Product Intervention and Product Governance Sourcebook (PROD)

Product Intervention and Product Governance Sourcebook (PROD)

Chapter 1

Product Intervention and Product Governance Sourcebook (PROD)

1.1 Application and purpose

Purpose

1.1.1 G The purpose of *PROD* is to improve *firms'* product oversight and governance processes and to set out the *FCA's* statement of policy on making *temporary product intervention rules*.

1.1.2 G Product oversight and governance refers to the systems and controls *firms* have in place to design, approve, market and manage products throughout the products' lifecycle to ensure they meet legal and regulatory requirements.

1.1.3 G Good product governance should result in products that:

(1) meet the needs of one or more identifiable target markets;

(2) are sold to clients in the target markets by appropriate *distribution* channels; and

(3) deliver appropriate *client* outcomes.

1.2 Application of PROD 2

1.2.1 R PROD 2 sets out the *FCA's* approach to issuing *temporary product intervention rules*. It is of relevance to all *firms*.

1.3 Application of PROD 3

General: Who? What?

1.3.1 R ■ PROD 3 applies to

(1) a *MiFID investment firm*;

(2) a *CRD credit institution*;

(3) a *MiFID optional exemption firm*; and

(4) branches of third country investment firms; with respect to:

(5) manufacturing financial instruments and *structured deposits*; and

(6) distributing financial instruments, *structured deposits* and *investment services*.

[**Note:** articles 1(3), 1(4), 16(3), 24(2) and 41(2) of *MiFID*]

Other firms manufacturing or distributing financial instruments or structured deposits

1.3.2 R Other *firms* which *manufacture* or *distribute financial instruments* or *structured deposits* should take account of ■ PROD 3 as if it were *guidance* on the *Principles* and other relevant *rules* and as if "should" appeared in ■ PROD 3 rules instead of "must".

Eligible counterparty business

1.3.3 R ■ PROD 3.3.1R does not apply to *eligible counterparty business*.

[**Note:** article 30(1) of *MiFID*]

Where?

1.3.4 R ■ PROD 3 applies to a *firm* with respect to activities carried on from an establishment maintained by it, or its *appointed representative*, in the *United Kingdom*.

1.3.5 R (1) ■ PROD 3 also applies to a *firm* with respect to activities from an establishment *overseas* with a *client* in the *United Kingdom*.

(2) But ■ PROD 3 does not apply to those activities if the office from which the activity is carried on were a separate *person* and the activity:

(a) would fall within the *overseas persons* exclusions in article 72 of the *Regulated Activities Order*; or

(b) would not be regarded as being carried on in the *United Kingdom*.

EEA territorial scope rule: compatibility with European law

1.3.6 R

(1) The territorial scope of this sourcebook is modified to the extent necessary to be compatible with European law (see ■ PROD 1.3.7G to ■ PROD 1.3.10G for guidance on this).

(2) This *rule* overrides every other *rule* in this sourcebook.

Effects of the EEA territorial scope rule

1.3.7 G One of the effects of ■ PROD 1.3.6R is to override the application of this sourcebook to the *overseas* establishments of *EEA firms* in circumstances covered by *MiFID*.

1.3.8 G The *guidance* in this chapter provides a general overview only and is not comprehensive.

1.3.9 G When considering the impact of a directive on the territorial application of a *rule*, a *firm* will first need to consider whether the relevant situation involves a non-*UK* element. ■ PROD 1.3.6R is unlikely to apply if a *UK firm* is doing business in a *UK establishment* for a *client* located in the *United Kingdom* in relation to a *UK* product, in other words ■ PROD 3 will apply to the *UK firm*. However, if there is a non-*UK* element, the *firm* should consider whether:

(1) it is subject to the directive (in general, directives only apply to *UK firms* and *EEA firms*, but the implementing provisions may not treat non-*EEA firms* more favourably than *EEA firms*);

(2) the business it is performing is subject to the directive; and

(3) the particular *rule* is within the scope of the directive.

If the answer to all three questions is 'yes', ■ PROD 1.3.6R may change the application of the *rules* in this sourcebook.

1.3.10 G When considering a particular situation, a *firm* should also consider whether two or more directives apply.

MiFID: effect on territorial scope

1.3.11 G ■ PERG 13 contains general *guidance* on the *persons* and businesses to which *MiFID* applies.

1.3.12 G For a *UK MiFID investment firm*, *rules* in this sourcebook that are within the scope of *MiFID* generally apply to its *MiFID business* carried on from an establishment in the *United Kingdom*. They also generally apply to its *MiFID business* carried on from an establishment in another *EEA State*, although in the case of rules that implement article 24(2) *MiFID* only where that business is not carried on within the territory of that *EEA State*. Where a *MiFID investment firm* carries on *MiFID business* from a branch in another *EEA State*, organisational requirements, including *rules* implementing product manufacture obligations under article 16 *MiFID* are home state requirements and therefore *FCA* responsibility (see ■ SUP 13A Annex 1G).

[**Note:** see articles 34(1) and 35(1) and (8) of *MiFID*]

1.3.13 G For an *EEA MiFID investment firm*, *rules* in this sourcebook that are within the scope of *MiFID* generally apply only to its *MiFID business* if that business is carried on from an establishment in, and within the territory of, the *United Kingdom* and only to the extent that the *rules* implement article 24(2) of *MiFID*.

[**Note:** see articles 35(1) and (8) of *MiFID*]

Electronic Commerce Directive: effect on territorial scope

1.3.14 G The guidance on the *Electronic Commerce Directive* in ■ COBS 1 Annex 1, Part 3, paragraph 7 applies equally in relation to the *rules* in ■ PROD 3.

Interaction of PROD 3 and the RPPD Guide

1.3.15 G A *firm* to which ■ PROD 3 applies need not apply the *guidance* in *RPPD* for matters covered by *PROD* if the firm has complied with ■ PROD 3.

1.4 Application of PROD 4

1.4.1 R

PROD 4 applies to:

(1) an *insurance intermediary*; and

(2) an *insurer*,

with respect to:

(3) manufacturing insurance products; and

(4) distributing insurance products.

[**Note**: articles 1(2) and 25 of the *IDD*]

1.4.2 G

In *PROD* an insurance product may be read as being a reference to the product for distribution to *customers* generally and is not intended to refer to each individual *contract of insurance* being sold or underwritten (unless the context indicates otherwise).

1.4.3 R

PROD 4 does not apply in relation to the *manufacturing* or *distributing* of:

(1) a *contract of large risks*, or

(2) a *reinsurance contract*.

[**Note**: article 25(4) of the *IDD*]

When an intermediary may be considered to be manufacturing

1.4.4 EU

3(1)For the purposes of Article 25(1) of Directive (EU) 2016/97, insurance intermediaries shall be considered manufacturers where an overall analysis of their activity shows that they have a decision-making role in designing and developing an insurance product for the market.

3(2)A decision-making role shall be assumed, in particular, where insurance intermediaries autonomously determine the essential features and main elements of an insurance product, including its coverage, price, costs, risk, target market and compensation and guarantee rights, which are not substantially modified by the insurance undertaking providing coverage for the insurance product.

1

3(3)Personalisation of and adaptation of existing insurance products in the context of insurance distribution activities for individual customers, as well as the design of tailor-made contracts at the request of a single customer, shall not be considered manufacturing.

[**Note**: article 3 of the *IDD POG Regulation*]

1.4.5 G The effect of ■ PROD 1.4.3EU and ■ PROD 1.4.6R is that an *insurance intermediary* needs to consider if it is *manufacturing* an insurance product and, if so, should comply with ■ PROD 4.2 (Manufacture of insurance products).

Effect of provisions marked "EU"

1.4.6 R (1) Subject to (2) and ■ PROD 1.4.3R, provisions in this section and in ■ PROD 4 marked "EU" apply to *firms manufacturing* or *distributing* insurance products, but to whom the *IDD POG Regulation* does not apply, as if they were *rules*.

(2) For the purposes of (1), a word or phrase used in the *IDD POG Regulation* and referred to in column (A) has the meaning indicated in Column (B) of the table below:

(a)	(b)
"Article 17(1) of Directive (EU) 2016/97"	ICOBS 2.5.-1R, in relation to a *non-investment insurance contract*, or COBS 2.1.1R, in relation to a *life policy*
"Article 25(1) of Directive (EU) 2016/97"	PROD 4.2.1R and PROD 4.2.2R
"Article 8(2)"	PROD 4.2.30EU
"competent authorities"	*FCA*
"customer" and "potential customer"	*customer*
"Directive (EU) 2016/97"	*IDD*
"insurance-based investment products"	*insurance-based investment products*
"insurance distribution activities" and "distribution activities"	*insurance distribution activities*
"insurance distributor"	*distributor*
"insurance intermediary"	*insurance intermediary*
"insurance undertaking"	*insurer*
"manufacturer" and "manufacturers within the meaning of Article 2 of this Delegated Regulation"	*manufacturer*
"manufacturing"	*manufacturing*
"shall"	must

(3) In this sourcebook, where a reproduced provision of an article of the *IDD POG Regulation* refers to another part of the *IDD POG Regulation*, that other provision must also be read with reference to the table in (2).

