INTERNAL AUDITORS DIVISION
An Affiliate of SIFMA

AUDIT GUIDELINES

New Products, Services and Complex Transactions

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TABLE OF CONTENTS

I. INTRODUCTION

General Background

Before a business offers any new products, complex transactions or services to clients, an appropriately structured product oversight process/committee ("Product Committee") should review and approve the product, transaction or service for suitability with the target market clients in accordance with predetermined parameters. The purpose of a Product Committee is to ensure that all risks, including reputational and franchise risks, in a new product, activity or complex transaction are identified and evaluated from every necessary perspective, determined to be appropriate for the Firm and its clients, and effectively controlled with all accountabilities in place.

In addition, the Firm should establish a process to review and update existing products for material changes on a periodic basis. The periodic review process will require the business to establish product programs. Product programs are documents designed to describe in some detail how a business unit manages a product. They are used by management, auditors and regulators to assure consistent high standards and practices in product management. Product programs are the final responsibility of the business sponsor managing the product set in question, and must be maintained and updated as product management practices evolve, irrespective of whether changes to a product are resubmitted to Product Committee. Product Programs should be reviewed by the business and supporting control functions (e.g., legal, compliance, risk management, etc.).

Scope

The business should also clearly establish policies and procedures that govern the scope of the Product Committee and the characteristics of products and services requiring their approval. The procedures should be broad enough to capture a wide spectrum of new product, services and transactions but also prescriptive enough provide a clear direction to the front and middle office staff within the product development functions. The new product, activity or complex transactions which meet prescribed criteria should fall under the policy. The following are sample criteria for products/transactions covered by an institutional and retail oversight function/Product Committee:

Institutional Products

- New to the marketplace or to the Firm;
- Exposes a trading desk to new market risk factors, or market risks that are different in magnitude or type from those previously approved by the Firm;
- New to the legal entity in which it will be booked;
- Raises legal, regulatory, compliance or appropriateness issues for the Firm or its counterparties;
- Raises franchise and/or reputation risks to the Firm that are not addressed under another approved oversight process;
- Raises accounting, tax, balance sheet, liquidity and/or funding issues for the Firm or its counterparties;
- Requires a new model to value the position and/or measure risk, or a model exists but the transaction is outside of model parameters, or requires changes to existing models;
- Cannot be booked in existing systems;

- Introduces pricing, valuation and/or price verification issues; and
- Requires new trade processing capability (including settlement, delivery or custody) or exposes the Firm to new settlement risks.

Retail Products

- A product or service that is new to the marketplace or has not been previously distributed by the Firm to its clients;
- An existing product or service proposed for retail distribution that has previously been sold only to institutional investors;
- An existing product or service that will be offered by the Firm's representatives or business units that have not previously sold the product or service;
- An existing product or service that will be offered in a new geographic region, in a new currency or to a new type of client;
- A modification to an existing product or service that will involve a new or material change in the approved sales practices and marketing strategies for a product or service;
- A material modification to an existing product or service that is expected to present increased or novel franchise, reputational, legal, market, investment or other risks;
- A modification to an existing product or service that will require material operational or systems changes;
- A modification to an existing product or service that presents conflicts of interest that have not previously been identified and addressed;
- A modification to an existing product or service that materially changes the time horizon, potential for loss, expected return or mark-to-market volatility of the product or service; and
- A modification to an existing product or service that materially changes the fee structure of the product or service or which is beyond previously approved pricing parameters.

Potential Areas of Risk/Red Flags

Product Description/Characteristics – Describes the product's features, benefits, terms, and conditions. Products with the following characteristics may give rise to franchise concerns if not adequately addressed by the product sponsor and Product Committee.

- The economic substance of the transaction is unclear and/or cannot be determined from the structure without significant review.
- Compensation for the transaction appears to be disproportionate to the services provided or to market norms. The costs and fees are not transparent and/or are not in line with comparable products offered by the Firm or by competitors.
- The true identity of a party to the transaction cannot be readily determined because of the complexity or the use of Special Purpose Vehicles (SPVs) or other legal entities.
- Conflicts of interest are not appropriately dimensioned or disclosed within the product documentation. Will the offering of the product or service create any conflicts of interest between the customer and any part of the firm or its affiliates? If so, how will those conflicts be addressed?
- A principal motivation for the transaction is targeted at a gray area of regulatory, legal, accounting, or tax issues.
- The rules governing the transaction are not predictable and could be subject to sudden application of different standards because of political or social developments.

- The transaction contains unusual terms that are significantly different from what one would expect in light of the substance of the transaction.
- Multiple groups are involved with internal governance of the product or transaction, making it more difficult to manage the process or to provide effective oversight.
- Local jurisdiction does not have sufficiently developed rules or practices; or business has not obtained local legal or accounting opinions to support a key component of the product.
- The transaction will have a significant impact on the customer's financial condition or will not be reflected as debt on the client's balance sheet or otherwise be clearly disclosed to investors.

