SECOND EBA REPORT

ON THE APPLICATION OF THE GUIDELINES ON PRODUCT OVERSIGHT AND GOVERNANCE (POG) ARRANGEMENTS (EBA/GL/2015/18)

EBA/REP/2020/28

EUROPEAN BANKING AUTHORITY

Contents

List of abbreviations

CI	Credit institution
CRD	Capital Requirements Directive
EBA	European Banking Authority
EMD	Electronic Money Directive
EMI	Electronic money institution
ESA	European supervisory authority
EU	European Union
FI	Financial institution
MCD	Mortgage Credit Directive
NCAs	National Competent Authorities
NPAP	New product approval process
PI	Payment institution
POG	Product oversight and governance
PSD	Payment Services Directive

Executive summary

The European Banking Authority (EBA) promotes a transparent, simple and fair internal market for consumer financial products and services. To that end, the EBA seeks to foster consumer protection and enhance the supervisory convergence of the retail conduct of financial institutions (FIs) within the EBA's scope of action across the European Union.

Developments in the markets for financial services have shown that failures in the conduct of FIs towards their customers may not only cause significant consumer detriment but also undermine market confidence and financial stability. By assessing the retail conduct of FIs, the EBA contributes to the transparency and integrity of the financial system.

To address some of the causal drivers of conduct failure, and following the initial work carried out in 2013 by the three European supervisory authorities (ESAs) through their Joint Committee, the EBA developed detailed product oversight and governance (POG) Guidelines for manufacturers and distributors of retail banking and payment products. The EBA POG Guidelines issued in March 2016, became applicable in January 2017.

In this context, the EBA carried out a review of the application of the EBA Guidelines by the industry, which the EBA published in a first report in July 2019.

As a follow-up to that first report, this second report aims again to examine the application of the EBA POG Guidelines by the industry, but this time based on a larger sample of financial institutions than in the first report, and in a larger number of Member States, to enable the EBA to come to more robust conclusions. The findings of the report are based on the review that was carried out with 78 credit, payment and e-money institutions across 12 EU Member States

This report identifies ways for FIs to strengthen further the application of the EBA POG Guidelines. It does so by outlining good practices identified in the sample concerning the scope of the EBA POG Guidelines and general governance, the identification of the target market, product testing, product monitoring and remedial actions, and the POG arrangements for distributors.

The second EBA report confirms the conclusions reached in the first report. Manufacturers made changes in particular in terms of process and governance. However despite the objectives of the EBA POG Guidelines to enhance consumer protection and also to address the prudential risks arising from mis-conduct, manufacturers appear to focus almost entirely on the requirements set out in the EBA Guidelines on internal governance under the Capital Requirements Directive (CRD IV) (EBA/GL/2017/11). In other words, while the manufacturers surveyed had implemented the internal processes in relation to product oversight for retail products, this was not necessarily done in a way that put the requisite focus on ensuring that consumers' needs are met, or that attracted the same level of attention as the compliance with the requirements or the profitability of the product and service.

When applying the POG arrangements manufacturers should indeed ensure that the interests, objectives and characteristics of consumers are taken into account to avoid consumer detriments.

The EBA and relevant competent authorities will continue to monitor how FIs apply the EBA POG Guidelines and whether they make use of the good practices identified in this report.

Background and rationale

1. Developments in the markets for financial services have shown that failures in the conduct of financial institutions (FIs) towards their customers may not only cause significant consumer detriment but also undermine market confidence, financial stability and the integrity of the financial system.

2. To address some of the causal drivers of the retail conduct failure of FIs as manufacturers of banking, insurance and investment products, the three European supervisory authorities (ESAs) carried out work in 2013 on the topic of manufacturers' product oversight and governance (POG) processes.

3. The ESAs assessed the extent to which consumers across the banking, insurance and securities markets have experienced, or are at risk of experiencing, detriment as a result of failures by manufacturers in overseeing and governing the development and marketing of their products. As a result, the ESAs published, on 28 November 2013, a joint position on manufacturers' POG processes, in accordance with Article 56 of each of the ESA regulations[1]. It included a specific focus on manufacturers' identification of target markets and how they take account of the interests, objectives and characteristics of these markets.

4. Following the initial work carried out by the ESAs, the EBA carried out various analyses and surveys among the 28 EU Member States in 2014/15, with a view to ascertaining the extent to which consumer detriment has arisen, or may arise, as a result of manufacturers of retail banking products having failed to have proper POG arrangements in place. A number of failures were identified by Member States through that process, as detailed in the rationale section (p. 6–7) of the final EBA POG Guidelines[2].

5. As a result, the EBA developed more detailed POG Guidelines for manufacturers (i.e. providers) and distributors of retail banking products that fall within the EBA's regulatory remit, namely mortgages, personal loans (when provided by credit institutions), deposits, payment accounts, electronic money, and payment services.

6. The EBA POG Guidelines consist of a set of eight Guidelines for manufacturers and four Guidelines for distributors, and they are addressed to:

[1] For the EBA Regulation, see Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L331, 15.12.2010, p.12); Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48–83); Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84–119).

[2] EBA Guidelines on product oversight and governance arrangements for retail banking products of 22 March 2016, EBA/GL /2015/18.

- credit institutions (CIs) under the Capital Requirements Directive (CRD IV)[3];
- payment institutions (PIs) under the Payment Services Directive (PSD 1 / PSD 2)[4];
- electronic money institutions (EMIs) under the Electronic Money Directive (EMD)[5]; and
- mortgage creditors under the Mortgage Credit Directive (MCD)[6] to the extent that those are FIs under the EBA Regulation[7].

7. Following extensive public consultation, the EBA POG Guidelines issued on 22 March 2016 became applicable from 3 January 2017. The EBA POG Guidelines are forward looking and do not simply address past failings but also aim to provide a framework for robust and responsible product design and distribution that avoids consumer detriment in the future and that should therefore reduce the need for national competent authorities (NCAs) to intervene in the markets ex post, namely after a failure has materialised.

8. The EBA POG Guidelines apply to products brought to the market after the application date of 3 January 2017, as well as to all existing products on the market that have significantly changed since that date. The overall objective is for manufacturers and distributors of the retail banking and payment sector to consider the needs of their customers when designing products and to develop products with consumers' interests, objectives and characteristics in mind.

9. Furthermore, the EBA POG Guidelines supplement other requirements that the EBA had already published by that time to address related issues of the governance of FIs, including the EBA Guidelines on internal governance under the Capital Requirements Directive (CRD IV) (EBA/GL/2017/11)[8], which set out requirements for a new product approval process (NPAP) that CIs should adopt.

10. According to the EBA POG Guidelines, FIs that manufacture financial products should set out internal arrangements for the design, marketing and life-cycle maintenance of products. These arrangements should ensure that products are designed to meet the interests, objectives and characteristics of consumers within the target market. Distributors of retail banking products

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[3] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338–436).

[4] Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (OJ L 337, 23.12.2015, p. 35–127).

[5] Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (OJ L 267, 10.10.2009, p. 7–17).

[6] Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (OJ L 60, 28.2.2014, p. 34–85).

[7] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L331, 15.12.2010, p. 12).

[8] EBA Guidelines on Internal Governance under Directive 2013/36/EU of 21 March 2018, EBA/GL/2017/11 (revised).

should comply with the POG arrangements of the manufacturer and should sell to customers who are not part of the target market on a justified basis only.

11. As the EBA POG Guidelines had been applicable for more than 3 years, the EBA considered it opportune to carry out an assessment of the way in which manufacturers have applied them.

12. On 5 July 2019, the EBA published its first report on the way the industry has implemented the EBA POG Guidelines[9]. The report was based on a small sample of CIs from 6 Member States and identified a number of good and bad practices. It showed that manufacturers had made welcome changes, in particular in terms of processes and governance. However, in a large number of cases, customer interests had not received the same level of attention as was given to manufacturers' commercial interests and prudential concerns. The EBA's assessment also suggested that the industry might have different understandings of the EBA POG Guidelines and that further clarification may be warranted to ensure further convergence across Europe.

13. As a follow-up to the first report, this second report aims to examine the application of the EBA POG Guidelines by the industry, but this time based on a much larger sample of FIs, and in a larger number of Member States, to enable the EBA to come to more robust conclusions.

