

ESMA
103 rue de Grenelle
75345 Paris Cedex 07

December 22, 2016

Consultation on Draft guidelines on MiFID II product governance requirements

Dear Sir or Madam!

Thank you for the opportunity to respond to your Consultation on Draft guidelines on MiFID II product governance requirements.

We are a Small to Medium Sized (SME) intermediary providing investment advice and the transmission of orders. We do not handle clients' money in any way.

The following statement is in line with our representatives of the Professional Association of Financial Service Provider (Federal Chamber of Commerce in Austria) and BIPAR.

The draft Guidelines create a shift of responsibilities from manufacturers to distributors like us, who, according to the level 1 text, are not meant to take on such requirements.

The guidance would create legal uncertainty, confusion in terms of responsibilities and double work. In their current shape, the draft guidelines are in our opinion not in line with the spirit and philosophy of the level 1 text and push the market structure into a fully vertically integrated market.

The draft guidelines also do not reflect our business model. We try to serve clients who walk into our offices (often coming to them via “word of mouth” publicity) regardless of their income or experience and will try and serve these clients as best as we can without having a “typical client base”.

Detailed Comments

Q3: Do you agree with the proposed method for the identification of the target market by the distributor?

No, we do not agree with the proposals for distributors and have listed our specific comments below and in our responses to the other consultation questions.

The current draft has a wrong understanding of distribution and of the business model of the intermediaries and advisers like us.

At the stage of product governance, no products are yet considered; they will be considered as part of an advised service where however suitability takes precedence.

We have serious question marks regarding the distributor-part of the product governance guidelines.

1. Relation between the product governance requirements and the assessment of suitability or appropriateness (p 26, point 29)

We refer to the obligation for the distributor to identify the actual target market and to ensure a product is distributed in accordance with the actual target market.

These are not level 1 or level 2 requirements for distributors that do not manufacture products.

We agree that product governance requirements and suitability/appropriateness requirements are not substitutable. The first set of requirements should largely lie with the manufacturer of the product and the second set of requirements with the distributor.

With the current draft proposals, ESMA however shifts requirements from manufacturers to distributors and puts extra requirements in the phase of the product governance process. ESMA seems to be effectively “replacing” suitability (or turn it into a box ticking process). This could indeed lead one to ask the question, if a product would be “by definition suitable” if it meets the product governance criteria.

2. Identification of the target market by the distributor: categories to be considered (p 26, points 30-35)

The draft guidelines do not reflect our business model. We try and serve our clients as best as we can without having a “typical client base”. The whole process starts with the client, not with the product. The clients are the ones that select us and not the other way around.

ESMA states that distributors should use (“at least” is added on p 9, point 26) the same 6 categories as manufacturers and define the target market on a more concrete level.

Distributors should on top of that conduct a thorough analysis of the characteristics of the client base (point 32+33 on p 26/27) and they “could use” any information at their disposal from other sources than investment or ancillary services (see p 27, point 33).

We believe that requiring this from distributors represents a serious confusion of responsibilities where the borders between the responsibilities and tasks of manufacturers and (non-manufacturing) distributors are confused and do not reflect the reality of the market. Such confusion is not beneficial for legal certainty.

Also, we believe that where distributors “should use any information and data deemed reasonably useful and available” (point 33, p 27) there is a risk of violation of fundamental rules such as data protection rules. Indeed, it may not even be legal for the distributor to use certain data.

The requirements also go into very much detail. ESMA should set out a basic framework but abstain from micro-managing firms’ processes.

We also wish to point out that (non-manufacturing) distributors do not currently have these data in a searchable form. They will have the relevant information but not necessarily in a database that is searchable by “experience” or “capacity for loss”. Putting existing clients in such a database will be costly and take a lot of time. There is also a cost in keeping it up to date (some criteria will change over time).

Finally, in particular regarding point 34, where the paper states distributors “may not just rely on the manufacturer’s target market without applying the appropriate scrutiny of how the target market defined by the manufacturer would fit to their client base”, we wonder what this would mean for UCITs products: what would and could a distributor have to add? Is the target market for UCITs captured in the KIID? If not, what granulari-

ty can the distributor possibly add? For many intermediaries and advisers, the main products they will work with are UCITs. We believe that in the case of these highly regulated products, it should be sufficient to check if the clients fit in the target market.

3. Identification of the target market: differentiation on the basis of the nature of the product distributed (p 27, point 36)

As mentioned already above, we agree as a general principle that requirements should be less onerous for the “ordinary mass retail market type products”.

4. Identification and assessment of the target market by the distributor: interaction with investment services (p 27, points 37-43)

As a specific comment, we would like to refer to point 40 (p 28) where we believe that the first sentence should be rephrased. Receiving “inducements from third parties” is not a conflict of interest per se. We therefore suggest deleting this example:

“This is especially relevant for products characterised by complexity/risk features (or other relevant features such as, for example, innovation), as well as for situations where there might be significant conflicts of interest (such as in relation to products issued by entities within the firm’s group or when distributors receive inducements from third parties), being also mindful of the limited level of protection afforded to clients at the point of sale by the appropriateness test (or no protection at all, in the case of execution-only).

