The French Banking Federation's response to ESMA's Consultation Paper.

General point

The professionals concerned by the planned/proposed provisions within the level 2 texts, have for a long time reported the persistent difficulties in terms of incomprehension and interpretation either directly or via their regulator. Moreover, there have been several alerts regarding the need for stabilised texts and clear guidelines at the latest by mid-2016. These aspects are essential so as to be able to implement the IS development work and receipt it in order to maintain the directive's application date, scheduled for 3 January 2018.

The FBF understands and shares the objectives of the MIF2 directive in terms of product Governance which, according to its understanding, aims to protect the investor by ensuring that investment companies that produce or market and/or provide advice on financial products, act in the client's interests throughout the life cycle of a product.

While it is pleased about the implementation of this consultation paper on the identification of the target market by ESMA, it regrets the fact that the grievances received from professionals were only taken into account in October.

The belated launch of this consultation paper with a timetable for the finalisation of guidelines in Q1/Q2 2017 adds to the operational difficulties related to the timeframes already set out. This point is particularly significant due to the new provisions introduced within this consultation paper, which are absent in the presentations made in June 2016, and ESMA's guidelines by national regulators. As a result, it was not possible to take them into account in the work already initiated by distributors and they would appear to be difficult to achieve in the six months given to the profession in the case of validation of technical rules occurring at the end of the second quarter.

However, the profession remains highly proactive in pursuing the work already implemented in order to be able to apply the guidelines known in June 2016.

It alerts the European regulators regarding the impossibility of taking into account the new guidelines introduced via the consultation paper between now and 3 January 2018.

Guidelines for manufacturers

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.

The marketing of the right product to the right investor requires the same understanding of the notion of target market by manufacturers and distributors.
In this respect, priority should be given to using a harmonised terminology between manufacturers and distributors and the simplest possible definition of the target market in order to limit the risk of wrong interpretation.

While we subscribe to ESMA's proposal to limit to 6, the number of criteria to be taken into account by manufacturers to identify the target market, the proposed procedures require a few comments:

1. Convergence between PRIIPs and MIF 2 texts

We would reiterate that the product-focused PRIIPS regulation provides, in its Article 8 paragraph 3 c, for a definition of the target market based on the identification by the manufacturer of the type of investment, the investment objectives and the target investor type. Without anticipating the developments of the level 2 texts of the PRIIPS regulation, it seems advisable to ensure a certain convergence between the planned product governance provisions within these two texts.

2. Difficulties in the application of the proposed criteria

a) The six criteria recommended by ESMA are among those that have to be assessed in the case of the suitability assessment. The obligation to systematically apply them for all products is inconsistent with the recommendations of the MIF2 directive which specifies in its Article 25 that product governance must apply without prejudice to the rules for assessing “suitability” and "appropriateness”. This point is confirmed by the provisions of the level 1 text which provides for the possibility for Member States to set the type of assessment to which the client should be subject by the distributor according to the type of service that has been provided.

b) Similarly, the obligatory and cumulative use of the six criteria proposed (page 22 point 14) is a source of complexification for the manufacturer. For example, not having the client relationship, apprehending the client's capacity to support losses can only be theoretical. This approach is likely to exclude from the target a whole section of clients that may be eligible with the support of a more asset-based approach to the client's situation, an approach that can only be achieved by the distributor.

c) Knowledge and experience: like the proposals formulated by EFAMA, we believe that the assessment of knowledge and experience must lead to the breakdown of investors and potential investors into two distinct categories: "without knowledge or experience" or "with/or without experience but with knowledge". This is to enable a client without experience to subscribe to a given financial instrument provided they have the necessary knowledge. Without this, a third of clients who have never subscribed to a product would never be able to access said products because they do not have the required experience and cannot develop it.