14. In publishing this second report, the EBA is fulfilling the objectives and tasks conferred on it in Articles 1(5) and 9(2) of its founding Regulation, in relation to supervisory convergence and the convergence of regulatory practice.

15. Article 1(5) of the EBA Regulation establishes, inter alia, the EBA's objective to contribute to improving the functioning of the internal market, including, in particular, a sound, effective and consistent level of regulation and supervision (point (a) of that provision), the objective of preventing regulatory arbitrage and promoting equal conditions of competition (point (d) of that provision) and the objective of enhancing customer and consumer protection (point (f) of that provision) as well as supervisory convergence across the internal market (point (g) of that provision).

16. Article 9(2) of the EBA Regulation states that the Authority shall monitor new and existing financial activities and may adopt guidelines and recommendations with a view to promoting the safety and soundness of markets, and the convergence and effectiveness of regulatory and supervisory practices.

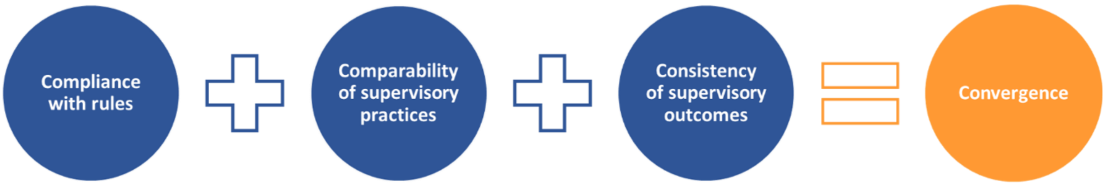
17. This second report should be read in conjunction with the first report, as it also identifies ways to strengthen further the application of the EBA POG Guidelines. It does so by outlining good practices concerning the scope of the EBA POG Guidelines and general governance, the identification of the target market, product testing, product monitoring and remedial actions, and the POG arrangements for distributors. Furthermore, with the publication of the second report, the EBA does not plan to carry out another analysis for the purpose of the EBA's supervisory convergence work on the EBA POG Guidelines in the immediate future.

[9] EBA Report on the application of the Guidelines on POG arrangements (EBA/GL/2015/18).

Methodology

18. The EBA has developed a three-pillar approach regarding supervisory convergence; this is defined as a process for achieving comparable supervisory practices in Member States that are based on compliance with the EU rules and that lead to consistent supervisory outcomes (see Figure 1). In the context of consumer protection, supervisory convergence aims to achieve a comparable supervisory practices across Member States and compliance by FIs with the retail financial services regulatory requirements, to enhance and safeguard a level of protection to EU consumers.

Figure 1: Components of supervisory convergence



19. To carry out the assessment of the application of the EBA POG Guidelines, similarly to the approach adopted for the first report, the EBA drafted a questionnaire, which participating CAs – where necessary – translated into their national languages and sent to the relevant FIs within their jurisdictions. For the participating NCAs that had already taken part in the first phase, the questionnaire was not sent to the same FIs again.

20. The assessment of the responses and resultant findings of the national authorities are based on the written responses received by 12 of the 27 EU NCAs from a sample of 78 FIs comprising credit, payment and e-money institutions.

21. This exercise does not encompass on-site visits of FIs or any other form of discussion with the institutions concerned. Similarly to the first report, the EBA encourages participating NCAs to provide feedback about the findings presented in this report to those institutions.

22. Regarding the scope of the assessment, it is worth noting that the EBA has carried out an exercise aiming to assess the consistency of the application of the EBA POG Guidelines by the FIs, therefore this exercise does not assess the supervisory practices of each NCA and does not represent an evaluation of the compliance with the POG requirements of each entity surveyed by the NCAs. Furthermore, the current assessment focuses only on the application of the EBA POG Guidelines in relation to consumers, even if some NCAs – as a result of the flexibility provided for by the EBA POG Guidelines – have extended the protection set out in those Guidelines in relation to persons other than consumers, such as micro-enterprises and small and medium-sized enterprises.

Assessment

23. One of the overreaching findings of this second EBA report confirms the conclusions reached in the first EBA report published in 2019. The second report shows that, despite the objectives of the EBA POG Guidelines to enhance consumer protection and also to address the prudential risks arising from mis-conduct, manufacturers appear to focus almost entirely on the requirements set out in the EBA Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2017/11)[10]. In other words, while the manufacturers surveyed had implemented the internal processes in relation to product oversight for retail products this was not necessarily done in a way that put the requisite focus on ensuring that consumers' needs are met, or that attracted the same level of attention as the compliance with the requirements or the profitability of the product and service. The assessment also highlights that the application of the EBA POG Guidelines varies significantly according to the size of the FIs, between the Member States and also within the same Member State.

24. This report provides an assessment of the main findings for the following five areas: (i) scope of the EBA POG Guidelines and general governance, (ii) the identification of the target market, (iii) testing, (iv) monitoring and remedial actions and (v) distribution. It includes examples of good practices considered by the EBA as compliant with the EBA POG Guidelines.

Scope of the EBA POG Guidelines and general governance

Main findings on the scope of the EBA POG Guidelines

25. The EBA POG Guidelines apply to manufacturers and distributors of products offered and sold to consumers and specify POG arrangements in relation to retail banking products that fall within the EBA's regulatory scope. The EBA POG Guidelines are therefore not limited to CIs but apply to all manufacturers and distributors of such products or services within the EBA's scope of action, including payment and e-money institutions.

26. The EBA POG Guidelines consequently apply to all credit agreements relating to immovable property as defined by the MCD in the form of deferred payments, loans or other similar financial accommodations, as well as consumer credits offered by CIs under CRD IV. The EBA POG Guidelines also apply to payment accounts, payment services and payment instruments as defined by PSD 1 / PSD 2 (such as services enabling cash placed on a payment account and cash withdrawal and all the operations required for the operating of a payment account, direct debit or credit transfer, card based payment transactions, acquiring and issuing of payment transactions, money remittance), electronic money as defined by the EMD and other means of payments as defined by CRD IV[11].

[10] Ibid.

[11] See the definitions of a product listed in paragraph 15 of the EBA POG Guidelines, p. 6.

27. As specified in the scope of application of the EBA POG Guidelines, these Guidelines apply to products brought to the market after the implementation date of the POG Guidelines as well as to all existing products on the market that are significantly changed after the implementation date of these Guidelines.

28. The following section provides details on the findings as regards (i) the number of products or services identified as new or significantly changed since the application date of the POG Guidelines and (ii) the criteria applied.

Number and type of products or services identified as new or significantly changed since the application date of the EBA POG Guidelines

29. Since the application date of the EBA POG Guidelines, approximately 890 new or significantly changed products have been launched by the FIs in the sample.

30. The assessment of the responses shows that, across the jurisdictions involved in the survey, almost all the new or significantly changed products were launched by CIs (875 out of 890 products) and their number varies significantly between jurisdictions, as well as between FIs within the same jurisdiction. For example, CIs in one country launched 13 new or significantly changed products, while in another country a similar set of CIs launched 240 such products. One CI alone reported having launched 187 products in one country, whereas another CI reported none for the same country.

31. Regarding the type of products concerned, CIs reported that the majority of new or significantly changed products that they launched can be classified as non-complex products that mainly consists of certain types of loans (e.g. sustainable car loans[12]), current accounts (e.g. accounts that may be opened using remote identification) and payment services (e.g. instant payments, payments using mobile wallets or mobile applications). Some respondents also explained that the majority of significantly changed products were launched as a result of national legislations and regulations such as, in one country, a legislation that had introduced new loan-to-value and loan-to-income requirements for lenders.

32. CIs also reported that less than 50% of the total number of new and significantly changed products have been identified on the grounds of introducing an alternative/innovative channel of selling. According to the responses collected, such products include credit cards or alternative account service channels introduced in the electronic banking service, in particular using mobile wallets or a mobile apps designed to provide financial services to the bank's customers on dominant mobile platforms to allow customers to register their credit cards on their smart watches equipped with near-field-communication contactless chips. Those products and services also include online consumer loans, internet banking portals offering a general banking interface for all eligible customers of the bank, including, for example, subscribing to an operational car-leasing service through the bank's online banking service.

