Brussels, 7 October 2022

EACB answer to the ESMA consultation on the review of the guidelines on MiFID II product governance requirements

October 2022

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Introduction

The EACB welcomes the opportunity to respond to the ESMA consultation on the review of the MiFID II product governance guidelines because this process is an important part of the investment chain for the distributor.

Prior to providing our answers we wished to make some general statements concerning our main priorities:

- **Proportionality, execution-only and appropriateness:** Seeing the product rules that our members implemented since MiFID II came into force, we have noted in some markets a bias towards simpler products and investment advice (e.g. Spain). In contrast, many of the proposals in the draft guidelines seem to push the manufacturer and distributer to go way beyond in terms of identification of the target market than what can be done on an aggregated basis. Many factors like early exit for example (paragraph 19e of the guidelines) must be addressed at the individual level (e.g. via the suitability assessment). Simple products can be sold to the client through execution only, whereas, complex products would require an appropriateness assessment, and thus we see in current MiFID II the proportionality element is already embedded. In this context, we wish to highlight that complex products and risky products are not the same. We see the use of "risky products" and "level of complexity" to be confusing when it comes to the proposed draft guidelines by ESMA. Indeed, a simple product can be riskier than another but is still not classified as complex. Therefore, we see that many of the proposals seems to be transcribing the concepts under the suitability assessment into the target market identification. Of course there must be alignment between the two, but it is going beyond especially for professional clients and considering there is the appropriateness assessment in place for execution-only. We believe that the use of appropriateness and execution-only rules should be upheld as per the current product governance rules.
- **Conceptual error** - ESMA believes most financial instruments (shares, bonds and funds) are manufactured by investment firms. In reality, stocks and bonds are issues by companies or governments, not by investment firms. In this case, defining target markets and conducting reviews, is legally not the responsibility of such issuers which are not manufactures under MIFID II. If this 'manufacturer' does not exist, the burden of these assessments should not be put at the level of the distributor. We believe that distributors should be able to rely on the correctness of the information regarding the target market provided by the manufacturer. We do not need to re-do the manufacturers 'homework'. This would be in line with the current Level I requirements that do not foresee a target market definition by distributors (see Art. 24 (2) MiFID II: "…also taking account of the identified target market of end clients as referred to in Article 16(3)….."). .
- **Sustainability** - On sustainability, these draft guidelines are based on and aligned with critical concepts in ESMA's guidelines on suitability requirements which were recently published. However, we already see issues in the suitability guidelines in terms of comparison with the EIOPA guidance published in July 2022 on suitability assessments under IDD. For example, the EIOPA guidance goes beyond in terms of the Taxonomy alignment KPIs. We call for better alignment between MiFID and IDD when it comes to ESG requirements as these will be confusing to clients buying investment and insurance products.In addition, we would encourage ESMA to consider the answers from the

European Commission to its Q&A JC 2022 47 submitted on 9 September 2022 (particularly question 1 on the definition of "sustainable investment") once completing the final report on the MiFID product governance guidelines.

- **Deviation possibility** – We wonder why ESMA mentions two specific categories, as appropriate reason for deviation of the target market. We do not see why Knowledge and Experience or Type of Client should obstruct a distributor to gain diversification advantages. We believe it would be better if ESMA deleted the two examples in the guidelines.
- **Professional clients**: In paragraph 17 of the proposed guidelines it is stated that manufacturers should not exclude any of the five categories. In case the type of client is professional, the categories' knowledge and experience, financial situation with a focus on ability to bear losses and risk tolerance and compatibility of the risk/ reward profile seem not that relevant. This would also be in line with the suitability requirements in case of investment advice or portfolio management provided to professional clients. We refer to article 54, paragraph 3 of Commission Delegated Regulation 2017/565. Alternatively a proportionate approach in line with the treatment of professional clients under the suitability requirements, should be acceptable.
- **ECM/ DCM business.** We note problems for the Equity Market (ECM) and Debt Market (DCM) activities of investment firms, in particular with regard to reviews on the basis of recital 15, and paragraph 1 Article 9 of Commission Delegated Directive 2017/ 593 where investment firms accompanying the issues of corporates assigned to act as the manufacturer even though they are not. In relation to corporate issues investment firms provide services like advice, underwriting and placing of the securities. The fees paid by corporates are related to these services. After the issue the services are ended and no on-going fees are paid by corporates. Therefore, there is no funding for ongoing reviews of individual securities (ISIN) by investment firms which have been involved in a corporate issue in the past.The corporates take the responsibility for the issued securities themselves. Normally these securities are traded on secondary markets (no specific distribution channels) and the corporate takes care of the publication of relevant information related to the securities e.g. public disclosure of inside information and through custody chains (e.g. on the basis of SRD 2). Investment firms providing investment advice, portfolio management and execution only services use this information as distributor for their reviews. Involvement of external parties like investment firms which were involved in a corporate issue in the past, doesn't have any added value. Therefore, we would advocate a proportionate approach with regard to reviews in relation to investment firms which have been involved in a corporate issue in the past. We refer in that context to point 57 of the ESMA product governance guidelines of 2nd June 2017. Reviews by these firms could be more generic on the type of instruments in relation to their services provided as accompanying investment firm and not on individual financial instruments (ISIN).

