

Brussels, 7th October 2022

EBF Response to the ESMA Consultation on the Review of the Guidelines on MiFID II product governance requirements

General Comments

- In order to ensure an orderly implementation of the amended ESMA guidelines on product governance, it is very important that investment firms are allowed sufficiently long time to implement the new requirements, preferably 12 months.
- It is important to ensure that the GL on suitability and the GL on product governance are aligned. Otherwise, there is a risk that significant resources will need to be spent on re-training of staff and updating IT-systems within a very short time frame. This is hardly effective and, in addition to increased costs, it would lead to unnecessary frustration for both staff and clients.).
- As ESMA guidelines will start to apply several months after the MiFID II delegated directive, investment firms will not have access to all necessary information when implementing the binding level 2-rules. In order to avoid legal uncertainty and unwanted compliance risks, it would therefore be helpful if ESMA could clarify in a supervisory statement that it does not expect NCAs to prioritize supervision of the level 2 rules until ESMA's guidelines on suitability and product governance have become applicable.
- It is important to keep the level of detail at a reasonable level and to avoid guidelines that create unnecessary additional complexity of the MiFID framework. Therefore, where there is uncertainty regarding the cost/benefit analysis or if there is a risk of unintended consequences for retail investors or the EU capital market as a whole, ESMA should take a cautious approach and refrain from proposing the guideline in question. ESMA can always revise the guidelines at a later stage e.g. when the relevant sustainability rules have become applicable and more ESG-data and sustainable products are available and both industry and NCAs have a clearer picture of why more guidance is needed. Complex rules and information overload can discourage retail investors from investing in sustainable products, other than contributing to greenwashing.
- The EBF notes that the consultation paper does not address the much-debated question regarding the review of obligations for firms that are deemed to be "manufacturers" when advising corporates issuers on the primary market e.g. in connection with a bond or share issue (recital 15 delegated directive). For the well-functioning of EU capital markets, it is of utmost importance that the product governance obligations for primary market services are applied in a proportionate manner. It is simply not reasonable to require that a "manufacturing" investment firm should keep track of subsequent distribution of a share on the secondary market e.g. on an exchange. The EBF suggests that ESMA confirms this approach in the final report.
- Product governance rules in MiFID II relate to the internal procedures of investment firms when manufacturing or distributing financial instruments. These rules should not be used as a tool for ESMA to restrict clients access to complex products such as CFDs. In fact, MiFID II stipulates that ESMA and NCAs should follow a specific procedure if they want to restrict distribution of a specific type of product, commonly referred to as the "product ban". It is not appropriate use level 3 guidelines to achieve this result. Item 26 of the guidelines (page 30) should therefore be deleted.

European Banking Federation aisbl

Brussels / Avenue des Arts 56, 1000 Brussels, Belgium / +32 2 508 3711 / info@ebf.eu

Frankfurt / Weißfrauenstraße 12-16, 60311 Frankfurt, Germany

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- We would like to convey our concerns towards the inclusion of “good and poor” practices in guidelines since the legal status of such examples is legally uncertain. If kept, we agree that it should be limited to good practices.

Questions

Question 1. Do you agree with the suggested clarifications on the identification of the potential target market by the manufacturer (excluding the suggested guidance on the sustainability-related objectives dealt with in Q2)? Please also state the reasons for your answer.

