

## **AEB's response ESMA CP Review of the Guidelines on MiFID II product governance requirements**

---

**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.**

Regarding sustainable finance, the extreme complexity of the matter, which is external to capital markets and to the knowledge of operators, supervisors, regulators and investors, should be stressed. While we welcome the ultimate objective of the European legislators and supervisors of promoting sustainable development, as a general remark, we would like to stress that the new regulation gives rise to several concerns and doubts already known by supervisors (different implementation timeframes for each piece of regulation, different scope regarding financial products...) so ESMA should allow for a sufficient broad implementation period following the publication of the final document.

Sharing the aim of integrating everything related to sustainability in the capital markets and in the investment decisions of investors, including retail investors, we must insist on the need for a flexible approach, based on simultaneous learning, monitoring the evolution of the regulations already in force and the approval of those yet to be approved, the consolidation of concepts, etc.

We also want to stress that product governance requirements, as they are configured now, have proved to be effective within the investor protection framework, requiring firms that manufacture or distribute products to act in clients' best interests during all stages of the life cycle of products or services. In this regards, new requirements added to the process should be carefully considered.

ESMA now proposes to add new requirements to this process: further documentation, additional explanations about the choices made, consideration of additional factors such as scenario analyses (which are, indeed, considered within the product definition process) or charging structure, which will impose a greater burden on manufacturers and distributors without a clear reflection on market protection (especially when talking about non complex products). As required by the proportionality principle which governs MIFID 2 legislations, these additional burdens should only be imposed by the Guidelines if the lack of those obligations have generated in the past a negative impact on investor protection. But this request for additional explanations, documentation, track record, etc. seems to be a "nice to have" with relevant implications for investment firms and no positive impact for clients.

We want to stress the key importance of the proportionality principle and its effective application. One example is the way in which the draft guidelines address the exemption included in Article 16a of MiFID II. Paragraph 19a of the draft guidelines seems to imply that if a specific product is marketed or distributed to retail, professional and ECPs, the product governance requirements should also be met for the ECPs, only because the product is also available to retail and professional clients.

When Article 16a of MIFID II removes product governance requirements for products



marketed or distributed exclusively to ECPs it is because the co-legislators have considered that (i) such category of entities (which may already provide regulated/complex services to clients) do not need to be protected by the legislation; and that (ii) applying the product governance requirements to ECPs is considered an administrative burden with no benefits to the market or the ECPs themselves. Thus, if legislators have considered that ECPs do not need this protection, that should imply not only that the whole product governance requirements are exempt if the product is addressed exclusively to ECPs, but also that no analysis should be made nor requirements to be complied with exclusively for ECPs when the product is marketed or distributed to retail, professionals and ECPs.

In relation to the use of additional data related to risk tolerance, we understand that SRI/SRRI are appropriate measures, compulsory in accordance with PRIIPS/UCITS legislation as a measure of identification of risk in accordance with very detailed methodologies and, therefore, should be considered as an accurate measure for this purpose.

It would be desirable to avoid that each factory establishes its own methodology for calculating total customer risk and product families can be more comparable in terms of risk.

**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.**

We agree with the alignment of the definition of "sustainability related objectives" with the definition of "sustainability preferences" according to Article 2(7) of the MiFID II Delegated Regulation, but only for the provision of portfolio management and investment advice, that are the investment services where the entities must collect detailed information about sustainability preferences. In other cases (for example, when actively marketing a product), entities don't have such information to assess the target market in these terms.

In this sense, we would welcome more clarity when considering proportionality for products distributed under the execution-only exemption:

*Still, ESMA notes that the application of the product governance requirements must be subject to proportionality, meaning that, for example, the target market for certain simpler products distributed under the execution-only exemption can be identified with less detail. Moreover, firms could also adopt a clustering approach in such cases (see the explanation provided below).*

Although we appreciate the inclusion of proportionality considerations, in practice the identification of a sustainability target audience outside of "Advisory" or "Portfolio Management" is considered as "theoretical" with a difficult "practical application", as there is no information from the client to know whether or not he/she meets the sustainability preferences of the product.



Given that in an execution-only regime no questions are asked to the client, trying to "infer" what their characteristics are (e.g. by evaluating their positions / investments over the past years) would be a bureaucratic burden that we also believe would lead to an incorrect conclusion (as there were far fewer sustainable products in the past, for example, and without SFDR rating prior to March 2021).