Where?

1.4.7 R ■ PROD 4 applies to a *firm* with respect to activities carried on from an establishment maintained by it, or its *appointed representative*, in the *United Kingdom*.

[**Note**: article 7(2) of the *IDD*]

EEA territorial scope rule: compatibility with European law

1.4.8 R (1) The territorial scope of ■ PROD 4 is modified to the extent necessary to be compatible with European law.

(2) This *rule* overrides every other *rule* in this sourcebook.

Electronic Commerce Directive: effect on territorial scope

1.4.9 G The *rules* and *guidance* on the *E-Commerce Directive* in ■ ICOBS 1 Annex 1, Part 3, paragraph 1.2R and Part 4 paragraph 8, and in■ COBS 1 Annex 1, Part 2, paragraph 1.2R and Part 3, paragraph 7, apply equally in relation to the *rules* in ■ PROD 4.

Interaction of PROD 4 and the RPPD Guide

1.4.10 G A *firm* to which ■ PROD 4 applies need not apply the *guidance* in *RPPD* for matters covered by *PROD* if the *firm* has complied with ■ PROD 4 (see also ■ PROD 4.4.2G). ■ PROD 4.4 includes *guidance* based on the *RPPD* which *firms* subject to ■ PROD 4 should apply.

Chapter 2

Statement of policy with respect to the making of temporary product intervention rules

2.1 Purpose

2.1.1 G This chapter explains the *FCA's* policy with respect to the making of *temporary product intervention rules* under sections 137D and 138M of the Act. This statement of policy replaces the "Statement of Policy for making temporary product intervention rules" published in Policy Statement PS13/03 (see https://www.fca.org.uk/publication/policy/fsa-ps13-03.pdf).

[**Note:** see section 138N of the *Act*]

2.1.2 G Product intervention *rules* are *rules* made under section 137D of the *Act* which apply to specific products (or types of products), product features or marketing practices relating to specific products.

2.1.3 G Product intervention *rules* may be made without consultation under section 138M of the *Act* but are limited to a maximum duration of 12 *months* and are referred to as "*temporary product intervention rules*".

2.2 General rule making and product intervention rules

2.2.1 G The *Act* empowers the *FCA* to make general *rules* as appear necessary or expedient for the purpose of advancing one or more of its *operational objectives*.

[**Note:** see section 137A of the *Act*]

2.2.2 G The *Act* also provides that the *FCA* may use its general rule-making power to make product intervention rules prohibiting *authorised persons* from, among other things, entering into specified agreements (section 137D of the *Act*). These *rules* may be made to advance:

(1) the consumer protection objective; or

(2) the competition objective; or

(3) the market integrity objective.

2.2.3 G Section 137D(2) of the *Act* sets out that the *FCA* may prohibit *authorised persons* from:

(1) entering into specified agreements with any *person* or specified person (specified person means a person who meets the description specified by *FCA rules*);

(2) entering into specified agreements with any *person* or specified person unless requirements specified in the *rules* have been satisfied;

(3) doing anything that would or might result in the entering into of specified agreements by *persons* or specified persons, or the holding by them of a beneficial or other kind of economic interest in specified agreements; and

(4) doing anything within paragraph (3) unless requirements specified in the *rules* have been satisfied.

2.2.4 G Section 137D of the *Act* makes it clear that a range of options would be available to us in making *rules* prohibiting *authorised persons* from entering into specified agreements.

2.2.5 G The extent of the *rules* which are made will generally depend on the type of intervention deemed necessary to address the issues identified, having regard to whether the intervention would be a proportionate response to the perceived risk to *consumers*, competition issues or market integrity issues.

2.2.6 G *Rules* may include:

(1) requiring certain product features to be included, excluded or changed; or

(2) requiring amendments to promotional materials; or

(3) the imposition of restrictions on sales or marketing of the product; or

(4) in more serious cases, a ban on sales or marketing of a product in relation to all or some types of *client*.

2.2.7 G Where the product is provided by a business outside of the *UK*, *rules* may be made targeting *regulated activities* by *authorised persons* in the *UK* that would lead to a specified agreement being formed.

[**Note:** see sections 137D(2)(c) and (d) of the *Act*]

2.3 Agreements made in breach of product intervention rules

2.3.1 G In relation to agreements entered into in breach of product intervention *rules*, section 137D(7) sets out that the rules may:

(1) provide for a relevant agreement or obligation to be unenforceable against any *person* or specified person;

(2) provide for the recovery of any money or other property paid or transferred under a relevant agreement or obligation by any *person* or specified person; and

(3) provide for the payment of compensation for any loss sustained by any *person* or specified person as a result of paying or transferring any money or other property under a relevant agreement or obligation.

2.3.1(3) G Where a *rule* provides for a relevant agreement or obligation to be unenforceable, the relevant agreement or obligation would only be unenforceable if the sale of the product was made after the introduction of the *rules* and there was a contravention of those *rules*. *Clients* with products bought after the introduction of *rules* incorporating unenforceability provisions would generally need to seek redress through the usual channels of complaints to the *firm* and to the *Financial Ombudsman Service*, or legal action against the *firm*.

2.3.1(3) G Arrangements made before the introduction of the *rules* would not be affected by the unenforceability and compensation provisions. *Clients* holding contracts made before these *rules* were in place would still be able to seek redress through the usual channels of complaints to the *firm* and to the *Financial Ombudsman Service* or legal action against the relevant *firm*. These *clients* would need to establish their claim to redress in the usual way, for example by demonstrating that the advice they received was unsuitable, or that they bought the product after receiving a misleading *financial promotion*.

2.4 Temporary product intervention rules

2.4.1 G Normally the *FCA* must consult the public before making any *rules*. However, the *Act* allows a general exemption in section 138L where the *FCA* considers that the delay involved in complying with the requirement to consult would be prejudicial to the interests of *consumers*.

2.4.2 G There is also a specific exemption to the consultation requirement in relation to making *temporary product intervention rules* (section 138M of the *Act*). The *FCA* may make *temporary product intervention rules* without consultation if it considers that it is necessary or expedient not to comply with such a requirement to advance:

(1) the consumer protection objective, or

(2) the competition objective, or

(3) the market integrity objective.

2.4.3 G The *FCA's* discretion to act under section 138M is therefore wider than under section 138L.

2.4.4 G Decisions to make any *rules*, including *temporary product intervention rules*, will be taken by the *FCA* Board. In doing so, the *FCA* Board will have regard to all the available, relevant evidence, as well as the impact of the measure to be introduced by the *rule*.

2.4.5 G The *FCA* Board will consider whether the evidence is sufficient to support the proposed measure and whether the measure is a proportionate response to the issue identified.

2.4.6 G In publishing *temporary product intervention rules* the *FCA* will also publish the rationale for these *rules*.

2.5 Factors the FCA will consider when making temporary product intervention rules

2.5.1 G In general terms the *FCA* will consider a product intervention *rule* where we identify a risk of *consumer* detriment, a threat to market integrity or ineffective competition arising from a particular product, type of product, or practices associated with a particular product or type of product.

2.5.2 G In deciding whether the *rule* should be made as a *temporary product intervention rule*, the *FCA's* main consideration will generally be whether prompt action is deemed necessary in seeking to reduce or prevent *consumer* detriment or a threat to market integrity or ineffective competition arising from that product, type of product or practices.

2

2.6 General considerations for product intervention rules

2.6.1 G Together with the considerations in ■ PROD 2.5, when making temporary or permanent product intervention *rules*, the *FCA* will have regard to the regulatory principles set out in section 3B of the *Act*, (see ■ PROD 2.9).

2.6.2 G The *FCA* will also take into account general considerations that include, but are not limited to, whether the proposed *rules* are:

(1) an appropriate and effective means of addressing actual or potential *consumer* detriment associated with a particular product or group of products;

(2) a proportionate and deliverable means of addressing actual or potential detriment;

(3) compatible with the *FCA's* duty to promote effective competition in the interests of *consumers* (section 1B(4) of the *Act*);

(4) supported by sufficient and appropriate evidence;

(5) transparent in their aim and operation;

(6) likely to be beneficial for *clients* when taken as a whole; and

(7) compatible (where relevant) with other applicable law, for example *EU* law.

2.6.3 G In accordance with the Equality Act 2010, the *FCA* will have due regard to the need to:

(1) eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010;

(2) advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it; and

(3) foster good relations between persons who share a relevant protected characteristic and persons who do not share it;

when making temporary or permanent product intervention *rules*.

