

Prepping POG arrangements for retail banking products

26/04/2016

Financial Services analysis: How is the new regime for product oversight and governance (POG) for retail banking products going to work in practice? Rosanna Bryant, partner in the financial regulation group at Addleshaw Goddard LLP, comments on the new guidelines from the European Banking Authority (EBA).

Original news

EBA guidelines to improve consumer protection in retail banking, LNB News 15/07/2015 139

Final guidelines on POG arrangements for retail banking products set out requirements for manufacturers and distributors when designing and bringing to market mortgages, personal loans, deposits, payment accounts, payment services and electronic money. Published by the EBA, the guidelines are the EBA's response to increasing risks arising from the misconduct of financial institutions in their dealing with consumers. The guidelines will apply from 3 January 2017.

How will the creation of oversight and governance arrangements affect the creation of new financial products?

When releasing a new product, manufacturers will have to consider that these guidelines are considered with the new product approval policy (NPAP) in line with guideline 44. The NPAP should cover every consideration to be taken into account before releasing new products. These arrangements add extra considerations when manufacturers release a new product to the market meaning that the release of the product could be delayed.

One of the main focuses of the arrangements is on target markets. Manufacturers should ensure that new products released meet the requirements of the identified target markets, such as financial capabilities. Many of the requirements within the EBA guidelines are already applicable with the UK regulatory regime for mortgages in any event and they therefore add little to existing requirements on regulated firms. For example, the measures surrounding target markets is already covered in the Mortgage Credit Directive 2014/17/EU (MCD) as well as inherent within the application of PRIN 6 in the Financial Conduct Authority (FCA) Handbook (treating customers fairly).

The arrangements also put guidelines in place in relation to distributors. Any manufacturer of a product should make sure that products are distributed to the correct target market and are only sold outside this target market on a justified basis. The manufacturer will also have to provide a distributor with all the relevant information to ensure that the product is placed properly on the market and enable it to recognise the correct target market by providing a description of the main characteristics of the product. This continuous monitoring may lead to changes in distributors which may affect the release of a product to the market. Again, these requirements are implicit within the current UK regulatory regime in any event.

Overall, these arrangements add an extra layer of liability when creating new products. This is particularly the case with regards to senior management who have to ensure that staff involved in designing a product are familiar with the product's features, characteristics and risks.

What criteria will the regulators consider when assessing new products?

There are three criteria which the regulator will assess when assessing new products:

- ensuring that the interests, objectives and characteristics of customers are taken into account
- avoiding potential consumer detriment, and
- minimising conflicts of interest

On the interests, objectives and characteristics of customers, a product manufacturer should ensure that products are monitored on an ongoing basis to ensure that these are still met. A product manufacturer should also periodically check their internal compliance and risk functions to ensure that their policies continue to meet these requirements.

On avoiding consumer detriment, if the product manufacturer recognises a problem relating to the product, they should take the necessary action to mitigate the situation and ensure that it doesn't happen again.

On minimising conflicts of interest, the manufacturers should consider how the new products fit in with the existing products which the firm has. Regulators will ask whether the variety of products on offer will make it harder for consumers to make an informed decision.

The guidelines do point out that arrangements should be proportionate to the nature, scale and complexity of the relevant product manufacturer. In this sense, there is some flexibility when considering these criteria.

What power will regulators have to demand changes to a given products structure?

This is sought to be achieved in these three ways:

- product testing,
- product monitoring, and
- remedial action

On product testing, FCA regulated firms are unlikely to introduce products that are not appealing to customers. Many firms already test their products using a range of measures, including market research. If they do find any problems, they will change them before releasing the product to the market. Having to test products so prescriptively therefore seems unnecessary and will delay the time it takes to get a product to market.

On product monitoring, in the UK the Council of Mortgage Lenders (CML) has always questioned the need for a guideline to monitor products. Firms keep their products under constant review, removing from the market those that are unappealing to customers or no longer competitive. A firm that did not do this would be unlikely to be able to compete with its peers. The CML does not believe firms should monitor a product according to the needs, interests or characteristics of a target market. This suggests the product may not at some future point become appealing to other markets.

As to remedial action, there are already a range of reasons for firms to take action where they identify problems with products. One major reason is reputational damage, which provides a substantial incentive to both monitor and rectify issues. Regulatory intervention and the threat of regulatory intervention are further incentives for firms to act to rectify problems. The FCA or Prudential Regulation Authority would intervene if there were an issue that a firm had allowed to crystallise.

How will this oversight affect products already on the market?

The guidelines will apply to all existing products on the market that are significantly changed after the implementation date of the guidelines. The main guidelines that firms may wish to consider with regard to existing products concern product monitoring and remedial action which are discussed earlier on in this paper.

A product manufacturer will need to consider how a new product fits in with its existing product range. This may mean that manufacturers have to completely redesign products so that they can put new products onto the market. If this change is made after the implementation date of the guidelines, the existing products will become subject to the requirements set out in the guidelines.

As mentioned above, existing products will only be affected if they are significantly changed after the implementation date of the guidelines. The EBA has, however, provided no guidance as to what 'significantly changed' means.

Will the sanctioning of a product by a regulator free an institution from risk if the product is later found to be damaging?

While there is no specific section in the guidelines which deals with this, based on other measures, an institution is unlikely to be entirely free from risk.

The reason for this is there is an underlying theme in the guidelines towards monitoring measures on an ongoing basis. For example, under guideline 5, a manufacturer should monitor the product on an ongoing basis to ensure that the requirements for new products are met. Also, in relation to remedial action, a manufacturer should notify the distributor of

any additional changes that need to be made to products. This suggests that if a manufacturer did not tell a distributor of a later change, in theory it could still be sanctioned by its regulator.

How does this all fit in with the broader regulatory landscape?

The CML has always questioned the need for these EBA guidelines. Existing European legislation already provides for consumer protection. For mortgages specifically, the MCD includes provisions on sales processes and requirements for firms' staff. Member States such as the UK already have regulatory regimes. The CML said it would have welcomed a more detailed explanation from the EBA about its approach to creating these guidelines. The scope of the guidelines spans the range of financial services and the breadth of Europe. Clients are concerned the UK mortgage market, which already ensures good outcomes for customers, faces further regulation due to issues regarding other products in other European countries.

These guidelines also appear to conflict with previous guidelines concerning distribution channels. As mentioned previously, firms have the option under these guidelines to sell products to firms outside the target market on an exceptional basis. However, in previous guidance firms had to identify who was and who was not a target for a product. This process is likely to be complex and may affect outcomes for customers. The CML notes that firms should have discretion—subject to existing regulations—over who they sell their products to so that they can decline to offer those products to customers who fail creditworthiness assessments.

The EBA may be seeking to deliver the policy objectives of other organisations and legislation. The EBA's rationale for these guidelines includes reference to mortgages sold alongside other products and to risks arising from foreign currency loans. The MCD includes rules on tying and bundling and on foreign currency lending. The CML has questioned why the EBA believes it needs to further regulate in this area.

In light of this, it would be better if the EBA at least allowed the existing regulations to take effect before introducing further regulations. Not doing so will add further complexity and it will not allow the EBA and other European authorities to see what, if any, gaps emerge after the implementation of legislation that has already been passed, such as the MCD.

Interviewed by David Bowden.

The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor



CLICK HERE FOR
A FREE TRIAL OF
LEXIS®PSL

About LexisNexis | Terms & Conditions | Privacy & Cookies Policy
Copyright © 2015 LexisNexis. All rights reserved.