European Association of Public Banks
European Association of Public Banks and Funding Agencies AISBL

Consultation on review of the guidelines on MIFID II product governance requirements

7th October 2022

Q1: 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.

EAPB welcomes clarifications to the existing guidance. However, we have a few reservations with respect to the proposed clarifications in paragraphs 13-23. Please find our comments below.

The requirement to consider qualitative factors in addition to quantitative factors (par. 14) for all financial instruments and in every case is too far-reaching. It should be possible to use exclusively qualitative or exclusively quantitative factors. Especially in the case of less complex or low-risk financial instruments, no relevant added value is generated if qualitative and quantitative factors are used. Any distrust of quantitative factors is not justified. It is not sufficiently appreciated that qualitative considerations must consider applying the appropriate algorithm.

It should also be possible to merge certain criteria of the target market determination in case the structure of the financial instrument and the potential investor audience permits. Therefore, it should be clarified that the complexity of the product and/or the targeted potential investors may justify a simplified target market determination (par. 16).

The addition (par. 19a) that the manufacturer who wants to refer to the exception in Art. 16a) MiFID II should consider before releasing the product whether it should only be sold to suitable counterparties and is therefore covered by the exception, could be understood in the sense of a general suspicion and should be deleted.

It is positive to adhere to the legally prescribed risk indicators (par. 19d). With regard to the SRRI, however, a note should be added that after the extension of the PRIIP Regulation to funds from 1 January 2023 onwards, this will at best only play a subordinate role. However, the additional requirement that the legal indicators should be corrected if they do not accurately reflect the product risk is problematic. This may lead to different product risks reported to the customer and on which the target market assessment was based. The use of different product risks under MiFID and PRIIPs would be very critical, as it is difficult to understand. The different product costs under MiFID and PRIIPs should be mentioned. Under no circumstances should this problem of non-harmonised specifications be transferred to the target market.

We are critical regarding the fine-tuning of the investment objectives (par. 19e). This is not provided in the law. It will hardly be possible at the level of the manufacturer to make a statement that a product is aimed for certain age groups. The tried and tested criteria of asset optimisation, old-age provision, excessive participation in price gains and specific old-age provision should be maintained. Insofar as ESMA wishes to retain the fine-tuning, this should be optional.

The requirement that the target market should always contain a statement on the investment horizon should be deleted.

While ESMA uses years as time scale, in practice, many firms work with time spans such as short-, medium- and long-term. This should also be possible in order to leave a certain flexibility in the implementation of new requirements and to enable users to continue working with the established processes.

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Q2: 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.

An alignment of the definition of "sustainability objectives" with the definition of "sustainability preferences" in Art. 2(7) CDR (EU) 2017/565 would be welcome. Such alignment would help matching a client's preferences with a product's identified target market and support the distributor's suitability assessment.

We also welcome the fact that ESMA does not propose the alignment as the only option which allows for greater flexibility on the manufacturer side. We support the additional optional category in no. 20 of the draft guidelines that goes beyond the "sustainability preferences" set out in Article 2(7) of Delegated Regulation (EU) 2017/565, i.e., "sustainability-related objectives" as specified in the third category of no. 20 (= product has focus on environmental, social or governance criteria or combination). This additional optional category allows specifying sustainability-related objectives as part of the target market where they cannot be attributed to the other three categories of "sustainability preferences" according to Article 2(7), e.g., where technical screening criteria for a certain environmental objective do not yet exist. It may become particularly relevant where distribution is not envisaged via investment firms providing investment advice or portfolio management services.

To avoid misunderstandings between manufacturers and distributors, it should be made clear for the minimum percentages in par. 20 whether it is an absolute figure or the current applicable and therefore variable percentage. Moreover, for financial instruments other than funds which do not have contractually guaranteed minimum values, the guidelines should provide for the explicit possibility of using the last actual share.

In the current reporting environment, information required to determine the sustainability preferences can only be obtained with difficulties. Most market participants are currently still struggling to determine an exact percentage for "environmentally sustainable investments" or "sustainable investments". The CSRD which will likely improve the level of available data is only due to apply in 2024. Manufacturers not having obtained relevant confirmations will likely not be willing to expose themselves and will determine that an investment cannot be regarded as sustainable. If the data required to determine sustainability-related objectives is not provided through statutory reporting, products matching investors sustainability preferences may not be available for placement to investors.

Q3: 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.

We assume that the concept of minimum proportion originates from the SFDR where it relates to specific products such as funds which are required to define a minimum proportion of sustainable investments. The concept cannot be applied to directly issued instruments such as shares or (other than use of proceeds) bonds. Therefore, this concept should not apply to these instruments. The guidelines should allow manufacturers to use the actual proportion of sustainable investments if there is no minimum proportion available.

In the absence of Taxonomy-alignment reporting at company level and with issuers facing challenges to determine Taxonomy-alignment for certain activities towards which (green) bond proceeds may be assigned to, the outcome may be that issuers will be unable or unwilling to share such information with the product manufacturer. A target market determination would then lack such information, or issuers would be forced to limit the eligible categories to those where Taxonomy-alignment can be assessed on a binary basis, ignoring activities where alignment is a mere possibility as for many transitionary activities. A minimum Taxonomy-alignment quota at company and/or instrument level will allow issuers and manufacturers to share true product information without running the risk of specifying ultimately false information.

At this stage there is not sufficient data, and many manufacturers cannot calculate any percentage values and will set "0" when providing information. Many companies are not obliged to calculate and report the Taxonomy-alignment of their economic activities until 2023.