In the case of the provision of order reception-transmission services involving financial instruments not promoted by the distributor, i.e. for which the distributor has no contractual link with the manufacturer, this observation is strengthened: the distributor cannot know the level of knowledge and the level of experience expected of the manufacturer (for example, mass retail, educated or sophisticated). Therefore, the distributor can only seek to find out if their client knows (i.e. what is the client's knowledge of the product?) and if the client has already carried out transactions (i.e. what is the client's experience on this product/), so as to prevent any order reception-transmission subscription.

d) **Risk tolerance**: Distributors providing an investment advisory service must have comprehensive and consistent information on the products proposed. This advice must cover the whole of a portfolio for which an "overall" risk rating must be published. It is essential for each financial instrument making up the portfolio to have a common and durable risk indicator making the risk assessment method for the client's portfolio

transparent to the client. In this respect, Product Governance should specify that the risk tolerance criterion must be based on the disclosure of a SRI rating as from January 2018 for PRIIPS and UCITS products. This provision would ensure better protection for investors by making it possible to measure the suitability of a portfolio with an investor's profile.

e) Needs and objectives

The dividing line between the investor's needs and objectives appears to be very fine in the examples used, with some objectives potentially, according to the investor's situation at a given time, coming more under one or the other. For example, for an investor with a young, active and changing profile in terms of salary, a tax-efficient investment may meet an objective to prevent or even anticipate the future tax burden. At the same time, it will meet the need to reduce the weight of taxation incurred for an investor who is already responsible for substantial assets.

From our understanding:

- **needs** should cover the issues relating to the investment horizon, the product's liquidity and the investor profile (search for income, search for performance, etc.)
- **objectives** should cover more the notions of diversification and be based on quantifiable factors.

However, in order to make these two terminologies easier to understand, the possibility of merging these two categories should be left for manufacturers to assess according to the type of product concerned

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.

- *Identification of the potential target market: differentiation on the basis of the nature of the product manufactured (point 16-18) p(6-7)*

We propose partially reiterating the draft response of the AFG which follows:

Yes, we do agree with the approach that the identification of the target market assessment should be done in an appropriate and proportionate manner, considering the nature of the investment product and with the approach described in §18-20, page 24 of the draft Guidelines.

As a consequence, we would like to make some comments on several points:

- Negative TM**:** Along with the principle of proportionality acknowledged by ESMA, we want to highlight that there are cases where negative TM should not be necessary, such as for simple, plain vanilla mass retail products suitable for all public; **therefore ESMA should allow that negative TM can fill be filled or not along with the proportionality principle.**

    - *Articulation between the distribution strategy of the manufacturer and its definition of the target market (point 19-21) p(7-8)*

- Role of manufacturers on selecting distributors: ESMA wrote §21, p.24 in the draft

GL:

[… This includes that, when the manufacturer can choose the distributors of its products, the manufacturer makes its best efforts to select distributors whose type of clients and services offered are compatible with the target market of the product.]

Manufacturers are not in a position to ensure that every distributor is compatible with each product, considering that:

- Manufacturers have large ranges of products and have distribution agreements with distributors on their whole range of their products
- ~~Manufacturers do not always know the sub distributors of their distributors~~
- It is the distributor's duty to screen and adjust the TM and the distribution strategy to their client base, see "distribution strategy of the distributor" §44-46, p.29 draft GL.

Therefore, we suggest "*the manufacturer makes its best efforts to inform distributors on type of clients and services offered compatible with the target market of the product*.]

- Role of manufacturers on specifying appropriate channels

ESMA wrote on §.22 of draft GL p. 24-25:

[…the firm should also specify the preferred acquisition channel (face-to-face, via telephone, online) and the specific design of the acquisition channel, if relevant.]

It should not be the duty of manufacturers to define the appropriate channel at such a granular level and to impose it to distributors; this kind of decision is clearly at the distributor's level.

Guidelines for distributors

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

The FBF only partially agrees with the recommendations put forward by ESMA.

Indeed, the importance for distributors of having a product governance policy in order to ensure that the range of recommended and marketed products is compatible with the needs and characteristics and the objectives of the investor is shared. Similarly, we agree that the application by distributors and manufacturers of six criteria will contribute to an equivalent approach and definition of the investor's needs and objectives.

That said, we do not share ESMA's intention concerning the obligation for distributors to define, considerably upstream, in fact as from the determination of the range of financial products proposed to clients, a distributor target market as measured by 6 criteria.