- Guidelines should allow for more flexibility for distributors when defining the TM in the secondary markets if they believe that the instrument is consistent with the needs of Retail Investors. A deviation by the distributor of the target market in the secondary market (vs the one defined by the manufacturer in the primary market) should be allowed, for example in the case of bonds with regard to the TM category “type of client”. This should no longer be considered exceptional (but of course limited to the deviation by the distributor of the -positive- target market in the secondary market versus the -positive- target market identified by the manufacturer)
- . Background:
 - Definition of target market in the secondary market by the distributor must take into account the target market as defined by the manufacturer. According to the ESMA guidelines, only exceptionally can a distributor deviate.
 - But Target market defined by manufacturers are determined mostly in the interest of the issuers – which wants to limit any potential liability with an investor classified as Retail under MiFID (eg risk of falling under PRIIPs) and find enough placement capacity with non-retail investors
 - This is especially true in the case of US bonds where a large proportion exclude Retail from the target market, but also EU manufacturers start to follow this trend.
 - Distributors use external data providers to determine target markets. These data providers base their assessment on the target market as defined in the primary market.
 - This is an issue for markets where Retail clients have access to bonds (and not only Pro and ECP) and where diversification issues arise, and the bond market risks to become illiquid.
- Further examples of qualitative criteria that may be used for the identification of the potential target market, for a given financial product by the manufacturer, would be welcome. Many resources are already being devoted for operationalizing the product governance requirements, especially, with regards to dataflow between manufacturers and distributors through FinDatEx and common European data templates.
- The main focus of ESMA should be the content of the information and not whether it is quantifiable or not. Most information is quantifiable and the growing POG requirements must be operational.
- **Item 13:** We believe that the scope of the new obligations in Item 13 of the guidelines “substantiate and document” are unclear. Moreover, the background information on item 20 only mentions the need of documenting and monitoring choices, while item 13 appears to be much broader. It would be helpful if the guidelines would explicitly refer to a principle of proportionality.
- **Item 14:** As a general remark, , we argue in favor of a clarification from ESMA of what is meant by “relevant products” as this notion seems very general Indeed, when identifying

the target market, it seems difficult to take into account the results of the scenario and changing structure analysis for a lot of products.

- *"Manufacturers should take into account analyses of the scenarios and cost structures associated with a financial instrument when defining their target markets". This stands as a mere repetition of article 9 (10) of the Delegated directive (EU) 2017/593 which provides that "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"* (see also 9 (12) of the DD). Therefore, its relevance is questionable: such detailed information is not useful for distributors. This should not lead to additional target market criteria or to any specific disclosure to clients which are often not understandable for most end investors.
- *"The potential target market by the manufacturer should not only be based on quantitative criteria but also on sufficient qualitative considerations as well".* This concept is already mentioned in the current version of the guidelines, but it has to be noted that distributors need standardized data that can be easily processed in their IT systems and that can be used to make comparisons between products. Moreover, such data is not included in the Findatex EET.
- **Item 19 :** Considering the further details that have been added to the five categories of information included in the manufacturers' target market, it is important to notice that this growing granularity of information could lead distributors to exclude many clients from their own target market. Moreover, a very high degree of the granularity of target markets and their clusters is neither desirable nor useful as it does not correspond to the characteristics of groups of similar clients. Secondly, it is important that the definition / implementation of the target market does not substitute for the suitability assessment carried out by the distributor (in the context of the provision of advised services).
 - **19 subparagraph b),** the element *"time period in which clients should have been active in the financial markets"* is already mentioned in the current version of the guidelines and is questionable. Therefore, we suggest the deletion of this mention.
 - **19 subparagraph d),** notes that the PRIIPs indicator does in fact include considerations regarding currency risk. We therefore interpret the example as referring to other products than PRIIPs. We would appreciate a confirmation from ESMA in this regard.
 - **19 subparagraph e),** we would like to express concerns on the ESMA proposal to add a reference to the need of duly considering the potential impacts for clients of an early exit. As per current practice, costs are determined based on forecasts of holding period that have a hypothetical nature. In the light of that, the new guidance put forth by ESMA risks of being extremely difficult to be concretely implemented and, therefore, should be deleted.

Question 2: Do you agree with the suggested approach on the identification of any sustainability-related objectives the product is compatible with? Do you believe that a different approach in the implementation of the new legislative requirements in the area of product governance should be taken? Please also state the reasons for your answer.

- Generally speaking, we agree with the proposal to align "sustainability objectives" with "sustainability preferences" as proposed by ESMA, but more flexibility with regards to sustainability preferences should be considered in the short to medium run.
- However, there is no need to re-state the definition of sustainability preferences: linking the two is sufficient. Moreover, considering that ESMA does not envisage this as the only option, another approach could be to include the possibility of specifying whether the product is compatible with sustainable preferences and to provide, in addition and on a

discretionary basis, more detailed information on the specific sustainable preferences, where relevant. The reasons for admitting this further approach are the following:

