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BVI[1] position on ESMA's consultation paper (CP) regarding draft guidelines on MiFID II product governance requirements

MiFID Product Governance rules have the potential to significantly alter the distribution landscape of financial instruments including fund units. BVI therefore very much welcomes ESMA's consultation on the draft guidelines regarding product governance requirements. While we appreciate that fund management companies are not obliged to fulfil the product governance requirements unless they render the MiFID services of individual portfolio management, investment advice, safe-keeping of fund units or reception and transmission of orders in other financial instruments, fund managers will have to provide distributors with product governance information for business reasons.

ESMA's approach to the product governance requirements is generally helpful in providing guidance for the implementation. A coherent approach of the target market requirements is crucial for a successful implementation not only for asset managers and market participants but in particular for investors. In this regard, specific wording as well as suggestions that could be read into the guidelines should be amended in order to achieve the objectives of the product governance requirements, i.e. enhancing the level of investor protection by requiring firms to take responsibility from the conception of a product until it is no longer available for the market. In particular, **the approach should not jeopardise investors' access to diversified portfolios and a competitive market**. It is decisive that in case of portfolio management, the focus is on the manager's responsibility to ensure the compatibility of the portfolio with the needs, objectives and characteristics of the client. An approach requiring each and every product to be compatible with the target market also in case of portfolio management ignores the benefits of diversification to the detriment of investors.

Furthermore, it is crucial to **keep the complexity to the minimum required in order to achieve investor protection**: the more complex the requirements are, the more likely distributors will significantly reduce their spectrum of financial instruments which are offered to investors today. For any "qualitative criteria" and discretionary "add-ons" a single **IT readable target market concept** will be difficult to establish. In particular manufacturers offering products cross-border or generally having hundreds of different distribution partners, it is vital to be able to use IT systems as far as possible. If this cannot be achieved, this will have a significant impact on the cross-border distribution of funds and the availability of products throughout the European Economic Area, thereby endangering any potential benefits deriving from the EU Commission's aim to increase competition in the fund market.

In this regard, we note that most of the wording ESMA uses focuses on complex products. While we appreciate that it is important to enhance investor protection for these products, **target market requirements apply to all sorts of products including very basic products**, such as a standard European Equity fund. We are sympathetic that ESMA needs to ensure that there is no misuse of such products. However, ESMA should ensure not to limit investors' access to common mass market products by using a wording which is drafted mainly with a focus on a potential risk of complex products being mis-sold.

[1] BVI represents the interests of the German investment fund and asset management industry. Its 98 members manage assets of some EUR 2.8 trillion in UCITS, AIFs and discretionary mandates. As such, BVI is committed to promoting a level playing field for all investors. BVI members manage, directly or indirectly, the assets of 50 million private clients in over 21 million households. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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We also appreciate ESMA's effort in aligning the target market concepts with the requirements according to the PRIIPs Regulation as well as the IDD. This should be pursued in order to facilitate effective implementation and investor protection by the target market regime for all investment products.

Q1: Do you agree on the list of categories that manufactures 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.

Conclusive list is decisive: As a general remark, we encourage ESMA to clarify that the list is conclusive. We believe that any other aspects of the target market which should be considered could be added as a subcategory in the existing comprehensive list of criteria. Any case-by-case approach would also jeopardise the practicability of the target market concept, thereby likely restricting the number of products available for investors.

IT-readable criteria: While we understand that manufacturers should base their assessment on both quantitative and qualitative criteria, we urge ESMA to clarify that such assessment has to be clearly distinguished from the result of such product assessment, i.e. the information to be shared with the distributors. Again, this has to be provided through IT systems and hence qualitative information cannot be shared.

Distinction between manufacturers' and distributors' knowledge: Although the list generally can be used in practice, the description of the categories could reflect better that the manufacturer has information on the product and no detailed, specific or individual information on clients. Further, we recognise that ESMA does not clearly distinct between the suitability test to be made in case of portfolio management or investment advice on the one hand and the product governance process including the target market determination on the other hand. Criteria for product manufactures should hence focus on the product features, while distributors should use those product features as described below (Q4) in order to match the target market with their client base. ESMA points out correctly that the manufacturers usually do not have direct client contact and therefore can only base their target market identification on theoretical knowledge. Consequently, their focus is on the features of the product and not the client's characteristics. In general, it is also important to allow sufficient room for first-time investors to be able to invest in MiFID products other than government bonds. For instance, an unstructured, unleveraged UCITS investing in European standard equities should be a financial instrument available for first-time investors.