In fact, Article 25 of the MIF2 directive specifies that the recommendations relating to product governance must apply without prejudice to the rules relating to the assessment of suitability and appropriateness. Level 1 of the MIF 2 directive defines, for investment companies and according to the type of investment service provided to the investor, the level of information to

be collected before allowing the investor to subscribe to a financial product. Accordingly, for services other than advisory or portfolio management services, investment companies must only verify the investor's degree of knowledge and competence in the case of the provision of order reception and transmission services and in the case of simple execution services on defined non-complex products, it is expected that Member States will be able to allow them to be marketed without the obligation of any assessment of the client

We are therefore in agreement with the principle that the assessment of the target market is influenced by the investment service provided by the distributor as covered by points 35 and 36 of the consultation paper.
Consequently, we are opposed to ESMA's recommendations, regarding the implementation of an in-depth client analysis (even in the case of the provision of an ancillary order reception and transmission or simple execution service), set out within paragraph 39 of the draft guideline and notably in cross-reference 16 which is inconsistent with the provisions reiterated above and those of the level 1 text.

We wish the obligations of establishments to be limited to the application of the obligations provided for in level 1.

Moreover, for products considered to be very complex or for which no distribution agreement exists between the distributor and the manufacturer, it is necessary for the manufacturer to provide an indication regarding the investment services which may or may not be applicable to the product concerned.

Furthermore, ESMA's recommendations in favour of the use of all information and data that may be deemed useful and available within the distributor's databases raise questions. They are considered to not take account of and not comply with the consumer's personal data protection rules specified by other European texts**.**

Finally, throughout their life, a client has a very diverse set of objectives (retirement, children's education, house purchase, etc.), whose satisfaction may involve several different products according to their financial capacity, investment horizon, applicable tax regime, etc., and who may additionally hold assets in several establishments. Consequently, how is it feasible to anticipate such or such a project, to decide for the client, as long as the client has not expressly indicated what they expected at a given time, for a given sum and for a given project!
It is possible, in this area, to reason statistically on all the clients (law of large numbers), but impossible to know precisely WHICH client will want WHAT and even more so WHEN in their relationship with a distributor

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.

The profession shares the positions of ESMA regarding the possibility, for the distributor, of being able to market a product outside the target market defined by the manufacturer. This situation can be justified due to a more asset-based client approach that may lead to diversification transactions being carried out.

That said, we consider the notion of “non-regular basis” included in point 32 of the consultation paper to be inappropriate. Diversification meets the expectations and objectives of some investors holding a certain level of assets and seeking additional performance. This situation is encountered fairly frequently in portfolio management activity where the investor defines, together with their manager, their additional performance expectations on their portfolio and

mandates the investment company to provide them with arbitrage proposals for their positions in order to achieve their objective.
To this end, the distributor may have cause to propose products to its client, for which the client is not included in the initial target market defined by the manufacturer.

As a result, sales made outside the target market but related to the practice of client portfolio diversification, must not be considered as exceptional transactions. A client is not classified once and for all in a target market from which they cannot withdraw. A client may pursue separate objectives, simultaneously or spread over time, which mean that, for a given PROJECT at a given TIME, they meet the characteristics of target market A, but that other expectations at the same time or later link them to target market B or C, etc... for another aspect of their investments.

Consequently, when the investment advisory service is provided to clients, in response to the client's expectations, by the adviser in accordance with the client's interests and the duty to provide advice, it is not possible to withdraw from the target market.

Diversification transactions must be likened to recurring transactions that come under the scope of transactions carried out in the target market. As such, they must not be the subject of systematic information transmission from the distributor to the manufacturer. This information transmission will lead to very cumbersome documentation for distributors, which will also be difficult to process by manufacturers.

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?

- *Distribution of products manufactured by entities not subject to the MiFID II product governance requirements(point 39)*

Point 39 of the consultation paper makes the distributor liable in the event of the inappropriate marketing of a product created by a manufacturer not subject to MIF2 provisions.

Distributors consider that the possibility of incurring their liability with regard to inappropriate sales to a client can only be made according to the degree of information that they hold or have been able to obtain from manufacturers.

Moreover, this level of information is taken into account during the definition of the distribution strategy that they will implement.