EACB answers

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.

The EACB notes the clarifications being suggested by ESMA regarding the potential target market identification by the manufacturer and would like to provide some specific feedback on the following paragraphs of the draft guidelines:

- **Paragraph 13:** Regarding paragraph 13, we would like to point out that the documentation of all choices would lead to a significant increase in record keeping. In this respect ESMA should be aware that some elements of the target market (i. e. the SRI) need to be calculated regularly. We therefore urge to clarify the wording and refer to the key elements of the choices made in the product governance processes.
- **Paragraph 14** suggests *"…clarifying that, for the purposes of the target market identification, manufacturers should also take into account the results of the scenario and charging structure analyses undertaken for the relevant product."* The charging structure of a product depends on various characteristics of a product, and as such it is not as relevant and simple a thing to be considered in product governance as ESMA proposes. It is much clearer and more understandable to look at the client's clients' knowledge and experience, investment horizon and risk tolerance when you consider more complex products also in terms of the products' charging structure. In relation to scenario analyses, ESMA's is unclear in terms of how to consider the product's sensitivity to negative market conditions in product governance. We note that nearly all financial products can be regarded to be sensitive to negative market conditions. During the last financial crises we have seen also deep declines of values of basic money market funds. UCITS money market funds might have one of the widest target markets as products may have and might be regarded one of the less risk sensitive products offered. Real estate funds are also seen less volatile but in history we have seen large declines of real estate values. All the financial instruments, by their virtue, are sensitive to negative market conditions and this is normal in financial markets. It is again clients' knowledge and experience, investment horizon and risk tolerance that are the more meaningful aspects to consider here, i.e. paragraphs 19 a-e in the ESMAs guidelines -, not scenario analyses in product governance, as proposed by ESMA now in paragraph 14. Therefore, we are proposing ESMA to delete the changes made in paragraph 14 since the target markety identification based on scenario and charging structure analyses is difficult to apply and interpret in practice.
- **Paragraph 14:** We have the further comment that the requirement to generally consider qualitative factors in addition to quantitative factors for all financial instruments and in all cases is, in our view, too far-reaching. According to the principle of proportionality, it should be possible to use exclusively qualitative or exclusively quantitative factors. Not least in the case of less complex or low-risk financial instruments, no relevant added value is generated if qualitative and quantitative factors are used.
- **Paragraph 16:** Regarding paragraph 16, we would like to note that, taking into account the principle of proportionality, it should be possible to combine certain criteria of target

market identification if the structure of the financial instrument and the potential investor base allow for this. The clarification inserted in paragraph 16 of the guidelines should therefore be supplemented by the exception "[...] unless the complexity of the product and/or the potential investors addressed justify a simplified target market determination".

