



# MiFID II Product Governance: Standard Responsibilities Annex

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Contact: [press@ukfinance.org.uk](mailto:press@ukfinance.org.uk)

[www.ukfinance.org.uk](http://www.ukfinance.org.uk)

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# Introduction

MiFID II requires firms, when they collaborate in the manufacturing of a product, to outline their mutual responsibilities in a written agreement (including when collaborating with non-EEA firms)<sup>1</sup>.

It is expected that firms will need to update their existing agreements and/or provide for appropriate documentation of previously undocumented relationships in order to comply with this requirement.

Amongst the challenges of such task, firms will need to:

- i. negotiate an amended agreement or new agreement with multiple counterparties;
- ii. resolve differences in opinion with respect to both their own and their counterparty's roles and responsibilities in the specific circumstances.

With a view to facilitating the repapering exercise, UK Finance has developed standard wording for the allocation of responsibilities for both a co-manufacturing and a standard manufacturer/distributor scenario.

**UK Finance recognises that the allocation of responsibilities between firms is a matter for negotiation. Accordingly, firms might want to consider whether specific product governance obligations should be allocated to one or the other party in the contractual relationship, taking into account the specific product governance framework of the firms.**

The draft attached has been produced to serve as an annex to a hypothetical structured products distribution agreement. Firms should therefore also consider whether any qualification, amendment or expansion may be appropriate in consideration of the fact that this might be used to cover a

different product type, distribution model, and/or underlying agreement.

The Annex is drafted on the basis that the manufacturer(s) and distributor are subject to the MiFID II product governance requirements. However, firms will need to consider whether alternative provisions need to be included where one of the parties is not subject to the MiFID II requirements<sup>2</sup>, where these have not been dealt with in the Distribution Agreement.

For instance, it may be difficult for firms to pursue a written agreement with firms which are not subject to the MiFID II requirements or to obtain representations of compliance with MiFID II. Where this is the case MiFID-regulated firms should consciously manage the risk represented by the non-existence of a written agreement (or the absence of key provisions in it). For example, it might be determined that local market practice or regulation is in line with the MiFID II requirements, or that such firm is able, notwithstanding the refusal of its counterparty to agree in writing to provide it, to obtain the necessary information through other channels. Such facts may allow firms to reach a position of comfort about their compliance with the MiFID II product governance requirements even in the absence of a written agreement with a non-MiFID firm.

**The attached document does not purport to cover responsibilities other than the product governance responsibilities envisaged by articles 9 and 10 of the MiFID II Delegated Directive.**

**Additional rights and obligations of the parties relevant for the specific contractual relationship are assumed to be covered by the underlying agreement which the parties have or will put in place.**

<sup>1</sup> Article 9(8) MiFID II Delegated Directive.

<sup>2</sup> For example to address the additional information requirements under Articles 10(1) and (2) of the MiFID II Delegated Directive.

# Co-manufacturing

Co-manufacturing is the key concept in the determination of whether firms can allocate a proportion of the responsibilities amongst each other.

Where co-manufacturing applies, it is reasonable to assume that firms will not duplicate obligations. For example “*where investment firms collaborate to manufacture a financial instrument, only one target market needs to be identified*”<sup>3</sup>.

When acting as co-manufacturer and agreeing on the apportionment of the relevant responsibilities, it is critical that firms ensure that all product governance requirements attaching to manufacturers and distributors are covered.

In some scenarios, one of the co-manufacturers could also act as a distributor. If so, the relevant firm might want to consider the opportunity of assuming certain manufacturing responsibilities that it will nonetheless be required to discharge as distributor. For example, “*when an investment firm*

*acts both as a manufacturer and a distributor, only one target market assessment will be required*”<sup>4</sup>.

Whilst the UK Finance Annex provides a proposed approach to the apportionment of responsibilities, firms should consider for themselves whether, taking into account theirs and their counterparty’s systems and controls, a different allocation would be more appropriate.

UK Finance believes that whether or not firms cooperate in the manufacturing of a product depends on the specific circumstances, and firms should ensure that they identify the scenarios in which the co-manufacturing provisions will apply. Subject to this, the below are examples of when firms could be deemed to be acting as co-manufacturers, although these examples are not intended to be an exhaustive or binding list and firms may take a different view as to what is co-manufacturing:

- i. In the structured products business:
  - when the issuance of the securities is carried out following a request by the distributor for the pricing of a bespoke payout structure designed by the distributor;
  - in a structured deposits context, when the structuring of the deposit is carried out by a third party;
- ii. In the structured fund business:
  - when an asset manager launches a new fund which provides exposure to a bespoke strategy designed by a third party.

UK Finance also believes that the following does not constitute co-manufacturing:

- i. In the structured products business:
  - a new issuance of securities is launched at the initiative of the issuer and made available to potential investors via direct exchange listing or via multiple distribution chains;
  - when securities are issued following a pricing request by the distributor (this could be the case where the issuer has received a reverse enquiry for the issuance of securities that incorporates a payout common in the market).

<sup>3</sup> Article 9(9) MiFID II Delegated Directive.

<sup>4</sup> Article 10(2) MiFID II Delegated Directive.

# Annex

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The Manufacturer and Distributor wish to set out their respective product governance roles and responsibilities, pursuant to Art. 9(8) of the Commission Delegated Directive [EU x/x] dated 7 April 2016 (the [MiFID II Delegated Directive](#)) where financial instruments or structured deposits

(the [Financial Instruments](#)) are issued by [x] and distributed by the Distributor to its own clients (as such term is defined in Markets in Financial Instruments Directive (Directive 2014/65/EU) ([MiFID II](#))).