2.7 Contextual considerations for product intervention rules

2.7.1 G When the *FCA* is considering whether to make temporary or permanent product intervention *rules* in response to an identified issue with a product, the following factors may be taken into account:

(1) The potential scale of detriment in the market. Issues involving products with a large or potentially large *client* base are more likely to require product intervention.

(2) The potential scale of detriment to individual *clients*. Issues that may lead to high detriment for individual *clients* are more likely to require product intervention.

(3) The social context. Issues that may lead to detriment for particular groups of *clients* (such as, in particular, vulnerable *client* groups) are more likely to require product intervention.

(4) The market context. Market mechanisms such as information disclosure and competition do not always work to protect *consumers*.

(5) Possible unintended consequences. Whether the use of product intervention *rules* or the timing of the intervention would in itself create undue risk of further *consumer* detriment, including harm to existing *clients* and in the market (although this will not necessarily comprise a full cost benefit analysis).

2.8 Competition considerations for temporary product intervention rules

2.8.1 G When making a temporary or permanent product intervention *rule*, the *FCA* will seek to promote effective competition in the interests of *consumers* where doing so is compatible with its consumer protection objective or integrity objective.

2.8.2 G In accordance with section 1E of the *Act* the *FCA* also has a competition objective and may make *rules*, including *temporary product intervention rules*, specifically to advance competition.

2.8.3 G Relevant competition-related considerations for the *FCA* in the context of temporary or permanent product intervention *rules* are likely to include:

(1) Whether there is reasonable scope for the *rules* under consideration to promote effective competition in the interests of *consumers*, for instance by addressing *consumer* behaviours that impair their ability to benefit from competition, by reducing information asymmetries or by correcting misaligned incentives.

(2) Whether the *rule* under consideration may have a negative impact on competition factors such as product innovation and barriers to entry for new market participants.

(3) Whether any negative impact on competition factors is proportionate, having regard to the aims of the *rule* under consideration.

(4) Whether alternative solutions may deliver the same intended outcome while having a more positive impact on competition.

(5) The overall effect of a proposed *rule* upon the operation of effective competition in the market for financial services, having regard to the interests of *consumers*.

2.9 Regulatory principles

2.9.1 G The *FCA* will have regard to the regulatory principles set out in section 3B of the *Act* when making *temporary product intervention rules*.

2.9.2 G As part of the *FCA's* consideration of issues including the desirability of facilitating innovation, we will consider the potential deterrent effect on entry to the market and innovation when making *temporary product intervention rules* against the potential for reducing anticipated consumer detriment.

2.10 Process for making temporary product intervention rules

2.10.1 G Once initial proposals have been discussed, a paper will be prepared at working group level for a committee (the Committee) with appropriate authority to propose *temporary product intervention rules* to the *FCA* Board.

2.10.2 G The Committee will either endorse the proposals and recommend that they are taken to the Board, or suggest rethinking or amending the proposals and coming back at a later date. A decision may be taken to use a different regulatory tool, or not to proceed.

2.10.3 G If the Committee decides that the proposals should go to the Board, the paper will be taken to the next available scheduled Board meeting, unless the matter is of great importance or there is an emergency, in which case the Board may convene specifically to consider the issue.

2.10.4 G If the Board makes a decision to act on the policy proposals the *FCA* will publish the *temporary product intervention rules* on its website and take the necessary follow-up actions.

2.11 Consulting the panels

2.11.1 G The *FCA* will generally seek the views of the Financial Services Practitioner Panel, the Smaller Businesses Practitioner Panel and the Financial Services Consumer Panel during the process for making *temporary product intervention rules* if there is sufficient time to do so.

2.12 Consulting the PRA

2.12.1 G Before any proposed product intervention *rules* are made (whether temporary or not) the *FCA* will consult the *PRA*.

2.13 Communication, publication and post-implementation review of temporary product intervention rules

2.13.1 G Before making a *temporary product intervention rule*, the Committee will consider how affected *firms* and *clients* are to be informed of the *rule* in good time.

2.13.2 G The *FCA* will publish a statement on its website explaining why it is introducing the *rule*. The *FCA* may choose to invite feedback, but this will not amount to a consultation exercise.

2.13.3 G The FCA may choose to review a *temporary product intervention rule* during the term for which the *rule* is in force. Such a review will generally depend on the perceived risk the *rule* seeks to mitigate. These reviews may be informed by market monitoring and feedback from stakeholders, including product *manufacturers*, *distributors* and *clients*.

2.13.4 G Where the *FCA* perceives potential uncertainty about how the *rule* operates, it may consider publishing *guidance*.

2.13.5 G Reviews are likely to consider whether a *rule* is functioning as intended, including whether:

(1) there have been any breaches of the *rule*; or

(2) there are any unintended consequences, such as an impact on products that were not intended to be caught by the *rule*; or

(3) there is evidence suggesting *firms* are avoiding or seeking to avoid the *rule* rather than complying with it, for instance where new products enter the market or new features are added to existing products that expose *clients* to the same or similar potential detriment; or,

(4) new evidence demonstrates that the *rule* is not necessary or detriment is unlikely.

2.13.6 G As a result of these reviews, where necessary, the *FCA* may:

(1) revoke a *temporary product intervention rule*; or

(2) amend the *rule*, for example where a *rule* specifies certain criteria under which the sale of a product may continue, change these criteria.

2.13.7 G Subsequent changes to a *temporary product intervention rule* will be communicated by issuing a new statement containing the revised *rule* and the rationale for the changes. Such changes will not extend the lifespan of the *temporary product intervention rule*.

2.13.8 G However, the *FCA* may consult on a new *rule* to replace the *temporary product intervention rule* from the date on which the *temporary product intervention rule* ceases to have effect. This exercise would be subject to the *FCA's* standard *rule*-making procedure including market failure analysis, cost benefit analysis and consultation to which all stakeholders, including *manufacturers*, *distributors* and *clients* would be invited to reply.

2.14 Revocation or replacement of rules

2.14.1 G When making *temporary product intervention rules* the *FCA* will state the duration of the *rule* and the date from which it will be effective. *Temporary product intervention rules* will have a maximum duration of 12 *months* from when the *rule* is made, but the *FCA* may decide on a shorter duration for a *rule*.

2.14.2 G The *FCA* may review or revoke *temporary product intervention rules* at any time before the end of the period for which they apply.

2.14.3 G *Rules* may be revoked or amended for a number of reasons, including but not limited to:

(1) new *rules* are introduced on a permanent basis following a consultation exercise; or

(2) industry initiatives are developed that specify sufficient minimum standards to address the sources of *consumer* detriment; or

(3) further evidence is submitted that demonstrates that *consumer* detriment will not occur; or

(4) demand for, or supply of, the relevant product disappears and is deemed unlikely to return; or

(5) the *FCA* identifies unforeseen negative effects of the *rule* which outweigh any positive impact upon consumer protection.

2.14.4 G Where *temporary product intervention rules* have been made, the *FCA* may not make further *temporary product intervention rules* containing the same, or substantially the same, provisions within 12 *months* beginning on the day on which the limited duration of the initial *rules* ends (whether or not the *rules* were revoked early). This period does not apply to *rules* that are not *temporary product intervention rules*, (i.e. rules which had been made subject to consultation, whether or not of set duration).

Chapter 3

Product governance: MiFID

3.1 General

[Note: ESMA has also issued guidelines under article 16(1) of the ESMA Regulation covering: "MiFID II product governance requirements", dated 5th February 2018. See https://www.esma.europa.eu/sites/default/files/library/esma35-43-620_guidelines_on_mifid_ii_product_governance_requirements_0.pdf.]

Interpretation: financial instruments and structured products

3.1.1 R For the purposes of ■ PROD 3, references to *financial instruments* include *structured deposits*.

Proportionate application of rules

3.1.2 R (1) A *firm* must, when *manufacturing financial instruments* or deciding on the range of *financial instruments* and *investment services* it intends to *distribute* to *clients*, comply, in a way that is appropriate and proportionate, with the requirements set out in this chapter.

(2) In complying with these requirements, a *firm* must take into account:

(a) the nature of the *financial instrument* or *investment service*; and

(b) the target market for the *financial instrument*.

[**Note:** articles 9(1) and 10(1) of the *MiFID Delegated Directive*]

3.1.3 G A proportionate application of the requirements in this chapter may mean that complying with the *rules* could be relatively simple for simple *financial instruments* distributed on an *execution-only transaction* basis where such *financial instruments* would be compatible with the needs and characteristics of the mass retail market.

3.2 Manufacture of products

General

3.2.1 R A *manufacturer* must:

(1) ensure that the *financial instruments* it *manufactures* are designed to meet the needs of an identified target market of *end clients* within the relevant category of *clients* (see ■ COBS 3 for client categories);

(2) ensure that the strategy for *distribution* of the *financial instruments* is compatible with the identified target market; and

(3) take reasonable steps to ensure that the *financial instrument* is distributed to the identified target market.