Target Market/Client Characteristics - Target Market should define to whom the product, transaction or service intended. Target market/client characteristics should link directly to product characteristics (as needed). The following areas should be considered when evaluating target market/client characteristics and product linkage:

- Is the product or service proposed for limited or general retail distribution, and, if limited, how will it be controlled (e.g. systemic restriction on the sale of products restricted to qualified institutional buyers, surveillance report targeting the sale of certain variable annuities to elderly clients)?
- What is the complexity of the product or service in structure, function, and description? Does such complexity impact suitability considerations and/or the training requirements associated with the product or service?
- What are the risks for clients? How liquid is the product? Is there a secondary market for the product? What risks must be disclosed, and how will that disclosure be made?
- Will the product or service necessitate the development or refinement of in-firm training programs for sales personnel and their supervisors? If so, how and when will the training be provided?

II. INTERNAL AUDIT GUIDELINES

Operation Risk – Governance Structure

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
The business has not established an adequate process or corresponding procedures to identity, review and monitor new products offer by the Firm.	The business established a process or corresponding procedure to identity, review and monitor new products offered by the Firm. An appropriately structured product oversight process/committee ("Product Committee") was established to review and approve the product, transaction or service in accordance with predetermined parameters. The purpose of a Product Committee is to ensure that all risks, including reputation and franchise risks, in a new product, activity or complex transaction are identified and evaluated from every necessary perspective, determined to be appropriate for the Firm and its clients, and effectively controlled with all accountabilities in place.	1. Review Product Committee charter and/or policies and procedures to ensure the business has established a comprehensive process for the evaluation of new products for the Firm. Product Committee charter and/or policies and procedures should address the following: scope of coverage, structure of the Product Committee, coordination with other regional/sector Product Committees, required approvals, required documentation and screening processes for the product sponsor, exemption /deviation processes, and periodic product evaluations. 2. Review the scope of Product Committee coverage to evaluate which business segments are covered under the scope of the policy and to ensure clear accountability and coverage. (Note: regional or sector specific committees may be required to adequately review regional and sector specific issue/concerns) 3. Ensure an appropriate quorum is required in order for final approval from the Product Committee. 4. Verify that a process has been established to track and resolve open concerns raised by the Product Committee. Ensure concerns were resolved prior to final approval. 5. Verify that the business/Product Committee has established a governance process to ensure new and existing product offerings are reviewed by the Product Committee and appropriately updated by the business in line with standards outlined by the Firm. Governance process should include reconciliation of approved products vs. products actively marketed and supported by front and middle office functions. It is the responsibility of the Business Unit to identify new products, activities and complex transactions that require.

		6. Ensure that product owners review products as relevant policies are issued/updated to determine if changes are needed.
Product Committee structure does not have the authority or expertise to review numerous risks associated with the launch of a new product or service.	Product Committee structure should include representation from the business and infrastructure support groups (e.g., legal, operations, compliance, systems and product specialist as needed (e.g. tax counsel)) to adequately dimension the risks pertaining to the new product.	Review the business oversight/ Product Committee structure and ensure the Product Committee includes experienced senior personnel who can contribute diverse perspectives and experiences to the process and who possess the training and skills to evaluate investment terms, the risks and benefits of new products and services, and product and service suitability for clients.

Franchise/Regulatory Risk

Risks to be Managed	*Types of Controls to Manage or Eliminate Risks*	*Potential Audit Work Step*
A new product, activity or complex transaction contains risks which are not identified, evaluated, and effectively controlled by the Firm prior to the launch of a new product.	The business's oversight process/Product Committee has executed a documented review evaluating key risk characteristics of the new products in line with predetermined procedures. Committee as defined process for follow-up of open items/questions and all open items are adequately resolved prior to final approval of the Product Committee.	The Business may transact in or distribute unapproved product(s) that may not meet client needs, regulatory requirements and the Firm's standards as to quality and appropriateness. Test Description: 1. Select a sample of all products reviewed and approved by the Product Committee to ensure the information provided addresses the key topical areas necessary to complete a comprehensive product evaluation. (Information should be prepared by the sponsoring business unit) Key topical areas for consideration are as follows: • Product Description/ Characteristics - Describes the product's features, benefits, terms, conditions and risks. • Product Business Plan - Gives the rationale for offering the product. Also, the product strategy, marketing plans, sales goals, selling agents and compensation structure, pricing, and profitability. Include market environment and competitive