- **Paragraph 17** states that manufacturers should not exclude any of the five categories. In case the type of client is professional, the categories knowledge and experience, financial situation with a focus on ability to bear losses and risk tolerance and compatibility of the risk/ reward profile seem not that relevant. This would also be in line with the suitability requirements in case of investment advice or portfolio management provided to professional clients. We refer to article 54, paragraph 3 of Commission Delegated Regulation 2017/565. Alternatively a proportionate approach in line with the treatment of professional client under the suitability requirements, should be acceptable.
- **Paragraph 19d:** We advocate for dispensing with the additional requirement in paragraph 19d that, in addition to the risk indicators provided for by law, other risks should be taken into account if the indicators do not accurately reflect the risk of the product in exceptional cases. This requirement would have the consequence that the product risk shown to the client in the relevant information sheet and the product risk used as a basis for the target market assessment could diverge (e.g. SRI 4 in the PRIIPs KID and SRI 4 plus additional risk in the target market). The use of different product risks under MiFID and PRIIPs would be very critical as it is hardly comprehensible for clients. At this point, the different product costs should be mentioned, which have been shown to clients for years under MiFID and PRIIPs and represent one of the biggest problems of investor-protective regulations. This problem of non-harmonised specifications should in no case be transferred to the target market. Moreover, the proposed addition to the risk indicator is also not necessary, as there will already be an adjustment mechanism in this respect for the calculation of the SRI under the PRIIPs Regulation from 1 January 2023. For example, the new PRIIPs RTS (COMMISSION DELEGATED REGULATION (EU) 2021/2268 of 6 September 2021) provides in Annex II, point 52a, the following requirement to adjust an SRI that does not adequately reflect the risks of the product: *"52a. Where the PRIIP manufacturer considers that the summary risk indicator number assigned following the aggregation of market and credit risk in accordance with point 52 does not adequately reflect the risks of the PRIIP, that PRIIP manufacturer may decide to increase that number. The decision making process for such an increase shall be documented."* This means that the manufacturer would already have to amend the SRI calculated in accordance with the statutory methods under the PRIIPs Regulation if it is of the opinion that it does not adequately reflect the risks of the product. A further correction under product governance is therefore not necessary and should therefore not be included in the final guidelines. Instead, a reference to the above-mentioned requirement in the PRIIPs RTS would be useful. With regard to the SRRI, a note should be added (e.g. in a footnote) that after the extension of the PRIIPs Regulation to funds from 1 January 2023, this will probably only play a minor role at best.
- **Paragraph 19e:** The optional fine-tuning of investment objectives proposed in paragraph 19e should be dispensed with, as this is not provided for in the legal requirements. Furthermore, it would hardly be possible at the level of the manufacturer to make a statement that a product is aimed at certain age groups, for example. Instead, the tried and tested criteria (asset optimisation, old-age provision, excessive participation in price gains and specific old-age provision) should remain in place. Should ESMA nevertheless stick to the fine-tuning, this should in any case be optional - as provided for in the draft.

Apart from the investment horizon and sustainability, further additions to the target market criteria should be omitted.

- **Paragraph 22:** Instead of *"across the five categories listed above"* the reference should be changed to "as listed in paragraph 19".

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.

The EACB supports the idea of alignment of the definition of "sustainability-related objectives" in ESMA's product governance guidelines with the definition of "sustainability preferences" according to Article 2(7) of the MiFID II Delegated Regulation. However, there are many issues with this alignment to address. First of all we note that this alignment is suited perfectly only for products that are in the scope of SFDR. For example, one may not be able to define sustainability related objectives the same way for simple stocks and bonds or derivatives, as you would do for a UCITS ESG stock fund. Furthermore, the definition of "sustainable investment can be interpreted differently across distributors as it is not clear under the SFDR at the moment. Indeed, we would appreciate clarification on whether ESMA shall consider in the product governance guidelines, the answer from the European Commission on the definition of "sustainable investment" to its Q&A JC 2022 47 submitted on 9 September 2022 (question 1). This would be very helpful in answering this question.

In addition, ESMA's Product Governance Guidelines, which will have to give concrete form to the amendments to the delegated directive published last year, are currently still in the consultation phase. However, the amended regulation will already apply from November 22, 2022. Because the Guidelines will probably not be published before Q1 2023, investment firms do not have insight into the definitive requirements that should give concrete substance to their Product Governance framework. Additionally, the MiFID Suitability Guidelines, which were recently published and which will influence the outcome of certain aspects of these product governance guidelines already have discrepancies with the EIOPA guidance published in July 2022 on suitability assessments under IDD. For example, the EIOPA guidance goes beyond in terms of the Taxonomy alignment KPIs. In addition, data arising from CSRD, SFDR and the European Taxonomy will not yet be available. For this reason, firms cannot comply with the obligation to check and document the sustainability related objectives and to ensure a sufficient level of granularity for each individual instrument whether that same instrument meets the criteria of a particular cluster or target market.

