could be catastrophic for a customer (up to 100% loss of capital).

On this basis, we believe that structured investment products with counterparty risk, where there is no FSCS coverage in the event of counterparty failure, are not suitable products for customers who do not want to risk any loss of capital or who have no capacity for loss. We believe that these customers should be investing in products such as cash deposits (see **Q13** for further information relating to tied advice models where the source of investment is cash on deposit in excess of £50,000).

For this to be a suitable investment for the customer, it is also vital that the customer is aware of, and is willing to take, the risk involved. This does not mean that the customer has to understand the underlying mechanics of the product, but they should be made fully aware, for example, that if the counterparty backing the investment fails, they could lose all of their investment. They should also be informed of all other relevant potential outcomes and risks, such as their potential return being dependent on the performance of the relevant index/indices. In any case, they should be in a position to withstand the loss of their capital in the event that the counterparty fails (see also **Q17** regarding ‘professional’ clients). There are, of course, many other factors that should be considered, such as the customer’s investment objectives. <back>

**Q4: Are you saying that, when recommending structured investment products, we cannot invest more than 10% of a customer's assets into any one structured investment product and no more than 25% into structured investment products generally?**

No – these figures are trigger points prompting further assessment of suitability and not limits or safe thresholds.

Although retail structured investment products are typically linked to a diversified index, the customer's protection of capital is, typically, ultimately dependent upon the solvency of a single counterparty. This makes the impact on default potentially catastrophic, so where an adviser determines that a structured investment product is suitable, the appropriate level of investment for a customer should be considered.

Assuming a customer understands and is willing to take the counterparty risk involved, the assessment template indicates two investment levels above which we expect assessors to consider the suitability of a structured investment product more closely. The first is where more than 10% of a customer's investable portfolio is placed in one product or is exposed to a single counterparty. The second is where more than 25% of a customer's assets are invested in a number of structured investment products.

Investment amounts exceeding these levels may be suitable for customers. The purpose of the triggers is to prompt those reviewing cases to consider relevant factors and the suitability of the investment, given customers' individual circumstances.

On the other hand, there may also be cases where it is unsuitable for customers to invest amounts smaller than the trigger points into structured investment products.

A number of factors will need to be taken into account when deciding the suitable level of exposure to structured investment products. These include (but are not limited to) the individual features of a product (e.g. the credit risk of a counterparty, the structure of a product, the nature of any collateral, the term of a product, whether it employs gearing, the location of a counterparty, etc) and how these variables meet customers' needs, circumstances and investment objectives.

The nature of structured investments means that a significant portion of any investment return is dependent on one, or a limited number, of particular outcomes. If that outcome does not materialise, the customer may be exposed to inflation risk and effective erosion of the real value of their capital. Of course, most savings and investment products are exposed to inflation risk, but the issue is most relevant in scenarios where the customer is seeking to protect capital and is exposed to a significant risk of no return.

So, the suitability of the amount to be invested will vary on a case-by-case basis.

For example, the following areas might suggest that a concentration of investable assets higher than the trigger points is suitable:

- The customer has recently inherited money that is surplus to their needs. They have no immediate need for the capital and will not be using it to maintain their standard of living. As the investment is speculative, they would like to lock it up for medium-term growth and are willing to accept the risks involved.
- The customer has only a small portfolio of savings and investments. If a relatively modest amount was to be invested in a single structured investment product, this could be higher than the trigger points, but might be an efficient investment that meets the customer's needs without adding extra administrative costs.
- The customer has a high net worth. Their overall portfolio is well diversified, including a range of investments and assets, and they have a significant capacity for loss.

