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

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EUROPEAN BANKING AUTHORITY

Contents

List of abbreviations

CA	Competent authority
CI	Credit institution
CRD	Capital Requirements Directive
EBA	European Banking Authority
EMD	Electronic Money Directive
ESA	European supervisory authority
EU	European Union
GL	Guidelines
MS	Member State
MCD	Mortgage Credit Directive
NPAP	New product approval process
POG	Product and oversight governance
PSD2	Payment Service Directive 2

Executive summary

The European Banking Authority (EBA) promotes a transparent, simple and fair internal market for consumer financial products and services. The EBA seeks to foster consumer protection in all European Union (EU) Member States (MSs), and one of the identified priorities stated in its work programme for 2019 is enhancing consumer protection and the retail conduct of financial institution in the EBA's scope of action.

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

To address some of the causal drivers of conduct failure, and following the initial work carried out by the European supervisory authorities, the EBA developed detailed product oversight and governance guidelines for manufacturers and distributors of retail banking and payment products. The EBA guidelines, published in July 2015, became applicable in January 2017.

Article 1(5) of the EBA Founding Regulation requires the EBA to 'contribute to improving the functioning of the internal market, including, in particular, a sound, effective and consistent level of regulation and supervision, … preventing regulatory arbitrage and promoting equal conditions of competition, … and enhancing customer protection'. The same article also refers to 'fostering supervisory convergence'. In this context, and jointly with a subset of national competent authorities, the EBA conducted a review of the application of said EBA guidelines. This is the first supervisory convergence exercise in the area of consumer protection.

Within this review, the EBA drafted a questionnaire, which participating competent authorities sent to the five most significant credit institutions within their territories. The EBA analysed the answers received from a total of 30 credit institutions to identify good practices. This report summarises these findings, focusing on the following five areas: (i) the scope of the guidelines and general governance, (ii) identification of the target market, (iii) product testing, (iv) product monitoring and (v) the distribution process. Many similarities were found across the different participating countries.

Manufacturers made changes in particular in terms of process and governance. However, in a large number of cases, customer interests did not quite receive the same level of attention as was given to commercial interests and prudential concerns. The report also found that there may be different understandings of the guidelines within the industry, a finding that was consistent across the different participating MSs, and that further clarification may be warranted to improve convergence across Europe. The EBA will reflect on the findings in this report to identify specific actions, such as guidance and further clarifications, which may be warranted to address the issues raised here.

Background

1. Developments in the markets for financial services have shown that failures in the conduct of financial institutions 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 financial institutions 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 of 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 the target market and on how they take account of the interests, objectives and characteristics of this market.

4. Following the initial work carried out by the ESAs, the EBA conducted various analyses and surveys among the 28 EU MSs 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 MSs in that process, as detailed in the rationale section (pages 6 and 7) of the final EBA guidelines on POG.

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

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

   - credit institutions under the Capital Requirements Directive (CRD IV);
   - payment institutions under the Payment Services Directive (PSD1/2);
   - electronic money institutions under the Electronic Money Directive (EMD); and

[1] For the EBA Regulation, see https://eur-lex.europa.eu/eli/reg/2010/1093/

- mortgage creditors and mortgage credit intermediaries under the Mortgage Credit Directive (MCD).[2]

7. Following extensive public consultation, the EBA published the final GL in July 2015, with the GL becoming applicable from 3 January 2017. The guidelines are forward looking and do not simply address past failings but 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 competent authorities (CAs) to intervene in the markets ex post, namely after a failure has materialised.

8. These GL apply to all products brought to the market after the application date of 3 January 2017, as well as to all existing products on the market that are significantly changed after that date. The overall objective is for the retail banking and payment sector to consider the needs of its customers when designing products and to develop products with the consumer's interest, objectives and characteristics in mind.

9. These GL supplement other requirements that the EBA has published to address related issues of the governance of financial institutions, including the EBA guidelines on internal governance (revised) EBA/GL/2017/11,[3] under the Capital Requirements Directive (CRD IV), which set out requirements for a new product approval process (NPAP) that CIs should adopt. The revised guidelines (replacing GL 44) have applied since June 2018 and are supplementary to the POG guidelines but apply only to credit institutions. They do not apply to payment institutions, e-money institutions, non-bank mortgage creditors or mortgage credit intermediaries.

10. According to the GL, financial institutions 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 a certain type of consumer (the target market). Distributors of retail banking products should comply with the POG arrangements of the manufacturer and should sell only to customers who are not part of the target market on a justified basis.