We also note that some target market criteria can be derived from the type, nature and conditions of the investment instruments and/or regulatory mandatory disclosures regarding to these investment instruments (prospectus). This is however not the case for ESG factors. The current target market criteria do not include or indicate the (environmental) activities and governance of the underlying company/issuer. The target market criteria / ESG factors should be included in the regulatory framework applicable to the offeror/issuer of investment instruments (UCITS/ AIFMD/ Prospectus Regulation/ etc.). As long as the "producers" of investment products are not legally required to provide information regarding to the ESG factors, it is not legitimate to put the

obligation to provide the same information on the distributors. Also, if investment products are offered directly to the investor without the intervention of an investment firm the ESG-factors do not have to be disclosed.

The above challenges should be taken into consideration by ESMA.

More specifically, we have some comments to make on paragraph 20:-

- In order to avoid misunderstandings between manufacturers and distributors, it should be clarified in paragraph 20 for the minimum percentages whether it is an absolute minimum percentage or the currently valid and thus variable percentage. Furthermore, for instruments such as shares, bonds and structured products, which - unlike funds - do not have contractually guaranteed minimum percentages (only funds have such requirements), the guidelines should explicitly provide for the possibility to use the latest actual percentage.
- Regarding the third bullet point of paragraph 20 ("Whether, where relevant, the product has a focus on either environmental, social or governance criteria or a combination of them") we would like to point out that there is no legal requirement to focus on ESG issues. Such information is provided, if at all, voluntarily. We ask that a corresponding clarification be included in the guidelines.

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.

Prior to commenting on which financial instruments fit under the concept of minimum proportion, we have some feedback regarding the approach itself to share.

First, we wish to highlight that companies are not obliged to calculate and report the Taxonomy-alignment of their economic activities until 2023. For this reason, there is currently a lack of data, which means that many manufacturers of financial instruments are unable to calculate percentage values and thus report a "0" percentage due to lack of data. It would have been imperative to harmonise the different requirements over time in order to avoid the currently observed low product spectrum. The problems resulting from the divergent entry into force should be taken into account by ESMA and the national administrative authorities within the framework of administrative practice.

Second, we would like to clarify whether ESMA will take into account the answers from the European Commission to their Q&A JC 2022 47 of 9 September 2022, particularly question 1 on the definition of "sustainable investment". The concept of sustainable investment as defined under the SFDR, is not so clear in terms of the method of measurement of this concept, nor on whether there is an obligation for companies to disclose this. There is thus a high risk of different interpretations amongst distributors. We thus believe that the proportion of sustainable investments should not be used for the time being as there exists the danger of misleading customers. In order to avoid misleading customers, the requirements must be fulfilled for the relevant products that the proportions published for this purpose must be minimum proportions in each case and that the published quotas must be comparable with each other. At the moment, this is not the case.

When it comes to bond- and equity-instruments, these are in scope of the concept of minimum proportion but as mentioned, we note that the actual proportion can also be used. However, this actual proportion should come from the company or other issuer in case of bonds since otherwise this could lead to different interpretations. We also ask ESMA to keep in mind that this is an EU regulation and only EU companies are required to comply with the disclosure obligations. We believe the information to determine the target market should come from the company itself and should not be calculated by the distributor in order to avoid discrepancies in the market.

On the use of the minimum proportion itself, we support that ESMA states on page 9 and section 26 of the consultation paper, the broad interpretation of "minimum proportion", as derived from SFRD and Taxonomy Regulation, in that it can also be applied to products with sustainability factors that are not in scope of the SFDR and/or the Taxonomy Regulation. However, the guidelines as compared to ESMA's comments on page 9 contradict each other. If this broad interpretation is mentioned only in ESMA's consultation comments, on page 9 and section 26, this broader interpretation cannot be applied. Therefore, we propose that this broad interpretation is also mentioned clearly in ESMA's actual product governance guidelines.