For these reasons, when the provision of the investment service is different from portfolio management and investment advice, the assessment of the target market must be in a general way, identifying only whether or not the client has sustainability preferences for the investment. Otherwise, the client could perceive, in relation to the sustainability preferences that is being advised. Therefore, we are of the view that softening this consideration would be appropriate, both in the introduction and in the guidance, although we believe and are supportive that the spirit of the guidance does not seek to include great detail in identifying the target audience outside of advisory/portfolio management. Regarding 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, while we agree on the fact that this approach may facilitate firm's implementation in different roles and different stages of the product cycle for certain products, we would like to highlight the need to provide some more flexibility and foresee other potential "sustainability objectives".

In particular, as explained in Q3 below, we are concerned on how the integration of sustainability objectives in the product government rules can affect certain financial instruments under MIFID 2 that are not "financial products" under SFDR Regulation and that, due to their own nature and characteristics, would not possibly fulfill any of the categories included in the "sustainability preferences" definition. For example, amongst others, this would be the case of derivative instruments concluded for hedging purposes. Thus, there may be other "financial products" under SFDR regulation and/or financial instruments under MIFID which clearly have sustainability attributes/characteristics although they do not meet any of the categories within the "sustainability preferences" definition. This would be the case, for instance, of funds classified as art. 8 of SFDR, certain financial instruments that follow recognized international standards such as ICMA principles, ISDA framework for sustainability-linked derivatives, etc. In this regard, we assess positively the introduction of an additional aspect in paragraph 20 of the draft guidelines: "whether, where relevant, the product has a focus on either environmental, social or governance criteria or a combination of them".

**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.**

The integration of sustainability objectives/preferences in MIFID 2 and, more specifically, within the product governance regime, as well as within the advisory process, poses significant challenges regarding certain financial instruments. In particular, while sustainability preferences are defined by reference to the Taxonomy and SFDR Regulations, the scope of which, in terms of affected products, is limited to "financial products" as defined in art. 2.12 of the SFDR Regulation, the amendments introduced in MIFID 2 extend the consideration of sustainability preferences to a broader range of



"financial instruments". This implies a great distortion regarding the application of the regulation as many of the financial instruments covered by MIFID 2 differ substantially (in nature and characteristics) from financial products under the scope of SFDR which are products with a clear investment portfolio approach.

A clear example would be a financial derivative instrument concluded for hedging purposes and with ESG characteristics. In order to meet the sustainability preferences' concept (and not only with regards to the concept of minimum proportion) the derivative should invest in sustainable or environmentally sustainable investments or consider principal adverse impacts on sustainability factors. It seems rather difficult or even impossible that a derivative instrument can meet these characteristics even when it may be a ESG KPI linked derivative. Similarly, there is no perfect match for other financial instruments which, despite being considered investment products, do not involve a direct investment with a separate investment portfolio approach. This would be the case for structured deposits.

Regarding the "minimum proportion" application, it will depend on the sustainability preference, but in general it could be calculated in RF and RV, although the cost of doing so may not justify the benefit obtained, especially when the client buys these instruments in isolation and there is no portfolio concept (for example, in a one-off advisory). This analysis by underlying is already carried out by the management companies, when evaluating each investment fund for example, and obtaining an "aggregate" valuation. Details are given below:

- Taxonomy: the evaluation can be made at the issuer level (and at the issuer level it could indeed be considered a "percentage" based on its revenues / income statement). In a fixed income, it would be necessary to extend the analysis to the "financed", therefore to the project. More than the impossibility of calculating it, the problem is the lack of standardization in calculating it, the difficulty of obtaining such data and the necessary quality (requiring interconnection with data providers, but on which it is sometimes necessary to review / analyze / contrast, and the even greater complexity of obtaining such data in fixed income that may require almost a case-by-case analysis). We understand that some "proportional" solution may help to meet this requirement.
- SFDR - Sustainable investment: If there is a "standard" definition, on earnings, alignment with taxonomy, best practices, etc., it is feasible to implement it, but without this standard definition, it requires a lot of work for the value provided by its evaluation (as it is more common to buy some instruments in isolation, and in these cases there is less possibility of performing engagement or other actions, more applicable in large managers with relevant positions, for example).
- PIAS: Although the underlying values of each PIA indicator could be calculated, the real integration difficulties are much less than in the management of a fund or a plan, since the positions are smaller, and an analysis cannot be carried out as a whole. Again, the lack of standardization and thresholds common to the entire sector makes it difficult to apply a minimum proportion, and it may be appropriate to "phase" the implementation, and to start with the minimum investment percentage only in SFDR products, until there is greater market practice and the homogeneity and information of issuers has improved. In any case, we consider it unlikely that such a phasing will occur for any investment, and at the very least be prepared for this to be required for



managed portfolios, which are considered "market participants" under SFDR regulation.

