Ref: ESMA Public Consultation on the Review of the Guidelines on MiFID II product governance requirements
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EXECUTIVE SUMMARY

Explanations	Manufacturers of investment products are held to certain obligations regarding the internal design and approval of the products they offer, including the requirement to determine what type of clients it targets (target market), how it should be marketed (distribution strategy), and whether it complies with sustainability goals. This set of rules is referred to as *product oversight and governance* (POG) and is laid down in the MiFID II framework. The rules concern also distributors, which must correlate investment products with particular (more concrete) types of clients – not to be confused with the *suitability* or *appropriateness* assessments. In implementing this framework, ESMA prepared Guidelines explaining what is expected from product manufacturers and distributors when complying with the law. ESMA published this public consultation in order to update specific parts of its Guidelines.
Integration of sustainability-related objectives	BETTER FINANCE recommends ESMA to not align the definition of sustainability-related objectives with that of sustainability preferences as the latter is incomplete and does not capture the broad spectrum of client preferences.
Clearer rules on potential target market determination	All products should have a target market identification, albeit simple ones (as defined by MiFID II) should benefit of a simpler or abbreviated assessment. Manufacturers should reflect the complexity of the product in the target market assessment and not rely solely on the dichotomy between simple and complex.
Rules for distributors	Distributors should refine the distribution strategy and the actual target market assessment in line with the evaluations from the manufacturer. To facilitate such process, granular information should be received from the product manufacturer.
Compatibility with ancillary services	Manufacturer should assess whether the investment and ancillary services provided are compatible with the clients' objectives and needs, including broad sustainability preferences.
List of good practices	BETTER FINANCE agrees and welcomes ESMA's list on good practices to be used as a benchmark by product manufacturers.

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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.

We understand the necessity to make amendments in relation to the MiFID II "quick fix" exemptions. However, we are concerned if the current the level of regulatory oversight will be sufficient to effectively monitor compliance with the regulatory changes. Also, we draw attention to the fact that proposed Paragraph 19 does not mention sustainability related objectives at all.

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.

ESMA is right to specify in the "clients' objectives and needs" as a key factor to be considered as part of the potential target market determination should include the sustainability-related objectives with which the product is compatible.

While we also agree with ESMA that the definitions for sustainability-related objectives and for sustainability preferences should be aligned, unfortunately the definition for sustainability preferences is flawed and the detrimental effects will be spread over the POG process as well. Therefore, the interpretation of sustainability related objectives should not be limited to the definition of sustainability preferences.

In line with the regulatory concept of sustainability preferences (as in the MiFID Suitability Amendments) it is client's wish for:

• a minimum proportion of investments aligned with the EU Taxonomy;

• a minimum proportion of *sustainable* investments - defined as such by the Sustainable Finance Disclosure Regulation (SFDR); or

• consideration of principal adverse impacts on sustainability factors under the SFDR.

However, since studies and research demonstrate that client's sustainability goals/objectives can vary between aligning with specific personal values, achieving impact in the real world[1] and boosting the financial performance through ESG integration, for some clients, investing in a financial product which falls under only one of those categories may be insufficient to satisfy their broader sustainability expectations/objectives. It remains unclear if impact-oriented financial products which have an objective of delivering additional, intentional and measurable environmental or social impact alongside a financial return are addressed in the regulatory definition of sustainability preferences.

Thus, ESMA should take the opportunity to provide an adequate definition for sustainability-related objectives, particularly one that is sufficiently broad as to capture the broad spectrum of sustainability preferences of clients.[2]

[1] In 2021 the AMF announced the results of a pair of studies into retail investors' perceptions and expectations of responsible or sustainable financial products. For 76% of French people, environmental impact of investments is an important issue https://www.amf-france.org/sites/default/files/private/2021-09/the-french-and-responsible-investment-products-july-2021_1.pdf and https://www.amf-france.org/sites/default/files/private/2021-09/legibility-study-of-sustainable-and-responsible-investment-documentation-july-2021.pdf

[2] 2 Degrees Investing Initiative, What Do Your Clients Actually Want? Understanding and Estimating Household Demand for Financial Products (2022) 2di, available at: https://2degrees-investing.org/wp-content/uploads/2022/05/What-do-your-clients-actually-want.pdf.

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.

N/A for BETTER FINANCE.

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.

We agree with ESMA that the obligation to determine the target market exists even for very simple products distributed under execution-only but a more simple or abbreviated assessment would be needed. BETTER FINANCE supports ESMA's findings that "*firms should not solely rely on the dichotomy between complex and non-complex products for the purpose of the target market assessment*" and should highlight, and justify, which factors can make a product more complex or simpler (not in the sense of "complex" products under MiFID II), for instance taking into consideration currency or inflation risks.

On clustering, we agree that the more complex a product is, the better documented the target market should be.

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.

BETTER FINANCE agrees with ESMA's assessment that not only the distribution strategy must be aligned with the nature and characteristics of the product, but also the investment and ancillary services must be compatible with the list of five key factors (incl. sustainability preferences).

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 concur with ESMA that actual target market evaluations require granular data and information from the product manufacturer and simple result/outcome forms will not suffice; thus, we support the amendments proposed in this sense.

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.

We agree with ESMA's assessment that "*distributors should refine the distribution strategy as proposed by the manufacturer*" – misalignments, as in the example given by ESMA, cannot be justified by the distributor, as is very well the case with other aspects of the POG process (for instance, if the manufacturer determines that the product is not intended for retail clients).

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.

No input from BETTER FINANCE on this topic.

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.

We agree with ESMA's amendments in this sense.

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 that the purpose pursued (to not exclude sustainability-factored products from passive clients or clients without sustainability preferences) will be achieved by exempting sustainability-related objectives from the negative target market identification.

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.

No input from BETTER FINANCE on this topic.

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

No further comments, BETTER FINANCE agrees with the proposed good practices to be included in the list.

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

No further comments from BETTER FINANC on this topic.