## A. The Manufacturer undertakes to:

1. identify, at a sufficiently granular level, the potential target market of end investors for each Financial Instrument by specifying the type(s) of client for whose needs, characteristics and objectives the financial instrument could, based on the Manufacturer's theoretical knowledge of and past experience with the Financial Instrument or similar Financial Instruments, be compatible (the Generic Target Market). The Generic Target Market will also include [where appropriate] information on any group(s) of clients for whose needs, characteristics and objectives the Financial Instrument is not compatible<sup>5</sup>;
2. provide the Distributor with such Generic Target Market assessment for each Financial Instrument it manufactures<sup>6</sup>;
3. provide the Distributor with its opinion on the appropriate channels for distribution of the Financial Instrument and, where appropriate, any other information which the Manufacturer considers relevant for the Distributor to understand the Financial

Instrument<sup>7</sup> or that the Distributor might reasonably request. The Manufacturer will notify the Distributor should the Manufacturer be unable to provide such information (which may in turn result in the Manufacturer deciding not to distribute through a relevant channel);

4. perform scenario analysis of the Financial Instrument to assess how it might perform in a range of market environments and to assess the risks of poor outcomes for end clients and in which circumstances these outcomes may occur, and use this data to determine the information to be disclosed to the Distributor about the Financial Instrument<sup>8</sup>; and
5. review the identified Generic Target Market and the performance of the Financial Instrument on a regular basis, taking into account events that could materially affect the potential risks of the Financial Instruments<sup>9</sup> and to take appropriate action where such an event is identified<sup>10</sup> including notifying the Distributor of the event and its consequences on the Financial Instrument.

<sup>5</sup> Article 9(9) MiFID 2 Delegated Directive.

<sup>6</sup> Article 9(13) MiFID 2 Delegated Directive.

<sup>7</sup> Article 9(13) MiFID 2 Delegated Directive.

<sup>8</sup> Article 9(10) MiFID 2 Delegated Directive.

<sup>9</sup> Article 9(14) MiFID 2 Delegated Directive.

<sup>10</sup> Article 9(15) MiFID 2 Delegated Directive.

## B. The Distributor undertakes to:

1. [taking into account the Issuer's Generic Target Market] identify a concrete target market for a Financial Instrument (the **Specific Target Market**)<sup>11</sup> and to ensure that the Financial Instrument that it intends to offer or recommend is compatible with the needs, characteristics and objectives of such Specific Target Market. The Specific Target Market will also include [where appropriate] information on any group(s) of clients for whose needs, characteristics and objectives the Financial Instrument is not compatible<sup>12</sup>;
2. on an on-going basis throughout the life of the Financial Instrument raise with the Manufacturer any issue of material discrepancy or incompatibility between the Specific Target Market and the Generic Target Market<sup>13</sup>;
3. ensure that the Financial Instruments are promoted, marketed and/or distributed to and through channels that are compatible with the Specific Target Market;
4. review the Financial Instruments and related services that it offers, on a regular basis, taking into account any event that could materially affect the Specific Target Market in order to make sure that the Financial Instruments remain consistent with the needs, characteristics and objectives of the Specific Target Market<sup>14</sup>;
5. [provide the Manufacturer with:
  - a. information on sales including any sales made outside the Specific Target Market [the number and type of investors to whom the Distributor has distributed the Financial Instruments (broken down to show Financial Instrument type and categories of sophistication) and the geographical location of such investors];
  - b. information on the results of the above mentioned periodic reviews conducted by the Distributor;
  - c. information on early redemption levels;
  - d. summary information of complaints received in relation to the Financial Instruments [(including details of the complaints raised, action taken by the Distributor, the number of complaints that remain open and the number of complaints that have been referred to any domestic complaints ombudsman service or other dispute resolution service)];
  - e. where a complaint relates to the Financial Instrument or the Manufacturer, and subject to any confidentiality treatment which the Distributor might need to afford to the identity of the complainant, full details of the complaint received; and
  - f. any other information it deems necessary or is reasonably requested by the Manufacturer in order for it to be able to review the Financial Instruments]<sup>15,16</sup>.

<sup>11</sup> ESMA Final Report: Guidelines on MiFID II Product Governance Requirements, paras. 30-31.

<sup>12</sup> Article 10(2) MiFID 2 Delegated Directive.

<sup>13</sup> ESMA Final Report: Guidelines on MiFID II Product Governance Requirements, para 37.

<sup>14</sup> Article 10(5) MiFID 2 Delegated Directive.

<sup>15</sup> Article 10(9) MiFID 2 Delegated Directive, PROD 3.2.29 – 3.2.30.

<sup>16</sup> Please refer to the UK Finance guidelines on information exchange between manufacturers and distributors.

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### C. Co-manufacturer scenarios

1. In circumstances where the Manufacturer and the Distributor collaborate to create, develop, issue and/or design a Financial Instrument<sup>17</sup>, the Manufacturer will not be required to identify the Generic Target Market and instead a single target market assessment will be undertaken by the Distributor. The parties may however agree a different allocation of responsibilities between themselves on a case by case basis.
2. In the circumstances highlighted above:
  - a. the Manufacturer will not be required to comply with section (1), (2) and (3) of clause A and with the requirements relating to “Generic Target Market” in section (5) of clause A; and
  - b. the Distributor will not be required to comply with (2) of clause B and with any provision of Clause B which refers to the Generic Target Market.
3. Where a co-manufacturing scenario exists responsibility for producing the Key Information Document under the [PRIIPs KID Regulation \(Regulation 1286/2014\)](#) should be allocated on a case by case basis.

<sup>17</sup> Firms should consider how to identify co-manufactured trades in their daily business.