**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.**

In relation to guidance on complexity, MIFID has divided the product into 2 categories, complex and non-complex products. There is no additional category that the manufacturers have to take into consideration. There are several requirements that rely on those 2 categories (for example the KIDs for PRIIPS products inform the clients if the product is complex or not by including a phrase "You are about to purchase a product that is not simple and may be difficult to understand."). The proportionality principle should be the guidance for the determination of the target market but, without changing the categories of products or establishing an obligation for the manufacturers to create additional categories that may not be shared by other manufacturers or distributors.

Key factors suggested by ESMA should be considered as examples and not compulsory for manufacturers, who should decide on the considerations to be taken into account for such clustering. Manufacturers should define which are relevant in order to identify different clusters of products.

Clustering should not be prohibited in the case of all structured products. This should be deleted in the new paragraph 27 or at least qualified by inserting "certain" (in line with wording used for OTC derivatives).

**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 investment services which might be adequate for the distribution of each specific product are already considered within the definition of the target market (please, check European MiFID Template "EMT" for further reference).

The services provided to clients by the financial entities depend not only on the entity but on the needs and requests of the clients themselves. Considering that, introducing a new obligation of assessment of the consistency of the products and services to be offered to clients, beyond the current practices, seem excessively burdensome and with no clear effects on client's protection.

-In accordance with paragraph 36, "certain aspects of a firm's proposition can add complexity and risk to a product that in itself would be considered relatively simple". Whilst we understand that might be the case, it is also important that the Guidelines includes a reference to the fact that certain aspects of a firm's proposition can help to reduce the complexity or the risks associated to a product. The main objective of the Guidelines should be providing legal certainty and level playing field to market participants and that objective may be achieved not only by restricting firms activity but also providing tools to provide more and better services to 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.**

We agree with the fact that distributors should perform their own analysis of the target market considering their direct knowledge of the final investor. However, we don't find it appropriate that the manufacturers have to share their internal governance procedures and documents in order to support their target market definition. Of course, there will always be a cooperation between manufacturers and distributors in order for the latter to understand what is beyond the manufacturer's definition of target market. We should take into consideration that distributors are authorized firms which are subject to authorization/supervision and provide investment services to end clients. This implies that (i) they should already have enough knowledge to understand the products they distribute and the diligence to ask for anything they may need for that purpose; (ii) any sensitive documentation shared with distributors may be used by them for their own benefit. We understand this should be clarified in the final guidelines.

**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.**

Yes, we agree.

**Q8: Do you agree with the suggested approach on the deviation possibility for diversification or hedging purposes when providing investment advice under a portfolio approach or portfolio management? In particular, do you agree that a deviation from the target market categories "type of client" and "knowledge and experience" cannot be justified for diversification or hedging purposes, neither in the context of investment advice under a portfolio approach, nor portfolio management? Please also state the reasons for your answer.**

Current ESMA Guidelines on MiFID II product governance requirements don't request that distributors report sales outside the positive target market to the manufacturer if the sales are for diversification and hedging purposes and, in turn, suitable for the client. In the same way, distributors must be allowed not to monitor deviations outside the positive target market when the sales comply the above requirements, i.e. the sales are for diversification and hedging purposes and, at the same time, suitable for the client, even in those cases that the deviation is due to the "client type" and/or "knowledge and experience". In our opinion, it's not relevant which category is outside of the positive target market if the sale is suitable for the client (always with a diversification and/or hedging purpose within the framework of investment advice or portfolio management); a client may be outside the target market due to his/her knowledge and experience, but if the sale is suitable for him/her in the framework of his/her investment portfolio, it doesn't matter if the category is one or another, especially in portfolio management where the client doesn't take the investment decisions.



The new approach that the Guidelines are proposing would limit the possibility of certain clients to acquire new products because they may not have expertise or knowledge enough besides that (i) they are paying the services of an advisor or a manager to cover the lack of expertise/knowledge they lack; (ii) the product may be reducing the risk that such client is facing. Thus, at the end of the day ESMA proposal would have a negative impact on those clients that need more protection and that are actually paying for that protection through added value services.

**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.**

No, we don't agree with the updates done in this section. The suggested approach includes a series of obligations that goes well beyond the regulation framework and the proportionality approach. As anticipated in our answer to Q1, these new obligations should be imposed only if there is a current risk or negative impact to client protection that need to be addressed but in the absence of it, the new obligations impose a huge administrative burden that go against the spirit and content of the MIFID Quick Fix package.

