



The European Federation of Investors and Financial Services Users  
Fédération Européenne des Épargnants et Usagers des Services Financiers

## **Public consultation: Draft guidelines on MiFiD product governance requirements**

**Q1: Do you agree on the list of categories that manufacturers should use as a basis for defining the target market for their products? If not, please explain what changes should be made to the list and why.**

The categorization used by manufacturers is a key aspect. We do not agree on this list, essentially because none of the six categories addresses the number one issue of investment product governance<sup>1</sup>. Toxic investment products, i.e. those that fail to deliver even the present value of the amount invested (the purchasing power of the savings) are by far the number one issue for savers and individual investors. This in turn, often points out to excessive (and often opaque) overall fees.

An investment product that is not likely to at least protect the real value of the clients' savings over the advised or needed time horizon is not a suitable product. The manufacturer should also determine (and document) if the overall fee weight still allows for this key requirement, especially in the current low yield environment.

It is also important to make sure that some concepts are well developed. For example words as "retail client", "professional client" or "eligible counterparty" could lead to a misunderstanding if they are not well explained. Concepts need to be clearly defined in order to avoid misinterpretations. We believe that the less clarity in the definitions, the greater risk for consumers of choosing the wrong product. This would be even more relevant when talking about the different cross-border interpretations.

Moreover, this issue also needs to be addressed on concepts such as "client's objectives" and "client's needs" due to the fact that "objectives" refer to the financial goals (of a target client) while "needs" include some other issues (ethical investment, green investment,...).

Furthermore, we believe that the "risk tolerance and compatibility of the risk/reward profile of the product with the target market" mixes different concepts. Even if both ideas are somehow aligned in defining target markets, the "risk tolerance" does not include a reference to a potential reward as it does the "risk/reward profile of the product". This needs to be clarified.

Lastly there is no such thing as a risk/reward profile (in the sense that high risk would imply high returns) in packaged investment products. A lot of independent research shows that most unfortunately, there are a lot of packaged retail investment products that are highly risky and at the

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<sup>1</sup> See Better Finance's response to Sven Giegold's consultation on mis-selling of products. [http://betterfinance.eu/fileadmin/user\\_upload/documents/Position\\_Papers/Investment/en/PP - Response to Sven Giegold Consultation on Mis-selling of products - 101016.pdf](http://betterfinance.eu/fileadmin/user_upload/documents/Position_Papers/Investment/en/PP_-_Response_to_Sven_Giegold_Consultation_on_Mis-selling_of_products_-_101016.pdf)

same time provide for (very) low return. See for example the unit-linked insurance products over the last 16 years<sup>2</sup>.

It is important to point out that we target the design phase, not the distribution one. Product governance should first and foremost ensure that the product is not toxic from the start and/or unsuitable for anyone, considering the manufacturer's recommended holding period.

**Q2: Do you agree with the approach proposed in paragraphs 18-20 of the draft guidelines on how to take the products' nature into account? If not, please explain what changes should be made and why.**

The approach is not incorrect. However, it could be improved. Firstly, it is not clear which are the responsibilities in case of instruments that are generally traded on secondary markets. We ask for more clarity with regard to instruments traded on the secondary market, with possible differentiation among the type of instruments (ranging from shares, bonds... to ETFs). Secondly, the sentence "*the target market should be identified at a sufficiently granular level*" should be better explained in order to avoid misinterpretations. And finally, the guidelines on how to take the products' nature into account could be improved (by including an example, case ...).

**Q3: Do you agree with the proposed method for the identification of the target market by the distributor?**

No, we do not agree with the proposed method for the identification of the target market by the distributor. There are several reasons why. The first one is semantic. In point number 21 it is said that "the manufacturer makes its best efforts to select distributors whose type of clients and services offered are compatible with the target market of the product". We do not believe this point is clear enough. The words "best efforts" are a very subjective term which could lead in misunderstandings.

Secondly, in point number 22 of the draft guidelines on MiFiD II product governance requirements, it is stated that "the manufacturer should propose the type of investment service through which the targeted clients should or could acquire the financial instrument is the product is deemed appropriate for a sale without advice, the firm should also specify the preferred acquisition channel (face-to-face, via telephone, online) and the specific design of the acquisition channel, if relevant". This section does not look at the responsibility of the manufacturer as deeply as it should. In the text it looks like the manufacturer's role was just the one of the managers in the distributor process, not being responsible for the product's performance. Moreover, the distributor should be responsible for choosing the appropriate acquisition channel, taking into account the target market definition.

Thirdly, the shared responsibility between manufacturer and distributor is feasible in a small market but we doubt that it could be achieved in large markets.

Finally, even if the roles of distributor and manufacturer are specified, what are their responsibilities if there is another party involved, a portfolio manager for example?