[**Note:** article 24(2) of *MiFID*]

3.2.2 G Consideration of target market factors should permeate all aspects of product development and *distribution*, as well as ensuring the selection of appropriate *distribution* channels and the promotion of the *financial instruments* are accompanied by sufficient and correct information.

Product governance arrangements

3.2.3 R A manufacturer must maintain, operate and review a process for the approval of:

(1) each *financial instrument*, and

(2) significant adaptations of existing *financial instruments*,

in each case before they are marketed or *distributed* to *clients*.

[**Note:** article 16(3) of *MiFID*]

3.2.4 R For each *financial instrument* the product approval process must:

(1) specify an identified target market of *end clients* within the relevant category of *clients* (see ■ COBS 3 for client categories);

(2) ensure that all relevant risks to the identified target market are assessed; and

(3) ensure that the intended *distribution* strategy is consistent with the identified target market.

[**Note:** article 16(3) of *MiFID*]

3.2.5 G When designing *financial instruments*, a *firm* should have in place systems and controls to manage adequately the risks posed by *financial instrument* design.

Manufacture by more than one firm

3.2.6 R Where *firms* collaborate to *manufacture* a *financial instrument*, only one target market needs to be identified.

[**Note:** article 9(9) of the *MiFID Delegated Directive*]

3.2.7 R Where *firms* collaborate, including with entities which are not authorised and supervised in accordance with *MiFID* or *third country investment firms*, to create, develop, issue and/or design a *financial instrument*, they must outline their mutual responsibilities in a written agreement.

[**Note:** article 9(8) of the *MiFID Delegated Directive*]

Target market

3.2.8 R *Manufacturers* must identify the potential target market for each *financial instrument* at a sufficiently granular level and must:

(1) specify the type or types of *client* for whose needs, characteristics and objectives the *financial instrument* is compatible; and

(2) identify any group or groups of *client* for whose needs, characteristics and objectives the *financial instrument* is not compatible.

[**Note:** article 9(9) of the *MiFID Delegated Directive*]

3.2.9 G The level of granularity of the target market and the criteria used to define the target market and determine the appropriate *distribution* strategy should be relevant for the *financial instrument* and should make it possible to assess which *clients* fall within the target market. For simpler, more common *financial instruments*, the target market could be identified with less detail while for more complicated *financial instruments* such as bail-inable instruments or less common *financial instruments*, the target market should be identified with more detail.

[**Note:** recital 19 of the *MiFID Delegated Directive*]

3.2.10 R *Manufacturers* must determine for each *financial instrument* they *manufacture*, whether it meets the identified needs, characteristics and objectives of the target market, and in doing so must include an examination of the following elements:

(1) whether the *financial instrument's* risk/reward profile is consistent with the target market; and

(2) whether the design of the *financial instrument* is driven by features that benefit the *client* and not by a business model which relies on poor *client* outcomes to be profitable.

[**Note:** article 9(11) of the *MiFID Delegated Directive*]

3.2.11 R *Manufacturers* of *financial instruments* that are *distributed* through other *firms* must determine the needs and characteristics of the *clients* for whom the product is compatible based on:

(1) their theoretical knowledge of, and past experience with, the *financial instrument* or similar *financial instruments*;

(2) the financial markets, and

(3) the needs, characteristics and objectives of potential *end clients*.

[**Note:** article 9(9) of the *MiFID Delegated Directive*]

Product testing

3.2.12 R *Manufacturers* must undertake a scenario analysis of their *financial instruments* to assess:

(1) the risks of poor outcomes for *end clients* posed by the *financial instrument*; and

(2) in which circumstances those poor outcomes may occur.

[**Note:** article 9(10) *MiFID Delegated Directive*]

3.2.13 R In conducting the scenario analysis *manufacturers* must assess their *financial instruments* under negative conditions covering what would happen if, for example:

(1) the market environment deteriorated; or

(2) the *manufacturer* or a third party involved in *manufacturing* and/or the functioning of the *financial instrument* experiences financial difficulties or other counterparty risk materialises; or

(3) the *financial instrument* fails to become commercially viable; or

(4) demand for the *financial instrument* is much higher than anticipated, putting a strain on the *firm's* resources and/or on the market of the underlying *financial instrument*.

[**Note:** article 9(10) *MiFID Delegated Directive*]

3.2.14 R *Manufacturers* must consider the charging structure proposed for each *financial instrument*, including examination of the following:

(1) whether the *financial instrument's* costs and charges are compatible with the needs, objectives and characteristics of the target market;

(2) whether the charges undermine the *financial instrument's* return expectations, such as where the costs or charges equal, exceed or remove almost all the expected tax advantages linked to a *financial instrument*; and

(3) whether the charging structure of the *financial instrument* is appropriately transparent for the target market, such as that it does not disguise charges or is too complex to understand.

[**Note:** article 9(12) of the *MiFID Delegated Directive*]

3.2.15 R *Manufacturers* must consider whether the *financial instrument* may represent a threat to the orderly functioning, or to the stability, of financial markets before deciding to proceed with the launch of the *financial instrument*.

[**Note:** article 9(4) of the *MiFID Delegated Directive*]

Information disclosure to distributors

3.2.16 R A manufacturer must make available to any distributor of that financial instrument:

(1) all appropriate information on the *financial instrument*;

(2) all appropriate information on the product approval process;

(3) the identified target market of the *financial instrument*, including information about the target market assessment undertaken;

(4) information about the appropriate channels for *distribution* of the *financial instrument*;

and must ensure that the information is of an adequate standard to enable *distributors* to understand and recommend or sell the *financial instrument* properly.

[**Note:** article 16(3) of *MiFID II* and 9(13) of the *MiFID Delegated Directive*]

3.2.17 G When providing information to *distributors*, a *manufacturer* should make it clear if that information is not intended for *end client* use.

3.2.18 G *Manufacturers* may consider, for example, with regard to each *distribution* channel or type of *distributor* what information *distributors* of that type already have, their likely level of knowledge and understanding, their information needs and what form or medium would best meet those needs (which could include discussions, written material or training as appropriate).

Review of financial instruments

3.2.19 R (1) A *manufacturer* must regularly review the *financial instruments* it *manufactures* taking into account any event that could materially affect the potential risk to the identified target market.

(2) In doing so, a *manufacturer* must assess for each *financial instrument* at least the following:

(a) whether the *financial instrument* remains consistent with the needs, characteristics and objectives of the identified target market;

(b) whether the intended *distribution* strategy remains appropriate;

(c) whether the *financial instrument* is being *distributed* to the target market; and

(d) whether the *financial instrument* is reaching *clients* for whose needs, characteristics and objectives the *financial instrument* is not compatible.

[**Note:** article 16(3) of *MiFID II* and article 9(14) of the *MiFID Delegated Directive*]

3.2.20 G In carrying out the reviews in ■ PROD 3.2.19R *manufacturers* should collect and analyse appropriate management information to detect patterns in *distribution* as compared with the planned target market in order to assess the performance of the *distribution* channels through which a *financial instrument* is being *distributed*.

3.2.21 G (1) When reviewing the *financial instruments* it manufactures, a *firm* should communicate to the *end client* contractual "breakpoints" such as the end of a long tie-in period that may have a material impact on the *end client* that the *end client* cannot reasonably be expected to recall or know about already.

(2) If the *manufacturer* does not know the identity of the *end client*, it should communicate any contractual breakpoints to the *distributor*.

3.2.22 R *Manufacturers* must:

(1) review *financial instruments* prior to any further issue or re-launch if they are aware of any event that could materially affect the potential risk to *clients*; and

(2) identify crucial events that would affect the potential risk or return expectations of the *financial instrument*.

3.2.23 G Crucial events that would affect the potential risk or return expectations of the *financial instrument* include:

(1) the crossing of a threshold that will affect the return profile of the *financial instrument*; or

(2) the solvency of certain issuers whose securities and guarantees may impact the performance of the *financial instrument*.

3.2.24 R When a crucial event affecting the potential risk or return expectation of the *financial instrument* occurs, a *manufacturer* must take appropriate action, which may consist of:

(1) the provision of any relevant information on the event and its consequences on the *financial instrument* to the *clients* or *distributors*

of the *financial instrument* if the *manufacturer* does not offer or sell the *financial instrument* directly to the *clients*;

(2) changing the product approval process;

(3) stopping further issuance of the *financial instrument*;

(4) changing the *financial instrument* to avoid unfair contract terms;

(5) considering whether the sales channels through which the *financial instrument* is sold are appropriate where the *manufacturer* becomes aware that the *financial instrument* is not being sold as envisaged;

(6) contacting the *distributor* to discuss a modification of the *distribution* process;

(7) terminating the relationship with the *distributor*; or

(8) informing the relevant *competent authority*.