[12] Car loan where the credit institution commits to make 'green' investments to compensate for the vehicles emission of carbon dioxide by 150% during the customer's ownership of the vehicle.

33. As regards, PIs and EMIs, only a limited number of new or significantly changed products were launched after the application of the EBA POG Guidelines. The PIs reported only 13 products as being new or significantly changed, including direct debits, online cash solutions used to upload funds into digital wallets, cash-in-cash-out money remittance services to individuals and dynamic currency conversion products. The EMIs reported 6 products, including electronic wallets, payment solutions for business and retail clients (e.g. via QR codes made available by in-store merchants) and online money transfer services. The large majority of those products launched by the PIs are new or significantly changed products on the ground of introducing an alternative/innovative channel of selling. The low number of products that PIs and EMIs reported having launched is likely to be explained by the more limited range of products provided by these institutions compared with CIs, and the smaller number of such institutions in the sample used for the EBA's assessment.

34. This variation in the number of products across the countries, as well as among FIs in the same country, is likely to be driven primarily by the size of the FIs, the lack of regulatory definition, the lack of uniformity in the criteria used by the FIs to assess whether a product is to be considered a new or significantly changed product, and possible failures by FIs to correctly identify those products that are within the scope of the EBA POG Guidelines.

Criteria applied to identify whether or not a product is new or significantly changed

35. In line with Guideline 1.1 of the EBA POG Guidelines, manufacturers should establish, implement and review effective POG arrangements. The arrangements should aim, when products are being designed and brought to the market, (i) to ensure that the interests, objectives and characteristics of consumers are taken into account, (ii) to avoid potential consumer detriment and (iii) to minimise conflicts of interest. This means that all manufacturers should apply specific criteria to define what would constitute new or significantly changed products or services. In addition, as stated in Guideline 1.3 of the EBA POG Guidelines, when launching a new product the manufacturer should ensure that the POG arrangements are considered in the NPAP, in line with the EBA Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2017/11)[13].

36. According to the responses from the FIs, to identify what constitutes a new or significantly changed products, the majority of manufacturers surveyed identified a wide and non-exhaustive range of criteria, in particular on the identification of risks, target markets, customer segments, compliance and sales channels. However, the level of details in the definition of the criteria varies significantly from one manufacturer to another.

[13] Paragraph 150 of the EBA Guidelines on internal governance under Directive 2013/36/EU (EBA-GL-2017-11) (revised): 'An institution's NPAP should cover every consideration to be taken into account before deciding to enter new markets, deal in new products, launch a new service, or make significant changes to existing products or services. The NPAP should also include the definitions of 'new product/market/business' and 'significant changes' to be used in the organisation and the internal functions to be involved in the decision-making process'.

37. The majority of PIs surveyed explained that they mainly refer to their NPAP and do not necessarily rely on specific criteria. A PI mentioned for example that a product is considered new as soon as it is launched on a new market. Among the few respondents representing the EMIs, a new product includes a product that has never been launched before. Some EMIs assess whether a product should be considered new based on the risk profile of the customer, compliance, process/structure, legal and regulatory requirements, information technology (IT), sales channels and the customer base.

38. Regarding a significantly changed product, the majority of respondents representing CIs mentioned that the main criteria includes the introduction of substantial variations in the characteristics of an existing product. CIs surveyed also indicated that they rely on a negative definition that specifies that an existing product is not considered to have significantly changed if there is no relevant variation of the existing commercial offer, when there is a re-pricing or when the product is renamed but its features remain basically the same.

39. The respondents representing PIs explained that a significantly changed product includes any product whose functionality has changed. Any changes are in scope unless they are minor, non-material details or practicalities of which the end-user does not need to be informed. The EMIs surveyed indicated that a significantly changed product constitutes a change to the target market, risk profile, features of the existing product, user experience, or legal and regulatory requirements. However, they could also rely on a negative definition, explaining what it does not include for example adjustments to existing products and/or services or changes that do not modify the target market, risk profile or price changes linked to temporary promotions, or product update e.g. due to minor regulatory changes.

40. Only a limited number of manufacturers mentioned that they do not apply specific criteria to define whether significant changes have been brought to a product, explaining that the decision is taken on a case-by-case basis by the business or the product development unit.

41. The assessment of the answers shows that manufacturers apply various criteria that might differ among CIs, PIs or EMIs. Most manufacturers have an internal process in place that applies to all new or significantly changed products or services that are part of the NPAPs, as allowed by the POG Guidelines. However, based on the list of criteria they provided, the approach of manufacturers appears to focus more on the requirements addressed by the EBA Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2017/11)[14] rather than on the interests, objectives and characteristics of consumers. Specific consideration is indeed given by the FIs, to the assessment of risks arising from new activities, of any potential shortcomings in the institution's risk management and of the ability of the institution to manage any new risks effectively. As stated in the EBA POG Guidelines, the implementation/application of the arrangements should also have regard to the level of potential risk for the consumer and complexity of the product[15].

[14] Ibid

[15] EBA POG Guidelines 1.5

Main findings on general governance

42. Guideline 2.1 of the EBA POG Guidelines further states that the manufacturer should ensure that POG arrangements are an integral part of its governance, risk management and internal control framework as referred to in the EBA Guidelines on internal governance (GL 44)[16], repealed by the EBA Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2017/11)[17], where applicable. To that end, the manufacturer's management body should endorse the establishment of the arrangements and subsequent reviews, which come under senior management responsibility. The Guideline also refers to the oversight of the process being integrated within normal risk and compliance functions.

43. The following section provides details on (i) the general organisation of POG mechanisms in the institution, (ii) the process to identify whether or not the product is new or significantly changed and (iii) the units in charge of POG processes among the FIs surveyed.

General organisation of POG mechanisms in the institution

44. The general organisation of the POG mechanism of the CIs tends to consist of several phases, which include:

    a) the product governance arrangement (i.e. product design, target market and distribution channels definition);
    b) the product consideration phase (i.e. product pricing, assessment of the product's risk and the steps towards its introduction),
    c) the product-testing phase;
    d) the approval process and the product implementation, product governance and monitoring.

    In addition to this general organisation, some CIs reported having developed a 'two-tier board structure consisting of what respondents have referred to as an 'Executive Board' and 'Supervisory Board' or 'Board of Directors' of the CI. They mentioned that the 'Executive Board' can execute a business plan for products and services only after approval by the 'Supervisory Board'.

45. Regarding PIs and EMIs, similar to CIs, the organisational structure might vary according to the type and size of the entity. It means that, for PIs or EMIs, product evaluation and monitoring remain an integral part of the day-to-day management and overall strategy of each business unit, in compliance with Guideline 2.1 of the EBA POG Guidelines.

46. According to the findings, specific consideration is given by FIs, to the assessment of risks arising from the internal control framework and to the ability of the institution to manage any

[16] EBA Guidelines on Internal Governance (GL 44) of 27 September 2011, repealed by the EBA Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2017/11) (Revised)

[17] Ibid

new risks effectively. However, the implementation/application of the arrangements put in place by the FIs does not sufficiently demonstrate that consideration is given to the potential risk for the consumer.

Process to identify whether or not a product is new or significantly changed

47. In line with the EBA POG Guidelines, the respondents representing the CIs indicated that to identify new or significantly changed products or services they have put in place a process and governance that is usually described in an NPAP. According to most manufacturers, the identification of new or significantly changed products is indeed generally performed by the product development and/or business unit; some CIs have in place a risk committee that carries out an impact assessment or a screening of already existing products and provides the management body with an advice to accept or not the related risks. The compliance department is also involved in case of doubt.

48. As regards the respondents representing EMIs, no common process has been reported to NCAs. Some of the EMIs surveyed, however, mentioned that the process to identify whether a product is new or significantly changed includes a presentation of the initiative to the management, a risk assessment and a stakeholder review.

49. The assessment of the answers shows that manufacturers have internal processes in place that apply to all new or significantly changed products or services, which can also be part of the NPAP, as allowed by the EBA POG Guidelines. In addition, the assessment of FIs' responses shows that processes focus on strengthening the management body's oversight of the institutions' activities and the risk frameworks of the institutions in compliance with the EBA Guidelines on internal governance as requested by Guideline 1.4 of the EBA POG Guidelines.