Finally on the scope of financial instruments, below is a non-exhaustive list of instruments for which, in our view, the concept of minimum proportion would not be practically applicable:

- **Derivatives:** These are not defined clearly in sustainable finance regulations. Derivatives that are used only for hedging purposes, such as interest rate derivatives linked to a bank loan, should not be in scope of ESG preferences or have ESG objectives in product governance. It is not even feasible to ask client's ESG preferences if investment advice is given only relating to interest rate hedging. Furthermore, if you are making investments and taking positions in financial markets through derivatives, e.g. options: What should one look at regarding sustainability preferences and sustainability objectives and product governance? Should one look at the delta value of a derivative or otherwise? How should one define ESG sustainability objectives for a derivative contract if this is seen as an investment?
- **Structured products:** Structured products are also problematic when one tries to characterize sustainability objectives: should one look at the product as a regular bond where the issuer's sustainability is the defining factor? Or should one look more at product characteristics, which are often achieved by a derivative?
- **Shares (and bonds):** One may end up with a similar kind of problem in regular stocks and bonds compared to e.g., ESG UCITS funds. The issuing company of a stock or a bond does not define whether this issued instrument is defined as a sustainable investment according to Article 2, point (17), of SFDR Regulation (EU) 2019/2088. Furthermore, the infromation to determine the minimum proportion is not available right now for the majority of shares and bonds, and proxy data or estimates may not be so precise at this stage. The situation might still be difficult even after CSRD and detailed sustainability reporting standards developed by EFRAG are entered into force. It is problematic to match these instruments to clients' sustainability preferences if there is a certain percentage threshold, defined by a client, regarding "minimum proportion of the product that is invested in sustainable investments as defined in Article 2, point (17), of Regulation (EU) 2019/2088". We hope that this is not leading to a situation where it is only possible to clearly match ESG funds or other packaged ESG products to clients' sustainability

preferences and these simpler products, such as stocks or bonds, are problematic in product governance and suitability.

Therefore, we would like to see regulation where it is easy to characterize ESG objectives in different kinds of financial instruments and there would not be too much room for different interpretations in Europe.

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.

The EACB supports the clustering approach proposed by ESMA as in some cases it is not practical to comply with product governance separately per financial instrument, when some instruments or products are similar in terms of characteristics, such as simple stocks, exchange traded products and bonds that can be distributed in execution-only or through other non-advised sales.

However, we are concerned and ultimately oppose the requirement in paragraphs 24 and 25 of the draft guidelines that the target market for complex products should be defined more granularly. On the one hand, there is no clear definition of complexity as also addressed by ESMA and we do not see that a definition can be clarified in the Level 3 guidelines. On the other hand, we do not consider the specification of a more granular target market definition to be the right way forward. In our view, the focus should not be on a more granular target market definition, but on a particularly careful and - if necessary - narrow definition of the target market for products that are particularly complex and/or risky. This is also in line with the requirement in paragraph 26 of the draft guidelines that products such as CfDs should have a correspondingly narrow target market. A more granular definition of the target market (in the sense of specifying additional criteria) is not necessary for this, as the special features of the CfDs mentioned as examples can be taken into account via the existing target market criteria of customer category, knowledge and experience, investment objective and risk-return profile.

In the same vein, we do not see necessary the granularity in the clustering of products under paragraph 28 of the draft guidelines which requires "risk factors (such as market, credit and liquidity risk) because this will be quite challenging to implement when clustering products. We thus advocate for the removal of this requirement under paragraph 28.

Finally, we would recommend the deletion of this clause in paragraph 27 of the draft guidelines where ESMA states that *"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."* On the one hand, there is a lack of a definition of complexity which in any case cannot be made within the Level 3 guidelines. On the other hand, the question of clustering should be based solely on the comparability of the product structure. If this allows a uniform target market definition, this must also be possible for complex products. In addition, of course, the target market for a particularly complex and high-risk product must be defined particularly carefully and - if necessary - also correspondingly narrowly. In the case of comparable product structures, however, this requirement can be observed uniformly for several products, so that a restriction of the cluster

possibility is not necessary. For example, many closely similar products are issued in the case of structured products. Often the target markets only differ in the investment horizon and the risk indicator depending on the maturity. If the highest risk indicator and the shortest investment horizon are specified for leverage products, this leads to the greatest possible investor protection. The result of this procedure can be described as clustering. There is also no reason to prohibit clustering if it is appropriate. Insofar as leading to inappropriate target markets, it is already inadmissible today. When it comes to OTC derivatives these also 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 markets 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.