11. As these guidelines have been applicable for more than 2 years, the EBA considered it opportune to carry out an initial assessment of the way in which manufacturers have applied these guidelines. In doing so, the EBA is fulfilling the objectives and tasks conferred on it in its Founding Regulation in accordance with Articles 1(5)(2) and 9(2) on supervisory convergence and convergence of regulatory practice. Article 1(5) establishes, inter alia, the EBA's objective to 'contribute to improving the functioning of the internal market, including, in particular, a

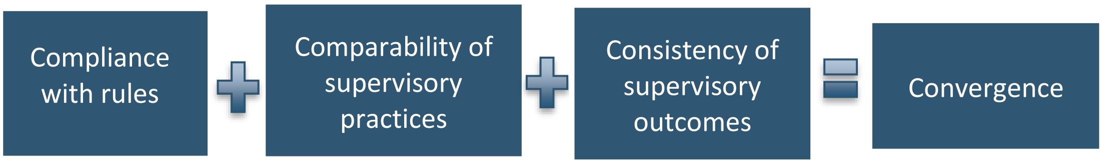
[2] CRD (https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0036&from=EN),
PSD2 (https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015L2366&from=en),
EMD (https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009L0110&from=EN) and
MCD (https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0017&from=EN).

[3] https://eba.europa.eu/documents/10180/2164689/Guidelines+on+Internal+Governance+%28EBA-GL-2017-11%29_EN.pdf/531e7d72-d8ff-4a24-a69a-c7884fa3e476

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 protection' (point (f) of that provision).[4]

12. In the context of consumer protection, supervisory convergence is a process for achieving comparable supervisory practices across MSs that are based on compliance with the regulatory framework by financial institutions within the scope of the EBA's remit and that lead to consistent supervisory outcomes/measures as experienced by consumers throughout the EU. Consequently, supervisory convergence includes three components (see Figure 1).

Figure 1: Components of supervisory convergence



13. In the context of the EBA POG guidelines, the EBA has conducted an exercise aiming to assess the consistency of outcomes in the industry; this exercise does not assess the supervisory practices of each competent authority.

14. To carry out the assessment of the application of the EBA POG guidelines, the EBA drafted a questionnaire, which participating CAs sent (at a minimum[5]) to the most significant CIs within their jurisdictions. A total of 30 CIs were included in the sample. The assessment of the responses and resultant findings of the national authorities from all 28 EU MSs, which are presented in this report, are based on the written responses received by CAs from CIs; no additional on-site visits of CIs were carried out at this stage, nor was any other form of discussion held with the institutions concerned. The EBA encourages participating CAs to provide feedback about the findings presented in this report to those institutions.

15. One of the overarching findings was the significant similarities across jurisdictions, in terms of the level of both differences and similarities identified across CIs within each jurisdiction. This suggests that, while the sample of the exercise was small, it allowed the EBA to arrive at findings that could be applied across the EU more widely.

16. The EBA analysed the answers received and identified a number of good practices as well as practices that would need to be improved to ensure that the guidelines are complied with beyond any doubt. Overall, the EBA found that manufacturers had made changes to internal

[4] Regulation (EU) No 1093/2010.

[5] A few CAs also sent the questionnaire to other institutions, but the responses from those other institutions were not included in the EBA supervisory exercise.

arrangements in an effort to comply with the POG requirements set out in the guidelines. Changes were particularly noticeable from a process and governance perspective.

17. In many instances, the responses provided by manufacturers suggested that, in a large number of cases, the interests of the consumers, although taken into account at a high level, did not quite attract the same attention as compliance with prudential requirements. In other words, while the manufacturers surveyed had implemented the required processes, this was not necessarily done in a way that put the necessary focus on ensuring that consumers' needs are met.

18. In addition, a large number of manufacturers did not appear to modulate or vary the specific steps followed at each stage of the POG process (e.g. testing and monitoring), despite the variations in customer needs and customer impact, which depended on the characteristics of the product, risks to customers and characteristics of the target market. By contrast, the EBA would expect a degree of variation in implementation. For instance, where the risk to customers is high or the product is especially complex, the testing carried out by the manufacturer should include a large set of scenarios.

19. The review also showed a similar degree of variation between manufacturers across the different MSs, including on the number of products or services identified as new or significantly changed. This suggests that the industry may have different understandings of the guidelines and that further clarification by the EBA may be warranted to further contribute to convergence across Europe.