Unit responsible for identifying whether or not a product is new or significantly changed

50. The majority of respondents surveyed, mentioned that the product owner/product developer and/or business unit is the responsible body in charge of identifying which product is deemed new or significantly changed following an impact assessment or a screening of already existing products. The respondents specified that a support system has been put in place to evaluate if a change should be subject to the NPAP.

51. The assessment of the responses shows however that the approach of the respondents does not appear to be totally uniform and differs among CIs, PIs and EMIs. For some of these entities, this unit is the 'Executive Committee', whereas for others it is the 'product management team' or the 'initiator' of the product itself. Some CIs reported that in some cases the responsibility lies down with the compliance unit or what the respondents call 'the chief risk officers' (even if in certain cases they are only consultative bodies requested to provide clarifications to the business unit). An important change related to the creation of the compliance function and the intervention of this function in the products' approval processes has also been reported.

52. This variety of approaches might be a result of the lack of a common definition of new or significantly changed products. It could also depend on the size of the FIs; for example, a FI with a large number of products and employees may not have the same approach as a small EMI that has recently launched its activity and has only very few employees. However, the differences in the approaches of the CIs surveyed are in line with the requirements of the EBA POG Guidelines, as outlined in Guideline 2.3, which states that the responsibilities for the oversight of this process by the risk control function and the compliance function should be integrated into the normal lines of duties, where applicable.

53. Concerning the variation of the approval and review process, depending on the product, the large majority of respondents representing CIs stated they follow a consistent and standardised process for the approval and review of products offered to consumers, in line with the EBA POG Guidelines. However the assessment of the responses received from CIs shows that the implementation/application of the arrangements does not pay sufficient attention to the level of potential risk for the consumer and the complexity of the product.

Good practices

54. As good practice, manufacturers might consider avoiding relying on a single criterion to define whether a product is new or significantly changed and might instead consider the following set of criteria:

- significant changes in the processing of the product including an extension of the product distribution, the introduction of new, or the withdrawal of existing, product or service features;
- a change in the target market and the introduction of a new customer market segment (including geographically) as a target market;
- changes that affect the use of the product by the customer on a day-to-day basis;
- changes for which the customer would reasonably perceive there to be a change in the level of service compared with what is currently being provided;
- changes in one or more material features that alter the risk profile or the complexity of the product from a consumer perspective. Those changes should not only consider the risk profile in relation to the effect on FIs business or risk assessment portfolio, but also include changes that affect the use of the product by the customer on a day-to-day basis, changes for which the customer would reasonably perceive there to have been a change in the level of service compared with what is currently being provided;
- a change in the sale conditions, a new distribution channel or the introduction of an alternative channel of selling, including the use of third parties for the sale of the product;
- significant modifications to the product pursuant to new legal or regulatory rules and standards;
- material changes to related processes (e.g. new outsourcing arrangements) and systems (e.g. IT change processes), as defined in Guideline 18 of the separate EBA Guidelines on

internal governance under Directive 2013/36/EU (EBA/GL/2017/11)[18], but only if such changes have an impact on customers.

55. Explicitly defining negative criteria (i.e. what a new or significantly changed product is not) and providing and recording the rationale for deciding that a product is not new or significantly changed would also be seen as good practice.

56. Regarding general governance, in line with the first EBA report on the application of the EBA POG Guidelines, the EBA considers it good practice to have defined structures and clear escalation lines and to have risk and compliance functions involved. However, the EBA is of the view that a process owned by the compliance or risk function is not good practice, as it may lead to that function losing some of its required independence.

57. In line with the first report, it would be considered good practice to have specific work-flow documents and/or checklists that need to be followed to ensure that the process is the same for all products and that there is a clear audit trail. For example, this could involve setting up a centralised documentation tool that clearly defines the roles and responsibilities of the different units and key staff involved in the POG process. To ensure that consumer needs are being considered during that process, it would be beneficial to seek views from consumers during the design phase of the product, for instance through consumer working groups, or to document the impact of the product on any potential customers throughout all stages of the product life-cycle, and monitor complaints and errors about the products.

Target market

58. Guideline 3.1 of the EBA POG Guidelines states that manufacturers should include, in their POG arrangements, steps and features that need to be followed to identify, and update when necessary, the relevant target market of a product. Manufacturers are also required under Guideline 3.2 of the EBA POG Guidelines on the target market to ensure that the product is deemed appropriate for the target market. Under Guideline 3.5 they are expected to identify the groups of consumers for which the product is considered likely not to meet their needs. Guideline 3.3 of the EBA POG Guidelines further states that the manufacturer should design and bring to the market only products with features, charges and risks that meet the interests, objectives and characteristics of, and are of benefit to, the particular target market identified for the product.

59. The following section provides details on the findings as regards the criteria to define the target market and the process followed to assess whether a given product or service meets the interests, objectives and characteristics of the product market and presents good practices.

[18] Ibid

Main findings

60. The following section provides details on (i) the criteria defining the target market and (ii) the process followed to assess whether the product meets the interests, objectives and characteristics of the target market.

Criteria defining the target market

61. In compliance with the EBA POG Guidelines, the majority of the manufacturers defined steps and features that need to be followed to identify and update when necessary the relevant target market of a product and what the respondents call the positive and negative target markets (i.e. customers for whom the product is suitable/unsuitable).

62. To ensure that the product is deemed appropriate for the interests, objectives and characteristics of the identified target market, CIs, PIs and EMIs focus on broad classifications and basic data such as:

   - category of customer (e.g. retail customers, private banking customers, micro-businesses);
   - customer segment (e.g. interests and spending habits such as current/savings account holder) – according to the respondents, this aims to identify the viability of the business case and if the critical mass required for product profitability can be met;
   - demographic data (e.g. age, gender);
   - potential interest in the product (including pricing policy);
   - risk profile and the financial situation of the customer, including creditworthiness assessment, accepted investment horizon, accepted risk level and ability to incur losses;
   - financial objectives;
   - minimum level of customer knowledge and experience required to understand the product and related purposes.

63. In addition, the manufacturers referred to additional criteria such as statistical data; and digitalisation (digital capability, ability) and the majority of the respondents mentioned that they apply non-exhaustive criteria for certain categories of products and services such as personal loans, namely financial habits, financial capability, digital affinity/capability, risk aversion, geographical data, taxation, and legal and compliance requirements as part of the required consumer creditworthiness assessment.

64. In relation to the above, the type and number of criteria used to define the target market appear to vary among manufacturers. The majority of manufacturers seem however to adjust the range of criteria according to the complexity of the product, the product features and their ability to govern such product and risks levels but they do include specific criteria about customers' benefits, as requested by the EBA POG Guidelines. For example, for personal loans the criteria focus on the level of risks, the liquidity the consumer is expected to access, and risk aversion, potential creditworthiness and financial capability of the consumer.

65. However, based on the assessment of the criteria provided by the FIs, before offering any product or service, the manufacturer in some cases does not seem to sufficiently assess whether the product to be marketed meets the interest of the particular target market identified for the product as required by the EBA POG Guidelines[19], such as a client's risk aversion profile. For example in the case of credit revolving, a group of customers may not need any financing, as they might have sufficient resources, and may simply need a general credit card to carry out certain type of transactions that require using a payment instrument (e.g. to rent a car or to pay for a stay in a hotel).

Process followed to assess whether the product meets the interests, objectives and the characteristics of the target market

66. Some CIs mentioned that they rely on several elements to assess whether the product meets the interests, objectives and characteristics of the target market, which include for example, customer interviews/listening; customer satisfaction surveys before development of the product and after the product launch (e.g. surveying customers on their opinions of the product in terms of pricing, product process/documentation, relationship with the CI); customers' complaints, feedback or technological trends. In addition, most respondents explained that they use market research or specific market analysis to identify the market potential, the attractiveness and the objective of the product as well as users' needs.

67. In addition, some respondents including PIs and EMIs consider the regulatory limitation and business case for each respective product as being part of the process to assess whether the product meets the interests, objectives and characteristics of the target market. Indeed manufacturers are subject to a number of licensing conditions that set very clear steps for the operations. These conditions are intrinsically designed to safeguard the interests, objectives and characteristics of the targeted customers.