Remarks regarding specific criteria: While we do not have specific comments on the criterion "client type", we would like to raise the following practical considerations regarding the other criteria:

- **Knowledge and experience:** We appreciate that the wording allows for taking product specifics into account. However, in order to have an IT-readable approach, it will be necessary to define subcategories such as "basic", "informed" and "specific knowledge/experience" regarding products, e.g. in case of additional payment obligations. Where relevant, the product specifics as suggested by ESMA could be taken into account when allocating the products to each group. We understand that such an approach would be in line with the proposed guidelines. Furthermore, investors do not need to have both knowledge and experience in all cases. In particular first-time investors do not have any experience. They should, however, be able to buy simple financial instruments without those being distributed outside the target market. Furthermore, regulations require specific offering documents such as a PRIIPs KID or a UCITS KIID. Those documents have to be made available in order to provide the investor with the knowledge he requires to understand the risks and potential outcomes of an investment in a financial instrument. It is important to bear in mind that the investor does not need to understand each element of the investment strategy.

- **Financial situation and ability to bear losses:** We appreciate that ESMA takes into account the limitations of manufacturers' knowledge of the clients' specifics. In this regard, we strongly support ESMA's approach not to require mandatory disclosure of the maximum proportion of the client net assets he should invest. It would simply not be possible for the manufacturer to determine this on an abstract level in a way beneficial for investors since their financial circumstances may vary significantly depending in particular on the income, the personal situation including any alimony responsibilities, pension entitlements and assets.

  Furthermore, Case study 2 in Annex 4 shows that ESMA does not require a specification of the amount of loss the investor should be able to bear. In our view the guidelines' wording does not yet reflect the approach. Consequently, the first sentence of paragraph 16 (c) of the guidelines should be amended as follows:

  > "*The firm should specify* ***, in general terms,*** *the amount of losses target clients should be able and willing to afford (for example, from minor loss to a total loss) (…)*."

  The current wording – although not reflected in all of ESMA's examples – could be read as a mandatory requirement to provide a percentage figure of potential loss. For this, it is important to bear in mind that market conditions may in exceptional circumstances (such as the dot com crisis or 9/11) lead to losses which under normal market conditions would generally not occur. Would manufacturers be required to provide a percentage figure, they would possibly have to take exceptional circumstances into account for liability reasons which consequently would limit the significance of the information for investors. Consequently, manufacturers should be required to determine whether the investor can bear losses (specifying whether those are e.g. minor) or whether he would even be able to make additional payments.

- **Risk tolerance and compatibility of the risk/reward profile of the product with the target market:** We generally agree with the approach. The synthetic risk indicator according to the PRIIPs Regulation is based on a thorough assessment of a PRIIP's risk and is the regulator's choice to present investors the risk of a PRIIP. Consequently, the risk section according to the PRIIPs Regulation should be sufficient to describe the risk tolerance and compatibility of the risk/reward profile of the product with the target market. In this regard, we suggest that the last sentence of the guidelines should read:

  > "*Firms should* ~~***also***~~ *use the risk indicator stipulated by the PRIIPs Regulation, where applicable, to fulfil this requirement*."

  It should be clear that for UCITS and AIFs which are exempt from the PRIIPs Regulation, the risk/ reward indicator as foreseen by the UCITS KIID Regulation could also be used, where applicable.

- **Clients' Objectives:** We believe that there should be a clear distinction between the personal objectives a client can have and an investment objective a product can provide. While manufacturers can provide the latter, they would not be able to categorise personal objectives. Clients' objectives should be translated into criteria which can be read by IT systems and therefore need to be clearly defined. Investment objectives of products are often distinct as follows: Preservation, Growth, Income and other (which e.g. could include speculative products). In addition, investment horizon could be a sub-criterion which would describe the target market. Both criteria would for instance also translate ESMA's example of "retirement provision", i.e. the question whether the investor needs his money back at a specific time (investment horizon) with a specific probability (preservation).