20. This report provides detail of the findings and includes examples of good practices (i.e. examples considered by the EBA as compliant with the EBA guidelines). The report is structured based on the following five areas: (i) scope and general governance, (ii) target market, (iii) testing, (iv) monitoring and (v) distribution.

1. Scope of the guidelines and general governance

Scope of the guidelines

21. The POG GL apply to manufacturers and distributors of retail banking products that fall within the EBA's regulatory remit. This means that the GL apply to payment and savings accounts, payment instruments (such as credit transfers or direct debit), payment services (such as money remittance or aggregation services), debit or pre-paid cards and mortgage credits (with other credit products included only if provided by CIs).[6]

22. This also means that the GL apply to the manufacturers of such products or services and so are not limited to CIs but also apply to payment and e-money institutions.

23. As the GL set out in the 'scope of application' section, the GL 'apply to all products brought to the market after the implementation date of the Guidelines as well as to all existing products on the market that are significantly changed after the implementation date of these Guidelines'.[7] Therefore, no such product or service can be exempted from the POG GL.

24. The number of products or services identified as new or significantly changed, as required by the guidelines, and that are therefore subject to the POG requirements has been found to vary materially between the manufacturers surveyed, ranging from zero for one manufacturer to 123 for another. Examples of new or significantly changed products or services included making a payment through a new channel, such as a mobile wallet. Such products also included mortgage products with new interest rates and conditions (e.g. fixed or variable rate, minimum deposit required), the introduction of contactless debit or credit cards and the extension of the selling of credit products through online channels.

25. In addition, and in line with the guidelines, all of the manufacturers surveyed should have a process in place that applies to all new or significantly changed products or services and all should also have criteria to define what would constitute a new or significantly changed product. That being said, the criteria used varied significantly between manufacturers. Many manufacturers have defined wide criteria for the purpose of assessing whether a product or service is new or significantly changed, while some applied only a few very generic criteria and others still had a very long list of specific criteria. Such variety may explain the discrepancy found in terms of the number of products or services ultimately identified as new or significantly changed between manufacturers.

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[6] See the definition of a product in paragraph 15, page 6, of the EBA guidelines on product oversight and governance: https://eba.europa.eu/documents/10180/1141044/EBA-GL-2015-18+Guidelines+on+product+oversight+and+governance.pdf

[7] Paragraph 10, page 4, of the EBA guidelines on product oversight and governance.

26. The criteria used by several manufacturers focused on prudential impacts, in ostensible alignment with the separate EBA Guidelines on internal governance, such as the impact on the credit, liquidity and/or operational risk of the CI, new processes and IT changes, as well as other impacts on commercial arrangements. The EBA is of the view that criteria stemming from prudential risks or commercial arrangements are of a different nature from the criteria for the purposes of meeting the EBA GL on POG. In the latter case, the focus should instead be on the impact on the needs, interests and characteristics of consumers, which only a few manufacturers seemed to take into account. In the context of assessing whether a change is 'significant', this means that it should be understood in terms of the potential impact of any change on consumers included within the segments targeted by the product.

27. The EBA is also of the view that, to identify products that are new or significantly changed, it would be good practice for manufacturers to consider criteria such as:

- the introduction of an alternative channel of selling or using a given product;
- the introduction of new, or the withdrawal of existing, product or service features;
- 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;
- '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 GL on internal governance but only if such changes have an impact on customers.

28. Some manufacturers helpfully explicitly defined negative criteria, i.e. changes that can be considered non-significant. Some also explained that, if the materiality threshold to qualify for a 'significant' change is not reached, this decision must be justified, with a clear rationale being provided and recorded, and the EBA considers this good practice.

General governance

29. Guideline 1 states that 'the manufacturer should establish, implement and review effective product oversight and governance arrangements' for the design, marketing and life-cycle maintenance of products.

30. Guideline 2 further states that such arrangements are an integral part of the manufacturer's governance, risk management and internal control framework and that responsibilities must

sit with senior management. The same guideline also refers to the oversight of the process being integrated within the normal risk and compliance functions.

31. All manufacturers that were surveyed explained that the primary responsibility of identifying whether a product or service is new or significantly changed sits with the product or service owner. The level in the hierarchy of the organisation of the owner varied between manufacturers.

32. For several manufacturers, the process seemed to be linked to the NPAP required under the CRD and the EBA GL on internal governance, while, in other cases, the POG process appeared to be separate (depending on the type of product and the regulation it derives from) and to run in parallel with the approval process set up to meet prudential and commercial objectives. The EBA is of the view that there may be merit in having one process to cover both, as this enables the manufacturer to consider any new product as a whole, facilitating decision-making based on all aspects, including the needs of and outcomes for consumers.

