German Banking Industry Committee

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Comments

on the ESMA Consultation Paper - Draft guidelines on MiFID II product governance requirements (ESMA/2016/1436)

Register of Interest Representatives
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Q1: Do you agree on the list of categories that manufactures 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.

1. Principle of proportionality

It is greatly welcomed that – as is already the case in the Level 2 texts – the principle of proportionality is again explicitly highlighted in the draft guidelines. As product governance is an area of regulation that calls for close interaction between manufacturers and distributors, each single requirement should be checked to determine whether it is proportionate.

Particularly the requirement in the draft guidelines that *"(…) each manufacturer should assess the target market at least in each of the six categories.*" (paragraph 14) does not, in our view, appear necessary in every case. There are, for example, numerous cases (e.g. transactions with professional clients or eligible counterparties, distribution of simple instruments, non-advised and execution-only distribution) where the product governance requirements should be less detailed with regard to the principle of proportionality.

We would like to stress how important it is that target market data can be transferred and processed by electronic data processing systems. Mass retail business mandatory requires that no individual data processing is necessary. This should be the general principle of the guidelines.

2. Target market criteria

a. General remarks

The target market criteria proposed by ESMA are basically appropriate, in our view, as they are derived from the Level 1 and Level 2 product governance requirements.

When defining the target market criteria, it should be borne in mind that distributors must be able to take the manufacturer's target market requirements into account. So that investors can be offered as wide a range of products as possible from different manufacturers, it is vital that the potential target market identified by the manufacturer can be processed automatically by the distributor. This includes automatic delivery of data by the manufacturer to distributors and subsequent assessment by distributors. This is the only way the target market can be respected in mass retail business.

The more complex and detailed the potential target market requirements set by the manufacturer are, the more difficult it will be for distributors to respect the potential target market. If a manufacturer defines the potential target market in too detailed a manner, distributors will effectively be unable to perform any matching due to a lack of available client information and data. This would practically impose an unintended sales barrier. Ultimately, it would seriously impede the distribution of third-party products and thus make it economically pointless. This would not, we believe, be in the interest of investors. The great challenge will therefore be making possible a practice that allows manufacturers

to define the target market in such a way that as many distributors as possible can perform matching on the basis of the client information and data already available. Hence, manufacturers should be able to define the target market in as general and technically standardisable a manner as possible.
It should be borne in mind in this context that if the different criteria are drafted freely by manufacturers these cannot be processed automatically and thus respected by distributors. A uniform understanding of differently worded target market criteria is therefore vital.

There should therefore be no room for subjective interpretation of target market criteria. Only distinct and unambiguous criteria will support ESMA's objective of a common, uniform and consistent application of the MiFID II requirements for product governance. As a good example of this level of distinction, we would like to cite the IBAN or the ISIN. By using these identifiers, there can be no doubt about which account or which financial instrument they refer to.

Both clients and regulators consider it important that as wide a range of products as possible from as many manufacturers as possible is available. This allows clients to find investments suited to their needs. Should product governance requirements result in each ISIN having to be processed manually in future, there is the danger of a reduction in the range of products currently available to clients. Unintended consequences would otherwise be:

- a reduction in the range of products, e.g. also of government bonds, and thus fewer solutions geared to investors' needs
- a degeneration of the 'open architecture' approach into a segmentation of the investment market (where certain products are concerned, clients would have to look for a bank that still offers such products, i.e. clients would have to read the information provided by all banks to find out which ones offer which products).
- a drying-up of the secondary market.

b. Number of criteria

We regard the proposed number of six target market identification criteria in the guidelines as a ceiling. A higher number of criteria would increase the complexity of target market identification to such an extent that this would lead to a significant reduction in the range of products for distributors. It is therefore necessary not to leave too much room for manufacturers to add more categories, as this will potentially lead to greater fragmentation of the various definitions and jeopardise consistent processes vis-à-vis investors.

We take the view that the criteria need not be applied fully in all cases if no recognisable improvement in investor protection is achieved as a result. As far as the principle of proportionality is concerned, reduced target market identification by the manufacturer should be possible in certain cases. This should apply at any rate to transactions with eligible counterparties in which both sides have equal status. The requirement of full target market identification by the manufacturer based on all criteria seems to be unnecessary at this point and should therefore be dropped. Also, reduced requirements

for identification of a manufacturer target market are appropriate for products that are created solely for professional clients as end-clients (see also Q7). The same goes, however, for certain products such as shares and simple bonds, where reduced target market identification should also be possible so that these can be geared in general to suitability for mass retail business.