- Manufacturers are not subject to provide the information required by the Delegated Regulations (EU) 2022/1288 for financial instruments out of the scope of SFDR.
- The concept of minimum proportion poorly applies to structured products. In particular, in relation to certificates i) no uniformity of views and ii) no agreed practice currently exist as to how to classify these products for ESG purposes; iii) distributors providing investment advice with a portfolio approach could collect client's preferences which are not differentiated among the three types of financial instruments listed under letters a) to c) and, consequently, verify the level of the client's sustainability-related ambitions with regard to three types of financial instruments considered together.
- **Item 20:** The scope of the third bullet in item 20 "*whether, where relevant, the product has a focus on either environmental, social or governance criteria or a combination of them*" should be clarified. Please provide some examples in the final report..
- The EBF finds it difficult to understand the different methodologies in point 27 (page 10) i.e. reference on the sustainability data of (i) the issuer, or (ii) the product itself. It is important that firms have access to both methods (which can be applied separately or in combination) and decide on a case-by-case basis which to apply. ESMA should also take into consideration that work relating to methodologies is ongoing in the industry (e.g. EUSIPA and FinDatEx).

Question 3: What are the financial instruments for which the concept of minimum proportion would not be practically applicable? Please also state the reasons for your answer.

- As a general remark, we would like to emphasize that the consultation paper is unclear as regards ESMA's proposal on "minimum proportion". For instance, the distinction between minimum proportion and actual minimum proportion should be further explained and not be hidden in a footnote (nr. 13).
- The concept of minimum proportion is not practically applicable especially, but not exclusively, to derivatives, shares, bonds (including sovereign bonds and with a possible extension to green bonds) and to most securities. For instance, information on the minimum proportion of issuers' activities invested in sustainable investments as defined in article 2 point 1 of Regulation (EU) 2020/582 is not available, yet.
- For equities and bonds, the sustainable investment proportion concept might be irrelevant. Manufacturers and distributors should as such be free to define the best methodology to assess how equities and bonds can be considered as sustainable. Indeed, even for SFDR products, there's no prescribed methodology to assess how the product contributes to a sustainable investment objective under SFDR 2.17 sustainable investment definition.
- Moreover, we note that there are ongoing industry-led initiatives in several member states to develop calculation methodology for structured products. At this stage, we consider that the EU rules should be limited to transparency requirements. If needed, ESMA could revert to the question of harmonized calculations at a later stage.

Question 4: Do you agree with the suggested guidance on complexity in relation to the target market assessment and the clustering approach? Please also state the reasons for your answer.

- The clustering approach is generally supported as it supports operational ability: however, the principle must be applied with proportionality. It is important that too granular requirements are avoided.
- **Item 27:** It has to be noted that some EU investment firms can issue a large number of OTC derivatives or structured products each year and many of them have similar

characteristics. Therefore, a clustering approach to define a single target market for such derivatives/ structured products is necessary. As a consequence, we argue in favor of an alteration of the following sentence in paragraph 27: *“for certain OTC derivatives or structured products, it is expected that a clustering approach will not be appropriate”*.

- **Items 28 and 29:** the request to consider multiple key factors, check and document when clustering products are very demanding and burdensome practices to implement. Therefore, we would like to ask ESMA to confirm that the mentioned key factors (i.e. risk factors, charging structure, optionality elements etc) are only examples. Moreover, we argue in favor of the replacement of the word “should” at the beginning of the paragraph with “could”.
- We would like to underline that it is unclear whether the distributor needs additional information from manufacturer for target market identification.
- In our view, the starting point of the assessment of whether a financial instrument is deemed complex or not should be at Art. 25.4 MiFID II, as phrased in point 30, page 11. In point 24 it seems that other criteria come first and that art 25.4 comes afterwards. Moreover, it should be sufficient to assess whether a product is complex or not basing on MiFID II, without specifying further levels of complexity.

Question 5: Do you agree with the suggested guidance on the assessment of the general consistency of the products and services to be offered to clients, including the distribution strategies used? Please also state the reasons for your answer.

- **Item 34 :** We argue in favor of a replacement of the terms “management body” with “senior management”: this because the management body is not involved in identifying the actual target markets for financial instruments, even if it is responsible for defining the distribution strategies to the firm in general terms.
- **Item 35 :** the reference to *“the needs, characteristics and objectives of the target clients”* is not only already mentioned in the current version of the guidelines, but is also confusing as it is not consistent with the provision of reception and transmission of orders or simple execution services. Ensuring compatibility between financial instruments and clients' needs, characteristics and objectives should remain part of the suitability assessment (in the context of the provision of an advised service). Therefore, we argue in favor of the deletion of this sentence.