33. Most manufacturers have set up a specific committee or another form of body specifically tasked with overseeing the product design phase, including product approval before market launch, while a few review new (or significantly changed) products within existing committees or other structures with new additional responsibilities for the design and/or approval of new products. Some also created working groups under those existing committees.

34. In addition, and relatedly, several manufacturers specified that the ultimate responsibility for oversight rests with the board, at either national or group level. A number of manufacturers also specified that the process included some oversight from the risk and/or compliance function and one manufacturer explained that a specific team within the risk and compliance function had overall responsibility for the POG process.

35. The EBA considers it good practice to have defined structures and clear escalation lines and for the risk and compliance functions to be involved with some decision-making power. However, the EBA is of the view that a process owned by the compliance or risk function is not a good practice, as it may lead to that function losing some of its required independence.

36. A number of manufacturers also explained that they have 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, which EBA staff also consider good practice. EBA staff also note that, to ensure that consumer needs are being considered during that process, some manufacturers found it beneficial to seek views from consumers during the design phase of the product, for instance through consumer working groups.

37. While manufacturers seem to have adequate processes in place in principle, when asked for the main changes they observed in their organisation as a result of the new POG requirements, they focused on the above-mentioned procedural aspect, rather than on the objective of the guidelines, which is to ensure that consumers' needs are considered and

met. That said, a few manufacturers responded that one of the key changes following the new POG requirements was the greater focus by the manufacturer on customer needs, which, if correct, would be a very positive outcome and one that the guidelines aim to achieve.

Conclusions

38. All manufacturers had POG arrangements in place. In the large majority of cases, the manufacturer's legal and compliance functions, the risk function and sometimes audit are included in the process and, in a significant number of cases, the ultimate responsibility for oversight rests with the board. However, this did not necessarily lead to a change in the way customer needs were considered and met in the organisation. In a significant number of cases, the process seemed to be focused more on prudential risk than on customer needs.

39. The EBA identified a number of good practices, including having defined structures and clear escalation lines, the involvement of risk and compliance functions, and a single process to cover requirements under both the EBA POG guidelines and the EBA Guidelines on internal governance. By contrast, 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.

40. All manufacturers have criteria or definitions to identify whether a product is new or significantly changed, but those criteria significantly differ between manufacturers and across all MSs included in the survey, resulting in differences in the number of products that were considered to be new or significantly changed. In a significant number of cases, criteria appeared focused more on prudential risk than on customer needs. In addition, the emphasis when considering whether any form of change is significant or not should be on its impact on customers (rather than on the institution itself).

41. The EBA identified, in this respect, a number of good practices, including 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'. In addition, when identifying products that are new or significantly changed, it was considered good practice to take into account the following criteria: (i) an alternative channel of selling or using a given product, (ii) changes in the product or service features, (iii) changes in the customer segment or geography and (iv) changes that affect the use of the product. Moreover, taking into account a change in the level of service and 'material changes to related processes (e.g. new outsourcing arrangements) and systems (e.g. IT change processes)', as defined in guideline 18 of the EBA GL on internal governance, could also be considered good practice providing that such changes have an impact on customers.

2. Target market

42. Guideline 3.1 states that 'manufacturers should include, in their product oversight and governance 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 to demonstrate how they have defined the target market, including the groups of consumers for which the product is considered likely not to meet their needs. Guideline 3.3 further states that 'the manufacturer should only design and bring to the market 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.'

43. This section provides details on the findings as regards the criteria to define the target market and the way in which manufacturers assess whether a given product or service 'meets the interests, objectives and characteristics of the product market'.

Criteria defining the target market

44. All manufacturers identified the target market for a new or significantly changed product or service, but the way in which they did so varied, and the consistency varied between manufacturers within the same jurisdiction.

45. Generally, when asked about the criteria they used to identify the target market, manufacturers provided diverse answers, ranging from whether a customer holds a debit/credit card to a detailed list of criteria including channel, geography, occupation, sector, age and other key attributes of the target market. Many also mentioned financial capability (where applicable), demographics and age as key criteria.

46. That being said, many seemed to focus on the generic criteria mentioned as 'good practice' examples in the accompanying documents in the EBA final report on the GL, which was published in 2015, or on criteria assessing financial capability from the perspective of the risk to the manufacturer itself. A few manufacturers focused only on market shares and other commercially relevant information, which the EBA does not consider good practice.