3.2.25 R *Manufacturers* must review *financial instruments* at regular intervals to assess whether they function as intended.

3.2.26 R *Manufacturers* must determine how regularly to review their *financial instruments* based on relevant factors including factors linked to the complexity or the innovative nature of the investment strategies pursued.[**Note:** article 9(15) of the *MiFID Delegated Directive*]

Conflicts of interest

3.2.27 R *Manufacturers* must establish, implement and maintain procedures and measures to ensure the *manufacture* of *financial instruments* complies with the requirements on proper management of conflicts of interest (see SYSC 10.1.7R), including *remuneration*.

3.2.28 R *Manufacturers* must ensure that the design of each *financial instrument*, including its features, does not:

(1) adversely affect *end clients*; or

(2) lead to problems with market integrity by enabling the *firm* to mitigate and/or dispose of its own risks or exposure to the underlying assets of the product where the *firm* already holds the underlying assets on own account.

[**Note:** article 9(2) of the *MiFID Delegated Directive*]

3.2.29 R Each time a *financial instrument* is *manufactured manufacturers* must analyse potential conflicts of interests.

3.2.30 R In analysing potential conflicts of interest *manufacturers* must assess whether the *financial instrument* creates a situation where *end clients* may be adversely affected if *end clients* take:

(1) an exposure opposite to the one previously held by the *manufacturer* itself; or

(2) an exposure opposite to the one that the *manufacturer* wants to hold after the sale of the product.

[**Note:** article 9(3) of the *MiFID Delegated Directive*]

Oversight and training requirements

3.2.31 R *Manufacturers* must ensure that their *management bodies* have effective control over their product governance process.

3.2.32 R The development and periodic review of product governance arrangements must be monitored by the *person* allocated the *compliance oversight function* of a *firm* in order to detect any risk of failure by the *manufacturer* to comply with applicable provisions of *PROD*.

[**Note:** article 9(6) and article 9(7) of the *MiFID Delegated Directive*]

3.2.33 R All relevant staff involved in the *manufacturing* of *financial instruments* must possess the necessary expertise to understand the characteristics and risks of the *financial instruments* they intend to *manufacture*.

[**Note:** article 9(5) of the *MiFID Delegated Directive*]

3.2.34 G *Firms* should have regard to SYSC 5.1, and in particular SYSC 5.1.5AB R, when considering whether their relevant staff have the necessary expertise.

Compliance reports

3.2.35 R Compliance reports to the *management body* must include information about the *financial instruments* that the firm has *manufactured*, including information on the *distribution* strategy.

3.2.36 R *Manufacturers* must make the compliance reports available to their *competent authority* on request.

[**Note:** article 9(6) *MiFID Delegated Directive*]

3

3.3 Distribution of products and investment services

General

3.3.1 R A *distributor* must:

(1) understand the *financial instruments* it *distributes* to *clients*;

(2) assess the compatibility of the *financial instruments* with the needs of the *clients* to whom it *distributes investment services*, taking into account the *manufacturer's* identified target market of *end clients*; and

(3) ensure that *financial instruments* are *distributed* only when this is in the best interests of the *client* (see ■ COBS 2.1.1R(1)).

[**Note:** article 24(2) of *MiFID*]

3.3.2 G A *distributor* should consider what impact the selection of a given *manufacturer* could have on the *end client* in terms of charges or the financial strength of the *manufacturer*, or possibly, where information is available to the *distributor*, how efficiently and reliably the *manufacturer* will deal with the *distributor* or *end client* at the point of sale (or subsequently, such as when queries/complaints arise, claims are made, or a *financial instrument* reaches maturity).

Obtaining information from manufacturers

3.3.3 R *Distributors* must obtain from *MiFID manufacturers* information to gain the necessary understanding and knowledge of the *financial instruments* they intend to *distribute* in order to ensure that the *financial instruments* will be *distributed* in accordance with the needs, characteristics and objectives of the target market.

[**Note:** article 16(3) *MiFID* and article 10(2) *MiFID Delegated Directive*]

3.3.4 G In ensuring that they have obtained sufficient information about the *financial instruments* they *distribute* and in ensuring they understand the *financial instruments* or *investment services distributed*, *distributors*:

(1) should consider whether they understand the materials provided by the *manufacturer* or *distributor* earlier in the sales chain;

(2) should ask the *manufacturer* to supply additional information or training where this seems necessary to understand the *financial instrument* or *investment service* adequately;

(3) should not *distribute* the *financial instrument* or *investment service* if they do not understand it sufficiently; and

(4) when providing information to another *distributor* in a distribution chain, should consider how the further *distributor* will use the information, such as whether it will be given to end *clients*. *Firms* should consider what information the further *distributor* requires and the likely level of knowledge and understanding of the further *distributor* and what medium may suit it best for the transmission of information.

Distributing financial instruments manufactured by non-MiFID firms, including third country firms

3.3.5 R

(1) *Distributors* must take all reasonable steps to comply with ■ PROD 3.3 when *distributing financial instruments manufactured* by any *firm* to which *MiFID manufacturer* product governance requirements (■ PROD 3.2 or equivalent requirements of another *EEA State*) do not apply.

(2) As part of this, *distributors* must put in place effective arrangements to ensure that they obtain sufficient, adequate and reliable information from the *manufacturer* about the *financial instruments* to ensure that they will be *distributed* in accordance with the characteristics, objectives and needs of the target market.

(3) This *rule* applies to *financial instruments* sold on either the primary or secondary market.

3.3.6 R

The obligation to obtain adequate and reliable information applies proportionately depending on:

(1) the degree to which publicly available information is obtainable; and

(2) the complexity of the *financial instrument*.

[**Note:** articles 10(1) and 10(2) of the *MiFID Delegated Directive*)

3.3.7 R

Where information relevant to the obligation in ■ PROD 3.3.5R is not publicly available, *distributors* must take all reasonable steps to obtain such relevant information from the *manufacturer* or its agent.

3.3.8 G

Acceptable publicly available information is information which is clear, reliable and produced to meet regulatory requirements, such as disclosure requirements under the *transparency rules* or the *prospectus rules*.

[**Note:** article 10(2) of the *MiFID Delegated Directive*]

3

Target market and distribution strategy

3.3.9 R *Distributors* must determine the target market for the respective *financial instrument*, even if the target market was not defined by the *manufacturer*.

[**Note:** article 10(1) of the *MiFID Delegated Directive*]

3.3.10 R *Distributors* must identify the target market and their *distribution* strategy using:

(1) the information obtained from *manufacturers*; and

(2) information they have on their own *clients*.

3.3.11 G In identifying the target market and creating a *distribution* strategy, *distributors* should consider:

(1) the nature of the *financial instruments* to be offered or recommended and how they fit with *end clients'* needs and risk appetite;

(2) the impact of charges on *end clients*;

(3) the financial strength of the *manufacturer*; and

(4) where information is available on the *manufacturer's* processes, how efficiently and reliably the *manufacturer* will deal with the *end client* at the point of sale or subsequently, such as when complaints arise, claims are made or the *financial instrument* reaches maturity.

3.3.12 G The target market identified by *distributors* for each *financial instrument* should be identified at a sufficiently granular level.

3.3.13 G Where a *distributor* is part of a distribution chain, the information referred to in ■ PROD 3.3.10R(2) should include information on the intended *end client*.

3.3.14 R Where a *firm* acts both as a *manufacturer* and a *distributor*, only one target market assessment is required.

[**Note:** article 10(2) of the *MiFID Delegated Directive*]

3.3.15 R (1) *Distributors* must have in place adequate product governance arrangements to ensure that:

(a) the *financial instruments* and *investment services* they intend to *distribute* are compatible with the needs, characteristics and objectives of the identified target market; and

(b) the intended *distribution* strategy is consistent with the identified target market.

(2) *Distributors* must appropriately identify and assess the circumstances and needs of the *clients* they intend to focus on to ensure that their

clients' interests are not compromised as a result of commercial or funding pressures.

(3) *Distributors* must identify any groups of *end clients* for whose needs, characteristics and objectives the *financial instrument* or *investment service* is not compatible.

[**Note:** article 10(2) of the *MiFID Delegated Directive*]

3

3.3.16 R *Distributors* must periodically review their product governance arrangements under ■ PROD 3.3.15R and must take appropriate actions where necessary to ensure they remain robust and fit for their purpose.

[**Note:** article 16(3) of *MiFID* and article 10(4) of the *MiFID Delegated Directive*]

3.3.17 G In the design of *investment services*, to help *clients* make an informed investment decision, *firms* should consider the support *clients* need before they reach the product selection part of the process.