Overall, it is noticeable that the distinction in the guidelines between mandatory information/ assessments and examples is very unclear. It should be borne in mind that the European Commission decided to adopt a directive at Level 2. The intention therefore appears to have been to be able to accommodate the different Member State market practices and needs through Member States implementing the product governance rules appropriately in their transposing legislation.

c. Client category

It is understandable that the already familiar MiFID II client categories, i.e. retail clients, professional clients and eligible counterparties, should be used to define the 'type of client' criterion. Through this categorisation, the legislator created a legally binding standard that should also be the basis for target market identification.

If the manufacturer uses client categories that are not called for in distribution, it is not possible for the manufacturer's target market to be respected. The distribution of third-party products would thus be impeded.

The draft guidelines refer to further sub-categories at least for retail clients, e.g. *"private wealth clients"*, *"sophisticated clients"* (cf. annex 3 paragraph 16) or "*sufficiently experienced and knowledgeable retail clients*" (cf. case study 1). However, we do not believe that such sub-categories make sense and therefore recommend that they be dropped from the guidelines. In the absence of standardisation, the result would be unclearly defined sub-categories that, as a consequence, could not be handled in the matching process between manufacturer and distributor.

d. Knowledge and experience

The 'knowledge and experience' criterion proposed in the guidelines causes serious problems, as the term 'knowledge and experience' has not been standardised.
Overall, the proposals on knowledge and experience made in the guidelines appear, in our view, to be too detailed and unworkable in practice. We recommend avoiding individualised descriptions for each element.

In particular, the concept of 'extensive' ('in-depth') knowledge and experience should be dropped. In the absence of any standardisation, a gradation of knowledge and experience makes matching against the target market requirements impossible.

There should, for example, also be no reference to certain time periods within which experience must be acquired, as implied in paragraph 16 (b). The relevant passages should therefore be deleted. Particularly in non-advised business, which is characterised by both the need and statutory requirement for prompt execution of orders, checking such detailed requirements with regard to the knowledge possessed by investors would be unfeasible – without any standardisation, at any rate.

The general rule is that distributors are only able to respect the potential target market identified by the manufacturer if they have the required client information and data at their disposal. MiFID II already specifies in detail in which situations which client information and data have to be requested by distributors. We would therefore welcome clarification that the guidelines do not set any further requirements for requesting or processing client information and data.

We assume that missing experience can be fully offset through appropriate knowledge, e.g. knowledge obtained within the scope of investment advice. This is the only way new investors without any previous experience of financial instruments can get access to the market.
Clarification is also required on whose knowledge/experience matters in cases of representation. There should be no conflicts with the requirements for the suitability test or appropriateness test. These tests are rightly geared to the person of the acting representative. The target market definition is, however, directed at the ‘client’ and thus to the party represented. Resulting inconsistency between respecting the target market and the suitability/appropriateness test would create severe problems.

e. Financial situation with a focus on the ability to bear losses

The ability to bear financial losses (paragraph 16 (c)) is a key element from the investor’s perspective and should therefore be included in the target market definition.

Yet it should be made clear that neither the manufacturer nor the distributor has to take the client’s assets into account when assessing the potential exposure to loss on a financial instrument. Whilst the maximum proportion of net investable assets does play a role within the context of a client’s investment strategy, it has no relevance to a client’s ability to bear losses. Also, the reference value for such expression of a maximum proportion will be of a relative nature and vary from client to client depending on different sizes of amounts to be invested, size of portfolios, etc. However, the target market description at product level needs to be standardised and cannot take individual and specific client situations into account. The proportion of net investable assets must remain the sole responsibility of the client.

f. Risk tolerance and compatibility of the risk/reward profile of the product with the target market

We agree that for packaged products in accordance with the PRIIPs Regulation using the overall risk indicator stipulated by the PRIIPs Regulation is a practicable approach. It is thus only logical that this risk indicator, where available, is given a key role also in the identification of the target market, as proposed in paragraph 16 (d). We do not believe that a verbal description of the categories would be

helpful, as uniform implementation would not be possible without binding standardisation and the PRIIPs Regulation also does not stipulate any mandatory description.
We propose that, where non-PRIIP products are concerned, a risk category using the same logic as the PRIIPs SRI could be used. Also, a 'translation' of this indicator by the distributor into distributor-used criteria must always be possible: if a distributor has agreed on a risk category system with its clients, e.g. a different risk metric than the SRI or the like, a distributor should always be allowed to use the SRI as a basis and, for its own target market, the risk classes agreed with clients.

