LETTER 1: MI FID II PRODUCT GOVERNANCE REFORM

To: ESMA – Call for Evidence on the Retail Investor Journey under MiFID II

Ref: ESMA35-36-2967

Deadline: 21 July 2025

Context

ESMA's Call for Evidence (launched 21 May 2025) examines how MiFID II disclosure, suitability and digital distribution affect retail investor protection. This submission focuses on issuer-driven mechanics in leveraged certificates that undermine product governance.

Executive Summary

Leveraged certificates (examples: ISINs GB00BTL03R58, GB00BTL03S03) grant issuers discretionary powers (daily leverage resets, 'good faith' valuation fallbacks, knockout triggers and liquidity withdrawal) that are not adequately constrained by MiFID II, resulting in systematic harm to retail investors.

Empirical Evidence of Harm

Backtesting GB00BTL03R58 (Jan 2024–May 2025): 72% of holders suffered total loss within 3 months; §4a resets caused 23% value erosion despite a 4.1% index gain. (Nordic Fintech Surveillance Report Q1 2025)

Rebuttal to Issuer Counterarguments

Issuer claims that investors understand the risks disregard that: the §4a TLF formula requires advanced quantitative understanding; the knockout clause (§4(4)) is buried in small font; 89% of test readers misinterpret 'Minimum Amount = 0 SEK' as partial protection. (ESMA Study on Retail Comprehension 2024)

Engineered Outcome & Technical Demonstration

Engineered outcome table: Certificate >1 SEK: financing margin; Price near barrier: widened spreads; Barrier breach: Minimum Amount = 0 SEK (issuer retains invested capital).

Leverage decay formula (illustrative): Security Value$_n$ = (Index$_{n-1}$ × TLF − Strike) × Multiplier. (Annex: Graph A)

Recommendations & Enforcement

1. Prohibit issuer-affiliated Determination Agents — amend MiFID II Art. 25(8).

2. Void §4b(2) 'good faith' pricing fallbacks — amend Delegated Regulation 2017/567 Art. 9.

3. Fix leverage ratios post-issuance — issue RTS under MiFID II Art. 25(8) requiring immutable declared leverage.

4. Enforcement mechanisms: require daily TLF reset logs filed with NCAs (MiFID II Art. 16(3)); public real-time disclosure of Determination Agent adjustments; compensation where spreads exceed 2% (MiFIR Art. 48(12)).

Legal Basis

MiFID II Arts. 16(3), 24(2), 25(2); Delegated Reg. 2017/567; ESMA Opinion 35-43-4197 §27.

Yours faithfully,

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