- An ongoing advisory or discretionary service is provided to a more sophisticated customer. This means that the portfolio changes daily, with tactical investments made depending on market conditions and then often sold on the secondary market. High concentrations may, therefore, only be short-term and the products are not intended to be held to term.
- The product is 100% collateralised with negligible risk, high quality assets (e.g. gilts and AAA-rated securities) and offers a significant degree of protection in the event of counterparty failure. All parties to the collateral agreement are known and are suitable for the customer. (Note that COLL sets requirements for acceptable collateral in UCITS and non-UCITS retail funds but, as part of the suitability process for an individual customer, firms should check that the nature of the collateral is suitable in each particular case).
- The product uses a range of high-quality counterparties to diversify risk.
- The customer has other structured investment products, but these are backed by a range of high-quality counterparties and the customer has no existing exposure to the counterparty underlying the product under consideration.

Similarly, for example, the following areas might suggest that lower concentrations of assets in a structured investment product are suitable:

- The customer is retired and relies on income from their investments to maintain their lifestyle. Loss of part of their capital (and therefore their income) would cause the customer financial difficulties.
- The customer has a large portfolio of savings and investments and an attitude to risk and reward expectations that allows scope to diversify and invest in a wide range of product and asset types. Placing a significant portion of their investment at risk with a single counterparty is not necessary to obtain the return expected by the customer.
- The customer has no experience of using structured investment products and holds the majority of their funds on deposit. Although they are willing to take a small risk with their capital, they would not be comfortable losing a significant sum.
- The customer is investing for a specific purpose, e.g. to pay for school fees. Although they may be able to cope with a limited shortfall in funding they would not be able to meet their objectives if the whole investment was lost.
- The customer is willing to take only a small amount of risk and has limited capacity for loss. They are recommended a product that is collateralised, but the level of collateral is significantly less than 100% and not held in sufficiently high quality, low risk assets.
- The customer is willing to take only a small amount of risk and has limited capacity for loss. They are recommended a product with a single counterparty because the potential returns are relatively attractive.
- The customer has other structured investment products and these are all backed by the same single counterparty underlying the product under consideration.

**This is not an exhaustive list of factors or scenarios.** The important point is that the product is suitable and the firm is acting in the customer's best interests, in accordance with the requirements in COBS. <back>

**Q5: Is concentration risk less of an issue as long as I make sure my customer is aware of the risks of a structured investment product?**

Disclosure is a very important element of structured investment product sales. This should clearly set out the product risks, including the potential implications of counterparty failure and any lack of FSCS coverage, as well as other risks associated with the product.

However, it is not sufficient just to disclose the nature of the additional risk that the customer takes. It is the adviser's responsibility to recommend a product that is suitable for the customer. When providing advice, disclosure cannot make an unsuitable product suitable. <back>

**Q6: Do you expect us to apply similar concentration considerations for other types of investment?**

Diversification is an important factor in determining suitability. There is no intention to apply these triggers more generally to our suitability assessments of recommendations for other investments or asset classes unless there are similar risks, but firms should be mindful of relevant issues where the particular nature of an investment involves similar risk characteristics to structured investment products (e.g. in terms of concentrated risk exposure and/or a lack of FSCS coverage). In such cases, it would be sensible to consider similar factors. <back>

**Q7: How does the template apply to tied advisers?**

We acknowledge that tied advisers have a limited range of products available to them, but their recommendations must still be suitable for their customers. If there are no suitable products, no investment advice should be provided and no products should be recommended. <back>

**Q8: I can understand why you might be concerned about potential over concentration in a single structured investment product, but why are you concerned about how much of a customer's portfolio is exposed to structured investment products generally?**

The template prompts file reviewers to examine cases in more detail where more than 25% of a customer's assets are invested in a number of structured investment products. This is not a limit, but a trigger point, to prompt file reviewers to consider the suitability of the recommendation more closely.

Our expectation is that customer portfolios are suitably diversified, taking into account their individual needs and circumstances. Diversification can help customers reduce risk and maximise returns by reducing the impact of poor performance in one part of an investment portfolio. High levels of exposure to a particular index, strategy or asset class can skew the portfolio.