In addition, the risk/reward profile should not be confused with a 'risk attitude'. We would like to emphasise that the target market description is at product level and a product does not have an attitude towards risk. The risk and potential risk are product-inherent, in contrast to the risk attitude which is attributed to the investor. Depending on how the product is used in a portfolio context, it can meet very different risk attitudes. The risk/reward profile needs to be described in a clear, standardised fashion, irrespective of a client's individual situation.

g. Clients' objectives

The investment objectives proposed in paragraph 16 (e) are basically appropriate, in our view. So that whether the target market criterion has been fulfilled in a given case can be checked in an automatic process, points that are regularly addressed in discussion of investment decisions should be used for defining the 'clients' objectives' criterion.

h. Clients' needs

We regard the description of clients' needs in paragraph 16 (f) as problematic.

The client-specific aspects proposed in paragraph 16 (f) can be taken into account within the scope of investment advice. When identifying the target market, it appears simply impossible to, for example, say anything about clients' age or country of tax residence at this early stage. The relevant passages should therefore be dropped.

Apart from that, taking into account the product-related aspects 'green investment' or 'ethical investment' could also create considerable problems. This is because, in the absence of a generally valid definition of these, distributors would effectively not be able to consider the information provided by manufacturers. Particularly in the area of ethical investment, no uniform definitions are likely to be feasible due to differing world views and religious confessions. Irrespective of the fact that such definitions would probably apply to only a very small number of investment products in any case, obtaining sufficient certification would also generate considerable costs.

What is more, distributors should only be required to take these criteria into account when providing advice if the client explicitly voices such preferences. Generally checking such rather rare product

characteristics would impose an enormous burden and would therefore be disproportionate. The special nature of this criterion should be reflected in the guidelines as well.

3. Target market identification process

A problematic point, in our view, is the reference in paragraph 13 to the fact that target market identification should be based not only on quantitative criteria but also on qualitative considerations. It is unclear how this is to be accomplished in practice, given the complexity of target market identification. In addition, in the absence of any standardisation, distributors cannot take qualitative information into account. To allow manufacturers the necessary leeway in identifying the target markets, the reference in paragraph 13 should therefore be dropped.

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 draft guidelines assume – correctly and in line with the Level 1 and Level 2 requirements – that, with the principle of proportionality in mind, the granularity of target market identification should be geared to the complexity of products.

Yet the draft guidelines fail to draw the logical conclusion that certain simple products are suitable for the mass retail market and a detailed target market identification is unnecessary in their case. This is stated in both ESMA's Final Report (p. 53, paragraph 11) and in the Delegated Directive (EC 18) as well as in the consultation paper (page 7, paragraph 17). It should be included by way of clarification in the guidelines as well.

The clarification that, where bespoke or tailor made products are concerned, no abstract target market identification by the manufacturer is required (paragraph 20) is correct, as the products concerned are tailored to each client. The individual client is therefore the target market. Abstract target market identification for customised products would impose an enormous burden without delivering any added value for clients, since these receive a product in line with their specifications.

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

We regard the content of paragraphs 23 ff. as highly problematic overall.

According to the draft guidelines, irrespective of whether or not a target market has been identified by the manufacturer, the distributor would at the same time always be required to identify a target market of its own as well. This blanket obligation would go beyond Level 1 and Level 2 and thus establish an additional requirement for distributors.

As the wording of Article 24 (2), second subparagraph of MiFID II shows, distributors have to "*take account of*" the target market identified by the manufacturer when selling products. It does not stipulate a requirement for the distributor to always identify a target market of its own or to concretise the target market identified by the manufacturer.