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.

ESMA seems to emphasize that the construction of the 'choice environment' should be part of the 'general consistency of the products and services to be offered to clients', however, 'it is distinct from the guidance on the distribution strategy for a specific product'. It is rather vague what is meant with the 'general consistency of the products and services to be offered to clients' and how/why this is different from the firm's distribution strategy. We believe ESMA could further clarify why this should not be an integral part of the distribution strategy. It would also be helpful if ESMA clarifies the legal basis for specifying requirements around the choice environment, as we do not see this basis in MiFID II/delegated regulation.

To further emphasise our point, for example one of our Austrian members pointed out that they currently have a distribution strategy for young adults between 18-27, one for monthly savings, and one for one-time savings. From their point of view, it would make little sense if their sales department had to develop a separate distribution strategy for each individual client category (by age group) as the benefits are not in proportion to the costs. Therefore, we believe that paragraph 39 of the guidelines *("distributors should consider what distribution strategies should be used for the different client groups")* is an excessive proposal.

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 agree that manufacturers and distributors should use the same categories. This is paramount since those categories are disclosed to the end clients in the PRIIP KIID and using the same methodology is key for the data transfer between manufacturer and distributor. We also support ESMA's proposal in paragraph 47 of the guidelines for distributors to be able to use the clustering

approach as indicated in paragraphs 27-29 and for example relating to similar kinds of UCITS funds.

However, we propose to delete the following clause under paragraph 46 of the guidelines: *"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."* First of all, most financial instruments (shares, bonds and funds) are not manufactured by investment firms. This is a conceptual error in MiFID/Delegated Directive. The result is that most issuers / "non-manufacturers" of financial instruments are not legally required to provide any target market information. This puts the burden on distributors to collect this information.

In the guidelines ESMA refers to 'manufacturers' as if every financial instrument is indeed 'manufactured'. After issuance of shares and bonds however, there is no manufacturer that performs any 'scenario and charging structure analyses', leaving distributors with the unduly task to perform these analyses. In paragraph 40 of the comments in ESMA's consultation paper, ESMA writes that *"firms sometimes only rely on the 'outcome'…without having access to the underlying or related documents that were used by the manufacturer in determining the target market for a given product."* We are unsure which underlying or related documents ESMA refers to and if this is the prospectus for example, this does not necessarily cover all the required information that a distributor would need to determine the target market.

Furthermore, we believe that distributors in principle should be able to rely on the correctness of the information regarding the target market provided by the manufacturer. But it is sometimes not possible for distributors to have access to the manufacturer's scenario and charging structure analyses, and also, such analyses would not even be reasonable to be made by manufacturers in most financial instruments at times. Therefore, we do not see a clear reasoning behind adding obligations relating to scenario and charging structure analyses for either product manufacturer or distributor. Distributors should look at their clients' knowledge and experience, investment horizon and risk tolerance to match the right kind of investment products to clients.

In addition, we also have some comments on specific paragraphs:

- Regarding the categories that ought to serve as the basis for determining the target market, we observe that paragraph 42 relates to paragraph 19. We believe that this paragraph should also refer to paragraph 20, which adds sustainability-related objectives as part of the client's objectives and needs to be included in the definition of a target market; and
- We are concerned that the requirement in paragraph 72 (distribution department should obtain certain information for target market identification, for example via questionnaires) could be interpreted excessively.

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.

The EACB supports ESMA's clarifications under paragraph 42 on concretization of the manufacturer-target market, as it appears that the European Commission may now not see it as condemnable to adopt the manufacturer's categories. We welcome this.

We also welcome the explicit statement in paragraph 59 that even very complex and high-risk products can be distributed by way of advice-free business. This corresponds to the expectations of many clients, who rely on the distributor to execute the order they have placed. Where this is not possible (e.g. in the case of bonds with a make-whole clause for which there is no PRIIPs KID), this leads to great displeasure on the part of the customers concerned. Any restrictions on distribution to execution-only clients would therefore be at the expense of the customers.

In this respect, the focus of the explanations should be placed even more strongly on special forms of distribution such as gamification or the active promotion of products by the distributor. Here, the requirement to review these measures as part of the definition of the sales strategy makes sense. This is different if the client acts on execution-only and the bank executes the customer order without any active sales measures with regard to the product.

