

Rome, 5th January 2017
Ref. no. 4/17

To ESMA
European Securities and Markets Authority
103 rue de Grenelle
75345 Paris

Via ESMA website

Object: ESMA's Consultation Paper – Draft guidelines on MiFID II product governance requirements (Ref. ESMA/2016/1436) – Q4.

Assoreti – Association of intermediaries which provide investment advice service through their advisors – would like to express its full appreciation for the overall structure of the consultation paper mentioned in the subject, that for sure will ensure an harmonized implementation of the new rules on product governance laid down in art. 16 and 24 MiFID II from the date of their application by Member States.

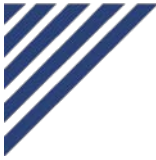
Assoreti welcomes the opportunity given to comment the mentioned consultation paper and intends to concentrate this paper on the question no. 4, concerning the relationship between the identification of the target market related to an individual financial instrument and the suitability test related to the client's portfolio when a tailored investment advice service is provided.

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.*

Rationale

The intermediary that provides investment advice service recommends to the client financial instruments that it has *ex ante* identified as suitable. The requirement, introduced by MiFID II, of the identification of the target market fits into a background that already belongs to the know-how of the intermediary. For the latter, in the end, the identification of the target market and the suitability test should be, at least in principle, the two sides of the same coin, where the first precedes the second temporally and logically.

Usually these two sides match each other until the suitability test relates to the individual financial instrument from time to time recommended to the client. When, instead, the client holds a portfolio consisting of different types of financial instruments, the suitability test tends to be portfolio-related (instead of product-related); the result is that this assessment may deviate from the target market assessment that necessarily is product-related. In such a case it could then happen that



a financial instrument is suitable according to a portfolio assessment, but it is outside the target market.

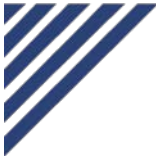
In this regard this Authority states, if we have not misunderstood, that if the target market has been well-identified *ex ante*, recommendation or sale of financial instruments to clients outside this market should not “occur on a regular basis” or should “be rare” (see paragraphs 61 and 62 of Annex 3 - draft guidelines); in these cases the intermediary should clearly document the reason for the deviation, including the case where the deviation has occurred in the context of the provision of investment advice service according to a portfolio diversification (paragraphs 31 and 32 of background on the draft guidelines).

From this, it follows the need to reconcile the target market definition, which is product-related, with the suitability test based instead on the overall portfolio of the client. Assoreti understands and shares Esma concern aimed at limit the possibility of derogating from the target market in order to discourage distorted and elusive behavior; however, we believe that the priority given, as a precautionary measure, to the *ex ante* identification of the target market – intended as a rule with respect to which any deviation has an exceptional nature – can be justified in the provision of placing and execution of orders services (with no investment advice service), while it doesn't fit with the provision of investment advice service, especially when recommendations are provided according to the portfolio of the client.

In the case of placing and execution of orders services (with no investment advice service), the intermediary has to make appropriateness test which concerns exclusively knowledge and experience of the client, *i.e.* only some of the aspects that must be considered in the target market identification. In this case, the exceptionality with which the sale to a client of a financial instrument outside the target market is allowed and the requirement of adequate reasons are justified.

In the case of investment advice service (provided alone or with other execution services), however, the intermediary has to make the suitability test that covers in practice almost all the aspects that are also considered in the identification of the target market. Therefore, if the target market identification and the suitability test gives rise to different results because the latter has been done taking into account the client's portfolio, it should be normal to give preference to the suitability test's results. These results should not be considered as a deviation from the target market identification of the individual financial instrument, but they should be seen as a natural consequence of the proper provision of a more advanced and tailored investment advice service, thus closer to the needs and objectives of the client considered in his individuality and not only as a member of the group identified with the target market.

In the provision of investment advice service, therefore, the suitability test should not be affected by the *ex ante* definition of the product market whenever such



a test is carried out with reference to the portfolio of the client; and the presence in the client's portfolio of financial instruments that are not in line with the target market should be considered not so much in terms of exceptional deviation from the target market (as it would seem to be according paragraphs 31 and 32 of background on the draft guidelines), but rather as a normal event stemming from the proper implementation of the suitability test as part of a more advanced investment advice service.

The intermediary has to explain in the suitability report the reasons for the deviation (as requested in the mentioned paragraph 32); this represents a natural consequence of the investment objectives chosen together with the client in accordance with its overall financial profile and, therefore, in its best interest, but not a justification of a derogation to the investor protection rule.

We believe that in this way product governance requirements would be applied in a proportional manner, according to the different characteristics of the investment service provided to client and consistently with these.

Proposed alternative

With the hope that the above can be shared, we propose to add in Annex 3 - draft guidelines, after paragraph 63, the following paragraph:

“63-*bis*. In the provision of investment advice service when the client's investment portfolio is adequately diversified and the intermediary undertakes an assessment of the suitability of the overall portfolio, it is normal that the intermediary, pursuing portfolio diversification in accordance with the client's objectives, recommends certain quantities of financial instruments that are not included in the positive target market or even belonging to the negative target market, when all investor protection rules are fulfilled, including those relating to disclosure, suitability, identification and management of conflicts of interest and inducements”.

Paragraphs 31 and 32 of the background on the draft guidelines should be revised accordingly.

Assoreti wishes to thank you for the attention provided and is available for any collaboration requests.

Marco Tofanelli