In our view, no extension of the requirements imposed on distributors was intended at Level 2. This follows from a written response by the European Commission on 13 May 2016 to a question by MEP Ferber, the ECON rapporteur on MiFID II:

> *"Unlike manufacturers who need to establish and publicly communicate the relevant target markets they have identified, distributors need to be mindful of the relevant target market when assessing whether a particular product is aligned to an individual client`s financial needs – this obligation arises by virtue of Art. 24 (4), second subparagraph, and Art. 9 (3) (b) of Directive 2014/65/EU."*

For practitioners, it is vital that this common understanding of the European Parliament and Commission is also reflected in the guidelines. Otherwise the Level 3 requirements would contradict those set at Level 1 and Level 2.

A requirement for distributors to always identify a target market of their own would lead to serious restrictions on the range of products available to investors.

- The legislator considers that describing products – and this includes identifying the target market – is a responsibility of the manufacturer (see. recital 12 of the PRIIPs Regulation (Regulation (EU) No. 1286/2014).
- In this context, it should be pointed out that, as things stand at the moment, the target market identified by the manufacturer is actually to be communicated to customers in the basic information sheets provided for under the PRIIPs Regulation.
- Especially small and medium-sized banks would be unable to identify the target market for third-party products on their own. That goes particularly in view of the fact that a very wide range of products is available to clients who decide by themselves.

- A requirement for distributors to identify a target market of their own would thus mean that investors could only be offered a restricted range of financial instruments. Such a requirement would therefore also be detrimental to investors.

The entire remarks in the consultation paper on target market identification by distributors should therefore be confined to the special case in which no target market has been identified by the manufacturer.

There should also be no requirement for distributors to further concretise the target market. While the distributor should be obligated under its own product approval procedure to take account of the potential target market identified by the manufacturer, it should not be forced to define the individual market criteria more granularly. This is part of the suitability test and thus a client-specific assessment within the scope of investment advice. In addition, the reference at the end of paragraph 27 on page 9 appears questionable to us for data protection reasons if, to identify the target market, it proposes allowing distributors to access data collected for other purposes, e.g. anti-money laundering information. In the absence of an appropriate legal basis, we believe this would not be permissible under Article 6 (4) of the General Data Protection Regulation.

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.

A positive point is that ESMA acknowledges in paragraph 29 ff. on page 9 f. that the abstractly identified target market need not always be the deciding factor when it comes to concrete distribution of a product. ESMA presents this point very graphically in paragraph 31, using portfolio advice as an example. It is obvious that a risky product does not in itself, or if the client were to invest all his money in it, suit a more conservative-minded investor, so that when separately matching target market and client this would be a case of distribution outside the target market. When the portfolio structure is taken into account, however, the product is nevertheless shown to be suitable, as mixing individual riskier instruments into the highly conservative portfolio is precisely in line with the investment objectives the client had in mind. The guidelines confirm this assessment.

What we do not understand, however, is why the guidelines nevertheless create the impression that each product has to be seen separately for the purpose of identifying the target market. This is particularly puzzling, as the example given in the guidelines makes clear that such an isolated approach ignoring the portfolio structure would be pure formalism and produce incorrect results. It should also be borne in mind in this context that such incorrect results produced by the target market assessment may be reported to the issuer and can lead there to faulty product monitoring. In the above example, distribution outside the target market under the guidelines would be reported to the issuer, which, together with other reports, may lead to the issuer modifying the target market although the error reported is merely due to the fact that the portfolio effect was not taken into account. For this reason as well, it should be made clear that the target market definition is taken into account in portfolio advice on putting together the portfolio but should be omitted where individual instruments are distributed. Only this approach does justice to the special nature of portfolio advice

If these arguments are not acknowledged and the obligation to assess the target market is retained, it should at least be made clear that no deviations from the target market should be reported to manufacturers within the scope of portfolio advice. There are likely to be a large number of deviations in practice that are all due to the above-mentioned portfolio effect. Communicating such deviations to the manufacturer would deliver no added value or could even lead to faulty product monitoring by the manufacturer. Portfolio advice should thus be explicitly excluded.

It must be possible to take portfolio structures in a non-advised situation into account. This assessment can be done by the client. By this, the client would be enabled to add products that are not only compatible to his portfolio, but also improve the overall portfolio structure, e.g. relating to risks, costs, or return. If the client would not be allowed to make the target market assessment by himself, the client would be barred from developing his portfolio. We think that would not be in the interests of clients.

