



Harmonised European Principles for Oversight of Financial Products Development

On November 28, 2013, the European Supervisory Authorities¹ (“ESAs”) issued a joint paper (the “Joint Position”)² setting out eight high level principles, intended to form a harmonised, cross-sector approach to the regulation of the development and governance processes to be observed by the originators of financial products and services in Europe. These are not intended to be directly applicable to financial institutions, but instead are to be guiding principles, within which each of the 3 ESAs will in time, develop more detailed provisions which will be applicable to institutions operating in their respective financial sectors (banking, pensions/insurance and securities/derivatives). The principles are the outcome of a survey of national competent authorities in the EU (“NCAs”), aimed at highlighting failures in product development and governance processes. However, they are not seeking to introduce any additional product approval, licensing or prohibition powers for NCAs.

The ESA Principles

1. Product manufacturers (being natural or legal persons that are responsible for developing, issuing or making changes to financial products (“products” also includes services for the purposes of the principles) and are subject to EU regulation) should establish, implement and maintain an ongoing review of all their product oversight and governance processes.
2. Such processes should be endorsed by the manufacturer’s executive board, and senior management is required to assume responsibility for compliance, both before and after a product has been launched. Senior management should also keep adequate records of its assessment in this area.
3. As part of such processes, manufacturers should be required to identify their target market for the relevant product, analyse the characteristics of that market and ensure that each product meets the identified objectives and interests of that market.

¹ Comprising the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

² JC-2013-77, “Joint Position of the European Supervisory Authorities on Manufacturers’ Product Oversight & Governance Processes”: [http://www.eba.europa.eu/documents/10180/15736/JC-2013-77+\(POG++Joint+Position\).pdf](http://www.eba.europa.eu/documents/10180/15736/JC-2013-77+(POG++Joint+Position).pdf).

4. Product testing should be performed by manufacturers to determine how the product would function in different market scenarios (such as during times of financial stress). The aim is to ensure that the products result in fair outcomes for their target markets.
5. Manufacturers should ensure that products are transparent for their target market.
6. Manufacturers should select appropriate distribution channels for the target market and ensure that distributors have clear, accurate and up-to-date information.
7. Manufacturers are required to perform periodic monitoring of the operation of products they have manufactured, in order to ensure that they continue to meet the objectives and interests of their target markets.
8. Manufacturers should take appropriate action in circumstances where the possibility of consumer detriment arises or is reasonably anticipated.

Following on from an already substantial body of work in this area³, the principles do not appear to break any new ground. However, this is the first time that clear statements of regulatory principles in this particular area have been made at EU-level.

These principles may be viewed as an extension of the harmonisation work currently being pursued by the structured products industry, through bodies such as the Joint Associations Committee, and by legislators through the PRIIPs initiative⁴ and the draft MiFID II legislation⁵, and certainly the harmonisation of European regulatory approaches to product development and governance processes is welcome. However, this represents relatively low-hanging fruit if the ultimate goal is greater EU-level harmonisation of overall regulation of structured and other financial products. The approaches of NCAs to financial product regulation and product intervention remain extremely fragmented across the different EU member states, and factors such as the differences in sophistication of investors, their traditional familiarity with certain types of products and asset classes and differences in national product distribution channels, will mean that such fragmentation will be with us for some time yet.

³ For example, similar themes appear in the Joint Associations Committee's manufacturer/distributor principles (<http://www.icmagroup.org/assets/documents/RSP%20Principles%20REVISEDFINAL.pdf>) and distributor/investor principles (<http://www.icmagroup.org/assets/documents/FINALGlobalPrinciplesJuly8-2008.pdf>), in the UK Financial Services Authority's Structured Products Guidance (See: <http://www.mofo.com/files/Uploads/Images/111205-Structured-Thoughts.pdf>) and more recently in the International Organization of Securities Commission's ("IOSCO") toolkit for regulating structured products – see: <http://www.mofo.com/files/Uploads/Images/130502-Structured-Thoughts.pdf>.

⁴ The European Commission's regulatory proposals in respect of the marketing and sale of Packaged Retail Investment Products ("PRIIPs") – see: <http://www.mofo.com/files/Uploads/Images/120720-Structured-Thoughts.pdf> - which resulted in proposed legislation (in the form of a Regulation) on key information documents in July 2012.

⁵ The European Commission's review into the effectiveness of the Markets in Financial Instruments Directive ("MiFID"). MiFID is currently proposed to be replaced by a MiFID II Directive and a new Markets in Financial Instruments Regulation.

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