There are different and varying degrees of risk associated with all investment products and asset classes. Diversification, by owning a portfolio of products, attempts to reduce the possible impact on the overall portfolio of any one risk or group of risks associated with a particular product, strategy or asset class. The less significant the exposure to a single index, asset class, or product-type (which carries the same risks), the less significant the potential downside impact from that index, asset class or product type on overall wealth.

Investing in structured investment products exposes a customer to inflation risk, market risk and the risk of catastrophic loss upon failure of the counterparty. The existence of some level of capital protection – thereby theoretically limiting downside risk – is unlikely to justify a disproportionate exposure to a single investment outcome, as concentration in such a strategy would preclude customers from earning the returns potentially available from other products.

Some customers may be happy to accept the higher levels of risk associated with a less diversified set of investments, but it is unlikely that it will be in the best interests of customers who are willing to take only a small amount of risk. Exposure to a single product-type carrying similar risks or a high level of portfolio concentration to a particular investment strategy, index or asset class will need to be justifiable. Of course, within this context, advisers and investment managers should make it clear that risks can only ever be reduced, but not eliminated, by diversification.

When considering cases in more detail where more than 25% of a customer's assets are invested in a number of structured investment products, examples of the things a file reviewer might consider are:

- How do the different products in this section of the portfolio relate to one another?
- Do they offer only a limited range of providers and counterparties?
- Do they each have similar inflation risks?
- Are they linked to the same underlying indices?
- Does this result in the portfolio being focused on a small number of outcomes (e.g. growth in the FTSE 100)?
- Should this proportion of the portfolio be invested in assets that do not pay dividends or have the other benefits of ownership of the underlying assets?
- Is it suitable to have this proportion of the portfolio in fixed-term contracts that cannot be altered in line with changes in the market or personal needs? <back>

**Q9: Is diversification a good thing if it leads to the use of weaker counterparties solely to achieve greater diversity?**

Where structured investment products are concerned, we stress the importance of the impact of counterparty risk, its potentially catastrophic nature and the associated relevance of a customer's capacity for loss. Diversification should be considered as a mitigating strategy in this regard, especially where a customer has limited capacity for loss.

As with other elements of the advice process for structured investment products, the nature of that diversification and its appropriateness would need to be considered on an individual customer basis, according to the customer's needs, circumstances and attitude to risk. It is possible that in reducing the impact of default through diversification of underlying counterparties this can increase the probability of a default especially where such diversification involves institutions with greater credit risk.  
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**Q10: To what extent must we consider taxation?**

The template and explanatory note do not extend obligations beyond the scope of the rules in COBS.

The suitability rules require that the customer's investment objectives and financial situation be taken into account. Assessing a product's suitability against these will generally include the tax implications of the product. If an adviser or portfolio manager is aware of a potential tax issue, or thinks that there might be one, this should be considered further.

The possibility of a tax liability at maturity does not necessarily mean that a product is unsuitable, but this should be taken into account in the suitability assessment and in any relevant customer disclosure.  
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**Q11: Does the template cover everything that we need to consider when selling structured investment products under the suitability rules?**

Suitability assessments should never follow a tick-box approach. However, given the very low standards we found across the market during our review of the suitability of Lehman-backed sales, we decided to highlight many of the common areas for analysis as a starting point. Advisers and investment managers are still obliged to consider all other relevant factors. The comments boxes in the template can be used by file checkers for referring to other issues.

If a product is not understood by an adviser or investment manager, it should not be recommended or traded in a portfolio.

