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**Consultation: Draft guidelines on MiFID II product governance requirements**

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.



- According to ESMA, the target market for a product according to MiFID II should be determined according to six categories. One of these is the risk tolerance or the risk / return profile of the end customer market. Even though ESMA considers classical classifications possible (such as 'speculative', 'balanced', 'conservative'), it is more or less prescribed to use the PRIIPs risk classes: *"Firms should also use the risk indicator stipulated by the PRIIPs Regulation, where applicable, to fulfill this requirement."* (ESMA-Consultation Paper Draft Guidelines on MiFID II product governance requirements of October 5, 2016, page 23).
- In the RTS of the ESMA to PRIIPs, there is a fundamental asymmetry regarding AIF. Although the RTS have now been rejected by the EU Parliament (for other reasons), the problem persists: Products whose underlying do not have at least monthly prices are automatically placed in the second highest of 7 risk classes, ie risk class 6.
- The RTS are inherently contradictory: Real estate funds or AIF are typically sorted into classes 3–4, which is comprehensible. However, since, as mentioned above, no monthly price determinations are possible oder useful, according to ESMA, the promotion in Class 6 for *"real estate"* or similar assets is necessary (*"Automatic assignment of PRIIPs without data to MRM 6"*, Final Draft RTS, pages 29-30, 103).



- The subject of the upgrade due to a lack of price/data base had already been the object of the consultation on the PRIIPs RTS and corresponding criticism, but apparently without any appreciable benefit for AIF. These seem to continue to be counted among the class of assets that are being promoted or falling into a residual category: "... the remaining PRIIPs which can not meet the requirements of MRM class 6" (Final Draft RTS, page 154).
- The original approach of ESMA, which we believe was more appropriate, was counteracted: EMSA initially favored a risk scheme with 6 instead 7 risk classes, which primarily took into account proprietary content features of the offers, such as diversification, foreign currencies and leverage. As AIF does not have classic credit or liquidity risks, an average risk class would be appropriate. In the original ESMA scheme, only "high leveraged AIFs" would have fallen into the second highest risk class (ESMA-Technical Discussion Paper: Risk, Performance Scenarios and Cost Disclosures In Key Information Documents for Packaged Retail and Insurance-based Investment Products/PRIIPs v. 23.06.2015, Seite 33-35). However, as a result of the further ESMA-Level 2 procedure, such a qualitative-oriented risk classification for AIF could not be achieved, but there is still the problem that AIF only land in the second highest risk class due to the data/price-fixing problem.
- Negative consequences of these EU targets would, of course, correspond to serious distorting disadvantages for AIF which would be equated with high-volatility equity funds, regardless of the investment class and strategy, for example.
- We recommend that ESMA rethink the risk class classification or upgrading due to a lack of data on AIF, also to avoid the disadvantage of the AIF in relation to open-ended real estate funds. The fact that the typical assets or assets of AIF do not allow monthly or daily price determinations is not a risk characteristic, but the value stability of the assets themselves. In our opinion, an shortening in the valuation intervals would not be a solution, but only generate additional costs for the investor.

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 support ESMA in its view that the distributor must be able to sell outside the target market (deviating from the target market). This does not only result from the fact that the distributor knows very well the concrete customers, whereas the manufacturer usually has only theoretical knowledge, but also from the diversification aspects mentioned by ESMA: Asset management and portfolio diversification can only be meaningful, if it is not limited to only one risk class. Private investors in lower risk classes would be disadvantaged if they could not diversify their portfolio by products of higher risk classes. The decisive factor here is of course the appropriate weighting.

- We suggest that ESMA allows and opens more the distribution outside the target market on a regular basis, provided that an appropriate weighting is ensured and the distribution is documented accordingly.

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?

- We share ESMA's view that products launched before 03.01.2018 are treated in principle as products falling without the scope of MiFID II. However, the requirement that a target market is determined within the framework of the so-called "*product review process*" pursuant to Article 16 (3) of the MiFID II Directive should exclude those products which are closed for new investors in the primary market after 3 January 2018. Otherwise, products on the secondary market would also be affected by this requirement, eg closed funds or AIF. This would lead to an additional complication of secondary market trading, with negative consequences for the old investors of infungible products.
- Similarly, such a deadline exemption for products which no longer include new investors in the primary market after January 3, 2018 should also apply to the preparation of a basic information sheet (PRIIPs).

Kind regards

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