47. By contrast, some manufacturers included other criteria, in addition to the general criteria mentioned in paragraph 43 above, such as customer needs and the level of customers' knowledge and understanding, which are good practice. For instance, considering the customer's life stage, account holdings and financial circumstances will contribute to identifying customer needs. In addition, the level of education and occupation may contribute to identifying knowledge and understanding. Many manufacturers provided examples of products or services for which a broad target market had been identified (e.g. a new debit card) or for which a narrow target had been identified (e.g. a requirement to be a tax resident in a specific province).

48. The EBA notes that the review and analysis is likely to differ depending on the product(s) in question. For instance, for credit or complex products, the list of criteria should be much more comprehensive than that for simple products or services. The (non-exhaustive) list of good practices published on page 73 of the EBA final report on the GL suggests that manufacturers could consider tax status implications, the level of risks, the liquidity accessibility the consumer is expected to get, the level of risks that the consumer is willing to bear (risk aversion), demographic factors, the level of knowledge and understanding of the complexity of the product, the potential creditworthiness of the consumer and the financial capability of the consumer. In general terms, the manufacturer needs to take into account all of the potential characteristics of the target market and the characteristics of the product.

49. The steps and features followed by manufacturers to identify a target market may be the same for all products and services, but the extent of the analysis may differ on a case-by-case basis depending on the risk and on the degree of complexity and the nature of the product, as well as other specific characteristics, in line with the principle of proportionality highlighted in guideline 1.5.

Meeting the interests, objectives and characteristics of the target market

50. The good practice examples in the EBA final report on the GL (again on page 73) suggest that, in respect of credit products, 'consumers could be provided with different scenarios or simulations of the amount of payment of the loan depending on the variation of the interest rate', while 'in the case of deposits, an assessment could take account of the various competing product features, such as accessibility, yield and security, and whether the combination of these meet said interests, objectives and characteristics'.

51. Most of the manufacturers surveyed were not very clear on the way in which they assess whether products or services meet the interests, objectives and characteristics of the target market. A significant number mentioned some form of customer research taking place, either in person or not and in a group or individually, conducted directly by them or a third party. However, in a number of these cases, the customer research seemed to be focused solely on commercial aspects, i.e. whether there will be a market for the product so that it can be sold, which does not chime with the aim of the guidelines to ensure that the interests, objectives and characteristics of the target market are met. Only a minority of manufacturers that did customer research also researched customer needs.

52. The assessment by manufacturers seemed to vary depending on the nature of the product or service, which would appear to be in line with the GL, although, in some cases, the degree with which manufacturers adjusted the assessment to reflect the risk and complexity of a product was not clear. The EBA considers it good practice for the assessment to vary depending on the risk borne by the customer and the degree of complexity and the nature and characteristics of the product. As indicated in the background section, manufacturers should articulate and record in their POG arrangements how the product 'meets the interests, objectives and characteristics of, and are of benefit to, the particular target market'

and their analysis may lead to a variation between products, depending on the risk and on the degree of complexity and the nature and other characteristics of the product, in line with the principle of proportionality highlighted in guideline 1.5.

53. The EBA notes that, when identifying whether a new or significantly changed product would be beneficial to consumers, manufacturers should consider aspects such as the cost, the added value of the product, whether the product does what it is meant to do and whether the product is unnecessarily complex.

Conclusions

54. Generally, all manufacturers have a process to identify the target market with a range of criteria, although these criteria vary between manufacturers in a given EU MS. That being said, only a minority of manufacturers would appear to focus on criteria that relate to the needs of consumers, rather than on those of manufacturers. The EBA reiterates, in this context, the examples of good practice published on page 73 of the EBA final report.

55. Manufacturers have set up processes and steps to identify whether a product meets the interests, objectives and characteristics of the target market, but the approach followed is not always clear, suggesting that further clarity may be beneficial. Most seem to carry out some form of customer research, but such research is often more focused on marketing or the commercial interests of the manufacturer than on customers' needs.

56. The EBA considers it good practice for the assessment to vary depending on the risk borne by the customer and the degree of complexity and the nature and characteristics of the product. When identifying the target market, a similar good practice is to consider aspects such as the cost, the added value of the product, whether the product does what it is meant to do and whether the product is unnecessarily complex.

3. Testing

57. Guideline 4.1 states that product testing should assess 'how the product would affect its consumers' in a 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.