- **Clients' Needs:** The examples provided by ESMA describe specific situations. We therefore understand that the criterion could also be filled in with a statement: no specific needs in case the product is properly described with all the aforementioned criteria.

Q2: Do you agree with the approach proposed in paragraphs 18-20 of the draft guidelines on how to take the products' nature into account? If not, please explain what changes should be made and why.

We generally agree with ESMA's approach in paragraphs 18 to 20. It is our understanding that the assessment described in paragraphs 18 and 19 would be the approach applicable to the determination of the target market criteria as described in paragraph 16. We understand that e.g. for mass retail market products, manufacturers would still have to consider all of the criteria; however, they could do this with less detail. In addition, the information for the distributor could comprise of less than every single criteria unless the specific information is relevant.

Furthermore, we very much appreciate ESMA's approach for tailor-made products as described in paragraph 20. **It is important that tailor-made products are not subject to a target market identification or assessment which has its focus on products distributed more widely.**

Nevertheless, regarding paragraph 21 et seq., we understand that ESMA has specific types of products in mind such as CFDs (this is in particular shown with the example provided for in part 2, paragraph 21, page 8 of the CP). We ask ESMA, however, to be considerate of the wording in paragraph 21 et seq. of the guidelines and not base the wording only on these specific types of products. For many products, e.g. non-structured UCITS, it is sufficient for the manufacturer to determine the distribution strategy by proposing the type of investment service to be used. Whether such service is provided via phone or face-to-face or online should in these cases not make any difference since MiFID requirements depend on the type of service, not the way how it is provided. In addition, we think that the guidelines should be technology neutral in order not to discriminate technologic developments. Whether a product is sold without advice but with appropriateness test either over the phone, the internet or face-to-face should not make any difference since the same regulatory requirements apply. Clearly, it is the distributors' decision which acquisition channels their clients would expect for such type of product. A general requirement for the manufacturer to specify the set-up of the distributors' websites seems inappropriate for most of the products.

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

We do not agree with ESMA's approach regarding determination of the target market by the distributor (1.). Further, we understand that ESMA's approach regarding interaction with investment services does not contradict the decision in MiFID II Level 1 to allow for certain products to be distributed by way of execution only (2.).

1. Distributor's target market determination only required in specific circumstances

ESMA indicates that distributors would have to determine a target market on their own for each and every product. Should ESMA pursue this approach, the range of products available to investors and the competition between products will decrease significantly. We urge ESMA to reconsider this approach for the following reasons:

- **No additional benefit for investors:** We do not believe that a separate target market assessment by the distributor would be of any advantage to investors. As pointed out by ESMA, the manufacturer is aware of the products features and the product specifics. Distributors, however, are aware of their client base and need to understand for what group of clients the product would be compatible regarding needs etc. Distributors should use the manufacturer's target market definition in order to determine (i) whether they have clients with whom the products would fit, i.e. whether they will distribute the product at all and if yes, to whom, and (ii) decide on the way they will distribute the products (actively, on request, etc.). A specific definition of the target market in addition to these requirements would not provide further benefits to investors. Any approach where the distributor would have to refine the manufacturer's target market identification would disregard the fact that distributors often do not sell products on a standalone basis but as part of a portfolio. While the manufacturer usually has no insight on how a portfolio is constructed, the distributor often does. A redefinition of the manufacturer's target market would consequently not take into account that distributors have the client's view at hand.