As we said in the explanatory note, the information captured, for example, in the product details section is not necessarily exhaustive. As each structured product can differ so widely, there may be other risk factors that should be taken into account. Products must match the specific needs and circumstances of the customer. <back>

**Q12: Can you provide examples of the sort of additional things we might want to consider about the product when making a suitability assessment for structured investment products?**

Relevant considerations include:

- the legal structure of the product and the implications it has for the customer;
- whether the product is tradable on the secondary market and, if so, whether this will be reviewed regularly by the adviser or customer;
- the likely product price on the secondary market over its life and in differing market conditions;
- whether there are redemption fees if the product is sold on the secondary market;
- on what basis the trigger point in a SCARP is calculated (e.g. if it is only at maturity or throughout the product term);
- the customer's overall exposure to the counterparty via other products;
- where the product is collateralised, how well diversified the collateral is and whether the risk profile of the collateral is suitable (remember that the use of collateral can reduce the risks but is unlikely to remove them in full);
- whether the pay-off is contingent on the underlying asset reaching or maintaining a certain level; and
- whether gearing is used for high participation rates in underlying assets or to leverage gains and losses in the underlying asset.

Of course, these are just some of the possible considerations when deciding whether to recommend a structured investment product. Advisers still need to consider all other relevant investment factors. <back>

**Q13: I am a tied adviser and my customer holds more than the FSCS limit on deposit with my firm; the excess on deposit is not protected by the FSCS in the event of default. Is this a valid justification for recommending a structured investment product with the money in excess of the FSCS limit?**

The risks of the customer's existing holdings do not change the suitability of a structured investment product. If you have no suitable products you should not be providing any investment advice.

Deposit takers have an obligation under our rules in COMP (16.2.1R) to notify a customer of the FSCS limits so that they are informed that their current savings strategy may not be as low risk as they might otherwise believe. <back>

**Q14: Does this template and explanatory note apply to structured deposits?**

No – as stated in the explanatory note, the template applies only to structured investment products.

However, when selling deposit products, firms may want to ask themselves whether there are similar issues to be considered.

Not all structured deposits benefit in full from the FSCS deposit protections. Pooled structured deposit products (i.e. where the customer does not hold a deposit directly with the deposit-taker, but instead the customer's investments are pooled and deposited by the plan manager) may not be covered by FSCS if the deposit-taker fails. So these products may not be suitable for customers who do not want to take any risk with their capital or who have no capacity for loss.

Information on the marketing of structured deposits is available in our **structured deposit report**, which was published in November 2009. <back>

**Q15: The template and explanatory note make reference to suitability reports and factfinding. As a Private Client Investment Manager, is the template relevant for me?**

The template is intended to provide a basis for the assessment of suitability across the whole of the industry, to be tailored where necessary for specific business models.

Even though specific references may not be fully relevant for your processes, it is likely that the key elements of our approach and the desired outcomes are relevant. Firms should therefore consider whether they should adapt it to take account of these differences. So, for example, references to suitability reports might also/instead cover any other customer communication, such as terms of business, or, once the provision of portfolio management service is ongoing, any other means a portfolio manager uses to record the basis of a decision to trade on behalf of a customer. References to any factfinding document might be read as applying to the customer mandate or another tool that explains the customer's details and circumstances and captures relevant investment objectives. <back>

**Q16: The template and explanatory note do not refer to the MiFID Connect guidance on assessing suitability. Are they consistent?**

We consider the template and explanatory note to be consistent with the MiFID provisions, as implemented in our COBS requirements, providing practical indications of some of the things that should be considered in order to meet MiFID requirements. <back>

**Q17: Does the template apply to suitability assessments for professional customers as well as retail customers?**

The template can be used wherever a suitability assessment is conducted.

It was primarily developed for retail customers and there may be adaptations that you need to make when dealing with a professional customer. For example, in the case of a suitability assessment for a per se professional customer (under COBS 3, a customer that is automatically classified as professional rather than having elected to 'opt up' to professional status), the firm is entitled to assume that the customer is able to sustain a financial loss (consistent with their investment objectives). <back>

**Q18: Does the template only apply to ‘holistic’ advice (advice or recommendations taking into account all the customer’s investment needs and financial circumstances) or does it also apply to ‘limited’ advice (advice focused on one aspect of a customer’s financial planning rather than across the range of the customer’s actual and planned financial needs)?**

It applies to both. With a limited service it is possible to limit the scope of products considered, but the adviser or portfolio manager still needs to know everything relevant and necessary about the customer and their investment portfolio to make a suitability assessment.

