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05/01/2017

**Consultation Paper ESMA/2016/1436**

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

Schroders manages €430 billion on behalf of institutional and retail investors, financial institutions and high net worth clients from around the world, invested in a broad range of asset classes across equities, fixed income, multi-asset and alternatives. Our principal Luxembourg UCITS range is an international fund range, sold across the EU and worldwide.

We welcome the guidelines which we hope will go some way to ensuring a harmonised approach by Member States’ Competent Authorities when reviewing MiFID firms’ compliance with the new product governance requirements. We appreciate the decision to consult on guidelines rather than to rely on Q & As. As a major provider of UCITS products, although our management company falls outside the direct scope of the MiFID product governance regime, it is of great relevance given our UCITS products (and some non-UCITS funds (AIFs)) are sold using MiFID distributors. Furthermore, UCITS are one of the few true cross-border products.[[1]](#footnote-1) As such, we see it as imperative that the product governance rules are implemented well, in a way that is operationally practical, and do not act as a barrier to its continued success as a cross-border product.

We would therefore suggest the guidelines would be further enhanced by a worked example of the product governance requirements surrounding a non-complex UCITS fund. As UCITS will be a non-MiFID manufactured product, the responsibilities of the UCITS management company and the MiFID distributor should usefully be clarified, including the legal (though not necessarily commercial) aspect relating to the flow of sales and management information. EFAMA’s suggested example in their response would seem a useful addition.

**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.**

We generally agree with the categories to be considered, but have the following detailed comments on paragraphs 13 to 16.

1. in terms of presentation we would suggest paragraph 15 of the guidelines should be put first in this section (and so renumber paragraphs 13/14 to 14/15).
2. Existing paragraph 13 appears to repeat the same information in the first and last paragraph.
3. Paragraph 14 states that “manufacturers should not leave out one of the six below mentioned categories”. In relation to the category “client needs” we consider “No specific needs” should be an acceptable response when determining the target market as manufacturers will not know client specific circumstances. This would be especially true where a product is being sold execution only to the mass retail market. So we would suggest the guidelines are amended to state a “nil return” is capable of being provided in certain circumstances.
4. Paragraph 16(a). We welcome the fact that the proposed categorisation will focus on existing MiFID client categorisation. We do not believe a product manufacturer would have, or need to know, further categories other than those MiFID categories. We consider that product manufacturers will not be able to know (and, again, should not need to know) if professional clients are “per se” or “opted up” professionals as this detail will only be known by distributors (see paragraph 72/73).
5. Paragraph 16(b). It would be useful to address the situation where a non-complex product is provided, meaning knowledge and experience may be basic (as the legislation at the overarching Directive level acknowledges) meaning these products may be sold with no appropriateness or suitability tests carried out.
6. Paragraph 16(c). We believe it is unreasonable for the guidelines to expect a product manufacturer to know the amount of loss target customers “are able and willing to afford”. We believe it is reasonable to state in general terms whether the product is targeted at those willing to bear losses or preserve their capital, or in cases where a product is a contingent liability whether they are willing to lose more than their original investment (in this latter case a warning related to a maximum proportion of net investable assets may be an appropriate consideration).
7. Paragraph 16(d). We recognise the need for a product manufacturer to explain the risk/reward profile of the product. For retail products this is what the risk indicator and related text contained in both the PRIIPs KID and UCITS KIID is designed for. We suggest using subjective categories such as “balanced” and “conservative” do not assist the product manufacturer meeting this requirement (but may assist a distributor when considering the synthetic risk indicator and related risk disclosures in terms of their responsibilities).

So we suggest the guidelines at the vey least should delete the word “also” in the penultimate line. This will give clear guidance to MiFID product distributors that provision of a key investor document under the PRIIPs Regulation (which by the nature of PRIIPs Regulation includes the UCITS KIID by virtue of the transitional provisions) is sufficient information on the risk of the product so that the MiFID distributor can consider the risk tolerance of the target market. The risk information contained in the KIID or KID is, of course, considered enough information for an investor to make an informed investment decision[[2]](#footnote-2).

1. Paragraph 16(e). As product manufacturers we think we can only provide general information in terms of clients’ objectives. It will be up to the MiFID distributor who is providing a service of advice or an appropriateness test as part of their responsibilities to know their clients’ objectives. Some of the information suggested lies in the current KID requirements (such as time horizon) but only where there is a recommended holding period. We support EFAMA’s comments in this area around the need for sub-categories to be used to populate data fields enabling a MiFID distributor to match the objectives of its client with the general product information.
2. Paragraph 16(f). Please see our comment in (iii) above.

**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 note the comments in paragraph 17 of the background introduction to the consultation paper in relation to the issue of proportionality and the need for less detail when products are simpler. Similar wording should be made in the guidelines here.

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

We note that paragraph 28 of the background introduction makes the point that proportionality applies to distributors as it does manufacturers. As such, in certain cases a product manufactured so as to be compatible with the mass retail market will be treated differently to a specialised one, as stated in paragraph 41 of the guidelines. This is most useful.

**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 general comments towards hedging and diversification and the ability of a distributor to deviate from the target market. We would disagree that this will be a limited occurrence as this will depend on the nature of the service of the distributor (and think it is unhelpful to introduce quantitative elements for fear of this creating a “box ticking” approach or distracting from the suitability and/or appropriateness requirements). In the case where an adviser is recommending a range of products as part of a portfolio and where a product may form part of a wider solution for a customer, it may be quite usual for a higher risk product to be sold as part of the solution. So the guidance needs to acknowledge the different types of MiFID distributor.

**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?**

The guidance is clear and the reference to the UCTS Directive is welcomed.

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

Please see our response to question 4. We do not agree with the comment that negative sales “should not occur on a regular basis”.

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

See our comment in response to question 1 (point (iv)) above.

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

Please see our introductory remarks and the request for an additional example of the sale of a non-complex product by a non-MiFID manufacturer.

Yours faithfully

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Sheila Nicoll

Head of Public Policy

1. According to the Commission, around 80% of UCITS funds are sold cross-border (Source: Commission Consultation on CMU action on cross border distribution of funds across the EU June 2016). This compares to the Commission statement in the retail financial services green paper: “Recent studies suggest that the share of consumers who have already purchased banking products from another Member State was less than 3% for credit cards, current accounts and mortgages. In consumer credit only 5% of loans had been obtained cross-border. In insurance, cross-border provision of services accounted for only about 3% of total gross written premiums in 2011 and 2012.” [↑](#footnote-ref-1)
2. Directive 2014/65/EC Article 24.5. [↑](#footnote-ref-2)