- **Administrative burden will reduce investors' choice and market competition:** Distributors would have to bear a huge administrative burden for products they decide to distribute. Consequently, distributors would reduce their range of products to be able to deal with the operational complexity, thereby reducing investors' choice and affecting competition of products and open architecture. This would also likely have a higher impact on smaller and medium sized manufacturers since distributors would have to reduce the amount of relationships with manufacturers and would likely reduce those with smaller manufacturers first. Likewise smaller and medium sized distributors would have to find a way to manage operational complexity and might therefore even be required to reduce their product range even more than larger distributors.
- **Risk of possible contradictions to the detriment of investors:** The current draft Level 2 measures of the PRIIPs Regulation require manufactures to describe the target retail investor. The description of the target retail investors' features as stipulated by the text is very much alike to ESMA's proposed criteria for the identification of the target market. Consequently, the investor will in future be informed of the target clients (i.e. the target market) in the PRIIPs KID. Any deviating definition of the distributor's target market would be inconsistent and confusing for investors. Furthermore, a redefinition of the target market could lead to different outcomes at different distributors for the same product. Again, this could confuse investors. For example, an investor could then be able to buy a product with one distributor but not the same product with another although the latter offers the product generally, just because he has defined the target market of the product differently.
- **Not legally required:** Furthermore, additional target market identification by the distributor is neither required explicitly nor is it line with the objective of the target market concept. According to MiFID II Level 1 (Art. 24 para. 2 subpara. 2), distributors need to take into account the target market provided by the manufacturer. Level 2 provides that the distributor should determine the target market even if it was not defined by the manufacturer. The difference in the expression ("determine" vs. "defined") already shows that the distributor's tasks do not need to be the same as the manufacturer's. For instance, while the manufacturer could be required to define the target market according to ESMA's proposal, the distributor could just be required to assess whether and with whom of its client base such target market fits. Furthermore, the wording in Level 2 in Art. 10 para. 1 subpara. 3 of the Delegated Directive has to be read in conjunction with Level 1. This wording has to be understood as clarification that distributors need to define the target market for products where no target market has been defined by the manufacturer, reading the expression "even" as "although". This is also shown by the context of the explicit wording of Art. 10 para. 1 subpara. 3 which directly follows the description of situations where the manufacturer is not a MiFID firm in subpara. 2.

The requirement for distributors to identify a target market according to the same criteria as the manufacturer should be limited to the situation where the manufacturer does not provide a target market on its own. The target market requirements will increase investor protection insofar as manufacturers will have to ensure that they consider the typical investor when designing their products. The distributor on the other hand will have to consider that target market when deciding which parts of his clients fall within the target market, if any. Consequently, he would have to decide if and by what service to which group of his clients he would distribute the products. A separate definition of the target market, however, is neither necessary nor helpful for this concept. This would result in an inappropriate administrative burden without any benefit for or even to the detriment of investors.

2. Execution only service remains possible

Furthermore, we understand the interaction between target market and distribution services as follows: The distributor decides on the basis of the manufacturer's target market identification whether he will distribute that product. In a second step, he decides how he will distribute the product, i.e. advised only or (also) without advice but with appropriateness test or even execution only without appropriateness test. Should he decide to distribute the product execution only, he should bear in mind that there will be no matching with any client information. MiFID II indeed allows certain products to be distributed by execution only. This must also be the case when distributors have no client information whatsoever since the execution only is the sole service they provide. In this regard, we support the guidelines in paragraph 39 where ESMA clearly states that the distributor cannot even assess clients' knowledge and experience in case of execution only. We appreciate that distributors might voluntarily decide to match some client information they have also in case of execution only. This would allow distributors to offer a wider range of products since they are able to determine their clients' base more precisely.

The same must be true for distribution with appropriateness test in case the distributor uses more information than just clients' knowledge and experience.

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.

While we appreciate ESMA's considerations regarding in particular portfolio diversification and also hedging, this approach is not yet properly reflected in the guidelines. Further, we agree with ESMA's statement that the target market assessment is product related – but only for products. Insofar as a target market has to be provided for a service, the MiFID firm should only be required to take the target market into account at the service level. **In this regard, we do not feel that the ESMA guidelines would be the proper place to clarify the requirements for a target market regarding services.**

It is in particular important for the investment service of **portfolio management** that the target market has to be assessed at portfolio level. **In this regard, we strongly disagree with the notion that for every product considered for the portfolio management a thorough target market assessment is concluded** (para. 43 of the draft guidelines). This approach would be gravely detrimental for investors, does not distinct distribution services and portfolio management properly and is not required by law:

- **Look-through approach contradicts the benefits of a portfolio diversification**: For the service of portfolio management, an investor delegates the decision on the purchase of the individual instrument to a professional. This is to entrust building up of a diversified portfolio to a professional with the intention to reduce unsystematic risk in a way the investor would not be able to do it himself. An approach that would require every product to be placed within a portfolio managed by a professional to be in line with the target market would not reflect the best interests of investors seeking a diversified portfolio of investments. In particular given the fact that for the investment advice each and every instrument has to be suitable, the investment possibilities of an investor are limited. Consequently, the investment advisor is legally limited in building a portfolio in particular for a first-time investor. In practice, first-time investors not only comprise young people who want to invest their first spare funds but also clients who have to build up wealth for a certain time. Practical examples are clients who always have invested money in their own business or in real estate or those who inherited it. A portfolio manager should be able to build a portfolio without being limited to only offering these types of investors only a limited range of low-risk investment options such as government bonds. When defining the target market, the manufacturer will look at the product without any enhanced view how it might be used in a portfolio. Though the manufacturer may describe that the product should only be purchased as part of a portfolio, he will never be in the position the portfolio manager is when deciding whether a product fits into the specific portfolio taking regard to the needs and investment objectives of a particular client.

- **Prudent hedging strategies would be inhibited:** Portfolio managers, being considered as professional investors under MiFID for good reason, might want to engage in more elaborate investment strategies comprising hedging mechanisms in strive for better returns for their end investors. By example, a portfolio manager might see high potential in a small-cap stock, the target market of which does not fit with the end investor. In order to hedge against excessive loss risk, the manager wants to acquire a corresponding put option, the target market of which would neither fit with the end investor. In combination, however, these two assets would end up with an "aggregate" target market which fits perfectly with the end investor. It would be detrimental for the end investor if such strategies were inhibited because the target markets of the assets individually do not fit with the end investor.

- **Regulatory circumvention seems unlikely:** We understand that ESMA fears portfolio managers could misuse the requirement to match the target market at portfolio level only and buy products for the client which are outside the target market or even unsuitable without any proper reason. While this would fundamentally violate the portfolio manager's fiduciary duty as stipulated by MiFID, UCITS Directive or AIFMD respectively and supervised by NCAs, a look-through approach on a product level is not the proper way to avoid such violation. MiFID II already adds additional safeguards to limit the incentives of a portfolio manager for such violation, in particular the ban of inducements for portfolio managers. The investor furthermore specifies in the investment management agreement detailed investment guidelines, i.e. the framework in which the discretionary portfolio manager may operate. It is out of the question that the portfolio manager has – when setting the investment guidelines – to act in the client's best interest. In addition, the manager has to ensure that the portfolio as a whole is at all times suitable for the client and consequently has to build a portfolio which meets the client's interests.

  Furthermore, ESMA should bear in mind that even investors with a low risk appetite have an interest and should be able to invest in high risk products if these are only a component of their overall portfolio if this fits within the overall portfolio. We fear that ESMA's intention to protect investors with a strict application of the target market assessment will in fact limit investors' choice in a way that is detrimental for them.

- **Portfolio management is no distribution service:** Considering portfolio management simply as distribution service would not do justice to the specifics of this service. Portfolio management is not about selling products to investors but is about providing a service to the investor where the portfolio manager is bound by his mandate and in particular his fiduciary duties. Unlike distribution services where products are sold, the portfolio manager buys **on his own discretion** products which he considers fitting into the investor's portfolio. Distribution services should rather be those services where the ultimate decision to buy a product is indeed made by the investor.

- **Not required by Level 2:** Besides these practical considerations, it is important to clarify that the suitability test within the financial portfolio management does not require that each and every product is suitable. In this respect the relevant provision in Art. 54 para. 2 sentence 2 of the draft delegated Regulation reads as follows: "(…) that the specific transaction to be recommended or entered into in the course of providing a portfolio management service (…) meets the investment objectives of the client in question, including client's risk tolerance (…)". The wording does not refer to the specific product, i.e. by stating that the specific product as such has to meet the client's investment objective. It is clear that for the transaction, suitability has to be assessed. In the case of portfolio management, however, the client does not enter into individual transactions, but delegates the management of his portfolio to a portfolio manager. Hence, suitability has not to be assessed against the individual product to which the transaction relates. Instead, it has to be assessed against the portfolio under management as a whole. This becomes apparent from the criteria for suitability testing in Art. 54 para. 2 lit. c) according to which the client's knowledge and experience shall be sufficient in order to understand the risk involved in the transaction or in the management of his portfolio. It should be clear that the second alternative applies to portfolio management and hence implies a suitability test at the portfolio level. Hence, the same concept has to apply for the target market assessment.

