Chapter 6

Product governance: additional provisions for pathway investments and default options

6.1 General

6.1.1 R This chapter does not affect the application of other requirements in the *FCA Handbook* or *onshored regulations* applying to *firms* within the scope of this chapter. *Firms* within the scope of PROD 1.3 (Application of PROD 3), PROD 1.4 (Application of PROD 4), PROD 3 (Product governance: MiFID) and PROD 4 (Product governance: IDD) must continue to comply with those provisions.

6.2 Manufacture of pathway investments

6.2.1 R A *manufacturer* must review its *pathway investments* at least annually to ensure that the *pathway investments*:

(1) remain consistent with the needs, characteristics and objectives of their identified target market, taking into account the *investment pathway* options in COBS 19.10.17R(1); and

(2) are being *distributed* to their target market.

6.2.2 G A *firm* to which the record-keeping rules in SYSC 3 (Systems and controls) or SYSC 9 (Record-keeping) apply should maintain, in relation to its *manufacture* of *pathway investments*, a record of the process undertaken to approve each *pathway investment*, and of the review conducted for each *pathway investment* to comply with PROD 6.2.1R.

6.3 Distribution of pathway investments

6.3.1 R A *firm* must not *distribute* a *pathway investment* unless it is compatible with the needs, characteristics and objectives of those *retail clients* that fall within the *pathway investment's* target market, taking into account the *investment pathway* options in COBS 19.10.17R(1).

6.3.2 R When carrying out the compatibility assessment referred to in PROD 6.3.1R, *firms* must take into account:

(1) the price and complexity of the *pathway investment*; and

(2) where the *firm* is referring *retail clients* to be transferred to the *personal pension scheme* or *stakeholder pension scheme* operated by another *firm*, they must also take into account:

(a) the charges and other product features of that other *firm's* drawdown product;

(b) the financial strength of that other *firm*; and

(c) the reliability and efficiency of that other *firm* in relation to its dealings with *retail clients*.

6.3.3 R A *firm* must review the distribution arrangements for the *pathway investments* it distributes at least on a two-yearly basis to ensure:

(1) the distribution arrangements are still valid and up to date; and

(2) the *pathway investments* remain compatible with, and are being *distributed* to, their target market in accordance with PROD 6.3.1R.

6.3.4 G A *firm* to which the record-keeping rules in SYSC 3 or SYSC 9 apply should maintain, in relation to its *distribution* of *pathway investments*, a record of the process undertaken to select each *pathway investment*, and of the review conducted for each *pathway investment* to comply with PROD 6.3.3R.

Obligations on firms where retail clients are not acting in their interests

6.3.5 R Where a *firm* (A) refers *retail clients* to another *firm* (B), where B can offer a *pathway investment* to the *retail client* if the *retail client* transfers to the *personal pension scheme* or *stakeholder pension scheme* operated by B, both A and B must comply with PROD 6.3.6R.

6.3.6 R Where:

(1) A becomes aware of a pattern of *retail clients* choosing to stay with A and not transferring to B; and

(2) A considers that this choice is unlikely to be in the interests of those *retail clients*, having regard to their objectives and characteristics; then

(3) A must promptly inform B of its concerns in (1) and (2); and

(4) A and B must each take reasonable steps to minimise the potential harm to *retail clients*.

6.3.7 G Reasonable steps for the purposes of PROD 6.3.6R may include A and B making it easier for *retail clients* to transfer to the *personal pension scheme* or *stakeholder pension scheme* operated by B.

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6.4 Manufacture of default options

6.4.1 R When designing a *default option*, a *manufacturer* should take into account, among other considerations, the fact that COBS 19.12 requires *operators* to offer the *default option* to *non-advised clients* for inclusion in their *non-workplace pensions*. As a result, the *default option* must be designed to be compatible with the needs, characteristics and objectives of a typical *non-advised client* in the *default option's* target market.

6.4.2 R A *manufacturer* must also ensure that:

when specifying the investment strategy of the *default option*, and its costs and charging structure, it takes into account what the *manufacturer* considers, on reasonable grounds, to be the likely needs, objectives and characteristics of a typical *non-advised client* in the target market;

the investment strategy of the *default option*:

(a) takes into account the target retirement age of a typical *non-advised client* in the target market, and their likely strategy for accessing their pension;

(b) includes *lifestyling*, unless *lifestyling* is not appropriate for the needs, objectives and characteristics of the typical *non-advised client* in the target market or the *default option* is based on *target date funds*; and

(c) seeks growth, while managing risks, through an appropriate and diversified asset allocation; and

the *default option* has appropriate and competitive price and charges, which bear a reasonable relationship with the services being provided.

6.4.3 G *Manufacturers* are expected to take reasonable steps to understand the likely needs, objectives and characteristics of a typical *non-advised client* in the *default option's* target market. This could include carrying out sufficient research and consumer testing in support of its conclusions. What amounts to a typical *non-advised client* may be based on the needs, objectives or characteristics that are most commonly seen among *non-advised clients* within the target market.

6.4.4 R *Manufacturers* must review their *default options* at least once every 3 years to ensure that they:

(1) remain consistent with the needs, characteristics and objectives of a typical *non-advised client* in the target markets; and

(2) are being *distributed* to their target markets.

6.5 Distribution of default options

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6.5.1 R A *firm* must not *distribute* a *default option* unless it is compatible with the needs, characteristics and objectives of the *retail clients* to whom the *firm* distributes the *default option*.

6.5.2 R When carrying out the compatibility assessment in PROD 6.5.1R, a *firm* must also take into account:

(1) the *manufacturer's* compliance with the requirements in PROD 6.4; and

(2) the financial strength of the *manufacturer*.

6.5.3 R A *firm* must review the distribution arrangements for the *default options* it distributes at least every 3 years.