Question 6: Do you agree with the suggested guidance on the identification of the target market by the distributor? Please also state the reasons for your answer.

- We are supportive of the fact that the clustering approach is also made available for distributors.
- **Item 42:** focusing on the second sentence mentioning that *“distributors should define the target market on a more concrete level...”*, we would like to mention that this wording seems to imply that a distributor might not rely on the manufacturer's target market to define its own target market. This is in contrast to article 10 (2) of EU delegated directive (2017/593) which provides that *“Investment firms shall use the information obtained from manufacturers and information on their own clients to identify the target market and distribution strategy”*
- It is important to notice that the definition of the distributor's target market cannot replace the suitability assessment that is carried out for each client. Too much granularity in the information used to define the distributor's target market could lead to the exclusion of clients from financial products that would have been suitable for them. Indeed, requiring a more granular classification of the target market for distributors is a disproportionate measures. In light of this, we suggest to change the wording in line 11, paragraph 42, from *“should adopt”* to *“could, where relevant, adopt”*.
- **Item 46:** The EBF notes that ESMA in point 46 of the guidelines (page 35) proposes that distributors should determine whether they need access to underlying documents from the

manufacturer, such as the outcome of scenario analysis and charging structure analysis. Such requirement will be very difficult to comply with in the following scenarios:

- when firms do not have a contractual relationship with the manufacturer of the products;
- when distributing third country products;
- In situations where the distribution takes place through trading on a regulated market and there is no way of knowing which investment firm has been advising on the primary market transaction (see General Comments regarding need for clarification of recital 15 of the delegated directive).

We therefore propose that the words “where appropriate” are added to the guidelines. Please also note that business secrecy considerations, as well as competition rules, may make it difficult to share information on costs structures between firms.

- The EBF proposes that the ESMA Guidelines uses the same terminology as in FinDatEx, e.g. “basic, informed and advanced” rather than “basic, average and advanced”.

Question 7: Do you agree with the suggested approach on the determination of distribution strategy by the distributor? Please also state the reasons for your answer.

- **Item 56** (penultimate sentence): In the context of a non-advised investment service, the firm must ask its clients only about their knowledge/experience of financial instruments. If an instrument is primarily distributed by the firm through non-advised investment services, the firm does not have reliable evidence to determine whether the target market has been reached. If ESMA's recommendation were to be applied, the firm would have to prevent many clients from using non-advised services on certain financial instruments even though these clients have sufficient knowledge and experience : this is neither desirable nor consistent with the Level 1 texts. It could also be considered as a refusal to sell a product/ provide a service. If ESMA wished to maintain this requirement, it would be appropriate to limit its scope to complex financial instruments sold to non-professional clients.

Question 8: Do you agree with the suggested approach on the deviation possibility for diversification or hedging purposes when providing investment advice under a portfolio approach or portfolio management? In particular, do you agree that a deviation from the target market categories “type of client” and “knowledge and experience” cannot be justified for diversification or hedging purposes, neither in the context of investment advice under a portfolio approach, nor portfolio management? Please also state the reasons for your answer.

- We do not agree with the suggested approach as it is to the detriment of clients. Indeed, the suggested approach prevents clients in portfolio management agreements from getting an optimal framework for portfolio optimization, including hedging risks. According to the current ESMA Guidelines on MiFID II product governance requirements, distributors are not required to report sales outside the positive target market to the manufacturer if sales are for diversification and hedging purposes (and therefore, suitable for the client). In the same way, distributors must be allowed to be exempted from monitoring deviations outside the positive target market when sales comply with the above requirements, even if the deviation is due to the “client type” and/or “knowledge and experience”. Indeed, in our opinion, if the sale is suitable to the client, the category which is outside the positive target market is not relevant, especially if considering portfolio management where the client doesn't take the investment decision.

Question 9: Do you agree with the suggested approach on the requirement to periodically review products, including the clarification of the proportionality principle? Please also state the reasons for your answer.

