

Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits (Text with EEA relevance)

CHAPTER III

PRODUCT GOVERNANCE REQUIREMENTS

Article 9

Product governance obligations for investment firms manufacturing financial instruments

1 Member States shall require investment firms to comply with this Article when manufacturing financial instruments, which encompasses the creation, development, issuance and/or design of financial instruments.

Member States shall require investment firms manufacturing financial instruments to comply, in a way that is appropriate and proportionate, with the relevant requirements in paragraphs 2 to 15, taking into account the nature of the financial instrument, the investment service and the target market for the product.

2 Member States shall require investment firms to establish, implement and maintain procedures and measures to ensure the manufacturing of financial instruments complies with the requirements on proper management of conflicts of interest, including remuneration. In particular, investment firms manufacturing financial instruments shall ensure that the design of the financial instrument, including its features, does not adversely affect end clients or does not lead to problems with market integrity by enabling the firm to mitigate and/or dispose of its own risks or exposure to the underlying assets of the product, where the investment firm already holds the underlying assets on own account.

3 Member States shall require investment firms to analyse potential conflicts of interests each time a financial instrument is manufactured. In particular, firms shall assess whether the financial instrument creates a situation where end clients may be adversely affected if they take:

- a an exposure opposite to the one previously held by the firm itself; or
- b an exposure opposite to the one that the firm wants to hold after the sale of the product.

4 Member States shall ensure that investment firms consider whether the financial instrument may represent a threat to the orderly functioning or to the stability of financial markets before deciding to proceed with the launch of the product.

5 Member States shall require investment firms to ensure that relevant staff involved in the manufacturing of financial instruments possess the necessary expertise to understand the characteristics and risks of the financial instruments they intend to manufacture.

6 Member States shall require investment firms to ensure that the management body has effective control over the firm's product governance process. Investment firms shall ensure that the compliance reports to the management body systematically include information about the financial instruments manufactured by the firm, including information on the distribution

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strategy. Investment firms shall make the reports available to their competent authority on request.

7 Member States shall require investment firms to ensure that the compliance function monitors the development and periodic review of product governance arrangements in order to detect any risk of failure by the firm to comply with the obligations set out in this Article.

8 Member States shall require investment firms, where they collaborate, including with entities which are not authorised and supervised in accordance with Directive 2014/65/EU or third-country firms, to create, develop, issue and/or design a product, to outline their mutual responsibilities in a written agreement.

9 Member States shall require investment firms to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client for whose needs, characteristics and objectives the financial instrument is compatible. As part of this process, the firm shall identify any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible. Where investment firms collaborate to manufacture a financial instrument, only one target market needs to be identified.

Investment firms manufacturing financial instruments that are distributed through other investment firms shall determine the needs and characteristics of clients for whom the product is compatible based on their theoretical knowledge of and past experience with the financial instrument or similar financial instruments, the financial markets and the needs, characteristics and objectives of potential end clients.

10 Member States shall require investment firms to undertake a scenario analysis of their financial instruments which shall assess the risks of poor outcomes for end clients posed by the product and in which circumstances these outcomes may occur. Investment firms shall assess the financial instrument under negative conditions covering what would happen if, for example:

- a the market environment deteriorated;
- b the manufacturer or a third party involved in manufacturing and or functioning of the financial instrument experiences financial difficulties or other counterparty risk materialises;
- c the financial instrument fails to become commercially viable; or
- d demand for the financial instrument is much higher than anticipated, putting a strain on the firm's resources and/or on the market of the underlying instrument.

11 Member States shall require investment firms to determine whether a financial instrument meets the identified needs, characteristics and objectives of the target market, including by examining the following elements:

- a the financial instrument's risk/reward profile is consistent with the target market; and
- b financial instrument design is driven by features that benefit the client and not by a business model that relies on poor client outcomes to be profitable.

12 Member States shall ensure that investment firms consider the charging structure proposed for the financial instrument, including by examining the following:

- a financial instrument's costs and charges are compatible with the needs, objectives and characteristics of the target market;
- b charges do not undermine the financial instrument's return expectations, such as where the costs or charges equal, exceed or remove almost all the expected tax advantages linked to a financial instrument; and
- c the charging structure of the financial instrument is appropriately transparent for the target market, such as that it does not disguise charges or is too complex to understand.

13 Member States shall require investment firms to ensure that the provision of information about a financial instrument to distributors includes information about the appropriate channels for distribution of the financial instrument, the product approval process and the target market assessment and is of an adequate standard to enable distributors to understand and recommend or sell the financial instrument properly.

14 Member States shall require investment firms to review the financial instruments they manufacture on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Investment firms shall consider if the financial instrument remains consistent with the needs, characteristics and objectives of the target market and if it is being distributed to the target market, or is reaching clients for whose needs, characteristics and objectives the financial instrument is not compatible.

15 Member States shall require investment firms to review financial instruments prior to any further issue or re-launch, if they are aware of any event that could materially affect the potential risk to investors and at regular intervals to assess whether the financial instruments function as intended. Investment firms shall determine how regularly to review their financial instruments based on relevant factors, including factors linked to the complexity or the innovative nature of the investment strategies pursued. Firms shall also identify crucial events that would affect the potential risk or return expectations of the financial instrument, such as:

- a the crossing of a threshold that will affect the return profile of the financial instrument;
or
- b the solvency of certain issuers whose securities or guarantees may impact the performance of the financial instrument.