So, when providing a limited service in relation to an investment, we would still expect an adviser or portfolio manager to gather much of the same information, e.g. the customer’s investment horizons, attitude to risk, capacity to absorb capital loss, their relevant knowledge and experience and even, where relevant, their other exposure to structured products to assess the suitability of the product in light of the impact it has on their portfolio as a whole.

Relevant factors will depend very much on the case in hand. If they are genuinely not relevant, this can be noted on the template. If they are relevant and missing, then this too should be captured by the template.

If the customer has refused to disclose certain information (for example, they have not given full details on all existing products), the standard rules apply. Any limitations to advice, or the service provided, must be disclosed to the customer and it must still be suitable within the context of what the customer is willing to tell you. If you cannot obtain the necessary information to assess suitability, you should not make a recommendation. Customers should not be discouraged from disclosing relevant information. <back>

**Q19: Is there an obligation on firms to check the ongoing suitability of structured investment products?**

Publication of the template should not be read as creating an obligation to ensure that any holding acquired continues to be suitable. But, if you have promised this service to a customer, then you should ensure you deliver it. <back>

**Q20: Why do you say that we should consider the customer’s individual investment portfolio?**

**Many couples prefer to think of their finances as joint holdings.**

When considering suitability for one partner, there are various considerations to take into account, including the implications for that individual on their own. Where the advice is to the couple jointly, it may well be appropriate to consider the joint assets.

We have not imposed absolute limits for investment in structured investment products. For example, if one partner’s investment in a product involves a high proportion of his or her savings and investments but, when the other partner’s portfolio is included, it does not. If the implications of loading the investment in one partner’s name rather than jointly have been considered and the customer is aware of the risks and potential impact, then it might be suitable to invest this much. But this should still be thought about when considering the concentration of assets. <back>

**Q21: My customer has a very high net worth. How should I be diversifying their holdings in structured investment products?**

Although larger sums are involved, the same principles still apply. The product must still be suitable for the customer and their portfolio should be appropriately diversified (see Q4 for further information about diversification and concentration of assets). <back>

**Q22: If we review any past sales of structured investment products and find any to be unsuitable what remedial action do you expect us to take?**

Where you identify any unsuitable sales of products that were backed by Lehman Brothers we expect appropriate redress to be offered to the customer (as well as explaining their right to pursue the matter through the FOS if they have made a complaint). In addition, you should consider whether the failings identified indicate wider problems with your firm's advice processes or systems and controls and whether any action is necessary to address them.

Where you identify any unsuitable sales of non-Lehman-backed structured investment products, unless the counterparty has failed, we do not consider it necessary for firms to take pro-active wholesale remedial action where the advice or investment management failings relate only to: potential over-concentration of investments in these products; or the recommendation of 100% capital protected products to customers who may not have been willing to take a risk with their capital or have no capacity for loss. This is a proportionate approach on the basis that these two scenarios only affect customers where there is counterparty failure.

However, this view is limited to these two specific scenarios alone where there is no counterparty failure and so no crystallised loss. Should the counterparty subsequently fail, pro-active wholesale remedial action may be required in respect of advice given, including where the advice failings relate to the two scenarios outlined above.

This view does not apply to any wider or other failings identified by any firm or by any FSA assessment (including where these two specific scenarios exist alongside other failings).

This view does not affect the customer's right to complain about these two issues (as well as other issues). Individual complaints on any issues should be considered fairly and in accordance with the rules in DISP.

Also, this view does not remove or reduce a firm's obligations regarding any past case in which unsuitable advice was given.

Our expectation is that firms now focus on making the necessary changes to their advice proposition. We will be carrying out follow-up assessments to check this. <back>