

The European Securities and Markets Authority

ESMA35-43-3114

Review of the Guidelines on MiFID II product governance requirements

## General Remarks

- **The guidelines on suitability and product governance are largely interdependent.**

The fact that the two guidelines are not drafted simultaneously poses practical problems and legal uncertainties since the two guidelines touch upon the same or similar legal definitions from different angles. When the two guidelines' consultation processes are not aligned, there is a risk that the guidelines may not be aligned, either.

- **While we understand the general rationale behind the Review, we have concerns about legislation overflow.**

We agree that product governance requirements are one of the most important elements in investor protection framework. This notwithstanding, it is of utmost importance to carefully assess whether a very detailed new guidance will bring added value. It should be highlighted that the shortcomings of the current regime are not clearly identified.

It is of crucial importance that new legislation is backed by transparent preparatory works and proper consultations.

We are also concerned how the various levels of legislation and guidance are not coordinated as of their applicability and entry into force. There are several points where it is difficult to be compliant with legal obligations when technical standards have not been confirmed yet.

- **Only clear definitions make products comparable.**

For example derivatives and structured products are not defined clearly in sustainable finance regulations. It is necessary to keep terminology coherent between regimes.

## Q1

Proposed guideline 3.3.2 for manufacturers section 14 is unclear, "manufacturers should also take into account the results of the scenario and charging structure analyses undertaken for the relevant product". Charging structure of a product depends on various characteristics of a product, and as such it is not simple to consider in product governance as ESMA proposes. It is more important to focus on client's

knowledge and experience, investment horizon and risk tolerance. It is unclear how the scenario analysis it should be interpreted. Nearly all financial products can be sensitive to negative market conditions. We propose ESMA to delete the changes made in section 14. Par 42: we suggest to change “should adopt” to “could, where relevant”

## Q2

Alignment of the terms "sustainable related objectives" and "sustainability preferences" is fit only for products that are in the scope of SFDR.

In order to ensure consistency throughout the guideline, paragraph 42 (page 33) in the guideline should be changed so that paragraph 42 not only cross-refer to target market categories as defined in paragraph 19, but also refer to the new paragraph 20.

We propose deleting the three bullets that are included as a part of paragraph 20 in page 29 which refer to taxonomy alignment (1st bullet), sustainable investments (2nd bullet) and PAI (4th bullet) and instead solely referring to the definition of “sustainability preferences” according to Article 2(7) of the MiFID II Delegated Regulation and as further detailed in the ESMA Guidelines on certain aspects of the MiFID II suitability requirements.

Furthermore, since the product governance requirements apply to all financial instruments and not only financial instruments distributed through advice, the concept of minimum proportion is not practically applicable to certain financial instruments.

Also, it is difficult to have data on the level of sustainable investments and PAI for other financial instruments than products subject to SFDR. Therefore, we support having the third bullet in paragraph 20 on page 29 as an alternative way of specifying sustainability related objectives for products that are not compatible with the elements in the “sustainability preferences”. However, we suggest that the application of the 3rd bullet is further elaborated.

## Q3

The guideline text and ESMA's comments seem to partly contradict each other. We propose that the broad interpretation as in page 9 section 26 is also mentioned in ESMA's guidelines.

Furthermore, term “sustainable investment” is not defined clearly in Article 2, point (17), of SFDR Regulation (EU) 2019/2088. This has also an effect on product governance.

Only clear definitions in regulation make all ESG products and other products comparable.

Derivatives and structured products are not defined clearly in sustainable finance regulations. Derivatives that are used only for hedging purposes, should not be in

scope of ESG preferences or have ESG objectives in product governance. It is not feasible to ask client's ESG preferences if investment advice is given only relating to interest rate hedging. Structured products are also problematic when characterizing sustainability objectives.

**Q4**

We support the clustering approach proposed by ESMA. It is not practical to make product governance procedures separately to all financial instruments that are essentially the same in product governance perspective; especially like simple products as stocks, other exchange traded products and bonds that can be distributed in execution only or through other non-advised sales.

ESMA proposes in guidelines, page 30, section 27 that: "firms should pay particular attention to the level of complexity of products, meaning that the more complex the underlying products of a cluster become, the more granular the clustering should be. For certain more complex products, such as certain OTC derivatives or structured products, it is expected that a clustering approach will not be appropriate and that firms should define the target market at the level of the individual product."