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?

In view of the reference in paragraph 41, it should be made clear that classification of products as suitable for the mass retail market should be possible not only for execution-only but, in general, for all distribution channels. The problem that there will, for example, be no manufacturer target market for shares and corporate bonds in many cases does not differ between the individual distribution channels.

Aware of this problem, the Level 2 legislator created the possibility to gear simple products, e.g. shares and simple corporate bonds whose manufacturers are not required to identify a target market, to the mass retail market. This is the only way a significant reduction in the product assortment can be avoided, particularly as paragraph 54 says that distributors are not allowed to sell a product for which there is no manufacturer target market and for which they cannot identify a target market themselves. This tough consequence can only be accepted if it is made easier for distributors to identify a target market for simple products.

Otherwise the consequence outlined in paragraph 54 would lead to a significant reduction in the range of funding products on offer to companies. This would be seriously at odds with the other political objectives of the EU (e.g. Capital Markets Union).

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

Paragraph 63 creates the impression that the sale of products outside the target market is only possible in rare cases. This approach would lead to a de facto ban on distribution. This would be completely unreasonable and go beyond the requirements set at Level 1 and Level 2. It already follows from the fact that sales outside the target market have to be reported to issuers that these generally need to be permissible. This fundamental assessment by the legislator should not be modified via the guidelines. But it is also clear that, where they wish to sell a product outside the target market, distributors have to check the suitability of the product particularly carefully when providing investment advice. If they confirm the suitability, then they should be allowed to sell the product without any restrictions. This is in line with the concept behind the product governance requirements, according to which distributors should take account of the target market.

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

Paragraphs 66 ff. contain some very important clarification on the treatment of the target market where products are distributed to wholesale clients:

1. Purchase of products that are sold on

Of particular importance is the clarification in paragraphs 66-69 to the effect that the target market is irrelevant where products are sold to professional clients or eligible counterparties if these only buy the product to sell it on to end-clients. From the issuer's perspective, this case is to be treated as if the product were sold directly to end-clients. For these, the target market naturally needs to be identified.

What should be dropped is the reference in paragraph 69 to the fact that the eligible counterparty that buys the product to sell it on as a distributor should be required to reassess the target market in line with its product governance obligations as a distributor. As explained earlier, this is not envisaged at Level 1 and Level 2.

The draft guidelines could be read in a way that suggests that the example in paragraph 89 only applies in a situation where the firm has no direct connection to the end client. That would not be appropriate.
It should be made clear that an intermediation chain also exists where there is client relationship with the end-client but the end-client is represented by an investment advisor or a portfolio manager. While in this case the account-keeping or order-executing party has a contractual relationship with the end-client, the latter is already adequately protected for product governance purposes through a MiFID firm providing investment advice or financial portfolio management services. An assessment by the account-keeping or order-executing party is therefore of no relevance, particularly as it usually has less information about the end-client than the MiFID firm consulted by the client.

2. Eligible counterparties

As regards distribution to eligible counterparties as end-clients (paragraphs 75, 76), it is correctly pointed out that Article 30 (1) of MiFID II suspends the obligations for distributors under Article 24 (2) of MiFID II. Even though Article 30 (1) of MiFID II explicitly refers only to the obligations for distributors under Article 24 of MiFID II, the assessment made in Article 30 (1) of MiFID II should be taken into account also with regard to the requirement to identify a target market under Article 16 (3) of MiFID II.

It should, in particular, be borne in mind that identifying a target market that does not have to be taken into account for distribution purposes appears to be a case of pure bureaucracy. It should hence be made clear in the final guidelines that no target market identification is needed for products that are to be sold exclusively to eligible counterparties as end-clients. This would only be logical in view of the provision of Article 30 (1) of MiFID II.

3. Professional clients

In the passages on distribution to professional clients as end-clients there is, in our view, a contradiction between the rules on product governance and the rules on cost transparency. Whereas reduced requirements can be agreed for cost transparency under Article 50 (1) of the MiFID II Delegated Regulation, the guidelines do not allow such reduced requirements in regard to product governance. This is inappropriate, in our view, as the Level 1 legislator signified in Article 30 (1) MiFID II that cost transparency generally needs to be protected more than product governance. The guidelines should thus allow agreement on reduced requirements also for business with professional clients, as provided for in regard to cost transparency under Article 50 (1) of the MiFID II Delegated Regulation.