We consequently urge ESMA to reconsider the approach to target market assessment regarding financial portfolio management. We generally believe that the criteria for the target market identification work well with respect to products. However, with regard to services, target market identification according to these criteria is not the proper approach to match the customers' needs and objectives. We therefore ask ESMA to reconsider the scope of the guidelines insofar as services should not be covered. ESMA could clarify the approach for services at a later stage, e.g. through Q&As.

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?

ESMA provides in our view sufficient guidance. ESMA's approach, however, should take into account MiFID II Level 1 which clearly states that the distributor is required to define a target market only in case the manufacturer does not provide him with the information he needs. Management companies for instance have an interest to provide distributors with the target market information. If distributors needed to define the target market on their own, the same product could have a different target market with every distributor. Management companies have a genuine interest that investors do not receive deviating or even conflicting information on their products. We believe that in fact the management companies will provide the distributors with a target market in a similar way that MiFID firms will be required to do. Furthermore, we understand that MiFID distributors would be under no legal obligation to provide non-MiFID manufacturers with sales information but may do so out of commercial considerations.

Regarding ESMA's approach to the application of product governance requirements to products that were manufactured before the entry into force of MiFID II, we generally agree with ESMA's statement in paragraphs 55 to 57. We understand, however, that if non-MiFID II manufacturers would provide the distributor with a target market of the product in time (even if not legally required) before 3 January 2018, distributors could follow the general rules applicable to them. Again, in this regard, we urge ESMA to reconsider the position regarding a separate definition of the target market (see answer to question 3).

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

We have difficulties understanding ESMA's approach regarding sales outside the target market as described in part 2, paragraph 21, page 8 of the CP. If sales outside the target market can only be justified by the individual facts of the case, the identification of a negative target market would have nearly no scope in practice. MiFID II Level 2 though requires manufacturers to identify any groups of clients for whose needs, characteristics and objectives the financial instrument is not compatible. We therefore believe that the mechanism as foreseen in MiFID II Level 2 allows sales outside the target market generally without limitation; however, sales to a negative target market should generally not occur. Only based on this understanding a negative target market and the general idea of target markets as well as the possibility for distributors to sell outside the target market fit together. Because otherwise, the negative target market could simply be the reverse of the positive target market. Furthermore, from a practical point of view it is important to allow first-time investors the appropriate range of products. With its approach ESMA risks that investors without experience and knowledge will not be in the position to build up wealth but will be required to stick with low interest government bonds. If ESMA pursues this approach of sales outside the target market, the product range available for investors will be reduced significantly. Moreover, we understand that for products which are designed for the mass retail market, the negative target market assessment could result in "none" that there is no client group identified to whom that product should not be distributed.

Q7: Do you agree with this treatment of professional clients and eligible counterparties in the wholesale market?

Should ESMA not review its position regarding portfolio management (cf. Q4), it is of the utmost importance to at the very least provide more specific flexibility for professional clients. In practice, this is in particular important for portfolio managers who manage investment funds as a delegated function for a UCITS or AIF management company (1.) and for cases where a fund manager provides individual portfolio management when a fund wrapper would be the less interesting option for the client (2.).

1. **Delegation of fund management to asset manager**. Where a fund manager delegates the asset management functions to a third party, this delegated party provides the service of individual portfolio management to the management company according to the EU Commission[2]. Consequently, ESMA's considerations regarding target market for portfolio management are of significant relevance for the delegation of fund management to a third party. If a portfolio manager would have to ensure that every transaction is generally within the target market for the fund management company as client of the MiFID service, this would be without any further benefits for products which are covered by other European and national frameworks and where the delegation of the function of portfolio management is subject to detailed rules.

    - **Rules covering fund management and delegation.** UCITS Directive and AIFMD set specific standards for the delegation of collective portfolio management. This includes that the portfolio in its entirety would have to comply with the fund rules. In case of UCITS the fund rules are harmonised on a European Level. This regime foresees eligible assets, investment limits and other minimum requirements for fund rules. The same is true for retail AIFs in many jurisdictions. In Germany, for instance, similar rules apply to retail funds whose fund rules have to be approved by BaFin. Furthermore, the delegation rules require the fund management company to monitor and control the performance of the engaged portfolio manager. The management company has a set of instruments such as control and access rights to supervise and instruct the portfolio manager. Moreover, the management company and hence also the portfolio manager are required to establish, implement and apply written policies and procedures on due diligence and implement effective arrangements for ensuring that investment decisions on behalf

[2] See FAQ MiFID I, ID 235 http://ec.europa.eu/finance/koel/index.cfm?fuseaction=question.show&questionId=235.

of the funds are carried out in compliance with the objectives, the investment strategy and any risk limits of the fund.