That said we note that the requirements on the distributor are more restrictive in paragraphs 54 and 56, when it comes to execution-only, and these should be deleted. Execution only is a valid procedure whereby clients can make investment decisions by themselves without answering to any questions made by their financial services provider. It is a common and widely accepted procedure in the EU area, questioning of which would be against the goals of retail clients' participation in the EU's capital markets. A large part of financial instruments are distributed through online tools, via the execution only and appropriateness assessment under MiFID II. In particular, there are rules on carrying out the appropriateness assessment in case the execution-only service covers complex financial instruments. 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 on product governance.

In paragraph 43 of the comments by ESMA in the consultation paper, it is suggested that distributors should *"refine the manufacturer's target market', especially for more complex products that have a relatively narrow target market".* Taking as an example stock or index options, these instruments have no clear manufacturer that reviews the target market. This would mean that distributors will have to make their own analysis. We thus ask ESMA to further clarify why the 'choice environment' is an essential part of the Product Governance requirements, but not of the distribution strategy (Question 5 of the consultation paper).

Regarding paragraph 39 of the guidelines, we consider that the requirement to define a separate strategy for each individual target group to be excessive. The distribution strategy is already not based on client categories but on a product basis. The marketing and distribution strategy are also not the same concept. Even if the target-market oriented products as noted under the distribution strategy could influence the options for marketing platforms (e.g. social media for younger clients), the marketing of products plays only a subordinate role. We thus believe that this requirement should be dropped.

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.

The EACB generally agrees with the suggested approach on the deviation possibility for diversification and hedging purposes when it comes to portfolio management but is unclear on what is meant by the "portfolio approach" and would appreciate a clarification or explanation from ESMA in this respect.

On the other hand, we do not agree *"that a deviation from the target market categories "type of client" and "knowledge and experience" <u>cannot</u> be justified for diversification or hedging purposes, neither in the context of investment advice under a portfolio approach, nor portfolio management."* From a practical perspective and as an example, if a firm offering portfolio management services, for diversification purposes, wants to invest in a hedge fund that is with professional investors as a target market, we do not see why Knowledge and Experience or Type of Client should obstruct the portfolio manager to gain these diversification advantages. We believe it would be better if ESMA deleted the two examples or provided more clarification behind their reasoning.

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.

The EACB supports the concept proposed by ESMA that by way of the principle of proportionality, distributors no longer would be required to review products where a distributor no longer offers a product (paragraph 48 of the consultation paper, paragraph 73 of the draft Guidelines) or that product is no longer sold, even if the client still has the product on deposit. However, we advocate for the deletion of the last sentence in paragraph 73 *("Where a distributor recommends to its clients to hold a product that it no longer offers or sells, it should be required to review the target market of that product"*) because this defies the purpose of the principle of proportionality.

Regarding paragraph 68 of the guidelines, ESMA states that *"Firms should use both quantitative and qualitative criteria to review products, relating to the product's characteristics".* We are not sure what is really meant by "quantitative and qualitative" and what this requirement would entail in practice and thus seek further clarification. That said, we support the clause under paragraph 68 that: *"Firms should determine the frequency and depth of product reviews while taking into account the nature of the product and, where appropriate, the service."*

Regarding paragraph 70 of the guidelines stating that*: "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",* we note that the situation is that product manufacturers are creating the target market of each financial product that is developed, for example by using the FinDatEX template which makes it possible to standardize target market product data and distribute it Europewide between different manufacturers and distributors. Distributors may have a wide variety of instruments from different manufacturers and this data must be handled like this: data from manufacturers (and

usually through data providers) to distributors. Then each distributor makes their own choices based on their client base and distribution models on how to distribute these various products and they thus do not need to change the target market or what distribution strategy to use. Manufacturers do not really request information back from distributors in this way as it is of no value. The distributor then solely decides which products are sold outside the positive target market for example based on portfolio approach, hedging and diversification. Therefore, we propose that this kind of mandatory information is not forced to be sent from distributors to manufacturers and to delete paragraph 70 as the information sent to manufacturers is not meaningful.