5. Distribution strategy of the distributor (p 29, points 44-46)

We believe further clarification should be provided in the guidelines of the difference between target market and distribution strategy. We have problems understanding this concept of distribution strategy, especially for the smallest companies.

ESMA establishes two new responsibilities for distributors in point 44.

- 1) Distributors have to take the manufacturer’s distribution strategy into account
- 2) Distributors are expected to review the manufacturer’s distribution strategy with a critical look

These two new obligations are not in line with level 1 and 2 and are in practice not useful. MiFID II, Level 1 and 2 only ask distributors to take the target market into account. The distribution strategy of a product will include many different distributors or even different distribution channels.

A distributor does not need to know, nor has responsibility, for the whole distribution strategy of a manufacturer. A distributor needs to know the target market and how he/she is going to implement this in his own distribution strategy.

As an example: why should a purely offline distributor have to „critically look” upon the online distribution strategy of a manufacturer?

We therefore suggest changing the first sentence in paragraph 44 into: „The distributor has to take the target market of the manufacturer into account.“

Should however, the final guidelines keep this reference to the distribution strategy, we believe that in any case the wording “critically look” must be adapted as it is unclear and could imply liabilities for the distributor.

For the same reasons, we believe that in point 45, the words „distribution strategy” have to be replaced by „target market”.

We believe that in the identification of the distribution strategy/ channels, manufacturers should be obliged to allow distribution channels which they feel appropriate to distribute “dynamic products”, to also distribute or intermediate the products which have a less dynamic investor profile.

If this point is not explicitly made, manufacturers may feel obliged to segment products in such a way that it would lead to exclusive rights of some distributors for certain less “dynamic” products. This cannot be the intention of the rules. Quite to the contrary.

In point 46, it seems unclear why a distributor would have the right to generally distribute a product against the explicit wish of the manufacturer. We agree that it should be possible in isolated cases for a product to be distributed to an individual client even though he/she is not in the target market. But it seems strange to explicitly allow to generally set aside target markets. This raises the question why there should be a target market if the distributor may completely ignore it. We suggest deleting this paragraph.

6. Regular review by the manufacturer and distributor to respectively assess whether products and services are reaching the target market (p 30, points 47-50)

The draft guidelines (point 47) set the same review requirements for distributors regarding as for manufacturers.

This is not in line with MiFID II level 1 or 2. This sentence therefore should be deleted or replaced. If the intention is that distributors should review their own obligations, then

this should be clarified. The way the sentence it is currently drafted, seems to add all obligations of the manufacturer regarding regular reviews to the distributor.

In point 49, the second sentence is unclear: “Furthermore, distributors should consider data and information that may give an indication that they have wrongly identified the target market for a specific product or service or that the product or service no longer meets the circumstances of the identified target market, such as where the product becomes illiquid or very volatile due to market changes.”

Does this mean that we should collect data and information on the product? It is the responsibility of the manufacturer to provide not only the data and information but also the concrete changes in the target market.

7. Application of product governance requirements to the distribution of products that were manufactured before the entry into force of MIFID II (p 31, points 55-57)

The draft guidelines create an exemption for manufacturers for products manufactured before the entry into force of MiFID II (3 January 2018) and shift the responsibility for product governance requirements explicitly on distributors that distribute such products after 3 January 2018.

We believe it is not in the interest of legal certainty, nor is it proportionate (also considering liability issues) that distributors (of which many are micro- and SME- type) would indeed be obliged to provide a target market on day 1 and manufacturers not.

This proposal is outside level 1 and goes against every logic of product governance (in any sector of the economy), it is disproportionate and represents an enormous change in the level playing field.

We urge ESMA to delete this reference in points 56 and 57 (p 32) and state that (product governance requirements and in particular) providing the target market is the responsibility of the manufacturer as of 3 January 2018.

Still with regard to this part of the draft guidelines, we have understood that a possible approach to tackle this shift of responsibility and liability, is to incite manufacturers and distributor to enter into agreements. We would like to better understand this concept of agreements and their legal value.

Q4: Do you agree with the suggested approach on hedging and portfolio diversification aspects? If not, please explain what changes should be made and why.

It seems that this issue is not specifically referred to in the draft guidelines but the explanation is given on p 9-11 of the consultation document. ESMA states it is appropriate in the explanatory section of the guidelines to clarify that the target market assessment is product-related and aimed at a group of target clients.

We refer to our responses given to Q 3.

Q5: Do you believe further guidance is needed on how distributors should apply product governance requirements for products manufactured by entities falling outside the scope of MiFID II?

Distribution of products manufactured by entities not subject to MiFID II product governance requirements (p 30, points 51-54)

In point 51, the draft guidelines require distributors to perform due diligence when distributing products that are manufactured by firms that do not fall under the MiFID II product governance requirements.

