**ESMA consultation paper**

**Review of the Guidelines on MiFID II product governance requirements**

**DDV response**

DDV would like to thank ESMA for the opportunity to comment on the Review of the Guidelines on MiFID II product governance requirements, which is of great importance to DDV members.

As a general comment, the spirit of these Guidelines sheds the light on shortcomings that shall not happen with regards to product governance. This approach is welcome by DDV, as well as the provision of good practices which show how the objectives could be achieved in a practical and pragmatic way. As far as the Sustainability part is concerned, we would like to salute the openness of ESMA, which will hopefully lead to solutions towards the reduction of the regulatory fragmentation.

As a general matter for consideration, some of the aspects mentioned in these Guidelines have an impact or would have been better placed in the Guidelines on appropriateness and execution-only requirements under MiFID II published in January 2022, the latter being currently implemented by firms. Therefore some of the contemplated adaptations will require another round of adjustments in the area of appropriateness and execution-only. The firms would have wished for a more sequenced publication of the two sets of Guidelines, or at least a clear-cut allocation of the topics tackled. In this context, an alignment of the implementation of these Guidelines would reveal very helpful.

In addition, we would like to encourage ESMA to align as much as possible the terminology of the draft guidelines with the existing associations’ concepts that have become the industry standards such as the German “MiFID II - Product Governance Common Minimum Standard for the identification of a target market for securities”[[1]](#footnote-1) as well as the European MiFID Template (EMT).

**Q1: Do you agree with the suggested clarifications on the identification of the potential target market by the manufacturer (excluding the suggested guidance on the sustainability-related objectives dealt with in Q2)? Please also state the reasons for your answer.**

The clarification about the substantiation and documents choices (G. 13) does not impact DDV members who already fulfill a high degree of compliance in the context of their product governance arrangements. However this may lead to the temptation of increasing the documentation burden which is going against the spirit that inspired in particular the Capital Markets recovery package.

With regards to the categories to consider for the identification of potential target markets, manufacturers already comply thoroughly with their duties that derive from MiFID II.

The clarifications brought in by G. 14 give us the opportunity to stress that there is no obvious need to have scenarios both in the target market assessment and in the PRIIPs KID. In addition, the scenarios analyses which are already required in the target market assessment do not have material relevance for the structured products. With regards to the example given that “the scenario analyses performed by the firm may reveal that a product’s value is particularly sensitive to negative market conditions”, more precision would be welcome as this may be difficult to foresee them exhaustively. In addition, it would imply a description that may not fit with automated processes.

Regarding the charging structure, we are of the opinion that cost assessment should be a separate exercise to the target market identification, and that the responsibility of the manufacturer should be to disclose the impact of cost on the product return based on the PRIIPs simulation and the KID cost table, in order to ensure comparability across products. Running other simulations than the ones used in the PRIIPs KID to assess costs risks entailing divergences of results between manufacturers. In any case it would be welcome that ESMA shares more details about what it has in mind regarding “the charging structure analyses”.

As far as qualitative considerations are concerned, too long narratives may not be a proper way of assessing the target market of millions of structured products in a consistent way across the EU. Automation and quantitative assessment are relevant to product a target market that is concise, objective, and comparable against other products’ target market. So far, the practical experience is that the automation of target market has allowed for a consistent reporting of sales in negative target market across distributors.

Moving on to G. 19, we would like to make the general statement that it is essential that the categories for the identification of the potential target market by the manufacturer are parameterised/standardised. This is the *sine qua non* condition for keeping an open architecture which allows for the distribution of financial products produced by different manufacturers.

Coming into more details:

* G. 19 a: The decision made *ex ante* to market or distribute to eligible counterparties makes full sense.
* G. 19 b: The level of details required to specify knowledge and experience is very high, in particular due to the fact that the manufacturer does not have a full level of information about end investors. The three basic categories “basic / informed / advanced” allows the manufacturer to set the “basic category” outside the positive target, and potentially for the most risk and complex product in the negative target market. A description of thematic knowledge (e.g. like emerging market knowledge, or bond market knowledge, which is assessed during the suitability process) is not adapted within the manufacturer target market as it is too granular.
* G. 19 d: The mention of going beyond risk tolerance as indicated in the PRIIPs summary indicator would deserve more precision. For instance, the currency risk may not be easy to implement by distributors in the case of cross-border activities, as it would imply that similar products would be treated under a different categorisation.
* G. 19 e: The manufacturers already specify the expected investment horizon for a product. However it could indeed be foreseeable to enlarge to a certain extent the specifications for the category “clients´ objectives and needs”.