68. Overall, the manufacturers' assessment seemed to vary depending on the nature of the product or the service, for example whether the target market is broad (e.g. payment accounts, personal loans, payment/credit cards, deposits) or more narrow, for example relating to payment accounts or credit cards addressed to wealthy clients who have an appropriate level of assets (e.g. clients who hold more than EUR 100 000 worth of assets). According to CIs, these products are often combined with additional features, e.g. 24-hour concierge care.

69. Even if the manufacturers seem to comply with the EBA POG Guidelines (by designing and bringing to the market, products and services with features, charges and risks that meet the interests, objectives and characteristics of the consumer and that could be of benefit to the particular target market identified for the product), the manufacturers' approach does not clearly demonstrate that products are assessed against the risk for the consumer and the complexity of the product. Further clarity on the approach followed to assess consumers'

[19] EBA POG Guideline 3.3

needs might prove beneficial. Indeed, the manufacturers do not seem to assess whether the products are unnecessarily complex, or if the presence of too many product variants prevents the consumer from making informed decision and instead makes them focus on their financial situation or their personal characteristics only.

Good practices

70. As a good practice, to define the target market for each product, manufacturers might consider using a set of criteria based on client segmentation to ensure that the product is deemed appropriate for the interests, objectives and characteristics of the target market such as :

- demographic data (e.g. age of the clients);
- the characteristics of the respective product in relation to the risk aversion profile of the customer (e.g. financial situation creditworthiness assessment and the other types of products offered);
- level of knowledge of financial capability;
- level of financial and investment expertise of the clients;
- relevant legislation.

71. As stated in Guideline 1.5 of the EBA POG Guidelines, the implementation/application of the arrangements should have regard to the level of potential risks for the consumer and complexity of the product. The EBA considers it good practice, therefore, that manufacturers' assessments vary depending on the risk borne by the customer and the degree of complexity and the nature and characteristics of the product. When identifying whether a new or significantly changed product would be beneficial to consumers, manufacturers might also consider giving further consideration to the nature, cost and added value of the product, and whether or not the product is unnecessarily complex.

72. Creating a product review template, that requires the product owner/product developer and/or business unit to clearly outline what measures are in place to ensure that sales are not made to non-target market customers, would be seen as good practice. The product review template could be designed in a way that necessitates internal mandatory approvals. Another good practice identified involves analysing whether customers for a particular target market need such a product or service. Thus, the manufacturers can rely more on customers' feedback, for example customer satisfaction surveys, before the development of the product and after the product launch, or on focus groups for the design of the innovative products (e.g. 'a panel community', selected in accordance with the target market to be intercepted).

73. Giving further consideration to innovation in the development of POG processes could also be seen as good practice, for example when targeting a broad target market and developing an existing product. Some further consideration should be given to certain groups of consumers who lack financial literacy and technology expertise, to prevent financial exclusion. Indeed, new products and services are often seen as offering new opportunities for consumers, but certain categories of consumers cannot – or do not want to – use those new services.

74. Taking into account that digital channels have been identified as a factor that facilitates access to credit by consumers, manufacturers might consider giving further attention to the risks that consumers might face due to the increasing use of digital channels by FIs (e.g. exposing consumers to market practices that exacerbate behavioral biases) when improving their POG processes.

Testing

75. Guideline 4.1 of the EBA POG Guidelines states that product testing should assess how the product would affect its consumers in a wide range of scenarios. While manufacturers should be required to articulate the way in which they carry out such assessments in all cases, the extent of such assessments is likely to differ depending on the risk, the simple or complex nature of the product and other specific characteristics, in line with the principle of proportionality highlighted in Guideline 1.5 of the EBA POG Guidelines.

Main findings

76. Most CIs reported the following main steps to carry out product testing:

a) technical/pre-implementation test;

b) sales process test;

c) internal test (internal users, expert tests); and

d) pilot testing (performance tests and qualitative tests) when describing the product-testing methodology.

77. The majority of CIs explained that product testing may vary depending on the type of product and service, its nature and the target market, and relies on several mechanisms to mitigate the risks to consumers, (e.g. the product features, pricing, interest rates). The testing methods apply most of the times on a case-by-case basis and could depend on the complexity or the extent of changes required to the product. Some respondents also argued that they use uniform testing and that the testing varies more according to distribution channels, that is whether the product is offered in a self-service channel, or a face-to-face channel where employees can assist. However, most respondents did not provide any detailed information and, some replied dismissively, regarding the examples of product testing provided that led to a change in the way manufacturers brought the product to the market. It is worth noting that, respondents reported that in some cases, no tests were performed for products originated from specific regulations, as they were deemed by CIs to be addressed to customers belonging to a target market defined by the law.

78. Only a few PIs reported that a similar three-steps approach is followed (system testing, internal user testing, and piloting phase). Respondents representing PIs mentioned that new products are introduced to the market in a controlled manner and the process and systems of PIs are

generally audited in accordance with specific requirements such as the Payment Card Industry Data Security Standards requirements[20].

79. Some of the EMIs surveyed reported four product testing steps: (i) creating a validation plan, (ii) defining the systems requirements, (iii) testing, and (iv) developing or revising procedures. These aim to avoid product overlaps with the existing product offer, and to ensure that the product concept is aligned to customers' needs and potential target market.

80. The analysis of the responses shows that there is a lack of clarity among some manufacturers (mainly CIs) in certain countries concerning the difference between testing and monitoring of the product. In certain countries, a limited number of CIs have put in place a test prior to the launch of the product or have carried out testing prior to extending the target market for an existing product. Some argued for example that, because of the specificities of the entity, the product could not be tested under a wide range of financial scenarios including stressed scenarios.

81. Various methodologies appear to exist for testing products across FIs. While all manufacturers carried out testing, the assessment of the responses demonstrates that the profitability analysis is common practice. Manufacturers seem to be focusing more on verifying if the product can be operationally sold, suggesting that testing is focused on identifying issues that may need to be addressed before the launch of the product, or on commercial aspects, rather than on verifying how the product would behave in time and if it fits the characteristics of the identified target market. It is therefore not always clear whether, when carrying out the testing, all manufacturers pursue the objective of the EBA POG Guidelines which state that product testing should be carried out by the manufacturer to assess how the product would affect consumers under a wide range of scenarios[21]. Testing for the purpose of the EBA POG Guidelines is about assessing the impact of a given product on its target market to understand potential issues that could be detrimental for the consumers (e.g. communication, distribution of the product), depending on the product.

Good practices

82. It should be reiterated that the objective of the product testing described in the EBA POG Guidelines is to focus on whether consumers know and understand what they are buying. As a good practice for product testing, manufacturers might consider incorporating scenarios from both manufacturers' as well as customers' perspectives (e.g. if the product is understandable, not overcomplicated and suitable to customers). The following good practice for the testing phases might therefore be considered:

[20] The Payment Card Industry Data Security Standard (PCI DSS) is an information security standard for organizations that handle branded credit cards from the major card schemes.

[21] Guideline 4.1 of the EBA POG Guidelines

a) progressive testing, that includes all newly developed features and processes;

b) regressive testing, that includes re-testing of all existing features to ensure, that a new development does not break what already exists;

c) post-implementation reporting/testing that includes for example, that, after development, end-users test the product before its launch in production so that an evaluation of the user experience and user interface can take place.

83. The EBA is of the view that, in line with the principle of proportionality articulated in Guideline 1.5 of the POG Guidelines, when products are simple and have very broad target markets, testing could also focus on whether customers know and understand what they are buying and on planned customer communication. By contrast, for more complex products or products that may be riskier for customers, such as credit products, the EBA would expect testing to include the testing of identified scenarios, with a view to identifying the way in which the intended target market would be affected.