3.3.18 R *Distributors* must have in place procedures and measures to ensure that when deciding the range of *financial instruments* and *investment services* to be *distributed*, and the target market, all applicable *rules* are complied with, including but not limited to:

(1) disclosure (see ■ COBS 4 and ■ COBS 14.3A);

(2) suitability (see ■ COBS 9A);

(3) appropriateness (see ■ COBS 10A);

(4) inducements (see ■ COBS 2.3A); and

(5) conflicts of interest (see ■ SYSC 10.1).

3.3.19 G *Distributors* should take particular care to ensure compliance with ■ PROD 3.3.18R when they intend to *distribute* new *financial instruments* or there are variations to the *investment services* they provide.

[**Note:** article 10(3) of the *MiFID Delegated Directive*]

Oversight and training requirements

3.3.20 R The development and periodic review of product governance arrangements must be monitored by the *person* allocated the *compliance oversight function* of a *firm* in order to detect any risk of failure by the *distributor* to comply with applicable provisions of *PROD*.

[**Note:** article 10(6) of the *MiFID Delegated Directive*]

3.3.21 R The *management body* of a *distributor* must have effective control over the *firm's* product governance process to determine:

(1) the range of *financial instruments* the *firm* offers or recommends; and

(2) the *investment services* provided to the respective target markets.

[**Note:** article 10(8) of the *MiFID Delegated Directive*]

3

3.3.22 R All relevant staff must possess the necessary expertise to understand:

(1) the characteristics and risks of the *financial instruments* that the *firm* intends to *distribute*;

(2) the *investment services* provided by the *firm*; and

(3) the needs, characteristics and objectives of the identified target market.

[**Note:** article 10(7) of the *MiFID Delegated Directive*]

3.3.23 G *Firms* should have regard to ■ SYSC 5.1, and in particular ■ SYSC 5.1.5AB R, when considering whether their relevant staff have the necessary expertise.

Compliance reports

3.3.24 R Compliance reports to the *management body* must include information about the *financial instruments distributed* by the *firm* and the *investment services* provided.

3.3.25 R A *distributor* shall make the compliance reports available to *competent authorities* on request.

[**Note:** article 10(8) of the *MiFID Delegated Directive*]

Post-sale review

3.3.26 R *Distributors* must regularly review the *financial instruments* they *distribute* and the *investment services* they provide, taking into account any event that could materially affect the potential risk to the identified target market.

3.3.27 R In carrying out the review in ■ PROD 3.3.26R, *distributors* must assess at least:

(1) whether the *financial instrument* or *investment service* remains consistent with the needs, characteristics and objectives of the identified target market; and

(2) whether the intended *distribution* strategy remains appropriate.

3.3.28 R If a *distributor* becomes aware that it has wrongly identified the target market for a specific *financial instrument* or *investment service*, or the *financial instrument* or *investment service* no longer meets the circumstances of the identified target market, it must take appropriate steps, including at least:

(1) reconsidering the target market; and/or

(2) updating its product governance arrangements.

3.3.29 G A *distributor* may need to take action under ■ PROD 3.3.28R in circumstances where the *financial instrument* becomes very illiquid or very volatile due to market changes.

[**Note:** article 16(3) of *MiFID* and article 10(5) of the *MiFID Delegated Directive*]

Information sharing

3.3.30 R To support the reviews carried out by *manufacturers* under ■ PROD 3.2.19R to ■ PROD 3.2.26R, a *distributor* must provide to the *manufacturer* of each *financial instrument* it *distributes*:

(1) information on sales; and

(2) where appropriate, information on the reviews carried out under ■ PROD 3.3.26R to ■ PROD 3.3.28R.

3.3.31 G (1) Information on sales should include information on any sales made outside the target market.

(2) In complying with ■ PROD 3.3.30R it is not necessary to report every sale to the *manufacturer*. *Distributors* should provide the data necessary for the *manufacturer* to review the *financial instrument* and check that it remains consistent with the needs, characteristics and objectives of the target market defined by the *manufacturer*. Relevant information could include:

(a) summary information of the types of *clients*;

(b) a summary of complaints received; and

(c) responses from *clients* to questions suggested by the *manufacturer* for the purposes of obtaining feedback from a *client* sample.

(3) In determining when providing information on the reviews carried out under ■ PROD 3.3.26R to ■ PROD3.3.28R is appropriate, a *distributor* should have regard to the requirements on the *manufacturer* in ■ PROD 3.2. Information on the reviews should be shared if the *manufacturer* requests it.

[**Note:** article 10(9) of and recital 20 to the *MiFID Delegated Directive*]

Responsibilities in chains of distributors

3.3.32 R (1) A *firm* which *distributes financial instruments* or *investment services* to *end clients* is responsible for ensuring that the obligations in this chapter are met in respect of any *financial instrument* or *investment service* it *distributes* to an *end client*.

(2) A *firm* which *distributes financial instruments* to *clients* which are not *end clients* must, in addition to complying with the *rules* in this

chapter, consider if they are also undertaking a *manufacturing* role and, if they are, also apply ■ PROD 3.2.

3.3.33 R A *distributor* which *distributes financial instruments* to other *distributors* must:

(1) ensure that relevant product information is passed from the *manufacturer* to the final *distributor* in the chain; and

(2) if the *manufacturer* requires information on product sales in order to comply with its obligations under ■ PROD 3.2, enable them to obtain it.

[**Note:** article 10(10) of the *MiFID Delegated Directive*]

Chapter 4

Product governance: IDD

4

4.1 General

Other requirements under the IDD

4.1.1 R This chapter does not affect the application of other requirements in the *FCA Handbook* applying to *firms* in relation to their *insurance distribution activities* including but not limited to:

(1) disclosure (■ ICOBS 2.2, ■ ICOBS 6.1, ■ COBS 4 and ■ COBS 14.2);

(2) suitability (■ COBS 9 or ■ COBS 9A);

(3) appropriateness (■ COBS 10A);

(4) identification and management of conflicts of interest (■ SYSC 10.1 for intermediaries or ■ SYSC 3.3 for insurers); and

(5) inducements (■ COBS 2.3A).

[**Note**: article 25(3) of the *IDD*]

4.2 Manufacture of insurance products

Product governance arrangements

4.2.1 R A *firm* which *manufactures* any insurance product must maintain, operate and review a process for the approval of:

(1) each insurance product; and

(2) significant adaptations of an existing insurance product,

in each case before it is marketed or *distributed* to *customers*.

[**Note**: first subparagraph of article 25(1) of the *IDD*]

4.2.2 R The product approval process referred to in ■ PROD 4.2.1R must be proportionate and appropriate to the nature of the insurance product.

[**Note**: second subparagraph of article 25(1) of the *IDD*]

4.2.3 G *Manufacturers* should take into account the following when considering whether the product approval process is proportionate and appropriate:

(1) the complexity of the insurance product;

(2) the degree to which publicly available information can be obtained;

(3) the nature of the insurance product and the risk of consumer detriment related to it;

(4) the characteristics of the target market; and

(5) the scale and complexity of the relevant business of the *manufacturer* or *distributor*.

[**Note**: recital 2 to the *IDD POG Regulation*]

4.2.4 G For the purposes of ■ PROD 4.2.2R proportionality means that the product approval process should be relatively simple for straightforward and non-complex products that are compatible with the needs and characteristics of the mass retail market. On the other hand, in the case of more complex products with a higher risk of consumer detriment more exacting measures should be required.

[**Note**: recital 2 to the *IDD POG Regulation*]

4

Product approval process

4.2.5 EU

4(1)Manufacturers shall maintain, operate and review a product approval process for newly developed insurance products and for significant adaptations of existing insurance products. That process shall contain measures and procedures for designing, monitoring, reviewing and distributing insurance products, as well as for corrective action for insurance products that are detrimental to customers. The measures and procedures shall be proportionate to the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the manufacturer.

[**Note**: article 4(1) of the *IDD POG Regulation*]

4.2.6 EU

4(2)The product approval process shall be set out in a written document ("product oversight and governance policy"), which shall be made available to the relevant staff.

[**Note**: article 4 (2) of the *IDD POG Regulation*]

4.2.7 EU

9Relevant actions taken by manufacturers in relation to their product approval process shall be duly documented, kept for audit purposes and made available to the competent authorities upon request.

[**Note**: article 9 of the *IDD POG Regulation*]

4.2.8 EU

4(3)The product approval process shall

(a)ensure that the design of insurance products:

(i)takes into account the objectives, interests and characteristics of customers;

(ii)does not adversely affect customers;

(iii)prevents or mitigates customer detriment;

(b)support a proper management of conflicts of interest.

[**Note**: article 4(3) of the *IDD POG Regulation*]

4.2.9 EU

4(4)The manufacturers' body or structure responsible for the manufacturing of insurance products shall:

(a)endorse and be ultimately responsible for establishing, implementing and reviewing the product approval process;

(b)continuously verify internal compliance with that process.