Furthermore, we note problems for the Equity Market (ECM) and Debt Market (DCM) activities of investment firms, in particular regarding reviews on the basis of recital 15, and paragraph 1 Article 9 of Commission Delegated Directive 2017/ 593 where investment firms accompanying the issues of corporates assigned to act as the manufacturer even though they are not. In relation to corporate issues investment firms provide services like advice, underwriting and placing of the securities. The fees paid by corporates are related to these services. After the issue the services are ended and no on- going fees are paid by corporates. Therefore, there is no funding for ongoing reviews of individual securities (ISIN) by investment firms which have been involved in a corporate issue in the past.

The corporates take the responsibility for the issued securities themselves. Normally these securities are traded on secondary markets (no specific distribution channels) and the corporate takes care of the publication of relevant information related to the securities e.g. public disclosure of inside information and through custody chains (e.g. on the basis of SRD 2). Investment firms providing investment advice, portfolio management and execution only services use this information as distributor for their reviews. Involvement of external parties like investment firms which were involved in a corporate issue in the past, doesn't have any added value.

Therefore, we would advocate a proportionate approach regarding reviews in relation to investment firms which have been involved in a corporate issue in the past. We refer in that context to point 57 of the ESMA product governance guidelines of 2nd June 2017. Reviews by these firms could be more generic on the type of instruments in relation to their services provided as accompanying investment firm and not on individual financial instruments (ISIN).

Reviews by these firms could be more generic on the type of instruments for which they provide their services as accompanying investment firm.

We support in general paragraph 72 of the guidelines that firms could in some cases reconsider their distribution strategy for more complex products distributed through non-advised sales. However, we do not support the clause that distributors would for example be *"sending a questionnaire to a sample of their clients that have bought a product under non-advised services"* because we believe that this is part of the appropriateness assessment and not the product governance process. The sale of financial instruments through execution-only (simple/less complex products) and appropriateness test (complex products) is already permitted and widely practiced across Europe. Indeed, the sales offices have all the customer information they need for the target market test in the respective service. Based on this, they can determine whether the respective product was distributed inside or outside the relevant target market. No further precautions are required, nor would they be feasible in mass retail business. We thus advocate

for the deletion of this paragraph except for the first sentence, as we cannot foresee any need for further measures.

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.

The EACB would agree that for products which consider sustainability factors, investment firms should not consider sustainability-related objectives of the products when performing a negative target market assessment as this will limit the availability of products with sustainability factors for clients that do not have sustainability preferences. However, the way the wording is construed by ESMA seems to indicate that a negative target market must always be formed for products that do not have any sustainability factors. We would appreciate if the wording by ESMA could clarify that no negative target market has to be defined for the new criterion of sustainability.

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.

The EACB welcomes that ESMA wants to transfer the exemption introduced by the MIFID Quick Fix for products that are only distributed to eligible counterparties into the guidelines and to delete outdated statements in the current guidelines.

Regarding paragraphs 94 and 95, we would like to point out that the presumption on knowledge and experience applies to all professional clients, i.e. both born and bred professional clients. The differentiation between born and bred professional clients only plays a role in the presumption of financial circumstances. These may only be assumed for born professional clients. This aspect should be adjusted accordingly when finalising the guidelines.

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

The EACB welcomes the clarification in paragraph 5 of Annex III that the list of good practices and examples do not form part of the guidelines themselves as these are already quite detailed and the amendments will lead to additional implementation efforts.

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

The EACB does not support the inclusion of these case studies as part of the guidelines for various reasons. First of all, the case studies seem to include lots of details that may not be part of the target market data at this time, such as the precisely defined aspects under the client’s knowledge

and experience. Such detail seems to push the standard too high for product governance practices, and the current guidelines are already very extensive and detailed.

Second, we note that case study 2 seems to imply that inflation would make the target market of some of the products narrower. Inflation is something that investors and service providers already consider. We have seen many years of low interest rates and making more profit on top of that means more risk. One can compare it to the interest rate received when one places their money to a cash account (we have also seen negative interest rates in recent history). For some investors capital protection in structured products is needed because of their lack of risk tolerance. This kind of inflation point made by ESMA could also push investors towards more risky financial instruments without capital protection. The negative target market, from our point of view, is not justified in these kinds of cases.

Contact:

The EACB trusts that its comments will be taken into account.

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