84. Some additional good practices might also be considered among the projects launched by some CIs:

- It may be considered good practice to include testing methodologies within the manufacturers POG policy. As outlined by a CI that is currently implementing a project, it could consist of creating a centralised documentation tool with a clear definition of the roles and responsibilities of the different units in terms of POG and an explanation of the performance of a catalogue testing to avoid overlaps among products offered.
- A supplementary good practice may consist of formalising a framework/tool (e.g. using business analysis tools to track the environment in which the FI is operating or is planning to launch a new project/product/service) to undertake an assessment of the current and potential future impact of the external environment on product performance to inform product testing (stress/scenario/simulation). It could also be done by the use of customer research and pilot (or limited) releases to assess the way in which the product would affect the target market. It could enable the manufacturer to assess the position of a new product in the light of the manufacturer's product offerings, to identify, among other things, possible overlaps and any resultant confusion for consumers.
- Another good practice that would be relevant for manufacturers to consider would be the testing of a number of scenarios with a simulation of the provision of services, during which potential customers could express their views at each of the steps taken, to get an objective feedback on the process.
- In line with the first report, another good practice identified was the inclusion of testing against the negative target market (e.g. whether individuals below the age of 18 years could apply for and access the product when only customers aged over 18 years are targeted) and testing of different communication channels.

Monitoring and remedial actions

85. Guideline 5 of the POG Guidelines states that manufacturers should monitor a product on an ongoing basis to ensure that the interests, objectives and characteristics of consumers continue to be appropriately taken into account. All manufacturers that responded to the survey appeared to be monitoring products, and most have mechanisms in place requiring specific reviews to be carried out on a regular basis.

Main findings

86. The following section provides detailed findings on (i) the instruments and process in place to monitor on an ongoing basis that the interests, objectives and characteristics of consumers' needs are taken into account and (ii) the frequency of the product monitoring as well as the remedial actions taken by manufacturers.

Instruments and process in place to monitor on an ongoing basis that the interests, objectives and characteristics of consumers' needs are taken into account

87. Most CIs have put in place a process to monitor products but the extent of this review varies among the CIs. The majority of the CIs surveyed described the product monitoring process as being led by the relevant business units with oversight from risk and compliance functions depending on the complexity of the product. A large number of respondents clarified, however, that monitoring activities are performed at least for products that have been launched following a POG procedure, but some of the respondents representing CIs also referred to monitoring activities being carried out before a product is launched.

88. Several CIs reported that the monitoring of a product focuses on pricing and profitability but other CIs referred also to the introduction of customer centric measures including consumers' feedback (e.g. chat, surveys, social networks, and interviews), complaints or looking at whether specific changes are needed because of new market trends. Several respondents among the CIs mentioned for example that additional (non-exhaustive) monitoring tools are used to monitor that the interests, objectives and characteristics of consumers continue to be appropriately taken into account for each product, and include, for example, customer satisfaction surveys, social media/app stores monitoring, service-level monitoring, credit risk, fraud level and consistency of sales.

89. The approach of the CIs appears to be aligned with the EBA POG Guidelines as the manufacturer remains ultimately responsible for the monitoring of products brought to the market to ensure that the interests, objectives and characteristics of consumers continue to be appropriately taken into account.

Frequency of the monitoring and remedial actions

90. According to the manufacturers, the frequency of the monitoring and the extent of the review vary significantly from one manufacturer to another and across jurisdictions. The CIs surveyed mentioned that they carry out regular monitoring without specifying the frequency, explaining that, for a majority of them continuously monitor and review products and services marketed. Some CIs stated that they review products on a weekly or monthly basis, while others review a given product or service on a yearly basis. Some CIs also explained that the monitoring of a product is also linked to the risk attached to the product. The frequency and intensity of the monitoring vary depending on the type and characteristics of the product. Even if FIs have to carry out monitoring for all products, the intensity of such monitoring might vary (in accordance with the proportionality principle in the POG Guidelines). For PIs, product monitoring is part of the ad hoc compliance process. Some PIs explained that if a change needs to be made to a product, it implies filling in a checklist for legal and compliance departments which is also aligned with the EBA Guidelines on internal governance[22].

91. Concerning remedial actions, a majority of respondents surveyed mentioned that they did not have to, or they did not take any remedial actions as a result of a product monitoring. Some manufacturers surveyed clarified, however, that remedial actions are taken if the performance of the product does not meet the expectations of the customers or the institution, for example when the product is too complex for the customers to understand it (e.g. the clause informing the customer about a benchmark use for a mortgage product was identified as not being clear enough, so an action has been registered and the credit agreement has been modified accordingly). The approach appears to be aligned with the objective of the EBA POG Guidelines.

Good practices

92. As stated in Guideline 5.1 of the POG Guidelines, once a product is brought to market, the manufacturer is ultimately responsible for product monitoring and should monitor the product on an ongoing basis to ensure that the interests, objectives and characteristics of consumers continue to be appropriately taken into account. It means that manufacturers must (i) carry out a revision of the product during the product monitoring; and (ii) take action, if an issue is identified, after the FI has carried out the said revision.

93. In addition, according to Guideline 6.1 of the POG Guidelines, FIs should take remedial actions to mitigate risks to consumers and prevent a re-occurrence of detriment, every time they find out that there is a problem with a particular product (e.g. when products are not being distributed as expected or, are posing unexpected problems for their buyers, or when firms receive many complaints about specific products).

[22] Ibid

94. In accordance with the proportionality principle, the frequency and intensity of the monitoring may vary depending on the type and characteristics of the product. The EBA is of the view that having regular reviews and establishing specific frequencies for such reviews are good practice, including when the frequency of the review is dependent on the riskiness for customers and/or the complexity or the specific features of the product. Manufacturers might consider it good practice to carry out more frequent monitoring of more complex and risky products and always take specific measures to solve the situation if a problem has been identified with a specific product is identified.

95. Undertaking lifecycle reviews more frequently based on the output of ongoing monitoring of products and services also represents good practice. Indeed, when implementing their POG policies, FIs may consider giving explicit considerations to the result of the monitoring for the product classification (e.g. to prioritize remedial initiatives). For example, where a customer-impacting event is identified, the event could be graded as Tier 1, 2 or 3. A Tier 1 event would be, for example, when the financial impact is higher than EUR 250,000 with over 100 customers affected and/or business disruption of longer than 4 hours. If a Tier 1 event occurs at any time during the life cycle of a product or service, then the next scheduled review would include a recommendation from the relevant product committee about whether to bring forward the next scheduled review period. The post-product-review process would require that a lesson learnt review is undertaken and presented to the relevant product committee 6 months after the withdrawal of every material product.

96. In addition, as mentioned in the first report, manufacturers might consider it good practice, to include customer-centric information such as direct consumer feedback. This could include the analysis of statistical indicators measuring customer behavior and customer activity as well as an analysis of consumer complaints received.

Distribution

97. Guideline 7 of the POG Guidelines defines the requirements on how the distribution channels should be selected and Guideline 8 of the POG Guidelines focuses on the information that manufacturers should provide to distributors.

Main findings

98. The following section provides the main findings regarding (i) the selection of the most appropriate distribution channel and documentation provided to the distributors, (ii) the agreement between the manufacturer and the distributor on the approach, and (iii) cases when distributors have sold products outside the target market.

Selection of the most appropriate distribution channel and documentation provided to distributors for product identified

99. The majority of respondents mentioned that they use their own branch network or an online platform for distribution, with the selection of the channel primarily driven by the target market, the risk nature of the product and consumer experience.

100. According to the manufacturers (mainly CIs), the selection of the distribution channel is primarily guided by the customer segment to which the product is directed, by benchmarking and market analyses, customer feedback, product and process needs, and legal and compliance guidelines. It is also based on characteristics of the identified target market, which includes the accessibility, availability, convenience, experience of the potential clients, behavioural patterns of the clients and the type of the product (mainly its complexity), as well as the general direction of the technology development

101. A similar approach is adopted by PIs and EMIs. PIs' assessment to determine whether the distribution channels are appropriate focuses mainly on the interests, objectives, characteristics of consumers including the needs, knowledge, and financial capability of the customers and checking that information about the product's characteristics and risks has been provided to the customers. For EMIs involved in the survey, the most appropriate distribution channel is selected (except if they do not have any distribution channel than their own platform) in consideration of the following elements: the characteristics of the market, product features, geographical location, the business activity and the customer segment.

102. Some respondents mentioned that a multichannel approach is sometimes followed, with the same products offered through different channels without major modifications (e.g. a new product is sold online, via an app or a website, in addition to being sold via traditional distribution channels at bank branches). Only a few respondents reported that separate products lines are marketed according to the distribution channel (e.g. private loans distributed through third parties are different from those directly marketed at bank's branches).

