# ANNEX I: PRODUCT OVERSIGHT AND GOVERNANCE ARRANGEMENTS FOR RETAIL BANKING PRODUCTS

## INTRODUCTION

1. Developments in the markets for financial services in recent years have shown that failures in the conduct of credit institutions towards their customers can, not only cause significant consumer detriment, but also undermine market confidence, financial stability and the integrity of the financial system. The overall objective of this Annex is for the retail banking 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.

2. Annex I to BR/24 establishes product oversight and governance arrangements for both credit institutions and distributors, as defined hereunder, as an integral part of the general organisational requirements linked to internal control systems of firms. The Annex refers to internal processes, functions and strategies aimed at designing products, bringing them to the market, and reviewing them over their life cycle. The Annex also sets procedures relevant for ensuring the interests, objectives and characteristics of the target market are met.

## SCOPE AND APPLICATION

3. This Annex applies to credit institutions and distributors of products offered and sold to consumers and specifies to credit institutions product oversight and governance arrangements in relation to:
    - Article 17B(1) of the Banking Act; and
    - Article 5(1) of the Credit Agreements for Consumers Relating to Residential Immovable Property Regulations (S.L. 378.10).

4. The protections set out in this Annex in relation to consumers, as defined in the Credit Agreements for Consumers Relating to Residential Immovable Property Regulations, shall also apply to micro-enterprises and small and medium-sized enterprises (SMEs).

## DEFINITIONS

5. Unless otherwise specified, terms used and defined in the Banking Act and in the Credit Agreements for Consumers Relating to Residential Immovable Property Regulations referred to in the scope and application have the same meaning in this Rule. In addition, for the purposes of this Rule, the following definitions apply:

"*Target market*" means the group or groups of end consumers for whom the product is designed, as defined by the credit institution.

"*Distributor*" means a person who offers and/or sells the product to consumers; this includes business units of credit institutions that are not involved in the designing of the product but are responsible for bringing the product to the market, such as branches as defined in the Banking Act.

"*Product*" means:

a) 'credit agreements relating to immovable property' as defined in Article 2(1) of the Credit Agreements for Consumers Relating to Residential Immovable Property Regulations;
b) 'deposits' as defined in Article 2 of the Depositor Compensation Scheme Regulations (S.L. 371.09);
c) 'payment accounts' as defined in Article 2(1) of the Financial Institutions Act;
d) 'payment services' as defined in Article 2(1) of the Financial Institutions Act;
e) 'payment instruments' as defined in Article 2(1) of the Financial Institutions Act;
f) Other means of payment, as listed in point 3 of the Schedule to the Banking Act;
g) 'electronic money' as defined in Article 2(1) of the Financial Institutions Act;
h) Other forms of credit for consumers, in addition to that included in (a), provided by the credit institutions listed above, in line with Article 1(5)(e) of the EBA Regulation.

## PRODUCT OVERSIGHT AND GOVERNANCE ARRANGEMENTS FOR CREDIT INSTITUTIONS

## Principle 1: Establishment, proportionality, review and documentation

1.1. Credit institutions shall establish, implement and review effective product oversight and governance arrangements. The arrangements shall 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.

1.2. The product oversight and governance arrangement shall be reviewed and updated by the credit institution on a regular basis.

1.3. When launching a new product, the credit institution shall ensure that the product oversight and governance arrangements are considered in the new product approval policy (NPAP) in line with Section 22 of BR/24.

1.4. All actions taken by the credit institution in relation to the product oversight and governance arrangements shall be duly documented; kept for audit purposes and made available to the Authority upon request.

1.5. Product oversight and governance arrangements shall be proportionate to the nature, scale and complexity of the relevant business of the credit institution. The implementation/application of the arrangements shall have regard to the level of potential risk for the consumer and complexity of the product.

## Principle 2: Credit institution's internal control functions

2.1. A credit institution shall ensure that product oversight and governance arrangements are an integral part of its governance, risk management and internal control framework as referred to in BR/24 on Internal Governance, where applicable. To that end, the credit institution's board of directors shall endorse the establishment of the arrangements and subsequent reviews.

2.2. Senior management, with support from representatives of the credit institution's compliance and risk management functions, shall be responsible for continued internal compliance with the product oversight and governance arrangements. They shall periodically check that the product oversight and governance arrangements are still appropriate and continue to meet the objectives as set out in paragraph 1.1 above, and shall propose to the board of directors that the arrangements be amended if this is no longer the case.

2.3. The responsibilities for the oversight of this process by the Risk Management function and the Compliance function shall be integrated into their normal line of duties as outlined in Section 24 and Section 25 of BR/24.

2.4. Senior management shall ensure that staff involved in designing a product are familiar with and follow the credit institution's product oversight and governance arrangements are competent, appropriately trained, and understand and are familiar with the product's features, characteristics and risks.

## Principle 3: Target market

3.1 Credit institutions shall 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.

3.2. The credit institution shall, having first identified the target market, ensure that the product is deemed appropriate for the interests, objectives and characteristics of the identified target market(s).

3.3. The credit institution shall 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.

3.4. The credit institution shall consider how the product fits within the credit institution's existing product range and whether the presence of too many product variants prevents the consumer from making informed decisions.

3.5. The credit institution shall also identify the market segments for which the product is considered not likely to meet their interests, objectives and characteristics.