		information. • Target Market/Client Characteristics – Describes to whom this product or service is intended, including product suitability and appropriateness information. Client characteristics should address if the product or service proposed is intended for limited or general distribution, and, if limited, how the product sponsor intends to control the distribution. Conversely, this section should also address to whom the product or service should not be offered-addressing any special eligibility requirements and countries where the product will be sold. If any exceptions to the suitability standards may be allowed, the exception approval process should be documented. • Client Service Platform/ Distribution Processes - Provides an overview of the distribution process and supporting systems, including: sales, suitability, and documentation processes, as well as transaction execution, client statements, and after-sales support. Include key participants' roles and responsibilities and linkages between internal or external units. Processes and support provided externally can be incorporated by reference to the provider. Any differences from standard processes should be highlighted. • Legal, Regulatory and Compliance Concerns - Details any special legal or regulatory considerations that affect the sale or distribution of the product. This section would identify any jurisdictions where the product cannot be sold or sold only after meeting certain restrictions, hot regulatory issues apply in to the product segment, usage of special purpose legal vehicles, and tax considerations. • Required Documentation - Includes any documentation requirements such as contracts, disclosures, prospectuses, account opening forms, and service agreements. Specific focus should be placed on the disclosure of firm conflicts of interest, compensation structure and safeguarding of client information.

		• Systems – Describe the necessary changes to trading, accounting and control systems, and provisions for technology/ operational failure. • Risks and Controls - Describes the product distribution-related risks to the Firm and controls over those risks. • Accounting/Tax – Describes typical accounting treatment for transactions and other regular entries associated with the product, including the location and vehicle in which revenues will be recorded and any revenue-sharing arrangements. • Service Providers - Lists any direct internal or external service providers, including vendors, agents, or other internal business units that support the product (i.e., it is not necessary to list secondary providers used by the Firm's provider). For third-party vendors, this section describes the due diligence process. 2. Based on the sample selected, review Product Committee approval for reasonableness and verify that final approval is adequately documents via Product Committee minutes/notification and ensure the business sponsor resolved any open items or qualifying conditions listed on the notification prior to approval becoming effective.

Note: Auditors should also consider completeness testing to verify that transactions have not been executed without the review and approval from the Product Committee. This can be accomplished either as part of the Product Committee Audit, or when auditing individual business units. Furthermore, when conducting business unit audits, auditors should consider whether changes to a product's terms were outside the scope of the original approval; see below for possible risk / associated work steps.

Risks to be Managed	***Types of Controls to Manage or Eliminate Risks***	***Potential Audit Work Step***
Product offerings were not appropriately updated to address changes in the legal regulatory, operational concerns or a shift in the Firms product strategy.	The Business should establish a process to update the product program on an annual basis and to ensure the program is reviewed and approval by product sponsor and functional units (Legal, Compliance, Tax, Business Risk, Finance, Operations/ Technology).	1. Consult with the Business & a representative from the Product Committee and ascertain whether any of the products offered by the Business require a product program. Responses should be validated via a review of the business actively marketed products, transactions and services against the product programs requirements established by the Product Committee. 2. Ensure the products offered by the Business are reviewed and approved by the product sponsor and functional units (Legal, Compliance, Tax, Business Risk, Finance, Operations and Technology) in accordance with product approval policy. 3. Review product programs/distribution documents and ensure that content and approval meet product approval policy guideline as outlined below: • Product Description/Characteristics - Describes the product's features, benefits, terms, and conditions. • Product Business Plan - Gives the rationale for offering the product. Also, the product strategy, marketing plans, sales goals, selling agents and compensation structure, pricing, and profitability. Include market environment and competitive information. • Target Market/Client Characteristics – Describes to whom is this product or service intended, including product suitability and appropriateness information. Client characteristics should address if the product or service proposed is intended for limited or general distribution, and, if limited, how the product sponsor intends to control the distribution. Conversely, this section should also address to whom the product or service should not be offered-addressing any special eligibility requirements and countries where the product will be sold. • Client Service Platform/Distribution Processes - Provides an overview of the distribution process and supporting systems, including: sales, suitability, and documentation processes, as well as transaction.

		• Execution, client statements, and after-sales support. Include key participants' roles and responsibilities and linkages between internal or external units. Processes and support provided externally can be incorporated by reference to the provider. Any differences from standard processes should be highlighted. • Legal, Regulatory and Compliance Concerns - Details any special legal or regulatory considerations that affect the sale or distribution of the product. This section would identify any countries where the product cannot be sold or sold only after meeting certain restrictions, hot regulatory issues apply in to the product segment, usage of special purpose legal vehicles, and tax considerations. • Required Documentation - Includes any documentation requirements such as contracts, disclosures, prospectuses, account opening forms, and service agreements. Specific focus should be placed on the disclosure of firm conflicts of interest, compensation structure and safeguarding of client information. • Systems – Describe the necessary changes to trading, accounting and control systems, and provisions for technology/operational failure. • Risks and Controls - Describes the product distribution-related risks to the Firm and controls over those risks. • Accounting – Describes typical accounting treatment for transactions and other regular entries associated with the product, including the location and vehicle in which revenues will be recorded and any revenue-sharing arrangements. • Service Providers - Lists any direct internal or external service providers, including vendors, agents, or other internal business units that support the product (i.e., it is not necessary to list secondary providers used by the Firm's provider). For third-party vendors, this section describes the due diligence process.