103. Manufacturers seem to give further consideration to customer's interest by checking that the distribution channel is appropriate for the target market, in compliance with the POG Guidelines. However, the criteria set out in Guideline 7.1 of the POG Guidelines do not seem to be the main ones the manufacturers rely on to select the distribution channel. Manufacturers continue relying mainly on the characteristics of the market, the business activity and customer segment rather than on checking whether the distributor has the appropriate knowledge, expertise and capability to market each product market and provide appropriate information explaining the characteristics and risks of the product to the customers.

104. Regarding the documentation provided to the distributors, some CIs surveyed mentioned that the distributors are bound to use the information and documentation provided by the CIs only when liaising with customers. In addition, some CIs reported that in some countries it is

prohibited for distributors to use any transparency, advertising or contractual documentation other than that made available by the CI. Those practices seem to be aligned with the EBA POG Guidelines but focus more on the compliance aspects such as the provision of information or the potential risks rather than on the interest of the consumer and his/her understanding of the products.

Agreement with the distributor on the approach

105. The large majority of CIs concerned mentioned that they have an agreement and policies/guidelines to ensure that products are sold within the defined target market. For example, the CIs mentioned that the distributor is obliged to act transparently and with professional care. Some CIs even reported that some POG related principles have been established with their distributors, to ensure that the distributors commit to the following steps:

- verifying that the products are in line with the needs, characteristics and objectives of the customers within the target market;
- providing adequate training to their staff so they can sell the product to the correct target market;
- maintaining the product they distribute unmodified;
- using only product documentation approved by the originator;
- monitoring conduct of sales staff.

106. In addition, some CIs in one country outlined the separation of the two functions within institutions (manufacturing and distribution) and the provision of adequate training to ensure that respective objectives are met to prevent consumer detriment.

107. These approaches appear to be compliant with the EBA POG Guidelines, which impose on the manufacturer to take all reasonable steps to ensure that distributors act in compliance with the objectives of the manufacturers POG arrangements and might be considered good practice.

108. Some CIs' practices seem, however to go beyond the EBA POG Guidelines (e.g. agreements that cover the conditions for providing binding or indicative offers and the provision of advice, or distribution agreement that prevent third parties from entering into the contract with the consumer, allowing the originator to further assess if the product is suitable for the customer).

109. Finally, most CIs indicated that they retain significant control of the distribution process, irrespective of whether they distribute through their own channels or through a distributor.

110. No answers have been provided by PIs and EMIs, with the exception of one PI, which mentioned that for retail banking products, it only uses its own distributors within the company group.

Cases of distributors selling products outside the target market

111. Only a small number of institutions mentioned that they do not have in place contractual and procedural mechanisms to ensure that distributors do not provide products and services to consumers outside the product or service's target market.

112. Indeed the majority of CIs surveyed reported that they monitor the regularity of distributors operations on an ongoing basis. As reported by the majority of CIs, according to the agreements, the distributors must abide by the rules, manuals and procedures provided by the CIs for the promotion and selling of products. This approach is intended to ensure that products are marketed within their respective target markets. Some CIs explained that they have an automated management system, which processes and filters requests to join the various products and blocks requests from customers who do not comply with the bank's parameters. IT procedures are also implemented to block any attempt to place a product outside the target market. CIs are therefore able to intercept any event of a product being sold outside the target market. In addition, according to CIs responses to NCAs, the distribution agreements impose on the distributor an obligation to report and justify any selling outside the identified target market.

113. Considering these elements, the large majority of CIs reported that it is very unlikely that products will be sold outside of the target market. Some CIs mentioned, for example, that they have to approve whether or not the product will be provided to individual consumers which could prevent the product being sold outside the target market. If irregularities are identified, the majority of CIs reported that actions are taken based on the type of issue identified, such as issuing a warning, a request for removal of irregularities and limitations of rights, or terminating the cooperation agreement as last resort.

114. According to CIs, the termination of the cooperation agreement and the working relationship with the distributor could lead to revaluating the characteristics of the products listed into the CIs' portfolio, in relation to the evidence coming from the monitoring phase. The large majority of CIs mentioned that no cases have been identified so far. A few CIs reported that they were aware of certain cases (e.g. mis-selling, fraud, granting a loan to a non-resident when non-resident financing was not the target market for the product). No specific responses were provided by PIs and EMIs except one PI, which mentioned that one of the cases concerned merchants.

115. The fact that there are no concrete confirmed cases of distributors selling outside the target market; might reflect either the usefulness and correct implementation of the POG Guidelines or that FIs may not have reported such occurrences because they do not yet have in place a proper system to monitor distributors' compliance with the clauses of the distribution agreement.

Good practices

116. When determining whether the distribution channels are appropriate, the practice of assessing the following elements (which focus on the interests, objectives and characteristics of consumers) could be considered good practice, in alignment with the objectives of the EBA POG Guidelines:

- the identified target group with consideration for the needs, knowledge and financial capability of the customers;
- the knowledge, expertise and capability of the distributor to market the products and services correctly; and
- the information provided to the customers: checking if the relevant information has been provided to the customers (including information about the product's characteristics and risks).

117. In addition, the practice observed by the large majority of CIs of reaching, an agreement with the distributor and policies/guidelines for the products to ensure they are sold within the defined target market might contribute to meeting the stipulation of Guideline 7.3, which states that the manufacturer should take all reasonable steps to ensure that distributors act in compliance with the objective of the manufacturers' POG arrangement. This could be, for example to ensure that the distributors commit to the following steps:

- verifying that products are in line with the needs, interests, objectives and characteristics of customers within the target market;
- providing adequate training to staff so they can sell the product to the correct target market;
- maintaining the product they distribute in an unmodified form;
- using only product documentation approved by the originator;
- monitoring the conduct of sales staff.

118. Having a clear policy on how to respond to selling outside the market would also be considered good practice.

Conclusions

119. A key finding of this second EBA report on the application of the POG Guidelines is that the assessment of this larger sample of FIs from a larger number of Member States confirms the conclusions reached in the first EBA report published in 2019.

120. Overall, manufacturers appear to have POG arrangements in place as required by the EBA POG Guidelines and have made the necessary changes in an effort to comply with the Guidelines. As a result of the improvements made, manufacturers have launched more stringent internal process management and monitoring of new products, with a clear definition of roles and responsibilities of all departments involved, including the introduction of new internal governance rules. In addition, most manufacturers have formalised, standardized and updated existing requirements including the principles of supervision over product creation, and the involvement in the product approval process of internal control functions, such as the intervention of compliance function in the product approval process.

121. However, and akin to the findings of the first EBA report, this report also shows that, despite the objectives of the POG Guidelines to enhance consumer protection and also to address the prudential risks arising from mis-conduct, manufacturers appear to focus almost entirely on the requirements set out in the EBA Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2017/11). In other words, while the manufacturers surveyed had implemented the internal processes in relation to product oversight for retail products this was not necessarily done in a way that put the required focus on ensuring that consumers' needs are met, or that attracted the same level of attention as the compliance with the requirements or the profitability of the product and service. When applying the POG arrangements manufacturers should ensure that the interests, objectives and characteristics of consumers are taken into account to avoid consumer detriments.

122. The assessment also highlights that the application of the EBA POG Guidelines varies significantly according to the size of the FIs, between the Member States and also between FIs within the same Member State. FIs with a large number of products and employees do not therefore have the same approach as a small EMI that has only recently been authorised and has only very few employees. This finding might be viewed as not altogether surprising, given that it is what the application of the proportionality principle in the EBA POG Guidelines is bound to lead to POG arrangements should be proportionate to the nature, scale and complexity of the relevant business of the manufacturer. However, this finding might also be driven by the lack of definition in the EBA POG Guidelines of what new and significantly changed products means, which then leads to divergent application of the EBA POG Guidelines across FIs.

123. Furthermore, in respect of the significant increase in digitalisation of retail banking products and services, manufacturers appear to have given, when identifying the target market, insufficient attention to the risks of financial exclusion and/or consumer detriment as a result of consumers lacking the financial literacy and/or technology capacity to access certain digital products and services.

124. Finally, the report sets out in its annex some good practices concerning the scope of the POG Guidelines and general governance, the identification of the target market, product testing, product monitoring and the POG arrangements for distributors, the application of which contributes to compliance with the EBA POG Guidelines and consistency of supervisory and consumer outcomes.