- We would like to highlight that certain aspects of the guidelines 67, 68 and 70 on periodic review are not applicable to bonds (and shares) in the secondary market (e.g. exchange of information between manufacturers and distributors).
- **Item 70:** we are not in agreement with the 2nd sentence stating that “*Whenever distributors have relevant information to support review by MIFID manufacturers, they should proactively provide it to the manufacturer and not provide such information only at the manufacturer’s request*”. It contradicts article 10 (b) of delegated directive 2017/593, which provides that distributors should transmit information on product sales only if manufacturers need it (at their request). We assume that it is a distributors’ correct approach to periodically (at least annually) provide MiFID manufacturers (with placement agreement executed with relevant distributor) with structured information on product governance defined in the distribution agreements. Distributors should not provide unstructured, and therefore difficult to process, feedback to the manufacturers. Therefore, we argue in favor of the deletion of this sentence as it could lead to an undesirable confusion in the respective responsibilities of manufacturers and distributors.
- **Item 72:** We argue in favor of the deletion of the wording referring to sending a questionnaire to a sample of clients who have purchased financial instruments under non-advised services. Indeed, it would not make sense to ask clients additional ex post questions on their financial situation and their investment objectives, especially when clients are not asked ex ante about these elements (since using non-advised services). This ex-post questionnaire would be very confusing and irritating for clients and many could refuse to answer it.
- **Item 73:** We support the clarification in the first part of paragraph 73 of the draft guidelines stating that “*where a distributor no longer offers, sells or recommends a product, the distributor is no longer obliged to review the target market of that product, despite that a client may still be invested in that product*”.
 - Requiring a questionnaire also for products that distributors just recommend to hold i) is useless as the target market does not play any role with regard to products that can just be hold and sold; ii) distributors can advise the maintenance of a product already in client’s portfolio, even if not in the positive target market. This can be done to protect the customer, because costs of the products are not yet amortized, for example.
 - When a “hold” recommendation after the closing of a new issuance is on the other hand particularly based on the product rationale (e.g. capital protection at maturity) and the absence of a secondary market, would you agree that the obligation to update the product governance data is probably limited to exceptional circumstances (e.g. default of the issuer)?

Question 10: Do you agree with the suggested approach on the negative target market assessment in relation to a product with sustainability factors? Please also state the reasons for your answer.

- **Item 81:** paragraph 81 expands the scope of Art. 9 Delegated Directive of 2021/1269 and this creates legal uncertainty. Therefore we ask for this uncertainty to be remedied.
- Moreover, we argue in favor of further guidance on negative/ positive TM with regards to sustainability for products which do not consider sustainability factors.

Question 11: Do you agree with the suggested updates on the application of the product governance requirements in wholesale markets? Please also state the reasons for your answer.

- The EBF welcomes the clarification in paragraph 89 of the Guidelines concerning the fact that the target market should be related to the anticipated potential end client and not

necessarily to the investor the manufacturer is facing. It is very positive that ESMA has included the exemption for products distributed only to eligible counterparties introduced by the MiFID quick fix in the guidelines and wants to delete outdated explanations in the current guidelines. With regard to the presentation in paragraphs 94 and 95, we would like to point out that the presumption on knowledge and experience applies to all professional clients, i.e. both born and chartered professional clients. The differentiation between born and earned professional clients only plays a role in the presumption of financial circumstances. These may only be assumed for born professional clients. This aspect should be adjusted accordingly when finalizing the guidelines.

Question 12: Do you have any comment on the suggested list of good practices? Please also explain your answer.

- It is surprising that such a list of “good practices” is included in the ESMA draft guidelines. Indeed, good practices are only intended to be examples that *“help firms comply with the relevant requirements”* (see Annex IV) and do not represent additional requirements. As the legal status of such examples is uncertain, we believe that their inclusion in the guidelines’ document could be misleading. If they are kept in the guidelines, we would appreciate ESMA specifying more clearly that the above mentioned good practices do not form part of the guidelines.
- Additionally, the Guidelines incorporate examples of the application of the different categories (of the target audience) to some products: however, these categories have not been modified. No examples have been included in the area of sustainability preferences, where important changes have taken place. Therefore, we would suggest to include examples that reduce the need for interpretation by entities in each product type and distribution scenario. .

Question 13: Do you have any comment on the suggested case study on options? Please also explain your answer.

- The suggested case studies on options are of limited use for investment firms: this is so because most of the examples of target markets that are supposed to have been defined by manufacturers, are too narrow or too granular to match the clients’ profiles defined by distributors.