The distinction between per se professional clients and elective professional clients in paragraph 72 of the draft guidelines is inaccurate, in our view, and the relevant passages should be deleted. In line with section II.1 of Annex II to MiFID II, the criteria and procedures mentioned therein have to be fulfilled for a client to be classified as an elective professional client. Once this classification has been carried out, clients are ‘professional clients’. No provision is made in MiFID II for per se professional clients and elective professional clients to be treated differently. There is therefore no room for a distinction between per se professional clients and elective professional clients within the scope of target market identification either, also not in regard to knowledge and experience.

For products that are distributed to professional clients as end-clients solely on a non-advised basis and where such clients are assumed by law to have the requisite knowledge and experience, reduced requirements for identification of the target market by the manufacturer should also be possible. Mandatory target market identification where products are distributed on a non-advised basis is, in our view, unreasonable and unnecessary, as the sole relevant criterion is assumed to exist by law.

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

1. Distribution strategy

Our understanding is that the distribution strategy is not part of the target market, but stands alongside it. This is confirmed by paragraph 25 on page 9, which correctly distinguishes between target market and distribution strategy. Other passages in the consultation paper (e.g. paragraph 21 on page 8) could be understood differently, however. We therefore request clarification that the distribution strategy is not a target market criterion.

The requirements imposed on the manufacturer for planning and setting a distribution strategy in paragraph 21 et seq. of the draft guidelines are much too concrete and narrow. For one thing, they impair the business flexibility that is essential to allow a response to new developments; for another, the requirements that the manufacturer of a financial product is thus to be required to fulfil may result in investors being restricted in their freedom to make decisions. Ultimately, the open access to the investment universe that is currently available in non-advised business could be restricted. The group of informed investors who make their investment decisions themselves without using advisory services is relatively large. We see the danger that some of these investors may consider moving their accounts to non-EU countries in future, as the product governance provisions could be tantamount to ‘disempowerment’ of clients.

2. Acquisition channels (paragraph 22)

If manufacturers were to be obligated to offer clients a special acquisition channel (face-to-face, by telephone or online) as well, distributors who offer other acquisition channels would be discriminated against. As long as all acquisition channels are well organised, there is no justification for giving preference to certain channels. On the contrary, with each acquisition channel delivering the same level of product information, they are to be considered equal. In addition, clients usually have the possibility to seek further contact with relationship managers should they wish to receive further information. This is a well-established and adequate arrangement. It should therefore be left to investors to decide which acquisition channel they wish to use individually. Any specifications in this respect by the manufacturer make no sense, so that the relevant wording in the final sentence of paragraph 22 should be deleted.

3. No restriction of the product assortment in non-advised business (Annex 2, paragraph 35)

We welcome ESMA’s acknowledgement that no full target market match can be made in non-advised business, as usually not all relevant client information and data are available here. Matching the client against the target market in the context of Art. 25 (3) MiFID II should therefore be based on the ‘knowledge and experience’ criterion that is also checked under the appropriateness test.

However, the wording in paragraph 36 reading "*they should pay particular attention to situations where they might not be able to make a thorough target market assessment by virtue of the type of services they provide*" is unclear. Identification of the target market is not impaired by the type of service via which a product can be purchased. If the intention here is to establish that no suitability test is performed where services are provided outside investment advice, then this is already specified by a legislator's assessment. Matching the client against the target market is thus still possible, namely to the extent provided for under Article 25 (2), (3) and (4) of MiFID II.

We therefore see a clear conflict with Level 1 if the guidelines were to be understood to mean that the distribution of certain products is only to be possible in future within the scope of investment advice. Such an understanding would run counter to the present system of non-advised business and execution-only business under MiFID II. It is precisely in line with what the legislator basically decided, i.e. that distribution of non-advised products should be subject to an appropriateness test for each product and that features such as, for example, the investment objective should not play any role. For distribution of non-complex products on a non-advised basis, the legislator actually deliberately refrained from setting an appropriateness test requirement because of the simple nature of such products. These decisions by the legislator must be respected when designing the product governance regime and must on no account be circumvented via Level 3 measures.