**Q2: Do you agree with the suggested approach on the identification of any sustainability-related objectives the product is compatible with? Do you believe that a different approach in the implementation of the new legislative requirements in the area of product governance should be taken? Please also state the reasons for your answer.**

DDV welcomes ESMA´s approach to align the definition of “sustainability-related objectives” with the definition of “sustainability preferences” according to Article 2(7) of the MiFID II Delegated Regulation. The lack of congruence between the two definitions has given rise to some concern in the market. It is of paramount importance in practice that the concept of “sustainability-related objectives” within the target market assessment is fully compatible with what is defined as “sustainability preferences” in Article 2(7) of the MiFID II Delegated Regulation. Otherwise, any target market assessment is in danger to become meaningless for both intermediaries and their clients. Hence, we appreciate that ESMA aims at aligning both definitions for the sake of a workable product governance process.

As to the question whether a manufacturer should specify sustainability-related objectives of a product by referring to the sustainability data of either the issuer of the product, or the product itself (para. 27), there is no one size fits all-approach. In certain cases, it should even be possible to combine both concepts. For example, the manufacturer of a structured product that is issued as a bond and has a basket of shares as underlying (derivative component) could specify the sustainability-related objectives of that product by making reference to both the bond and the derivative component. The sustainable characteristic of the bond component could e.g. derive from the issuer´s use-of-proceeds whereas the sustainable characteristic of the derivative component is stemming from the demand impact which is caused by the issuer´s risk reducing hedging practice. Insofar a sustainable structured product should be treated as an indirect investment having a similar effect to any secondary market acquisition, including those exercised by investment funds such as UCITS and AIFs.

As this question ties in with the treatment of derivatives from a sustainability perspective, we would like to take this opportunity to stress the importance of further considering their role there, as promised by the European Commission and the ESAs. It would indeed be of importance that the ratios appropriately reflect the contribution of derivatives to taxonomy-aligned economic activities. Work should be encouraged on clear methodologies in order to assess derivatives´ alignment.

Against this background, we strongly encourage ESMA to go further down the road and allow for different concepts of specifying sustainability-related objectives along the broad product range.

**Q3: What are the financial instruments for which the concept of minimum proportion would not be practically applicable? Please also state the reasons for your answer.**

We strongly support ESMA’s approach to handle the concept of “minimum proportion” with some flexibility. Insofar, we fully endorse ESMA´s analysis in footnote 13 that the concept of “minimum proportion” does not apply to financial instruments for which it is not practically possible to define such minimum proportion and that, instead, these types of products could refer to the actual proportion instead of the minimum one. In this respect, it should be kept in mind that various financial instruments, such as bonds, shares and structured products, are not in the scope of the SFDR. Therefore, any “minimum proportion” requirement for financial products deriving from the templates set out in the Annexes to the Delegated Regulation (EU) 2022/1288 do not apply to financial instruments which do not qualify as financial products under the SFDR regime. And we see no legal basis for extending this requirement to these financial instruments within the context of the MiFID II product governance framework.

As for the types of financial instruments for which the concept of minimum proportion would not be practically applicable, these are instruments that are – different from an investment fund – not actively managed during their life cycle. For these instruments, it is hardly possible for a manufacturer to give any commitment on keeping a minimum proportion from issuance to maturity. Hence, the information on the actual proportion at the point in time of the issuance should be sufficient.

**Q4: Do you agree with the suggested guidance on complexity in relation to the target market assessment and the clustering approach? Please also state the reasons for your answer.**

As far as the differentiation on the basis of the nature of the product manufactured is concerned, the clarifications mentioned in G. 23 are already implemented by firms. A greater level of details for high complex products (e.g., futures with the obligation to make additional payments), accompanied with appropriate proportionality makes sense.