We note that clustering should also be applied in some more complex products. For example, OTC derivatives consist of many different sub-groups where clustering should be regarded acceptable. For example, interest rate caps or swaps can include the same currency and structure, but only different interest rate levels and time periods and they are used for similar situations for client hedging. The products in these OTC derivative sub-groups have identical target market and it should be possible to do some level of clustering also in this kind of OTC derivatives sub-group. The number of similar kinds of product inside this one specific OTC derivative sub-group might be large and it is not feasible to do product by product level target market, because the target market in these products can be identical. This same principle of clustering should apply to all products, also to more complex products, when applicable.

Therefore, we suggest that ESMA deletes this paragraph from section 27: "Generally speaking, for certain more complex products, such as certain OTC derivatives or structured products, it is expected that a clustering approach will not be appropriate and that firms should define the target market at the level of the individual product."

**Q5**

No comments

**Q6**

We propose to change "should adopt" to "could, where relevant"

We propose deleting the following paragraph of the section 47 : "To ensure a proper scrutiny of such more complex products, distributors should also determine whether, next to the manufacturers' target market description, they need access to underlying

assessments such as the outcomes of the manufacturer's scenario and charging structure analyses."

It is not always possible for distributors to have access to the manufacturer's scenario and charging structure analyses. This obligation would not be reasonable for manufacturers and hardly feasible for distributors.

**Q7**

It is problematic to include restrictions on basic financial service models through 3rd level ESMA guidance.

MiFID directive 2014/65/EU sets out in 1st level directive article 25(4) that regarding non-complex financial instruments it is possible to provide financial services execution only bases. Execution only is therefore a valid procedure where clients see and want that they can make investment decisions be themselves without answering to any questions made by their financial services provider. Execution only is very common and widely accepted procedure in the EU area, questioning of which would be against the goals of retail clients' participation to EU's capital markets. A large part of financial instruments is distributed through online tools, execution only and appropriateness assessment in Europe. If execution service covers complex financial instruments, then according to MiFID directive, clients need to be asked only about their knowledge and experience, an appropriateness assessment. If the service provider is giving investment advice or portfolio management to a client, then and only then is there a need to do a full questionnaire and suitability assessment. This should be reflected clearly also in ESMA's guidelines about product governance.

However, we agree on ESMA reminding service providers about gamification and marketing of complex instruments in context of distribution strategy and product governance.

Proposals in paragraphs 54, 56 and 59 should therefore be deleted.

**Q8**

No comments

**Q9**

We agree with the concept of periodical reviews of products in product governance. However, principle of proportionality should be applied to all the obligations relating to reviews.

We find that the target market of most of the financial instruments remains unaltered from a product governance point of view once their target market is established in the first place.

It is hard to think why the target market of a simple stocks sold through execution only platform should be altered and why this target market should be reviewed respectively.

ESMA proposes (par 68) that “Firms should use both quantitative and qualitative criteria to review products, relating to the product’s characteristics”. It is not clear what “quantitative and qualitative” means in this context and how this requirement could be met in practice.

We support the statement: “Firms should determine the frequency and depth of product reviews while taking into account the nature of the product and, where appropriate, the service.”

We do not support this clause in section 70: “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”.

Considering that the manufacturers create a target market for each product using the FinDatEX template, and that the distributors may have a large variety of instruments from different manufacturers, and given that this data must be sent from manufacturers - through data providers - to distributors, *manufacturers do not need information back from distributors*. We propose that this unbeneficial obligation is not added to the guidelines.

We support the idea (par 72) that firms could reconsider their distribution strategy for more complex products distributed through non-advised sales. However, we do not support the proposal the idea that distributors should be “sending a questionnaire to a sample of their clients that have bought a product under non-advised services”. We do not see rationale in asking clients these questions after the investment decision.

Q10

- It is unclear from the guideline whether the exemption from defining the negative target market in relation to sustainability related objectives apply to all products or only apply to products that consider sustainability factors. This is further complicated by the fact that the term “products which consider sustainability factors” is not defined anywhere in legislation nor guidelines.

Q11

No comments

Q12

It is a unclear how binding “good practices” are. By these examples ESMA seems to be putting the standard very high for product governance practices.

Q13

It is unclear how binding the case study options are and what is their purpose.

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