- **Administrative burden.** A look-through approach would in addition to the pre-investment due diligence require the external portfolio manager to implement the target market assessment on an instrument level within its investment process. Exemplarily, this would include the following steps:
  - Extract Target Market data per instrument
  - Capture Target Market data in master data system
  - Code investment guideline checks in front office system to reflect target market requirements on instrument level
  - Conduct pre-trade checks to confirm compliance with the fund's profile (needs, objective and characteristics) / target market per transaction
  - Define rules for exceptions and document exception on a case-by-case basis (e.g. because of portfolio hedging)
  - Conduct post-trade check
  - Adapt investment strategy (target market requirements on instrument level might interfere with existing fund rules)
  - Adapt investment management agreement and potentially fund prospectuses
  - Review target market on instrument level on a regular basis
  - Report back to the manufacturer deviations from the distribution to the target market

  Implementation of these steps would require not only internal adaptation of the systems but would also trigger the following steps:
  - Negotiate and discuss with external IT providers implementation of these requirements
  - Assess and clarify license requirements if data on instruments' target markets are transferred to external IT providers or internal data hubs.

  Besides the high administrative implementation expenses, ongoing assessment would be required in the investment compliance process.

  Implementing this would be quite significant for asset managers which in some cases are in charge of up to 1,000 funds administered by other management companies, often cross-border. As described above, in case of a fund, we believe that there would be no benefit for investors which would justify such administrative burden.

2. **Segregated mandates**. Furthermore, professional investors such as insurance companies regularly decide to invest their funds through segregated mandates instead of using a fund vehicle. The portfolio manager is required to ensure that the assets of all products remain within the boundaries specified by the investment guidelines determined by the institutional investor. Consequently, the additional target market assessment would provide for administrative requirements without any additional benefits for such investors.

Furthermore, instead of a delegation of portfolio management, a management company or a MiFID firm may provide investment advice to another management company for a fund. The requirement to provide for a full matching of the target market in these instances would also trigger the administrative measures as outlined above. We also believe that in these cases, a fund's eligible assets and investment limits according to the fund rules provide for the appropriate rules for investment. An additional target market assessment would not be for the benefit of investors but only add administrative red tape. Consequently, if an instrument is eligible under the fund rules of the relevant fund, the fund should be considered matching the target market of the instrument.

Moreover, ESMA's proposal to differentiate between elective or per se professional clients is not in line with MiFID II. Art. 54 para. 3 of the Delegated Regulation does not distinct between those types of professional clients for knowledge and experience. Rather, it allows assuming knowledge and experience in relation to products, transactions and services for which the client has been classified as professional regardless of the service. The rule only distinguishes between elective and per se professionals in case of investment advice regarding the ability to bear investment risks. The guidelines should respect the approach at Level 2 and thus reflect the same distinction.

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

Timing is crucial: We urge ESMA to publish the final report as soon as possible. For implementation of the product governance and target market requirements major IT changes/amendments will be required. A period of less than nine months will prove to be extremely challenging for market participants and will again jeopardise an effective and standardised implementation of the target market regime. This also ties in with some of the aforementioned complexities in the concept and ESMA's understanding of the distributor's requirements to redefine the target market. Both manufactures and distributors will have to implement IT systems in order to be able to align their set-ups to the new requirement. In addition, the manufacturers will have to define the target market for all their products (which in case of a management company will not be a regulatory requirement), and distributors will have to assess how the target market of the products they intend to offer will be compatible with the circumstances of their clients.

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)?

It is difficult to identify specifically the costs for the implementation of these guidelines in the context of the general MiFID II implementation costs. However, costs for implementing these guidelines will comprise costs for systemic changes in particular for IT systems, operational resources as well as the use of shared services such as legal, compliance, risk, product management. Any requirement of additional target market identification by the distributor and/or a look-through approach for portfolio management would significantly increase costs.