

Consultation Paper: Derivatives Issuer Standard Condition on Suitability

Suitability of products for clients

8 September 2014

In November 2013 the Financial Markets Authority consulted on the minimum standards and conditions for derivatives issuers wishing to be licensed under the Financial Markets Conduct Act 2013 (the Act).

As part of that consultation we sought responses on a condition relating to the assessment of suitability of products for clients. Two options were provided, one being disclosure based and the other an assessment by the issuer.

Submitters noted this standard should focus on assessing suitability for retail investors. They noted the potential for overlap with other regulatory requirements and sought greater clarification on what the requirement would be.

We have reviewed this feedback and developed a draft suitability condition based on an assessment by the issuer. Because processes may need to be put in place by some issuers, we propose this standard condition will come into effect on 1 December 2015.

This paper outlines our proposed suitability standard condition. We invite you to review this and share your feedback with us. Other derivatives issuer standard conditions are now final and have been published on our website.

Submissions on this standard condition close on Monday 29 September 2014. The form at the back provides more details.

Suitability of products for clients

FMA propose that the following condition and explanatory note is added to the derivatives issuer standard conditions from 1 December 2015.

Suitability of products for clients

Standard condition: *(This standard condition will be effective from 1 December 2015)*

Before entering into a derivative with a retail investor you must ask the retail investor to provide information about their knowledge and experience in the relevant type of derivative (unless they have previously provided such information) so as to enable you to assess whether the derivative is suitable for them.

When assessing suitability you must determine whether the retail investor has the necessary experience and knowledge in order to understand the risks involved in relation to the particular type of derivative.

If, based on the information received from the retail investor, you consider that the derivative is not suitable for them, you must warn them you do not think it is suitable for them to enter into the derivative. The warning must note that, if they do enter into the derivative, they risk exposing themselves to risks that fall outside their knowledge and experience and that they may not have the knowledge or experience properly to assess and/or mitigate the effects of the derivative. The warning must be in writing and be prominently displayed in any other written information you are providing.

If the retail investor elects not to provide the information to enable you to assess suitability, or if they provide insufficient information, you must warn them that you are required to obtain information from them in order to assess whether the derivative is suitable for them. The warning must note that without such information there is a strong risk you will not be able to assess whether they have the necessary knowledge and experience to understand the risks involved. This warning must also be in writing and prominently displayed.

Consequently, you must strongly advise them to provide you with any requested information that you believe is necessary to enable you to assess suitability.

If a retail investor asks you to go ahead with entering into a derivative, despite being given a warning, you may consider whether to do so having regard to all the circumstances.

Explanatory note: This standard condition does not require, or authorise, the licensee to provide financial advice in relation to the derivative. The purpose of the condition is to reduce the risk of derivatives being sold to people who do not have the necessary knowledge and experience to understand the risks involved.

The approach to the suitability assessment may be graduated according to the complexity of the derivative. For example, where a derivative is more straightforward (for example it has no contingent liability), the intensity of the suitability assessment may be less - unless the nature of the investor dictates otherwise.

When assessing an investor's knowledge and experience it may be appropriate to consider information such as:

- whether the investor is familiar with the particular type of derivative;

- the nature, volume, and frequency of other relevant transactions entered into by the investor and the period over which they have been carried out;
 - the level of education, profession or relevant former profession of the investor;
 - the nature of the proposed transaction as a whole, including the nature of any financial advice the investor may have received.
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The next step

How do I make a submission?

Please use the form on the next page – this gives the details of what you need to do. Forms must be submitted electronically in both PDF and word formats and emailed to consultation@fma.govt.nz – please put ‘Feedback derivatives issuer standard condition – suitability’ in the subject line.

Alternatively, you can make an online submission on our engagement site www.talktous.fma.govt.nz. You need to register to be able to use the site.

Submissions close on 29 September 2013.

Where can I get more information?

You’ll find more information about the changes on our website www.fma.govt.nz, or at the Ministry of Business Innovation and Employment site www.mbie.govt.nz

If you have questions about the consultation process, please get in touch.

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