Member States shall ensure that, when such events occur, investment firms take appropriate action which may consist of:

- a the provision of any relevant information on the event and its consequences on the financial instrument to the clients or the distributors of the financial instrument if the investment firm does not offer or sell the financial instrument directly to the clients;
- b changing the product approval process;
- c stopping further issuance of the financial instrument;
- d changing the financial instrument to avoid unfair contract terms;
- e considering whether the sales channels through which the financial instruments are sold are appropriate where firms become aware that the financial instrument is not being sold as envisaged;
- f contacting the distributor to discuss a modification of the distribution process;
- g terminating the relationship with the distributor; or
- h informing the relevant competent authority.

Article 10

Product governance obligations for distributors

1 Member States shall require investment firms, when deciding the range of financial instruments issued by themselves or other firms and services they intend to offer or recommend to clients, to comply, in a way that is appropriate and proportionate, with the relevant requirements laid down in paragraphs 2 to 10, taking into account the nature of the financial instrument, the investment service and the target market for the product.

Member States shall ensure that investment firms also comply with the requirements of Directive 2014/65/EU when offering or recommending financial instruments

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manufactured by entities that are not subject to Directive 2014/65/EU. As part of this process, such investment firms shall have in place effective arrangements to ensure that they obtain sufficient information about these financial instruments from these manufacturers.

Investment firms shall determine the target market for the respective financial instrument, even if the target market was not defined by the manufacturer.

2 Member States shall require investment firms to have in place adequate product governance arrangements to ensure that products and services they intend to offer or recommend are compatible with the needs, characteristics, and objectives of an identified target market and that the intended distribution strategy is consistent with the identified target market. Investment firms shall appropriately identify and assess the circumstances and needs of the clients they intend to focus on, so as to ensure that clients' interests are not compromised as a result of commercial or funding pressures. As part of this process, firms shall identify any groups of clients for whose needs, characteristics and objectives the product or service is not compatible.

Member States shall ensure that investment firms obtain from manufactures that are subject to Directive 2014/65/EU information to gain the necessary understanding and knowledge of the products they intend to recommend or sell in order to ensure that these products will be distributed in accordance with the needs, characteristics and objectives of the identified target market,

Member States shall require investment firms to take all reasonable steps to ensure they also obtain adequate and reliable information from manufacturers not subject to Directive 2014/65/EU to ensure that products will be distributed in accordance with the characteristics, objectives and needs of the target market. Where relevant information is not publicly available, the distributor shall take all reasonable steps to obtain such relevant information from the manufacturer or its agent. Acceptable publicly available information is information which is clear, reliable and produced to meet regulatory requirements, such as disclosure requirements under Directive 2003/71/EC⁽¹⁾ or 2004/109/EC⁽²⁾ of the European Parliament and of the Council. This obligation is relevant for products sold on primary and secondary markets and shall apply in a proportionate manner, depending on the degree to which publicly available information is obtainable and the complexity of the product.

Investment firms shall use the information obtained from manufacturers and information on their own clients to identify the target market and distribution strategy. When an investment firm acts both as a manufacturer and a distributor, only one target market assessment shall be required.

3 Member States shall require investment firms, when deciding the range of financial instrument and services that they offer or recommend and the respective target markets, to maintain procedures and measures to ensure compliance with all applicable requirements under Directive 2014/65/EU including those relating to disclosure, assessment of suitability or appropriateness, inducements and proper management of conflicts of interest. In this context, particular care shall be taken when distributors intend to offer or recommend new products or there are variations to the services they provide.

4 Member States shall require investment firms to periodically review and update their product governance arrangements in order to ensure that they remain robust and fit for their purpose, and take appropriate actions where necessary.

5 Member States shall require investment firms to review the investment products they offer or recommend and the services they provide on a regular basis, taking into account any

event that could materially affect the potential risk to the identified target market. Firms shall assess at least whether the product or service remains consistent with the needs, characteristics and objectives of the identified target market and whether the intended distribution strategy remains appropriate. Firms shall reconsider the target market and/or update the product governance arrangements if they become aware that they have wrongly identified the target market for a specific product or service or that the product or service no longer meets the circumstances of the identified target market, such as where the product becomes illiquid or very volatile due to market changes.

6 Member States shall require investment firms to ensure their compliance function oversee the development and periodic review of product governance arrangements in order to detect any risk of failure to comply with the obligations set out in this Article.

7 Member States shall require investment firms to ensure that relevant staff possess the necessary expertise to understand the characteristics and risks of the products that intend to offer or recommend and the services provided as well as the needs, characteristics and objectives of the identified target market.

8 Member States shall require investment firms to ensure that the management body has effective control over the firm's product governance process to determine the range of investment products that they offer or recommend and the services provided to the respective target markets. Investment firms shall ensure that the compliance reports to the management body systematically include information about the products they offer or recommend and the services provided. The compliance reports shall be made available to competent authorities on request.

9 Member States shall ensure distributors provide manufacturers with information on sales and, where appropriate, information on the above reviews to support product reviews carried out by manufacturers.

10 Where different firms work together in the distribution of a product or service, Member States shall ensure the investment firm with the direct client relationship has ultimate responsibility to meet the product governance obligations set out in this Article. However, intermediary investment firms shall:

- a ensure that relevant product information is passed from the manufacturer to the final distributor in the chain;
- b if the manufacturer requires information on product sales in order to comply with their own product governance obligations, enable them to obtain it; and
- c apply the product governance obligations for manufacturers, as relevant, in relation to the service they provide.

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- (1) Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC ([OJ L 345, 31.12.2003, p. 64](#)).
- (2) Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC ([OJ L 390, 31.12.2004, p. 38](#)).