We do not support this “reversal of responsibilities”. In some markets, this situation will mean these products will not be distributed anymore.

We also wonder what would be the situation of UCITS products? It was not intended, nor is there any indication in the level 1 Directive, that distributors should be responsible for the product governance for almost all the products sold to clients and this is what will be precisely the consequence in some member states.

This situation has to be clarified. It has to become clearer how proportionality will apply with regard to UCITs, distributed by small companies.

We understand that the fund manufacturers may have indicated a willingness to comply with the MiFID rules, but this does not give distributors any legal certainty.

In point 52, the way the first sentence is phrased: “where a product has not been designed in accordance with the MiFID product governance requirements”, gives another potential liability to the distributor that in case the manufacturer should have followed the MiFID product governance rules but did not (fully) comply, it is always up to the distributor to set the target market. It should be clarified that this is not the intention.

In point 52, examples are given of publicly available “acceptable information”. We believe that the last sentence of this point should not be phrased conditionally (“may be” be acceptable). Information in compliance with requirements of for example the Prospectus Directive “is” acceptable information that can be used.

Q6: Do you agree with the proposed approach for the identification of the ‘negative’ target market?

Regarding sales outside the (positive) target market, the draft guidelines state that such cases should be justified, the reason clearly documented etc. (see p 10, point 32 and p 33, point 61). What will be the consequences for the distributor if he/she motivates his/her choice “insufficiently”? Could the distributor’s choice be questioned by the manufacturer and could the latter “sanction” the distributor?

The draft guidelines also require the distributors to mirror the proposed requirements regarding the “positive target market” into identifying a “negative target market”.

The same comments we made regarding the “positive target market”, apply to what is proposed for the “negative target market”. The draft guidelines refer to distributors to make the “theoretical” negative target market more concrete, which also here transfers a responsibility to the distributors that does not belong there.

Regarding deviations from the (positive or negative) target market, we do not believe that every deviation should be reported (p 33, point 65). Reporting deviations should be proportionate to the risk of a product and its frequency.

Q8: Do you have any further comment or input on the draft guidelines?

1. Definitions

On p 21, point 6, the draft guidelines define “distributor” as: “a firm that offers, recommends or sells an investment product and service to a client. »

Following the logic which is reflected in recital 15 of the MiFID II Delegated Directive that is referred to (which uses « services » in plural), « products » and « services » should be used in plural to make clear that a firm does not sell a product and a service but that it can be a combination of products and/or services.

The definition would then be as follows:

a firm that offers, recommends or sells an investment products and services to a client. »

2. Proportionality

As a general comment, we believe that the final guidelines should not only make reference to proportionality but also effectively apply proportionality within the text of the guidelines. We refer in this respect to all our above comments regarding the shift of responsibilities from manufacturers to distributors, where proportionality is missing.

Also with regard to proportionality, we note that on p 5, point 8, the consultation paper states that: “These guidelines should be applied in a proportionate manner, taking into account the nature, scale and complexity of a firm's business and the nature and range of financial services and activities undertaken.”

We obviously support a specific reference to proportionality. On p 22 however, in point 11 of the draft guidelines, it is stated that the guidelines should “be applied in a way that is appropriate and proportionate, taking into account the nature of the financial instrument, the investment service and the target market of the product.”

Annex 2 – Cost Benefit analysis (p 16-19)

The consultation documents states on p 17, point 6 that market participants will benefit from increased legal certainty and a harmonised application of the requirements across Member States.

We strongly disagree, our company will not benefit from the draft distributor guidelines as they are currently phrased.

Manufacturers may indeed benefit from them but for (non-manufacturing) us as intermediaries, considerable and disproportionate extra duties are created, with only costs and no benefits attached.

Regarding the reasoning behind the choice of instrument of guidelines (p 19, point 17), the current proposals go far beyond the level 1 and 2 of MiFID II. This is not the purpose of guidelines.

Annex 4 - Illustrative examples and case studies related to the application of certain aspects of the guidelines

We agree that providing case studies may be useful and therefore ask to add a case study of a UCIT Fund.

Q9: What level of resources (financial and other) would be required to implement and comply with the Guidelines (market researches, organisational, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? If possible please specify the respective costs/resources separately for the assessment of suitability and related policies and procedures, the implementation of a diversity policy and the guidelines regarding induction and training. When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.

The draft guidelines add disproportionate responsibilities and costs to mainly micro- or SME- type (non-manufacturing) distributors and reduce the responsibility and costs for manufacturers. It is unclear why guidelines would require distributors to repeat tasks already done by regulated manufacturers.

By extending the involvement and responsibilities towards distributors, the costs in general of the product governance process will increase.

This will push the market to reduce the amount of distributors and therefore reduce the chance for tailored guidance (be it “independent advice” or another form of tailored guidance) for clients.

See also our response to Q 3 on the cost of applying the categories for distributors.

Best regards

Josef Weichselbraun

Mag. Reinhard Puntigam

Members of the Board