58. Such variation was reflected in the responses provided by the manufacturers that were surveyed. Indeed, while all manufacturers conducted some form of testing, the way in which they did so varied significantly. While a number of manufacturers had the same testing process in place for all products or services, others had testing processes that varied depending on the type of service or product or on its level of risk. It would seem good practice, in the context of testing, to have different types or degrees of testing depending on the nature and scale of the risk that is borne by the consumer, which in turn is often linked to the product's features and complexity.

59. In many cases, the focus of manufacturers' responses was on the operational aspects of the testing process, suggesting that testing was primarily an operational task to identify the existence of issues that may need to be addressed before product launch, or on commercial aspects (i.e. whether customers like it), rather than testing being focused on customers and the identified target market. Testing solely focused on operational (e.g. IT) issues with no consideration of how the product would affect the appropriate target market and so did not meet the requirement in the guidelines.

60. In addition, it was not always clear whether there was a distinction between the customer research mentioned in the context of testing to assess how products affect the target market and that mentioned in the context of identifying the target market's needs (as discussed in the previous section).

61. Some manufacturers tested against the negative target market, i.e. those customers at which the product or service is not targeted. For instance, one manufacturer tested, for a product that had a target market of those aged 18 years and over, whether individuals below the age of 18 could apply for and access the product in question. In some cases, testing also included testing the different communication channels. The EBA is of the view that both of these examples are good practice.

62. In addition, a number of manufacturers mentioned that they conduct customer research and pilot releases to a narrow audience as a way of testing, for instance, with employees only. The EBA views the use of customer research and pilot (or limited) releases to assess the way in which the product would affect the target market as good practice. It would also be good practice for such testing to enable the manufacturer to assess the position of a new product

in the light of the manufacturer's product offerings, among others, to identify possible overlaps and any resultant confusion for consumers. In addition, the EBA considers it good practice to include, in the testing process, the way in which planned customer communication would affect the target market.

63. Given that guideline 4.1 requires that the assessment of the way in which the product would affect its target market should be done 'under a wide range of scenarios, including stress scenarios', manufacturers did not provide much information on whether they were testing a range of scenarios and, if so, what types of scenarios they considered. The EBA would like to reiterate the examples of good practice highlighted in the final report on the GL, namely that 'in the case of a loan with a variable interest rate, the assessment could include the borrower's repayment requirements at reasonably higher interest rates'.

64. The EBA is of the view that, in line with the principle of proportionality articulated in guideline 1.5, when products are simple and have broad target markets, testing could mostly 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 a number of identified scenarios, with a view to identifying the way in which the intended target market would be affected.

65. A common scenario for credit products would, for example, be different interest rate rises through which to identify the way in which the intended target market would be affected under each scenario. A good practice observed in this context focused on testing the transparency of product features, the simplicity and clarity of the process to contract, the method for price setting, the application of scenarios in relation to employment or disability, testing different changes in the variable interest rates (including stressed tests) and testing the exit strategy (where applicable, for instance if there was an early repayment fee).

66. For products with a long-term effect, such as a mortgage or long-term loans with high value, the manufacturer would be expected to run some scenarios, such as in the event of death, disability, retirement or unemployment, to identify the target market for each mortgage product, in line with the examples published in the final guidelines. This could of course also include external scenarios, such as sharp increases in interest rates, as mentioned in the previous paragraph, but for credit products in general.

67. In the event of loans that are very high cost and short term and that tend to target consumers with very limited financial means, the EBA considers it good practice to account for the financial vulnerability of the target market.

68. In addition, manufacturers may find it beneficial to collaborate by conducting the testing together with other manufacturers if they are testing similar products with similar target markets, under the proviso that each would need to document the testing conducted.

69. When designing scenarios, manufacturers may also take into account the most relevant topics for customers, which the EBA presents on a regular basis in its bi-annual consumer trends reports.[8]

70. Some manufacturers also provided examples of the way in which some of the characteristics or features of the products were changed as a result of the testing. For instance, one manufacturer removed one of the planned benefits of the products, as the testing showed that the target market was insensitive to such an incentive. The product was a package of products for students, with an account and a card that included a financial incentive when the customer switched to such a package, provided that the student made a number of transactions using the card linked to the account. With the testing showing that the target market was insensitive to such a financial incentive, the manufacturer removed it.