[**Note**: article 4(4) of the *IDD POG Regulation*]

4.2.10 EU

5(4)Manufacturers shall ensure that staff involved in designing and manufacturing insurance products has the necessary skills, knowledge and expertise to properly understand the insurance products sold and

the interests, objectives and characteristics of the customers belonging to the target market.

[**Note**: article 5(4) of the *IDD POG Regulation*]

4.2.11 EU 4(5)Manufacturers designating a third party to design products on their behalf shall remain fully responsible for compliance with the product approval process.

[**Note**: article 4(5) of the *IDD POG Regulation*]

4.2.12 EU 4(6)Manufacturers shall regularly review their product approval process to ensure that that process is still valid and up to date. They shall amend the product approval process where necessary.

[**Note**: article 4(6) of the *IDD POG Regulation*]

Manufacture by more than one firm

4.2.13 EU 3(4)An insurance intermediary and an insurance undertaking that are both manufacturers within the meaning of Article 2 of this Delegated Regulation, shall sign a written agreement which specifies their collaboration to comply with the requirements for manufacturers referred to in Article 25(1) of Directive (EU) 2016/97, the procedures through which they shall agree on the identification of the target market and their respective roles in the product approval process.

[**Note**: article 3(4) of the *IDD POG Regulation*]

4.2.14 R In circumstances other than ■ PROD 4.2.13EU, when *firms* collaborate to *manufacture* an insurance product, they must outline their mutual responsibilities in a written agreement.

Target market

4.2.15 R For each insurance product the product approval process must:

(1) specify an identified target market;

(2) ensure that all relevant risks to the identified target market are assessed;

(3) ensure that the intended distribution strategy is consistent with the identified target market; and

(4) require the *manufacturer* to take reasonable steps to ensure that the insurance product is *distributed* to the identified target market.

[**Note**: third subparagraph of article 25(1) of the *IDD*]

4.2.16 EU 5(1)The product approval process shall for each insurance product identify the target market and the group of compatible customers.

The target market shall be identified at a sufficiently granular level, taking into account the characteristics, risk profile, complexity and nature of the insurance product.

[**Note**: article 5(1) of the *IDD POG Regulation*]

4.2.17 EU

5(2)Manufacturers may, in particular with regard to insurance-based investment products, identify groups of customers for whose needs, characteristics and objectives the insurance product is generally not compatible.

[**Note**: article 5(2) of the *IDD POG Regulation*]

4.2.18 EU

5(3)Manufacturers shall only design and market insurance products that are compatible with the needs, characteristics and objectives of the customers belonging to the target market. When assessing whether an insurance product is compatible with a target market, manufacturers shall take into account the level of information available to the customers belonging to that target market and their financial literacy.

[**Note**: article 5(3) of the *IDD POG Regulation*]

4.2.19 G

The identification of the target market by the *manufacturer* should be understood as describing a group of *customers* sharing common characteristics at an abstract and generalised level in order to enable the *manufacturer* to adapt the features of the product to the needs, characteristics and objectives of that group of *customers*.

4.2.20 G

The identification of the target market should be distinguished from the individual assessment at the point of sale to determine whether a product meets the demands and needs and, where applicable, whether an *insurance-based investment product* is suitable or appropriate for the individual *customer*.

[**Note:** recital 5 to the *IDD POG Regulation*]

4.2.21 G

The level of granularity of the target market and the criteria used to define the target market and determine the appropriate distribution strategy should be relevant for the product and should make it possible to assess which *customers* fall within the target market. For simpler, more common products, the target market should be identified with less detail while for more complicated products or less common products, the target market should be identified with more detail taking into account the increased risk of consumer detriment associated with such products.

[**Note**: recital 6 to the *IDD POG Regulation*]

Product testing

4.2.22 EU

6(1)Manufacturers shall test their insurance products appropriately, including scenario analyses where relevant, before bringing that product to the market or significantly adapting it, or in case the

target market has significantly changed. That product testing shall assess whether the insurance product over its lifetime meets the identified needs, objectives and characteristics of the target market. Manufacturers shall test their insurance products in a qualitative manner and, depending on the type and nature of the insurance product and the related risk of detriment to customers, quantitative manner.

[**Note**: article 6(1) of the *IDD POG Regulation*]

4.2.23 G For the purposes of ■ PROD 4.2.22EU, *manufacturers* should include assessments of the performance and risk/reward profile of their insurance product where appropriate.

[**Note**: recital 8 to the *IDD POG Regulation*]

4.2.24 EU 6(2)Manufacturers shall not bring insurance products to the market if the results of the product testing show that the products do not meet the identified needs, objectives and characteristics of the target market.

[**Note**: article 6(2) of the *IDD POG Regulation*]

4.2.25 R *Manufacturers* must consider the charging structure proposed for each insurance product, including examination of the following:

(1) whether the costs and charges of the insurance product are compatible with the needs, objectives and characteristics of the target market;

(2) where relevant, whether the charging structure of the insurance product is appropriately transparent for the target market, such as that it does not disguise charges or is too complex to understand; and

(3) where relevant, whether the charges undermine the return expectations of the insurance product, such as where the costs or charges equal, exceed or remove almost all the expected tax advantages linked to a *life policy*.

4.2.26 G (1) ■ PROD 4.2.25R does not affect the *manufacturer's* freedom to set *premiums*.

(2) In relation to a *non-investment insurance contract* a *firm* should consider whether, as a result of the charging structure it has put in place, the overall cost for the *customer* is consistent with its obligations under the *Principles* and *ICOBS*.

(3) ■ PROD 4.2.25R should be read in light of a *firm's* wider obligations under the *Handbook* which impose specific restrictions or requirements around what costs and charges may be permissible. For example, the *rules* in ■ COBS 20.2 govern what may be charged to a *with-profits policy* when considering its charging structure under ■ PROD 4.2.25R.

Distribution channels and information disclosure to distributors

4.2.27 EU

8(1)Manufacturers shall carefully select distribution channels that are appropriate for the target market, thereby taking into account the particular characteristics of the relevant insurance products.

[**Note**: article 8(1) of the *IDD POG Regulation*]

4

4.2.28 G

To ensure appropriate information for *customers*, *manufacturers* should select *distributors* that have the necessary knowledge, expertise and competence to understand the features of an insurance product and the identified target market.

[**Note**: recital 9 to the *IDD POG Regulation*]

4.2.29 R

A *firm* which *manufactures* an insurance product, must make available to a *distributor*:

(1) all appropriate information on the insurance product

(2) all appropriate information on the product approval process; and

(3) the identified target market of the insurance product.

[**Note**: fifth subparagraph of article 25(1) of the *IDD*]

4.2.30 EU

8(2)Manufacturers shall provide insurance distributors with all appropriate information on the insurance products, the identified target market and the suggested distribution strategy, including information on the main features and characteristics of the insurance products, their risks and costs, including implicit costs, and any circumstances which might cause a conflict of interest to the detriment of the customer. That information shall be clear, complete and up to date.

[**Note**: article 8(2) of the *IDD POG Regulation*]

4.2.31 EU

8(3)The information referred to in paragraph 2 shall enable the insurance distributors to:

(a)understand the insurance products;

(b)comprehend the identified target market for the insurance products;

(c)identify any customers for whom the insurance product is not compatible with their needs, characteristics and objectives;

(d)carry out distribution activities for the relevant insurance products in accordance with the best interests of their customers as prescribed in Article 17(1) of Directive (EU) 2016/97.

[**Note**: article 8(3) of the *IDD POG Regulation*]

4.2.32 R A *manufacturer* must make available to any *distributor* information about the target market assessment.

The information made available under (1) must be of an adequate standard to enable *distributors* to:

comprehend the identified target market for the insurance products; and

be able to identify any customers for whom the insurance product is not compatible with their needs, characteristics and objectives.

A *manufacturer* is not required to disclose specific information objectively considered to be commercially sensitive if the information it does make available would still allow *distributors* to meet (2)(a) and (b).

Monitoring and review of insurance products

4.2.33 R A *firm* must understand the insurance products it offers or markets.

[**Note**: fourth subparagraph of article 25(1) of the *IDD*]

4.2.34 R A *firm* must regularly review the insurance products it offers or markets taking into account any event that could materially affect the potential risk to the identified target market. In doing so, the *firm* must assess at least the following:

(1) whether the insurance product remains consistent with the needs of the identified target market; and

(2) whether the intended distribution strategy remains appropriate.

[**Note**: fourth subparagraph of article 25(1) of the *IDD*]

4.2.35 EU 7(1)Manufacturers shall continuously monitor and regularly review insurance products they have brought to the market, to identify events that could materially affect the main features, the risk coverage or the guarantees of those products. They shall assess whether the insurance products remain consistent with the needs, characteristics and objectives of the identified target market and whether those products are distributed to the target market or is reaching customers outside the target market.

