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Via website upload  
European Securities and Markets  
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Response to ESMA's Consultation Paper – Draft guidelines on MiFID II product governance requirements  
as of 5 October 2016

Ref.: ESMA/2016/1436

Dear Sir or Madam,

~~Thank you for providing us with the opportunity to respond to ESMA's Consultation Paper in relation to draft guidelines on MiFID II product governance requirements as of 5 October 2016 (ESMA/2016/1436). We would like to share the following comments with you:~~

#### 1. General comments

We support the aim of the consultation paper to have manufacturers and distributors act in their clients' best interest during all stages of the life-cycle of product and services.

From our point of view based on the German market, we think that some of the new product governance requirements may be interpreted in a way which may severely limit investment opportunities for private investors they had before. We do not see that these interpretations would result in increased benefits for private investors. We are doubtful that such interpretations would be in line with the relevant legal requirements such as the MiFID II directive and Commission delegated directive on which the final ESMA advice would be based on.

New product governance requirements should be able to be processed by IT systems of manufacturer and distributors as far as possible, so they should be standardised. Tailor-made requirements by the manufacturer which would have to be processed in a non-automated way by the distributor would significantly increase the costs of distribution and lead ultimately a reduction of or much more expensive investment opportunities for private investors. This view is based in particular on the experiences in the German market in which German regulation ~~gold plating MiFID I in recent years have led to such reductions. Consequently, we think that manufacturers should be allowed to generally avoid providing tailor-made target market requirements.~~

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2. Q1: Do you agree with the list of categories that manufacturers should use as a basis for defining the target market for their products? If not, please explain what changes should be made to the list and why.

In general, we agree with the list of categories to be used by manufacturers. However, we would like to point out that in the German market we typically have a so-called "open architecture". This term is used for a market development that took place in the last one to two decades and led to a mature market which is very favourable for retail investors. It describes a situation with (comparably) few bilateral distribution agreements between manufacturers and distributors. In an "open architecture" distributors sell independently the best products offered by many manufacturers in an open market. A result of this highly competitive market is a high diversity in product offerings of good quality and low prices. From a regulatory point of view, the open architecture serves to reduce conflicts of interest in distributing products to retail clients. An open architecture can only work effectively using a standardised format to exchange target market data.

An exchange of not standardised categories beyond the minimum six categories will lead to the following problems:

- No (semi)automated exchange of target market data and no efficient process in matching target markets of flow market products with client target markets. This would severely hamper the open architecture and its inherent benefits for investors.
- Frequent use of individual target markets by manufacturers may result in difficulties for distributors to objectively come to the same target market conclusion for the same products. Potential investors might be irritated to have a financial instrument offered by one distributor and being denied the same financial instrument by another distributor when wanting to compare prices. We also see the risk this situation may result in an (unwanted) competition between manufacturers to find the additional target market categories that work best in promoting the product.

In this respect we expect the use of additional target market categories (according to paragraph 15) only in exceptional cases. Especially for flow products – even when deemed to be complex – we would expect that manufacturers would not make use of additional target market categories.

Regarding the individual target market categories we would like to make the following remarks:

- Type of clients: We agree that the category should include the three types of clients categorized in MiFID. From our point of view, additional descriptions would not provide added value. We think that the sample descriptions mentioned in the consultation paper support our point of view. "Private wealth clients" are usually clients with significantly more investable assets than a mass retail client. This aspect of larger assets should be solely covered by the category "financial situation". If this would also be covered by the category "type of clients" we see only operational risks by unclear descriptions and processes and no corresponding benefits by additional clarity. Similarly, "sophisticated clients" have above average knowledge and experience when compared to the average mass retail investor, this aspect should be covered alone by the relevant category "knowledge and experience". We had considered internally the description for type of client of "corporate client using an OTC derivative for hedging purposes" as potential sub-type of client but now think that the objective of these clients is much better reflected in the category "client's objective". We also feel that our above interpretation is more in line with the inherent logic of the six categories.

- Knowledge and experience: We believe that for the manufacturer's target market three simple sub-categories such as low/medium/high should be used. More elaborate descriptions would lead to increased risk without providing corresponding additional benefit to the retail investor. From our point of view, both knowledge and experience serve to indicate the end investor's understanding of the product. Lack of experience would not prevent sufficient understanding of the retail investor if he has adequate knowledge. Therefore, it should be made clear that sufficient knowledge can always compensate lack of experience. Otherwise, unexperienced retail investors would be shut out from products because they never have a chance to accumulate experience in these products.
- Financial situation with a focus on the ability to bear loss: We agree that in this category it should be indicated which risks target clients would be able and willing to afford, so "normally only minor loss", "up to total loss", "additional payments" (for OTC derivatives with no invested amount, e.g. swaps) and "total loss of invested amount and additional payments" should be included. NB that the description should be clear that "only minor loss" is based on normal conditions because even investments widely considered as risk free such as certain EU government bonds may lead to very significant losses up to total loss in certain situations.