71. None of the manufacturers provided examples of changing the target market as a result of testing, although one manufacturer decided not to launch a payment protection insurance product to be sold alongside a mortgage as a result of its testing, due to the ratio of the price to be paid by consumers and the expected benefits of the product not being satisfactory as revealed by consumers during the testing.

Conclusions

72. Testing for the purpose of the GL is about assessing the impact of a given product on its target market. Testing is important for identifying any potential drawback, understanding the future use of the product, testing the communication with and distribution to consumers and putting the customer at the heart of the product launch. It assesses whether any changes need to be made to the target market as a result. The testing process should vary depending on the product.

73. While all manufacturers carried out testing, it was not always clear whether, when conducting the testing, all manufacturers pursued the objective of the GL. That being said, some good practices were observed, for example in terms of scenarios considered and the use of 'soft launches' (also sometimes known as 'friends and family' releases).

74. A good practice observed was differentiation in the types or degrees of testing, depending on the product (e.g. a credit product versus a deposit product) and on the nature and scale of the risk that is borne by the consumer. Another good practice was the inclusion of testing against the negative target market and testing of different communication channels. In addition, other good practices included the use of customer research and pilot (or limited) releases to assess the way in which the product would affect the target market and the inclusion, in the testing process, of the transparency of product features, the simplicity and clarity of the process to contract and the way in which planned customer communication

[8] See EBA Consumer Trends Report 2018/19, 20 February 2019, and in particular the topical issues detailed on pages 46 to 68: https://eba.europa.eu/documents/10180/2551996/Consumer+Trends+Report+2018-19.pdf

would affect the target market. Different scenarios based on changes in the variable interest rates and testing the exit strategy (where applicable, for instance if there was an early repayment fee), would also be good practice for products with long-term effects.

4. Monitoring

75. Guideline 5 states that manufacturers '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'. All manufacturers appeared to be monitoring products and most have mechanisms in place requiring specific reviews to be conducted on a regular basis.

76. However, the extent of the review and its frequency varied significantly. Some manufacturers stated that they review products on a weekly or monthly basis, while others review a given product or service every 5 years. Furthermore, others review products with a frequency determined by the risk attached to the product, ranging from a yearly review cycle for riskier and/or complex products to a review every 3 years for all other products.

77. The EBA is of the view that having regular reviews and establishing specific frequencies for such reviews are good practice, including where the frequency of the review is dependent on the riskiness for customers and/or the complexity or the specific features of the product. Manufacturers may also wish to implement a review process beyond the scope of the guidelines, i.e. not solely limited to those products that have been identified as new or significantly changed since the GL have applied. The responses received from the manufacturers that were surveyed suggest that this is often already the case.

78. A number of manufacturers also have a process in place to map and track the dates when reviews are due, with regular updates provided at relevant committees or meetings of other governance bodies. Such practice is good, as it enables ongoing monitoring in a structured and transparent manner. Specific manufacturers mentioned the use of dashboards on which specific data and information are monitored with regard to the products. Information would include customer-centric information as well as commercial information and other information relevant for assessing the risks to the manufacturer. Depending on their design and the type of information included, such dashboards also seem to be good practice.

79. In addition, a few manufacturers mentioned carrying out a specific post-implementation review that would take place 6 months after the launch of the product, at which point a number of criteria would be considered. The EBA considers such post-launch reviews good practice, especially for products that may be complex or risky for customers. The EBA also considers it good practice for manufacturers to set up a policy to identify which environmental and product changes would trigger unplanned reviews.

80. The tools used in the review process, and the criteria assessed, varied between manufacturers. While a number of institutions were focused mostly on commercial aspects (i.e. whether the product was sold), others also identified more customer-centric measures, including customer satisfaction, complaints and the general feedback received. Customer-centric measures when monitoring a product or service are not only good practice but, in the

EBA's view, essential to (i) monitor whether the 'interests, objectives and characteristics of consumers' continue to be met, (ii) verify, ex post, the coherence between the offer and the needs of the clients and (iii) identify whether any changes should be made with regard to the distribution (and distributors).

81. A number of manufacturers included welcome calling, customer sampling using customer satisfaction surveys, staff sampling (by surveying a sample of staff to obtain feedback), sales staff observations on product sales and on the customers they are being sold to, customer complaints, client feedback received and mystery shopping. All such tools, especially direct customer feedback (including complaints), are good practice for the purpose of the POG guidelines. Manufacturers may also wish to include in the monitoring and review process the consideration of categories of consumers as a whole, looking at which product suites are available for each category of consumers, in addition to conducting product-by-product reviews.