[**Note**: article 7(1) of the *IDD POG Regulation*]

4.2.36 EU 7(2)Manufacturers shall determine the appropriate intervals for the regular review of their insurance products, thereby taking into account the size, scale, contractual duration and complexity of those insurance products, their respective distribution channels, and any relevant external factors such as changes to the applicable legal rules, technological developments, or changes to the market situation.

[**Note**: article 7(2) of the *IDD POG Regulation*]

4.2.37 EU

7(3)Manufacturers that identify during the lifetime of an insurance product any circumstances related to the insurance product that may adversely affect the customer of that product shall take appropriate action to mitigate the situation and prevent further occurrences of the detrimental event. Manufacturers shall promptly inform concerned insurance distributors and customers about the remedial action taken.

[**Note**: article 7(3) of the *IDD POG Regulation*]

4

4.2.38 EU

8(4)Manufacturers shall take appropriate steps to monitor that insurance distributors act in accordance with the objectives of the manufacturers' product approval process. They shall in particular verify on a regular basis whether the insurance products are distributed on the identified target market. That monitoring obligation shall not extend to the general regulatory requirements with which insurance distributors have to comply when carrying out insurance distribution activities for individual customers. The monitoring activities shall be reasonable, taking into consideration the characteristics and the legal framework of the respective distribution channels.

[**Note**: article 8(4) of the *IDD POG Regulation*]

4.2.39 EU

8(5)Manufacturers considering that the distribution of their insurance products is not in accordance with the objectives of their product approval process shall take appropriate remedial action.

[**Note**: article 8(5) of the *IDD POG Regulation*]

4.3 Distribution of insurance products

4.3.1 R Where a *firm distributes* insurance products which it does not *manufacture* it must have in place adequate arrangements to obtain the information in ■ PROD 4.2.29R from the *manufacturer*.

[**Note**: sixth sub-paragraph of article 25(1) of the *IDD*]

4.3.2 R Where a *firm distributes* insurance products which it does not *manufacture*, it must have in place adequate arrangements to understand:

(1) the characteristics of each insurance product; and

(2) the identified target market of each insurance product.

[**Note**: sixth sub-paragraph of article 25(1) of the *IDD*]

4.3.3 R A *distributor* must take all reasonable steps to obtain the information in ■ PROD 4.2.29R when *distributing* insurance products *manufactured* by any *person* to which *IDD manufacturer* product governance requirements (■ PROD 4.2, equivalent requirements of another *EEA State* or directly applicable requirements of the *IDD POG Regulation*) do not apply.

4.3.4 G To comply with ■ PROD 4.3.2R, *distributors* should put in place effective arrangements to ensure that they obtain sufficient, adequate and reliable information from the *manufacturer* about the insurance products to ensure that they will be *distributed* in accordance with the characteristics, objectives and needs of the target market.

4.3.5 EU 10(1)Insurance distributors shall have in place product distribution arrangements containing appropriate measures and procedures to obtain from the manufacturer all appropriate information on the insurance products they intend to offer to their customers and to fully comprehend those insurance products, taking into account the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the distributor.

[**Note**: first sub-paragraph of article 10(1) of the *IDD POG Regulation*]

4.3.6 EU EU10(2)The product distribution arrangements shall:

(a)aim to prevent and mitigate customer detriment;

(b)support a proper management of conflicts of interest;

(c)ensure that the objectives, interests and characteristics of customers are duly taken into account.

[**Note**: article 10(2) of the *IDD POG Regulation*]

4.3.7 EU

10(3)The product distribution arrangements shall ensure that the insurance distributors obtain from the manufacturer the information to be communicated under Article 8(2).

[**Note**: article 10(3) of the *IDD POG Regulation*]

4.3.8 EU

10(4)Any specific distribution strategy set up or applied by insurance distributors shall be in accordance with the distribution strategy set up and the target market identified by the manufacturer.

[**Note**: article 10(4) of the *IDD POG Regulation*]

4.3.9 EU

10(5)The insurance distributors' body or structure responsible for insurance distribution shall endorse and be ultimately responsible for establishing, implementing and reviewing the product distribution arrangements and continuously verify internal compliance with those arrangements.

[**Note**: article 10(5) of the *IDD POG Regulation*]

4.3.10 EU

10(6)Insurance distributors shall regularly review their product distribution arrangements to ensure that those arrangements are still valid and up to date. They shall amend product distribution arrangements where appropriate. Insurance distributors that have set up or apply a specific distribution strategy shall, where appropriate, amend that strategy in view of the outcome of the review of the product distribution arrangements. When reviewing their product distribution arrangements, insurance distributors shall verify that the insurance products are distributed to the identified target market.

Insurance distributors shall determine the appropriate intervals for the regular review of their product distribution arrangements, thereby taking into account the size, scale and complexity of the different insurance products involved. To support product reviews carried out by manufacturers, insurance distributors shall upon request provide manufacturers with relevant sales information, including, where appropriate, information on the regular reviews of the product distribution arrangements.

[**Note**: article 10(6) of the *IDD POG Regulation*]

4.3.11 EU

11Insurance distributors becoming aware that an insurance product is not in line with the interests, objectives and characteristics of its identified target market or becoming aware of other product-related circumstances that may adversely affect the customer shall promptly

inform the manufacturer and, where appropriate, amend their distribution strategy for that insurance product.

[**Note**: article 11 of the *IDD POG Regulation*]

4.3.12 G *Manufacturers* and *distributors* should take appropriate action in order to avert the risk of consumer detriment when they consider that the insurance product is not, or is no longer, aligned with the interests, objectives and characteristics of the identified target market.

[**Note**: recital 12 to the *IDD POG Regulation*]

4.3.13 EU 12Relevant actions taken by insurance distributors in relation to their product distribution arrangements shall be duly documented, kept for audit purposes and made available to the competent authorities upon request.

[**Note**: article 12 of the *IDD POG Regulation*]

4.3.14 EU 10(1)Insurance distributors shall set out the product distribution arrangements in a written document and make it available to their relevant staff.

[**Note**: second sub-paragraph of article 10(1) of the *IDD POG Regulation*]

4.4 Additional expectations for manufacturers and distributors of insurance products

4.4.1 G In addition to ■ PROD 4.1, ■ PROD 4.2 and ■ PROD 4.3, *firms* should also consider what needs to be done to comply with obligations found elsewhere in the *FCA Handbook*, including under the *Principles* and in *SYSC*. In considering this *firms* should consider any relevant *guidance*.

4.4.2 G ■ PROD 1.4.10G provides that, where ■ PROD 4 applies, a *firm* need not apply the *guidance* in *RPPD* for matters covered by *PROD*, if that *firm* has complied with ■ PROD 4. However, ■ PROD 4 and the *IDD POG Regulation* does not cover all parts of the *RPPD* or wider obligations in the *FCA Handbook* and the following *guidance*, some of which is reproduced from the *RPPD*, remains relevant.

4.4.3 G *Manufacturers* should consider whether the design of an insurance product is driven by features that benefit the *customer* and not by a business model which relies on poor *customer* outcomes to be profitable.

4.4.4 G When providing information to *distributors*, a *manufacturer* should:

(1) make it clear if that information is not intended for *customer* use;

(2) ensure the information is sufficient, appropriate and comprehensible in substance and form, including considering whether it will enable *distributors* to understand it enough to give suitable advice (where advice is given) and to extract any relevant information and communicate it to the end *customer*. As part of meeting this standard, the *manufacturer* may wish to consider, with regard to each *distribution* channel or type of *distributor* what information *distributors* of that type already have, their likely level of knowledge and understanding, their information needs and what form or medium would best meet those needs (which could include discussions, written material or training as appropriate).

4.4.5 G When reviewing the insurance products it *manufactures*, a *firm* should communicate to the *customer* and/or *distributor* contractual "breakpoints" such as the end of a long tie-in period that may have a material impact on a *customer* that the *customer* cannot reasonably be expected to recall or know about already.

4.4.6 G *Manufacturers* should act fairly and promptly when handling claims or when paying out on an insurance product that has been surrendered or reached maturity. In doing this, the *manufacturer* should meet any reasonable *customer* expectations that it may have created with regard to the outcomes or how the process would be handled.

4.4.7 G In ensuring that they have obtained sufficient information about the insurance products they *distribute* and in ensuring they understand the insurance products *distributed*, *distributors*:

(1) should consider whether they understand the materials provided by the *manufacturer* or *distributor* earlier in the sales chain;

(2) should ask the *manufacturer* to supply additional information or training where this seems necessary to understand the insurance product adequately;

(3) should not *distribute* the insurance product if they do not understand it sufficiently; and

(4) when providing information to another *distributor* in a distribution chain, should consider how the further *distributor* will use the information, such as whether it will be given to *customers*. *Firms* should consider what information the further *distributor* requires and the likely level of knowledge and understanding of the further *distributor* and what medium may suit it best for the transmission of information.