Distributors consider that their liability with regard to inappropriate sales on products specified by this point can only be sought in the following cases:

a) The product is the subject of validation by distributors' "new product" committees. The distributor has a sufficient level of information enabling it to be aware of the risks and benefits related to the product and to precisely define whether it can be marketed through all the investment services (advisory, order reception and transmission, simple execution, etc.).

b) The product is not the subject of validation in the “new product committee”. However, the distributor has sufficient information, provided by companies specialised in supplying information on financial products. The distributor can

therefore assess the product's risks and benefits and define whether the product can be marketed within all the investment services that it offers, and control the possibility of inappropriate sales.

However, distributors consider that they cannot be held liable for sales if they do not have sufficient information to assess the risks and benefits related to the product due to the absence of information communicated by the manufacturer.
Consequently, the marketing of this product can only be carried out via the order reception and transmission service, the investment service for which the distributor only has an obligation to verify the level of knowledge and competence of the client. If these obligations have been respected, the distributor cannot be held liable for any inappropriate sale carried out directly by the investor who has been given all the necessary warnings if applicable.

Guidelines on transversal issues applicable to both manufacturer and distributor

- *Identification of the 'negative ' target market by the manufacturer and distributor – clients for whom the investment products they manufacture and/or distribute are not compatible (point 42)*

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

The FBF is totally opposed to ESMA's proposal concerning the definition of a negative target market. If a product must not be sold to a particular type of client, this point must be specified directly as part of the determination of the target market by the manufacturer.

The aspects referred to in points 61 to 63 of the draft guidelines corroborate this opinion. We understand, from the examples that are referred to, that the negative target market does not correspond to all the investors that are not included in the target market. Moreover, ESMA confirms the possibility, under certain conditions (that have to be justified), for the distributor to carry out sales outside the target market. Consequently, it proposes the creation of a "grey" market covering these sales.

The difference between the grey market and the target market is not clear and, in our view, is a major source of question marks and/or wrong interpretation.

We also consider that the "industrial" and effective implementation of these negative target markets and/or grey markets is not possible.

Finally, as part of the definition of the target market for any financial product, the manufacturer must specify the types of clients for whom the sale of the said product is prohibited due to the provisions laid down by national regulators.

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

For customised products created for a professional client or eligible counterparty and at their request, distributors consider there is no assessment to be made of the client.

Similarly, since professionals and eligible counterparties are considered to have sufficient knowledge and expertise, it does not seem appropriate for the guidelines to address this issue and provide any further explanations.

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

No comments

3.2 Annex 2 – Cost-benefit analysis (page 16-19)

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)? If possible please specify the respective costs/resources separately for the assessment
Of suitability and related policies and procedures, the implementation of a diversity policy and the guidelines regarding induction and training. When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.

The set of recommendations concerning the implementation of level 2 texts introducing new obligations is not well-known.

While the determination of a target market by the manufacturer is a step towards improving investor protection, the obligations in terms of information and notably when it is collected by the different players (expected considerably upstream) appear to be a major source of complexification. The difficulties in terms of collection will be particularly difficult for products designed in other European countries.

The collection of sufficient quantitative and qualitative information requires finding and being able to use data providers having the capacity to aggregate and reference data on all European products and from different European countries. We query the number of providers that can be identified as being able to meet these specifications.

Overall, the difficulty and cost of obtaining this information is ultimately likely to result in a reduction in distributors liable to work in open architecture within the distributors. By extension, this situation could result in the attrition of the client offering and the more limited return of individuals' assets to the markets and therefore the ability to finance companies through this means.

Annex 4.

In our view, the illustrative examples are too detailed and consequently too complex to implement, since they go against the desired standardisation and automation process.

In addition, these examples are very different from what is proposed by the PRIIPs regulation, which makes it an obligation to mention the target market of the packaged product, within the KID. The PRIIPs regulation has a much more restricted view with regard to mentioning the target market within the KID: a few lines suffice, since the KID is a standardised document in a format that must not exceed 3 A4 pages.

Therefore, in an effort to harmonise with the PRIIPs regulation, but also and more importantly to automate the target market definition process, it would be appropriate to review the case studies mentioned in annex 4 of the consultation paper. A less granular view is desired.