We do not think that it provides added value to let the manufacturer suggest a maximum proportion of net investable assets since such portfolio aspects cannot be adequately commented on by the manufacturer who will normally not have any information on the end retail client's portfolio composition.

- ~~Risk tolerance: From our point of view, risk tolerance should be indicated by a number ("1" to "7") which would be a clear and simple indicator. We strongly agree with your proposal that the risk indicator as stipulated by the PRIIPs Regulation should be used if available. Alternatively, the UCITS risk indicator should be used. For financial instruments not covered by the PRIIPs Regulation or UCITS Directive, the number should be calculated using the methodology described in the PRIIPs Regulation. We refer to the European Commission's study "Consumer testing study of the possible new format and content for retail disclosures of packaged retail and insurance based investment products", 2015, p. 198 which supports our point of view.~~

The risk-attitudes described in the consultation paper, e.g. "balanced" or "conservative" may lead to misunderstandings even if they would be described in further detail so we think wording should be avoided which would make these mandatory for the manufacturer's target market. We understand that the distributor may "translate" risk indicators into descriptions used by the distributor such as "balanced" or "conservative" and think that such a translation is helpful for many retail investors.

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

Referring to p. 28, paragraphs 40 – 42, we understand that in the assessing of the target market by the distributor, for some complex products it has to be reviewed if distribution on a non-advised basis is possible. To this, we have the following comments.

We understand that based on a comparison of complex products available on the German market, there are complex products which are less complex, more mainstream products (e.g. reverse convertibles with a blue chips equity underlying) for which there is no reason to restrict distribution on an advisory-only basis.

For complex products with special features (paragraph 40: e.g. special complexity/risk or innovation, the product described on p.36 in case study 1) it would have to be considered if only a sale on advisory only basis would be permitted. We believe that instead of a restriction to advisory-only distribution, other arrangements to ensure adequate investor protection would be possible (e.g. documented warnings or risk disclosures, non-advised distribution to clients with advanced knowledge and experience etc.). Many of the German private investors that purchase complex products are sophisticated and do not require and also do not wish to receive any advice. In addition, for such investors timing and speed of the execution is very important; mandatory investment recommendations would significantly decrease timing and speed of execution. We would also like to point out that the restriction to "advisory only" in more complex products would result in a de-facto product ban as commercial banks typically do not have the resources to provide proper advice for a large number of complex products with special features – in contrary to investors who often have very detailed knowledge and experience in a very specific market and/or financial instrument. This view is supported by the fact that we are not aware of significant complaints regarding complex products sold without advice compared to advised transactions.

We also think that the manufacturers should not include any guidelines how distributors should present information on their websites since we do not see any added value for the end investor. From our point of view, indicating a preferred acquisition channel such as face-to-face etc. for non-advised distribution is not necessary since all three distribution channels indicated in paragraph 20 are working satisfactorily in the open architecture used for such distribution in Germany. In particular, retail investors with additional information needs have adequate options to obtain additional information, e.g. by receiving such information on a face-to-face basis by their distributor.

**4. 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.**

We agree with the suggested approach on hedging and portfolio diversification aspects as described in paragraphs 31 and 34. From our point of view, in case of target market deviations such as described in paragraph 31 for the purposes of diversification, there should be no obligation for portfolio managers to report such deviations to the manufacturer if such deviations occurred in line with the relevant investment guidelines agreed by the portfolio manager and its clients.

We believe that some wording changes might further increase the clarity of these texts:

- Paragraph 31: current wording is "(the client may therefore invest only in instruments that are "risk category 5" or below)". We suggest the wording should reflect more clearly that "risk category 5" refers to the average risk of included instruments and does not indicate a maximum risk level per instrument. Otherwise we think the investment advisor would provide a recommendation outside the client's investment objectives. Also, the "very risky structured note" should have a risk category of no more than 7, in line with the maximum Summary Risk Indicator according to the PRIIPs regulation.
- Paragraph 54: current wording is "The same Interest Rate Swap could also be targeted at clients with an adequate understanding of the instrument and the need of protection against interest rate risks inherent in other investments already within their portfolio of assets." We suggest to delete the underlined wording since according to our understanding of Interest Rate Swap transactions conducted with smaller corporates MIFID-categorised as retail clients in Germany, these clients do not hedge interest rate risk resulting from