82. One manufacturer mentioned an example of a fee for the first issue of a debit card (and PIN) being abolished following the product's review that included feedback received by customers, complaints (with the caveat that this information is dependent on the complaints being well defined and categorised) and looking at competitive offerings. This illustrates a well-functioning monitoring and review process.

83. The review process that manufacturers have in place may be linked to the process identifying whether a product has significantly changed or not, with the latter possibly being embedded in the monitoring process set up by firms. Manufacturers may also wish, at this stage, to consider carrying out some testing.

Conclusions

84. All of the manufacturers surveyed have processes in place to monitor the product after its launch, and most included regular review cycles, the frequency of which may or may not vary between products depending on the characteristics, complexity or risk to the customer of a given product. Some also had a post-launch review scheduled after a specific period had elapsed following the launch (often 6 months).

85. In most cases, the elements monitored included commercial aspects (e.g. number of sales) and a number of manufacturers used a range of customer-centric measures.

86. The EBA considers it essential for the data to include customer-centric information, such as direct customer feedback.

5. Distribution

87. Guideline 7 defines the requirements via-à-vis distribution channels and guideline 8 focuses on the information that manufacturers should provide to distributors.

88. Most manufacturers did not seem to select specific distribution channels but instead used them all. By contrast, a few made a conscious decision in this regard by including the testing of possible channels for distribution. The EBA considers this to be good practice, especially for complex or niche products for which certain channels of distribution may not be suitable.

89. Some manufacturers also seemed to be of the view that the requirements for distributors did not apply to their own sales staff, i.e. in the case of internal distribution. This is not in line with the GL, as manufacturers have obligations towards distributors that apply irrespective of whether or not the distribution takes place in-house. In addition, some manufacturers seemed to be of the view that the application of the rules was limited to specific distributors. Given that guideline 7 contains requirements for manufacturers, such requirements extend to all types of distributors covered, irrespective of whether the distributors themselves would be covered under the scope of the EBA guidelines or not. This means, for example, that, in the instance of a distributor white-labelling a product and distributing it as its own product, the guidelines would apply.

90. In line with the GL, all manufacturers appeared to provide specific materials to distributors, including marketing materials, FAQs, key information documents, brochures providing information on the product and its target market, etc. Most also mentioned providing training material, including, in some cases, delivering training (physically or online). Providing training material, including delivering training, is good practice. Manufacturers may also provide distributors with a tool to evaluate the financial sustainability of a given credit product for the end customer. In addition, manufacturers may wish to ensure that the remuneration scheme of the distributors is linked to the overall result and/or to the level of customer satisfaction.

91. Most manufacturers prevented the sale of products or services outside their target market, some of them actively doing so through technical blocks (by disabling the ability of a customer outside the target market to buy a product online). Only a few manufacturers seemed to have a clear policy on how to respond to such selling taking place. The EBA considers such a policy as good practice.

Conclusions

92. Most manufacturers did not seem to select specific distribution channels but instead used them all. The EBA considers selection as good practice. A number of manufacturers seemed to interpret the scope of the meaning of the term distributor to be very narrow, which is not in line with the GL.

93. All manufacturers reported that they provided a range of documents to distributors, in line with the GL, but the breadth of these varied between manufacturers. The EBA considers it good practice to distribute training material and deliver training, as well as to ensure that the remuneration scheme of the distributors is linked to the overall result and/or to the level of customer satisfaction.

94. Most manufacturers also reported that sales outside the target market were prohibited. Having a clear policy on how to respond to selling outside the market is an example of good practice.

Conclusion

95. This report has highlighted findings from the EBA's first assessment of the way in which manufacturers have applied the EBA POG guidelines and includes a number of good practice examples.

96. Overall, the exercise identified significant similarities across jurisdictions, with the same degree of similarities and differences between institutions within each jurisdiction. Differences, for instance in the understanding of what constitutes a new or significantly changed product, indicate that the industry may have different understandings of the guidelines and that further clarification may be warranted to improve convergence across Europe.

97. The EBA also found that manufacturers had POG arrangements in place as required by the guidelines and had made changes to internal arrangements in an effort to comply with the guidelines. Changes were particularly noticeable in terms of manufacturers' processes and governance. In many instances, however, the responses provided by manufacturers suggested that customers' interests, although taken into account at a high level, may not quite attract the same level of attention as compliance with prudential requirements. In other words, while manufacturers had implemented the required processes, this was not necessarily done in a way that put the necessary focus on ensuring that consumers' needs are met.

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