

Chapter 3

Product governance: MiFID



3.3 Distribution of products and investment services

General

- 3.3.1R
- 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]

- 3.3.2G
- 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).

- 3.3.2AG
- A distributor is reminded of its obligations under ■ ESG 4.1.16R to ■ ESG 4.1.19R in meeting its obligations under ■ PROD 3.3.1R.

Obtaining information from manufacturers

- 3.3.3R
- Distributors must obtain from *manufacturers* subject to ■ PROD 3.2 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]

- 3.3.4G
- 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 firms to whom PROD 3.2 does not apply including third country firms

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- (1) *Distributors* must take all reasonable steps to comply with ■ PROD 3.3 when *distributing financial instruments manufactured* by any *firm* to which product governance requirements in ■ PROD 3.2 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.

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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*]

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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.

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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 Regulation*.

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

Target market and distribution strategy	
3.3.9	<div>R</div> <div>Distributors must determine the target market for the respective <i>financial instrument</i>, even if the target market was not defined by the <i>manufacturer</i>. [Note: article 10(1) of the <i>MiFID Delegated Directive</i>]</div>
3.3.10	<div>R</div> <div>Distributors must identify the target market and their <i>distribution</i> strategy using: <div><div>(1) the information obtained from <i>manufacturers</i>; and</div><div>(2) information they have on their own <i>clients</i>.</div></div></div>
3.3.11	<div>G</div> <div>In identifying the target market and creating a <i>distribution</i> strategy, <i>distributors</i> should consider: <div><div>(1) the nature of the <i>financial instruments</i> to be offered or recommended and how they fit with <i>end clients</i>' needs and risk appetite;</div><div>(2) the impact of charges on <i>end clients</i>;</div><div>(3) the financial strength of the <i>manufacturer</i>; and</div><div>(4) where information is available on the <i>manufacturer's</i> processes, how efficiently and reliably the <i>manufacturer</i> will deal with the <i>end client</i> at the point of sale or subsequently, such as when complaints arise, claims are made or the <i>financial instrument</i> reaches maturity.</div></div></div>
3.3.12	<div>G</div> <div>The target market identified by <i>distributors</i> for each <i>financial instrument</i> should be identified at a sufficiently granular level.</div>
3.3.13	<div>G</div> <div>Where a <i>distributor</i> is part of a distribution chain, the information referred to in ■ PROD 3.3.10R(2) should include information on the intended <i>end client</i>.</div>
3.3.14	<div>R</div> <div>Where a <i>firm</i> acts both as a <i>manufacturer</i> and a <i>distributor</i>, only one target market assessment is required. [Note: article 10(2) of the <i>MiFID Delegated Directive</i>]</div>
3.3.15	<div>R</div> <div><div>(1) <i>Distributors</i> must have in place adequate product governance arrangements to ensure that: <div><div>(a) the <i>financial instruments</i> and <i>investment services</i> they intend to <i>distribute</i> are compatible with the needs, characteristics and objectives of the identified target market; and</div><div>(b) the intended <i>distribution</i> strategy is consistent with the identified target market.</div></div></div><div>(2) <i>Distributors</i> must appropriately identify and assess the circumstances and needs of the <i>clients</i> they intend to focus on to ensure that their</div></div>

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*]

3.3.16 **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:

		<div><div>(1) the range of <i>financial instruments</i> the <i>firm</i> offers or recommends; and</div><div>(2) the <i>investment services</i> provided to the respective target markets.</div><div>[Note: article 10(8) of the <i>MiFID Delegated Directive</i>]</div></div>
3.3.22	R	<div>All relevant staff must possess the necessary expertise to understand:<div><div>(1) the characteristics and risks of the <i>financial instruments</i> that the <i>firm</i> intends to <i>distribute</i>;</div><div>(2) the <i>investment services</i> provided by the <i>firm</i>; and</div><div>(3) the needs, characteristics and objectives of the identified target market.</div></div><div>[Note: article 10(7) of the <i>MiFID Delegated Directive</i>]</div></div>
3.3.23	G	<div><i>Firms</i> 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.</div>
3.3.24	R	<div><div>Compliance reports</div><div>Compliance reports to the <i>management body</i> must include information about the <i>financial instruments distributed</i> by the <i>firm</i> and the <i>investment services</i> provided.</div></div>
3.3.25	R	<div><div>A <i>distributor</i> shall make the compliance reports available to the <i>FCA</i> on request.</div><div>[Note: article 10(8) of the <i>MiFID Delegated Directive</i>]</div></div>
3.3.26	R	<div><div>Post-sale review</div><div><i>Distributors</i> must regularly review the <i>financial instruments</i> they <i>distribute</i> and the <i>investment services</i> they provide, taking into account any event that could materially affect the potential risk to the identified target market.</div></div>
3.3.27	R	<div><div>In carrying out the review in ■ PROD 3.3.26R, <i>distributors</i> must assess at least:<div><div>(1) whether the <i>financial instrument</i> or <i>investment service</i> remains consistent with the needs, characteristics and objectives of the identified target market; and</div><div>(2) whether the intended <i>distribution</i> strategy remains appropriate.</div></div></div></div>
3.3.28	R	<div><div>If a <i>distributor</i> becomes aware that it has wrongly identified the target market for a specific <i>financial instrument</i> or <i>investment service</i>, or the <i>financial instrument</i> or <i>investment service</i> no longer meets the circumstances of the identified target market, it must take appropriate steps, including at least:</div></div>

		<ul style="list-style-type: none"> (1) reconsidering the target market; and/or (2) updating its product governance arrangements.
3.3.29	G	<p>A <i>distributor</i> may need to take action under ■ PROD 3.3.28R in circumstances where the <i>financial instrument</i> becomes very illiquid or very volatile due to market changes.</p> <p>[Note: article 16(3) of <i>MiFID</i> and article 10(5) of the <i>MiFID Delegated Directive</i>]</p>
		<p>Information sharing</p>
3.3.30	R	<p>To support the reviews carried out by <i>manufacturers</i> under ■ PROD 3.2.19R to ■ PROD 3.2.26R, a <i>distributor</i> must provide to the <i>manufacturer</i> of each <i>financial instrument</i> it <i>distributes</i>:</p> <ul style="list-style-type: none"> (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	<ul style="list-style-type: none"> (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 <i>manufacturer</i>. <i>Distributors</i> should provide the data necessary for the <i>manufacturer</i> to review the <i>financial instrument</i> and check that it remains consistent with the needs, characteristics and objectives of the target market defined by the <i>manufacturer</i>. Relevant information could include: <ul style="list-style-type: none"> (a) summary information of the types of <i>clients</i>; (b) a summary of complaints received; and (c) responses from <i>clients</i> to questions suggested by the <i>manufacturer</i> for the purposes of obtaining feedback from a <i>client</i> sample. (3) In determining when providing information on the reviews carried out under ■ PROD 3.3.26R to ■ PROD 3.3.28R is appropriate, a <i>distributor</i> should have regard to the requirements on the <i>manufacturer</i> in ■ PROD 3.2. Information on the reviews should be shared if the <i>manufacturer</i> requests it. <p>[Note: article 10(9) of and recital 20 to the <i>MiFID Delegated Directive</i>]</p>
		<p>Responsibilities in chains of distributors</p>
3.3.32	R	<ul style="list-style-type: none"> (1) A <i>firm</i> which <i>distributes financial instruments or investment services</i> to <i>end clients</i> is responsible for ensuring that the obligations in this chapter are met in respect of any <i>financial instrument</i> or <i>investment service</i> it <i>distributes</i> to an <i>end client</i>. (2) A <i>firm</i> which <i>distributes financial instruments</i> to <i>clients</i> which are not <i>end clients</i> must, in addition to complying with the rules in this

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

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*]