In addition, echoing G. 24, a graduation of the level of products´ complexity through a list of factors/criteria is necessary, due to the limits of the definition stated by MiFID I. This is already being set by firms in particular in the category “knowledge and experience” and allows them to thoroughly determine what makes a product more or less complex.

In addition, more precision would be welcome about what is expected with regards to wholesale markets.

About the clustering of structured products (G. 27), although we understand the concern of ESMA, we would like to plead for a not too strict approach. Clustering can indeed be protective when it leads to an appropriate target market; in the opposite case, such a clustering is already prohibited anyway. It should be noted that, in the case of structured products, both for investment and leverage products, many have very similar target markets which are restrictive due to their specificities (short recommended holding periods and higher risk indicators).

Keeping such flexibility in the clustering approach matters to firms which are currently operating based on a specific catalogue which defines target market; an excess of granularity would be cumbersome and not necessarily helpful, including for structured products. Indeed

the latter should keep benefitting from this possibility provided that these products have a sufficient level of standardisation.

From a more general perspective, we would like to stress how important it is that the key factors are not cumulative in order to allow for a certain degree of flexibility in the clustering approach.

On a side note, we would like to reiterate that complexity should not be confused with risks. Non-complex products are not automatically risk-free and easy to understand for investors – and complexity *per se* is not automatically harmful to retail investors and may even include product characteristics that are designed to add value (e.g., principal protection) for investors.

**Q5: Do you agree with the suggested guidance on the assessment of the general consistency of the products and services to be offered to clients, including the distribution strategies used? Please also state the reasons for your answer.**

The adjustment made in G. 39 poses question, in particular the fact that the distributors should consider digital engagement practices such as gamification in the context of the analysis of the distribution strategy. It is indeed very unlikely that gamification leads to a distribution outside the target market as clients who do not meet the pre-defined target requirements will not be able to access the product.

In addition, this consideration may not be fit in the context of these Guidelines, and may have been better placed in other pieces of regulation, e.g. the ones which address misleading information. It should also be borne in mind that the application of such obligation would be challenging in the case of mass-marketing campaigns, and that for instance the use of web-trading cannot be tailored for different categories of clients.

**Q6: Do you agree with the suggested guidance on the identification of the target market by the distributor? Please also state the reasons for your answer.**

The refinement exercise which is required from distributors (G. 42) may be challenging in some cases due to the number of products and in case of providing cross border services within the EU. In case a too high level of granularity would be required, this may contribute to increase the risk of inconsistent approaches by the distributors, which is the contrary of what is intended. A difficulty would also lie from a consistency perspective in the fact that the target market is documented by the manufacturer in the PRIIPs KID. A deviation from this target market may entail a risk of confusion on the investor´s side.

G. 46 leads to wonder whether the documentation is intended strictly at the product level or whether the robustness of the process followed by the manufacturer shall be assessed by the distributor. We are of the opinion that a sanity check should be sufficient. Moreover, very importantly, the requirement regarding the provision of the underlying documents should not be too far reaching. The manufacturers cannot provide the distributors with too many details about their scenario and charging structure because they cannot share their models, which are proprietary internal methodologies of the manufacturer. However distributors should be allowed to ask questions about the outcomes of manufacturers’ target market.

**Q7: Do you agree with the suggested approach on the determination of distribution strategy by the distributor? Please also state the reasons for your answer.**

While the clarification in G. 56 is already implemented by firms, G. 59 is more challenging as it is quite far reaching and one may wonder whether it fits with the level 1/level 2 mandates. Moreover neither is clearly defined its scope (it is unclear which are the more complex products) nor the concept “client´s choice environment”. The latter would indeed be complex to determine *ex ante* and would pose difficulty for different products which are sold through different channels. Other Guidelines which are dedicated to a specific distribution channel may have been more appropriate in order to address this topic.

From a more general perspective, the solution in terms of distribution of more complex products does not lie *per se* in the advised business. The leverage products, for instance, are intended for specific markets where the positions are sometimes sold the same day or the day after, which does not correspond to the logic of financial advice based on the bank´s market opinion. The solution and the protection lie there in the assessment of the knowledge and experience, through a thorough appropriateness assessment.

