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**Consultation Paper**

**Review of the Guidelines on MiFID II product governance requirements – response of the Polish Bank Association**

**About the Polish Bank Association (“PBA”)**

PBA established in 1991 is a voluntary organisation of banks created on chamber of commerce charter. 100 banks operating in Poland are members of the Polish Bank Association. The organisation represents the interest of the whole banking community to parliament, government and general public. Another very important task of the Association is inter-bank infrastructure building.

Within the Association there are numerous consultative committees, councils, task forces and other bodies. Their objective is to develop and issue opinions and positions in matters determining the correct operation of the Polish banking system.

1. **Answer on the question asked by ESMA**

**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 our opinion the clustering approach should be permitted if the investment firm is able to present enough rationale for a composition of the cluster. Products included in the cluster should have similar features, not only the construction of the product, but firstly similar risk level for the client.

In case of OTC traded products (treasury), following criteria may be used for clustering:

1. how the product is built?
2. what is the underlying asset?
3. what is the level of risk?
4. is the underlying asset deliverable or not?

Applying such criteria is for example possible to include FX Forward and FX Swap in one cluster.

Regarding options situation seems to be more complicated. Analysis how the product is built should be much more detailed than in case of simpler products. For example, following criteria may be taken into account:

1. is the option bought or sold by a client?
2. are there any knock-out / knock-in barriers?
3. is it a single option or option strategy (for example seagull or butterfly)?
4. If it the strategy – is it symmetrical or asymmetrical?

Taking into account that different answers on above mentioned questions means the different risk reward for the client, in such cases structurally different options cannot be included in one cluster.

Generally we think that clustering may be useful for investment firms, simplifying target market definition and distribution strategy, but the firm using cluster should implement internal clustering methodology approved by Senior Management.

1. **Comments to the particular parts of the Proposal**

**Point 19 d)**

Using benchmarks defined in PRIIPs Regulation or UCITS Directive raises some practical problems. Firstly, determining the risk ratio based on scale mentioned above can be difficult for the client and counterintuitive. Secondly, using of the scale can generate some organizational problems. It can cause that one should use different scales for PRIIPs products, for UCITS and for remaining products. We suggest to leave the decision on the choosing scale for the investment firm during the process of product governance.

**Point 20**

We would like to express that in our opinion “sustainability preferences” should not be understood the same as “sustainability objectives”. Since the legislator uses two different terms, they should not be equated. This means that investment objectives should be defined more broadly than sustainable preferences.

The use of the terms of sustainable preferences should be voluntary and limited.

As part of these criteria, the client should be able to specify that he is interested, for example, in products investing in investments in the understanding of Regulation 2020/852, but without specifying a minimum proportion. Specifying the minimum proportions of investments makes the requirements for investment advice pointless, and also means that the review of such products should be more frequent, because these values (percentage of sustainable investments) may constantly change.

The applied conceptual framework refers only to some products (mainly investment funds), while the remaining financial instrument under MIFID products are extremely difficult, if even impossible, to apply these products with sustainability factors. With regard to other financial instruments, such as shares, a separate conceptual framework should be developed, i.e. the company should define what criteria must be met by a given product to be considered as meeting the goals of sustainable development. Companies could use available ratings or other sources of information. In our opinion, the guidelines should provide guidance to the criteria that should be used to evaluate groups of individual products. One should also take into account here the problem of derivatives, which are also subject to assessment in terms of the implementation of the sustainable development goals.

We would like to point out that the designation of preferences according to the conceptual framework of investment advisory services requires considerable competence and awareness of the client. In our opinion, the requirements should define a simplified threshold for entering into sustainable investments for the client so as not to require him to be aware of whether to invest in a product taking into account PAI, or products investing in accordance with Regulation 2020/852 or Regulation 2019/2088.

Finally, we would like to point out that the range of sustainable products varies greatly between Member States. In some markets, there are only a few products that qualify as sustainable. As a result, such a gradual approach is redundant, and in addition, it will result in literally 1 or 2 products in the customer's target market. Therefore, product governance requirements for sustainable development goals should allow the company to take into account the breadth broad wide range of products of the offer, so that the introduced action actually serves customers and encourages them to take advantage of that sustainable investment.

At the same time, we would like to point out that the approach indicated in the Guidelines means that a small group of products will be qualified as meeting the sustainable development goals. In the case that some product groups will be completely excluded, this approach will significantly narrow the range of products offered to customers, which will rather discourage customers from investing products supporting the goals of sustainable development.