In particular:

- a) In relation to the approach in paragraph 72, we consider that it makes no sense to gather information about sales in the target market and/or outside it in those cases where the target market assessment is not required, like sales under only-execution regime. Collecting ex-post information that would depend on the customers' answers would probably have a low success rate (most customers will not answer a questionnaire about something they have already bought and may not buy again), and for drawing reliable conclusions it would be necessary a not expected high answer rate. In addition, there are other factors that complicate this proposal, such as the long period of time that customers may take to answer or those customers who carry out a large number of operations (daily or weekly) to whom it is non-viable to send a questionnaire for each one of them. Finally, the commercial and economic cost associated with this task would not be proportionate to the potential benefits it may bring (when, again, no negative impact on clients has been identified).
- b) In relation to the proposal to include an obligation for the distributors to provide information on products' review to manufacturers to support their own reviews on a proactive periodic basis and not at the manufacturer's request, we would like to point out the following:
  - 1.- Guideline 69 remains as it was in the current applicable guidelines: "manufacturers should consider, on a proportionate basis, what information they need in order to complete their review and how to gather that information". Such guideline is more than accurate since it permits manufacturers to decide the way they want to proceed with the product governance reviews in accordance with their policies and procedures and needs.
  - 2.- This guideline seems, to some extent, contradictory with the new proposed one under number 70, which determined that "whenever distributors have relevant



information to support reviews by MiFID manufacturers, they should proactively provide it to the manufacturer and not provide such information only at the manufacturer's request".

3.- The obligation of distributors to provide this information to manufacturers should not be understood, in our opinion, in an absolute manner that obliges distributors to generate information and automated feedback to all manufacturers without considering what information they need and how to collect it, as indicated in the guidelines and the regulation itself. This interpretation not only generates costly and disproportionate obligations for distributors in view of the large number of ISINs they distribute/market, but may also jeopardize and difficult the manufacturers' own review, since they might receive more information and data than what they would have considered appropriate, in a reasonable and proportionate manner, as necessary to carry out their review, hindering, with an information overload, the objective pursued by the regulation.

4.- In addition to the above, it should also be taken into account that certain manufacturers of financial instruments (in particular, for example, UCITS and UCIs management companies) are not subject to MiFID II and, therefore, to the obligations of identification and review of the target market. In this framework, therefore, they may not request any information from their distributors about the target market or require it only partially within the framework of good practices.

5.- Considering the above, we understand that the obligation for distributors to provide information on the target market must be understood only in response to an express request from the manufacturer ("to support the reviews of the manufacturers" when such reviews are carried out by the latter, especially when they are not obliged by MiFID II).

6.- If the above considerations are not taken into account as a whole, the obligation to proactively provide information to the manufacturer as included in guideline 70 should only be limited to "relevant information", concept which should be defined to avoid legal uncertainty and define clear obligations on the relevant parties.

7.- Last, but not least, feedback should be standardized to smooth and ease all relevant processes.

**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.**

Yes, we agree with the approach given to the negative target market.

Finally, we understand that the need not to establish negative target markets for sustainable preferences could be extended to other factors included in the category of objectives and needs.



**Q11: Do you agree with the suggested updates on the application of the product governance requirements in wholesale markets? Please also state the reasons for your answer.**

Yes, we agree with the updates

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

Regarding the good practice: Distribution strategy by the manufacturer some remarks are needed: When dealing with potential distributors, manufacturers perform a high level due diligence where key aspects of the distributors business model are informed, such as the distribution methods, type of target clients or possibility of re-distribution. Performing a formal due diligence over the compliance of the distributor with the product governance rules would add disproportionate complexity to the process in relation to the objective pursued, taking into account that distributors are authorized firms which are subject to authorization/supervision and provide investment services to end clients.

Additionally, the guidelines incorporate examples on the application of the different categories of the target audience in some products while these categories have not been modified. No examples have been included in the area of sustainability preferences, where an important change has happened, so we would suggest including examples that reduce the need for interpretation by entities in each product type and by distribution scenario.

**Q13: Do you have any comment on the suggested case study on options? Please also explain your answer.**

On the example of options: note the complexity added to the distributor. The fact that in the case of products with a high degree of complexity, unsuitable sales are limited, as well as the requirement of a specific suitability test for the product, in addition to ratification by the customer, can be understood to be a measure aimed at discouraging the distribution of this type of product.