**Q9: Do you agree with the suggested approach on the requirement to periodically review products, including the clarification of the proportionality principle? Please also state the reasons for your answer.**

As far as reviews are concerned, what particularly matters is that i) the process of reviews should be compatible with automation when it is intended to mass-retail market; ii) it is important that the reviews are constructed in a way that they do not lead each time to a full readjustment of the categories, which would be disruptive; iii) the interaction between the distributors and the manufacturers is fluid[[2]](#footnote-2).

Regarding ad-hoc reviews as mentioned in G. 68, the balanced approach taken by ESMA should be followed by national jurisdictions. Proportionality should indeed be prominent and it is legitimate that firms determine, based on this principle, the frequency and depth of product reviews. We do not see any need to go beyond the ESMA´s requirement by imposing more frequent reviews for “more complex, riskier and illiquid or innovative products”, as stated in some jurisdictions.

In addition, in this same Guideline, more specification regarding “market events” would be welcome as not every change in market conditions can be considered as a crucial event – proportionality would be needed in this respect.

It should also be noted that sending questionnaires to a sample of clients in non-advised business (G. 72) does not correspond to a real need, and may lead to an overload of interaction with the investor. Investors who do not seek deliberately advice through online banks´ channels intend precisely to avoid being overloaded with administrative burdens. Such an approach that may be understood as an attempt to introduce a unique suitability distribution regime in all cases would not be desirable.

**Q10: Do you agree with the suggested approach on the negative target market assessment in relation to a product with sustainability factors? Please also state the reasons for your answer.**

We agree with ESMA´s approach that manufacturers should not be obliged to consider the sustainability-related objectives of the product when performing a negative target market assessment. Otherwise, clients that do not have sustainability preferences would de facto be excluded from products with sustainability factors where such clients seek investment advice or portfolio management from their bank. This would jeopardize the overarching goal of the European Sustainable Finance regulation to make products with sustainability factors easily available for all kinds of clients, including those that do not have explicit sustainability preferences.

**Q12: Do you have any comment on the suggested list of good practices? Please also explain your answer.**

These good practices reflect well the manufacturers´ practices and are useful in order to show the way towards regulatory compliance in a pragmatic way.

*The* ***Deutscher Derivate Verband*** *(DDV), the German Derivatives Association, is the industry representative body for the leading issuers of structured securities in Germany. Members are BNP Paribas, Citigroup, DekaBank, Deutsche Bank, DZ BANK, Goldman Sachs, HSBC Trinkaus, HypoVereinsbank, J.P. Morgan, LBBW, Morgan Stanley, Société Générale, UBS and Vontobel. Furthermore, the Association’s work is supported by more than 20 sponsoring members, which include the stock exchanges in Stuttgart, Frankfurt, and gettex, which belongs to the Bavarian Stock Exchange in Munich, Baader Bank, and the direct banks comdirect bank, Consorsbank, DKB, flatexDEGIRO, ING-DiBa, maxblue, S Broker, Smartbroker, Trade Republic, as well as the finance portals finanzen.net, onvista and wallstreet:online, and other service providers. Based in Berlin, Frankfurt and Brussels, the DDV has the mandate to elaborate self-regulatory standards such as the Fairness Code which is observed by the issuers with respect to the structuring, issuing, marketing and trading of structured securities. Transparency and education of retail investors is at the heart of its mission.*

*For more information, please consult www.derivateverband.de.*

1. <https://die-dk.de/media/files/210521_DK_DDV_BVI_Zielmarktkonzept_ENG_new_final_C4wxqg9.pdf> [↑](#footnote-ref-1)
2. A market standard, set by the national associations, exists in this respect in Germany under the name “MiFID II – Product Governance Common Standard on the Feedback Regime”, which is accessible under this link: <https://www.derivateverband.de/EN/MediaLibrary/Document/Englisch/19%2006%2020_DK_DDV_BVI_Zielmarkt_R%C3%BCckmelderegime_final_EN_v2.pdf> [↑](#footnote-ref-2)