**Point 56**

We would like to express our doubts concerning shape and validity of such a warning. Where a product is distributed without an investment advisory service, the investment firm is not obliged to ensure that the product is suitable for the client (as defined in the investment recommendation requirements). For clients covered by investment advice service, such a product should not be recommended, but other clients should not expect the company to test the suitability of such a product for the client. Clients who do not use investment advisory services should not expect an analysis of the product from the point of view of suitability. Indeed, this warning may confuse or even scare the customer. Additionally, it is incomprehensible in the case of companies that distribute entire product segments in the model without investment advice service, and in particular in the case of investment companies that do not provide investment advisory services at all.

Finally, we would like to also point out that the content of the guidelines does not indicate what should be included in such a warning.

**Point 64**

In general, this is the correct approach: the client should not be advised of a product that he or she does not know and understand. However, this solution makes it impossible for the client to obtain a specific profile in terms of knowledge and experience, which prevents him from advising on diversification or securing the portfolio.

In our opinion, the requirement here should be more liberal and leave some flexibility to the investment firm regarding this requirement.

**Point 70**

The content of this point is too general. The distributor is required to provide the correct information to the manufacturer from the distributor's own review. It seems that this obligation should be limited to information on the incorrect definition of the target market, as well as its timeliness (with regard to information from distribution). This information should be of an auxiliary nature, but the main responsibility should rest with the producer and the actions of distributors should not replace or replace the actions of the producer.

**Point 72**

The requirement imposes an examination of further data about the customers who purchased the product. In our opinion, this should be done in the context of testing whether the product was purchased by customers outside the target market. Gathering additional information about the customer seems unrelated to the task at hand.

**Point 73**

We ask for the additional analysis whether the requirement: "Where a distributor recommends to its clients to hold a product it no longer offers or sell, it should still be required to review the target market of that product" is it necessary and provides a real increased protection for the client.

1. **Additional important issues which we would like to rise**

**Bonds and product governance**

Taking advantage of the review of the Guidelines, we propose to provide an explanation of the scope and consequences of the exclusion of bonds from the product governance requirements (according to the art. 16a MIFID II). Does it mean that such products can be distributed to all customers (assuming obligations to act in the best interest of the customer)? Does only bonds with product governance requirements affect the possibility of advising them in the investment advisory service?

**Derivatives and sustainable factors**

We suggest that derivative transactions should be excluded from the obligation of classification as to the compliance of the product with sustainability factors by the manufacturer / issuer and the obligation to meet the requirements of offering a product in accordance with the sustainability related objectives and sustainability preferences. Alternatively ESMA could indicate how to classify standard derivative transactions hedging clients' financial risks. The following arguments support this thesis:

- it is difficult to unequivocally classify or define the nature of a derivative transaction as sustainable investment; only a transaction that in itself creates a cash flow for sustainable related purposes (allocates part of the bonus, exchange rate remuneration or other transaction elements directly to ESG-related purposes) would be unambiguously consistent with the sustainability objectives. At the same time, any standard non-speculative derivative transaction essentially secures the risks arising from financing (credit) and thus contributes to sustainability, hence it is unclear how to classify standard transactions that hedge clients' financial risks;

- assuming that a derivative transaction contributes to sustainable development as it secures the client's financial risks, how to classify a transaction that secures a transaction financed for purposes clearly contrary to sustainable development goals (e.g. a loan to finance a coal power plant). If the transaction is directly related to financing, should it not be given a status such as financing, unless it itself creates a flow for sustainable objectives?

- practical problems arise in relation to the definition of the target market for the product; the same derivative transaction may hedge different types of the client's activities and indirectly contribute to or be contrary to the objectives of the sustainability, which we can clearly determine only at the stage of examining the client's activity or even at the time of concluding the transaction; at the same time the product governance requirements need to be full field at the stage of determining the target market for the product / derivative;

- the difficulty of classifying derivatives as an sustainable instrument (investment) and, in practice, the variety of classification of the same instruments by financial institutions may lead to a situation in which the client will turn to claims that the purchased financial product does not comply with the client's preferences indicated in the MiFID study; in view of the diversity of classifications, it is easy to accuse the instrument that the instrument does not meet the sustainable objectives/ requirements and, consequently, to demonstrate that the client was misled and, on this basis, demand the annulment of the transaction.

**Classification of financial instruments based on the rating**

Can an independent ESG rating of a counterparty (producer/issuer) of a financial instrument (in particular a derivative) determine the status of a transaction if we are unable to assign sustainability status to financial instruments, in particular derivatives, assuming that the transaction has the same "color" as the entity containing it seems justified ?

In case of e.g. a company producing wind farms financing itself by issuing bonds, concluding a loan or derivative transactions, allocates funds for economic purposes in accordance with the statute, thus achieving the sustainability objectives; assuming the opposite, a company with a low rating, e.g. a coal-fired power plant, generally allocates financing for purposes contrary to ESG.

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