ESMA_QA_1123

Submission Date
06/11/2020

Status: Answer Published

Additional Information

Level 1 Regulation
Markets in Financial Instruments Directive II (MiFID II) Directive 2014/65/EU- Investor Protection and Intermediaries

Topic
Product governance

Subject Matter
Product governance

Question
How should firms manufacturing financial instruments ensure that these financial instruments' costs and charges are compatible with the needs, objectives and characteristics of the target market, as required by Article 9(12)(a) of the MiFID II Delegated Directive?

ESMA Answer

06-11-2020

Original language

[ESMA35-43-439 Investor protection Product governance Q&A 2]

As part of the product approval process, firms should have clear and robust policies and procedures to identify and quantify all product related costs and charges. This encompasses all implicit and explicit product costs but also service costs likely to be incurred by the client (e.g. inducements).

These policies and procedures should be approved by the management body and should be assessed and monitored by the compliance function as part of the general obligation to "monitor the development and periodic review of product governance arrangements"[1]. The policies and procedures should be be robust and documented, with a clear determination of roles and responsibilities in the process.

For instance, policies and procedures should be clear on which market parameters are used for the pricing of products and related determination of costs (sources, frequency of updates, how they are applied to products of different characteristics/duration, etc.).

Firms should then assess if and how the costs identified are compatible with the envisaged target market of the product and whether adjustments are needed. In doing so, firms should especially take into account the manner in which costs accrue (e.g. upfront by a mark-up or mark-down, ongoing, as separate payment, etc.).

Firms should substantiate how cost structures and components are compatible with the characteristics of the target market. For example, firms should ensure that a financial instrument with significant up-front costs should not have in its target market clients with investment horizons that are too short for possibly retrieving the costs from expected returns over time.

Firms should bear in mind that Article 9(13) of the MIFID II Delegated Directive requires manufacturers to provide to distributors all information necessary to understand and

recommend or sell the financial instrument properly. In ESMA's view, this does also include information about the product-related costs and charges, which also enables distributors to provide ex-ante and ex-post cost transparency to clients according to Article 24 (4) MiFID II.

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[1] On this topic see also ESMA Guidelines on certain aspects of the MiFID II compliance function requirements [Ref: ESMA35-36-1946] and specifically guideline 4 that states "Firms should ensure that the compliance function fulfils its advisory and assistance responsibilities, including […] participating in the establishment of policies and procedures within the firm (e.g. the firm's remuneration policy or the firm's product governance policies and procedures)"