The different requirements should be aligned over time in order to avoid the current low product spectrum, and diverging entry-into-force of interacting regulation should be avoided.

Q4: 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.

We have difficulties with the suggested guidance on complexity, requiring a more granular target market determination for complex products (par. 24, 25). There is no clear definition of complexity, but only the differentiation between complex and non-complex in the context of marketing a product without appropriateness test. The strong emphasis on complexity and associated obligations thus creates a great deal of legal uncertainty. This problem can be mitigated by focusing on a careful and narrow definition of the target market for products that are particularly complex and/or risky. This would be consistent with the requirement in par. 26 that products such as CfDs should have a correspondingly narrow target market. A more granular determination of the target market by means of additional criteria is not necessary, as the special features of the CfDs mentioned as examples can be considered via the client category criteria of knowledge and experience, investment objective and risk-return profile.

We also do not agree that in the context of the target market definition a clustering of similar products should not be possible in case of particularly complex products (par. 27). Besides the lack of definition of complexity, the restriction is not appropriate. Clustering should be based solely on the comparability of the product structure. If it permits a uniform target market definition, it must also be possible for complex products. The additional requirement that the target market for a particularly complex and high-risk product must be determined particularly carefully and, if necessary, also correspondingly narrowly can be observed uniformly for several products in case of comparable product structures, so there is no need to restrict the cluster option. When clustering leads to inappropriate target market, it is already inadmissible under existing regulation. For example, in case of structured products, the target market often only differs in the investment horizon and the risk indicator depending on the maturity of different products. If the highest risk indicator and the shortest investment horizon are specified for leverage products, it results in the greatest possible investor protection.

Q5: 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.

We welcome that ESMA is considering new developments such as gamification in the sales strategy of distributors. The amendments in par. 34-40 are welcome clarifications. However, the one-sided positioning with respect to gamification techniques is problematic since it is unclear which characteristics lead to the classification as gamification techniques, when at the same time "certain" gamification techniques should never be in the interest of the client. It should be clarified that the classification of the securities service providers is decisive whether gamification techniques can be compatible with client interests.

Q6: 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.

Q7: Do you agree with the suggested approach on the determination of distribution strategy by the distributor? Please also state the reasons for your answer.

The amendments in par. 56 and 59 are a useful clarification. It is welcome that even very complex and high-risk products can be distributed non-advisory. This reflects client expectations, who rely on the distributor to execute their orders. As soon as such order execution is denied, it leads to great customer dissatisfaction. Restricting the so-called “self-deciders” would be at their detriment. Explanations in this regard should focus on special forms of distribution such as gamification or active product promotion by distributors. The requirement to review such measures as part of the definition of the sales strategy makes sense. The situation is different if the customer acts on own initiative as a self-decider and the firm executes the customer order without any active sales measures with regard to the product.

Q8: 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.

The assumption in par. 64 that a divergence in the category "knowledge and experience" cannot be justified seems too far-reaching. Particularly for complex or risky products, cases are conceivable which make the financial instrument appear suitable in a portfolio analysis even for customers who do not have the level of "knowledge and experience" because the risk-increasing or complexity-creating features are not relevant from a portfolio perspective.

Q9: 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.

The general statements in par. 67 and 68 regarding the necessity of a review of the product approval procedure are understandable. We welcome (par. 70) that investment firms are responsible for providing only relevant information to manufacturers to support their reviews. Approaching all distributors in relation to each product under review would incur unreasonably high costs, considering that a manufacturer is not aware which distributor may be able to provide relevant information on a specific financial instrument. Par. 72 should be deleted except for the first sentence, as there is no need for further measures. The sales offices have all the customer information they need for the target market test and can determine whether a product was distributed inside or outside the relevant target market.

A positive aspect is the clarification that a product that is no longer sold is not subject anymore to the review processes.

A positive aspect is the clarification in paragraph 73 that a product that is no longer sold is no longer subject to the review processes, even if clients still have it on deposit. In the third sentence there is an exemption from that principle when the distributor recommends holding the product. In our view, the exemption goes too far. A product should not be subject to the review if a recommendation to hold the product occurs only from time to time. There should only be an obligation to review the product if the distributor regularly recommends holding that product.

Q10: 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.

EAPB agrees with the suggested approach as sustainable products remain available for clients without sustainability preferences. Even if investor does not express sustainability preferences, a sustainable product should not be in contrast to the investor's preferences. However, based on the wording, it could be inferred that a negative target market must always be formed in reverse for products that do not have sustainability factors. This would not be appropriate. It should be clarified that for the criterion of sustainability no negative target market needs to be defined.

Q11: 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.

EAPB welcomes that the exemption for products distributed only to eligible counterparties, as introduced by the MiFID quick fix, has been incorporated into the guidelines and that outdated explanations should be deleted. Par. 94 and 95 need revision, since the presumption on knowledge and experience applies to both per se and opt-up professional clients. The differentiation between per se and opt-up is, however, only relevant in the presumption of financial circumstances which may only be assumed for per se professional clients.

Q12: Do you have any comment on the suggested list of good practices? Please also explain your answer.

The current guidelines are becoming even more extensive and detailed. Good practice examples should therefore not become part of the guidelines. Therefore, we support the clarification in paragraph 5 of Annex III. Furthermore, the wording of the section "Target market assessment by the distributor" can lead to misunderstanding and should be revisited. The distributor is not required to determine a narrower target market than the manufacturer. It may be the result of the distributor's target market assessment, however, the manufacturer and the distributor may also arrive at identical assessments.

Q13: Do you have any comment on the suggested case study on options? Please also explain your answer.

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