125. The EBA and relevant competent authorities will continue to monitor how FIs apply the EBA POG Guidelines and whether they make use of the good practices identified in this report.

Annex – Good practices for the application of the EBA POG Guidelines by manufacturers

EBA POG Guidelines	No	Good practices
Scope of the EBA POG Guidelines and general governance: **GL 1: Establishment, proportionality, review and Documentation** **GL 2: Manufacturers' internal control functions**	1	Avoiding relying on a single criterion to define whether a product is new or significantly changed, and considering instead the following set of criteria: - significant changes in the processing of the product including an extension of the product distribution, the introduction of new, or the withdrawal of existing, product or service features; - a change in the target market and the introduction of a new customer market segment (including geographically) as a target market; - changes that affect the use of the product by the customer on a day-to-day basis; - changes for which the customer would reasonably perceive there to be a change in the level of service compared with what is currently being provided; - change in one or more material features that alter the risk profile of the product from a consumer perspective and the complexity of the product. Those changes should not only consider the risk profile in relation to the effect on FIs business or risk assessment portfolio, but also include changes that affect the use of the product by the customer on a day-to-day basis, changes for which the customer would reasonably perceive there to have been a change in the level of service compared with what is currently being provided; - a change in the sale conditions, a new distribution channel or the introduction of an alternative channel of selling, including the use of third parties for the sale of the product; - significant modifications to the product pursuant to new legal or regulatory rules and standards; - material changes to related processes (e.g. new outsourcing arrangements) and systems (e.g. IT change processes), as defined in Guideline 18 of the separate EBA Guidelines on internal governance but only if such changes have an impact on customers.

	2	Explicitly defining negative criteria (i.e. what a new or significantly changed product is not) and providing and recording the rationale for deciding that a product is not new or significantly changed.
	3	Having defined structures and clear escalation lines and involving the risk and compliance functions. However, the EBA is of the view that a process owned by the compliance or risk function is not good practice, as it may lead to that function losing some of its required independence.
	4	Having specific work-flow documents and/or checklists that need to be followed to ensure that the process followed is the same for all products and that there is a clear audit trail, for example setting up a centralized documentation tool that clearly defines the roles and responsibilities of the different units and key staff involved in the POG process. To ensure that consumer needs are being considered during the process, seeking views from consumers during the design phase of the product, for instance through consumer working groups or documenting the impact of the product on any potential customers throughout all stages of the product life-cycle and monitoring complaints and errors about the products.
GL 3: Target market	5	Using a set of criteria based on client segmentation to ensure that the product is deemed appropriate for the interests, objectives and characteristics of the target market such as: - demographic data (e.g. age of the clients); - the characteristics of the respective product in relation to the risk aversion profile of the customer (e.g. financial situation, creditworthiness assessment. and the other types of offered products); - level of knowledge of financial capability; - level of financial and investment expertise of the clients; - relevant legislation.
	6	Varying the assessment depending on the risk borne by the customer and the degree of complexity and the nature and characteristics of the product. When identifying whether a new or significantly changed product would be beneficial to consumers (customers' segmentation), giving further consideration to the nature, cost and added value of the product andwhether or not the product is unnecessarily complex.
	7	Creating a product review template that requires the product owner /product development and/or business unit to clearly outline what measures are in place to ensure that sales are not made to non-target market customers. The product

		approval template could be designed in a way that necessitates internal mandatory approvals.
	8	Analysing whether customers for a particular target markets need such product or service. Thus, the manufacturers can rely even more on customers' feedback, for example on, customer satisfaction surveys before the development of the product and after the product launch, focus groups for the design of the innovative products (e.g. 'a panel community', selected in accordance with the target market to be intercepted).
	9	Giving further consideration to innovation in the development of POG processes, for example when targeting a broad target market and developing existing product, some further consideration should be given to certain groups of consumers who lack financial literacy and technology expertise to prevent financial exclusion. Indeed, new products and services are often seen as offering new opportunities for consumers but certain categories of consumers cannot – or do not want – to use those new services.
	10	Taking into account that digital channels have been identified as a factor that facilitates access to credit by consumers, giving further attention to the risks that consumers might face due to the increasing use of digital channels by FIs (e.g. exposing consumers to market practices that exacerbate behavioral biases) when improving their POG processes.
GL 4: **Product testing**	11	Considering the following testing phases: a) progressive testing, that includes all newly developed features and processes; b) regressive testing, that includes retesting of all existing features to ensure, that new development does not break what already exists; c) post-implementation testing that includes for example that, after the development, end-users test the product before its launch in production so that where an evaluation of the user experience and user interface can take place. In line with the principle of proportionality articulated in Guideline 1.5 of the EBA POG Guidelines, when products are simple and have very broad target markets, testing could also focus on whether customers know and understand what they are buying and on planned customer communication. By contrast, for more complex products or products that may be riskier for customers, such as credit products, the EBA would expect testing of identified scenarios, with a view to identifying the way in which the intended target market would be affected.

	12	Including testing methodologies within the manufacturers POG policy, for example creating a centralized documentation tool with a clear definition of the roles and responsibilities of the different units in terms of POG and an explanation of the performance of a catalogue testing to avoid overlaps among products offered.
	13	Formalising a framework/tool (e.g. using business analysis tool to track the environment in which the FI is operating or is planning to launch a new project/product/service) to undertake an assessment of the current and potential future impact of the external environment on product performance to inform product testing (stress/scenario/simulation). It could also be done by the use of customer research and pilot (or limited) releases to assess the way in which the product would affect the target market. It could enable the manufacturer to assess the position of a new product in the light of the manufacturer's product offerings, to identify, among other things, possible overlaps and any resultant confusion for consumers.
	14	Testing a number of scenarios with a simulation of the provision of services, during which potential customers could express their views at each of the steps taken, to get an objective feedback on the process.
	15	Inclusion of testing against the negative target market (e.g. whether individuals below the age of 18 years could apply for and access the product when only customers aged over 18 years are targeted) and testing of different communication channels.
GL 5: Product monitoring **GL 6: Remedial actions**	16	Having regular reviews and establishing specific frequencies for such reviews are good practice, including when the frequency of the review is dependent on the riskiness for customers and/or the complexity or the specific features of the product. Carrying out more frequent monitoring of more complex and risky products and always taking specific measures to solve the situation identified if a problem is identified with a specific product.
	17	Undertaking lifecycle reviews more frequently based on the output of ongoing monitoring of products and services. When implementing their POG policy, FIs may consider giving explicit considerations to the result of the monitoring for the product classification (e.g. in order to prioritize remedial initiatives). For example, where a customer impacting event is identified, the event could be graded as Tier 1, 2 or 3. A Tier 1 event would be, for example, when the financial impact is higher than EUR 250,000 with over 100 customers affected and/or business disruption of longer than 4 hours. If a Tier 1 event occurs at any time

		during the life-cycle of a product or service, then the next scheduled review would include a recommendation from the relevant product committee about whether to bring forward the next scheduled review period. The post-product-review process would require that a lessons learnt review is undertaken and presented to the relevant product committee 6months after the withdrawal of every material product.
	18	Including customer centric information such as direct consumer feedback. This could include the analysis of statistical indicators measuring customer behavior and customer activity as well as an analysis of consumer complaints received.
GL7: Distribution channels **GL8: Information for distributors**	19	When determining whether the distribution channels are appropriate, assessing the following elements (which focus on interests, objectives and characteristics of consumers) in alignment with the objectives of the EBA POG Guidelines: - the identified target group with consideration for the needs, knowledge and financial capability of the customers; - the knowledge, expertise and capability of the distributor to market the products and services correctly; and - the information provided to the customers: checking if the relevant information has been provided to the customers (including information about the product's characteristics and risks).
	20	Ensuring that the distributors commit to the following steps: - verifying that the products are in line with the needs, interests, objectives and characteristics of the customers within the target market; - providing adequate training to staff so they can sell the product to the correct target market; - maintaining the product they distribute in an unmodified form; - using only product documentation approved by the originator; - monitoring the conduct of sales staff.
	21	Having a clear policy on how to respond to selling outside the market.

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