3.6. When deciding whether a product meets the interests, objectives and characteristics of a particular target market, the credit institution shall assess the degree of financial capability of the target market.

## Principle 4: Product testing

4.1. Before a product is brought to the market, an existing product is sold to a new target market or significant change is made to an existing product, the credit institution shall conduct product testing, in order to be able to assess how the product would affect its consumers under a wide range of scenarios, including stressed scenarios. Credit institutions shall make appropriate product changes where the scenario analysis gives rise to poor results for the target market.

## Principle 5: Product monitoring

5.1. Once the product is brought to the market, the credit institution is ultimately responsible for product monitoring and shall monitor the product on an ongoing basis to ensure that the interests, objectives and characteristics of consumers continue to be appropriately taken into account.

## Principle 6: Remedial action

6.1. If the credit institution identifies a problem related to the product in the market, or when monitoring the performance of the product as required in Principle 5.1 above, the credit institution shall take the necessary action to mitigate the situation and prevent a re-occurrence of detriment.

6.2. The remedial action shall include promptly notifying the distributor of changes or modifications to the existing products and any additional actions that need to be taken to remedy the situation.

## Principle 7: Distribution channels

7.1. The credit institution shall select distribution channels that are appropriate for the particular target market. To that end, the credit institution shall select distributors that have the appropriate knowledge, expertise and capability correctly to place each product in the market and to provide appropriate information explaining the characteristics and risks of the product to the consumers. When selecting its distribution channels, the credit institution may consider limiting the distribution of a specific product to channels that offer specific features to consumers.

7.2. The credit institution shall monitor that the products are distributed to the identified target market and sold outside the target market only on a justified basis.

7.3. The credit institution shall take all reasonable steps to ensure that distributors act in compliance with the objectives of the credit institution's product oversight and governance arrangements. The credit institution shall take appropriate action when concerns about the appropriateness of a distribution channel are raised, for example by ceasing to use the particular channel for a particular product. More specifically, the credit institution shall ensure, on an ongoing basis that the products reach mainly the particular intended target market through the distribution channels used.

## Principle 8: Information for distributors

8.1. Where relevant, the credit institution shall provide the distributor with a description of the main characteristics of the product, its risks and any limitations; and the total price of the product (as known, or reasonably expected to be known by the credit institution) to be borne by the consumer, including all related fees, charges and expenses.

8.2. The information and details of the products to be provided to distributors shall be of an adequate standard, clear, precise and up to date.

8.3. The credit institution shall ensure that the information given to the distributor includes all relevant details to enable them:

a) to understand and place the product properly on the market; and
b) to recognise the target market for which the produce is designed (see Principle 3.1), and also to recognise market segments whose objectives, interests and characteristics are considered likely not to be met (see Principle 3.5).

# PRODUCT OVERSIGHT AND GOVERNANCE ARRANGEMENTS FOR DISTRIBUTORS

## Principle 9: Establishment, proportionality, review and documentation

5.1. The distributor shall establish, implement and review effective product oversight and governance arrangements which are specific and proportionate to its size and to its role of bringing products to the market. The arrangements shall be designed to ensure that, when bringing products to the market, the interests, objectives and characteristics of consumers are appropriately taken into account, to avoid potential consumer detriment, and to minimise conflicts of interest.

5.2. The distributor shall review and update the product oversight and governance arrangements on a regular basis.

5.3. All actions taken by the distributor in relation to the product oversight and governance arrangements shall be duly documented, kept for audit purposes and made available to the Authority, or the credit institution, upon request.

## Principle 10: Distributors’ governance

10.1. The distributor shall ensure that product oversight and governance arrangements are an integral part of its general system and controls. To that end, the board of directors, if relevant, shall endorse their establishment and subsequent reviews.

## Principle 11: Knowledge of the target market

11.1. The distributor shall use the information provided by the credit institution and have relevant knowledge and the ability to determine whether a consumer belongs to the target market. The distributor shall in particular take due account of all relevant information allowing it to recognise the target market for which the product is designed, and also to recognise market segments for which the product is considered likely not to meet their interests, objectives and characteristics.

## Principle 12: Information and support for the credit institution's arrangements

12.1 The distributor shall take into account the information provided by the credit institution and disclose to the consumer a description of the main characteristics of the product, its risks and the total price of the product to be paid by the consumer, including all related fees, charges, and expenses, as well as providing additional material supplied by the credit institution to be used by the target market.

12.2 The distributor shall sell the product to a consumer who does not belong to the target market only on a justified basis. The distributor shall also be able to provide information to justify to the credit institution why it offered a product to a consumer who does not belong to the target market.

12.3 In order to assist credit institutions in their obligation of product monitoring, the distributor shall collect information to permit the credit institution to decide whether the product the distributor brings to the market meets the interests, objectives and characteristics of the target market on an ongoing basis.

12.4 If the distributor identifies any problems regarding the product features, product information or the target market when offering and selling products, the distributor shall promptly inform the credit institution of the issue.

## OUTSOURCING

13.1. Where an activity of a credit institution and/or distributor is in whole or in part outsourced, the credit institution and, where applicable, the distributor shall ensure that in doing so, they comply with the requirements established in BR/14 on Outsourcing By Credit Institutions Authorised Under The Banking Act 1994 accordingly. This includes, in particular, the principle the ultimate responsibility for the proper management of the risks associated with outsourcing or the outsourced activities lies with an outsourcing institution's senior management.

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