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<sup>2</sup> Better Finance's report "Pension Savings: The Real Return (2016 edition)". September, 2016. pages 11 and 20. Please find the complete document here: [http://betterfinance.eu/fileadmin/user\\_upload/documents/Research\\_Reports/en/Pension\\_report\\_2016\\_For\\_Web\\_-\\_Final.pdf](http://betterfinance.eu/fileadmin/user_upload/documents/Research_Reports/en/Pension_report_2016_For_Web_-_Final.pdf)

**Q4: Do you agree with the suggested approach on hedging and portfolio diversification aspects? If not, please explain what changes should be made and why.**

We believe that when a distributor sells outside the target market, the reason of the deviations should be obviously justified and explained, but we do not understand why it should not occur on a regular basis (for a limited percentage of investors' portfolios). Moreover, we are convinced that a crucial aspect of investment advice is portfolio diversification. In this respect, there is a restriction when a product cannot be sold outside the target market, and it reduces the usefulness of the portfolio approach.

**Q5: Do you believe further guidance is needed on how distributors should apply product governance requirements for products manufactured by entities falling outside the scope of MiFiD II?**

Better Finance understands that these guidelines assume that, on the one hand, the manufacturer has knowledge about the features of the product and, on the other hand, the distributors are well informed about the characteristics of the client. And therefore the interaction among them would decrease the risk of mis-selling. Nevertheless, there is a relevant gap of interaction. This gap does not result from the guidelines but from the level 1 legislation. Some asset managers are not included in MiFiD II. Since the target market description is a MiFiD II requirement, the mentioned asset managers are not obliged to define the target market, and then the responsibility is transferred to the distributor (see paragraph 39 on page 12 of the draft guidelines). This fact contradicts the reasoning behind these guidelines.

Moreover, assuming that it is complicated to introduce the mentioned changes in the timespan available before the implementation of these guidelines, our opinion is that ESMA should search for mitigating approaches. In this respect, one approach of mitigation could be to encourage manufacturers outside the scope of MiFiD II to define the target market as a service to the distributor.

Another mitigating approach could be to utilize the provision for the PRIIPs KID to define the target market. That is, when the manufacturer is not under MiFiD II scope, the distributor should be responsible to determine the target market (as described in PRIIPS). This would imply that target market description on the KID is a broad summary of the target market, as described under MiFiD II product governance requirements.

**Q6: Do you agree with the proposed approach for the identification of the 'negative' target market?**

Regarding the proposed approach for the identification of the "negative" target market, we would mainly agree with ESMA's approach. The distribution to investors that are considered falling within the negative target market should be a rare occurrence and in any case duly justified by the distributor as both manufacturer and distributor have decided after their own analysis that a certain product should not be sold to a certain group of investors.

Better Finance believes that a sale outside the positive target market could be allowed in restricted cases and not on a regular basis (to make sure that investors are not fully deprived from certain products which may be suitable for them). A sale to investors falling within the negative target market however should be even more

restricted and possible only on a very exceptional basis while duly justified by the distributor. We need to take into account that:

- a. the introduction of the necessity to define a target market is an additional safeguard for investors and
- b. the definition of the target market is a general/abstract procedure - both at manufacturer and distributor level and should therefore in our opinion be related to the product itself. The individual assessment, i.e. the portfolio approach, would then be part of the suitability assessment required under MiFiD II.

**Q7: Do you agree with this treatment of professional clients and eligible counterparties in the wholesale market?**

The treatment of professional clients and eligible counterparties in the wholesale market seems correct. In this respect, Annex 2 of MiFiD II, where the special knowledge and experience applicable to professional clients are described needs to be clearly defined. As in the case of Article 24 (2) of MiFiD II, which is not applicable in the case of eligible counterparties.

**Q8: Do you have any further comment or input on the draft guidelines?**

In general terms these guidelines provide a good framework for determining the target market without being overly complicated, with a major caveat: the inappropriate list of six categories that manufacturers should use as a basis for defining the target market for their products, see our reply to Q1.

Moreover, the document could be improved if there was more clarity on the requirements stemming from monitoring and supervision. We assume that the supervision will be carried out by the National Competent Authority. In this respect, some more information about how it will be done and the methods they are going to be used is necessary.

Furthermore, even if the exchange of information has to remain within the limits of client confidentiality and competition law, certain requirements taken into account in the guidelines protects excessively the distributor's side.

**Q9: What level of resources (financial and other) would be required to implement and comply with the Guidelines (market researches, organizational, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? If possible please specify the respective costs/resources separately for the assessment of suitability and related policies and procedures, the implementation of a diversity policy and the guidelines regarding induction and training. When answering this question, please also provide information about the size, internal organization and the nature, scale and complexity of the activities of your institution, where relevant.**

This is up to the industry to reply not to clients. However, we could mention that the KID included in the PRIIPs needs to determine the target market. We assume that the target market included in the PRIIP's KID is aligned with the one required by MiFiD II product governance. However, as this aspect is of a great importance we cannot rely on assumptions so we would recommend the authorities to be more precise in the definition of product governance target market and the definition of the requirements included in the PRIIP's KID.