A different approach could effectively lead to the abolishment of non-advised business for a large number of products, though Level 1 does not deliver any legal basis whatsoever for this. What is more, this would not be in the interest of investors, as many investors have deliberately opted for the non-advised distribution channel for securities, as they can and wish to make their investment decisions on their own at a time of their own choosing. This would no longer be possible in future if it were to be concluded that the range of non-advised products would be seriously restricted. For clients, this would mean that they would only be able to purchase the desired product after being 'forced' to obtain advice beforehand or would not be able to do so at all, as result of which the purchase of the desired product may be delayed considerably (e.g. in the case of a forward rate agreement) or impossible (range of advised products is limited). This would lead, in the event of prices rising, to the client only being able to purchase the product at a much higher price. In addition, it should be borne in mind that investment services firms are effectively unable to provide advice on all products. Due to the stringent requirements to which investment advisers are subject when providing investment advice, the range of advised products can always only cover a small number of financial instruments.

What is more, such an assessment would jeopardise the existence of all investment services firms that mainly conduct non-advised business, e.g. online banks or online brokers.

Ultimately, it is to be feared that all products that are not typical advised products would effectively disappear from the market.

The reference to complexity/risk in paragraph 26 seems to be misleading. First, there is no recognisable connection between complexity and risk. Second, the complexity of a product is sufficiently reflected by

the requirements on knowledge and experience. An additional test by the distributor would be redundant. The reference to limited protection is equally misleading, as a whole variety of measures are conceivable to additionally protect clients.

4. Assessment solely of knowledge and experience in non-advised business

It must, in addition, be made clear that in non-advised business solely the ‘knowledge and experience’ criterion has to be assessed. We believe that it would be incompatible with MiFID II if an investment services firm were to be required in future in non-advised business to also take into account client information that it has obtained outside non-advised business, e.g. in the course of investment advice or lending. In our view, footnote 8 on paragraph 36 (page 11) could be misunderstood and should therefore be deleted.

The distinction between advised business and non-advised business should, moreover, not be softened via the ‘actively market’ criterion, as implied in guideline 43. Even if distributors take measures to promote the sale of a product, this does not alter the fact that only limited client information and data are available to them in non-advised business and that they can thus only assess knowledge and experience. This limited scope for assessment, to which ESMA draws attention at various points in the draft guidelines, also applies where products are actively marketed. Insofar as ‘actively market’ refers to the cost transparency requirements under Article 50 (6) of the MiFID II Implementing Regulation, adoption of the assessment therein is inappropriate. Whilst cost transparency is about displaying the product-related costs, which is mandatory for the distributor in the case of actively marketed products, the problem with target market identification is the missing client information and data. The fact that certain sales or placement agreements exist, thus establishing proximity to the manufacturer, may enable the distributor to determine and display the costs inherent in products. The fact that client information and data are not available is not altered in any way by product-related sales measures. As a result, the statutory distinction between advised orders and non-advised orders and the accompanying obligations should be retained also for target market identification.

5. Distributors’ feedback to manufacturers

ESMA correctly points out in paragraph 48 ff. of the draft guidelines that product governance should include a dialogue between manufacturers and distributors. As in non-advised business a distributor will potentially offer virtually all products available on the market for sale, the flow of information is highly complex, since all relevant information on all products must be available to all distributors. This requirement shows that the amount of information in each case has to be limited so that implementation remains manageable. Any information overload threatens to make the exchange of information too complex to handle in practice. This would, in turn, result in distributors having to focus on the products of certain providers, culminating in a reduction in the range of products that would not be politically desirable.

- It should be made clear in the guidelines that manufacturers only have to make available the information and data of relevance for the distribution processes.
- It should be made clear that feedback should only be delivered to manufacturers in accordance with MiFID II.
- It should also be made clear that not all sales outside the target market have to be reported to the respective manufacturer but that this may be made dependent on certain absolute and relative thresholds being reached. This is the only way to ensure that irrelevant information is not exchanged and that distributors' feedback is confined to information that gives grounds for reviewing the target market. To this end, the deviations should have reached a certain level. It is in this sense that we interpret paragraph 49 of the draft guidelines, although it should include explicit reference again to thresholds.

6. Portfolio treatment

ESMA correctly highlights the need for portfolio diversification. We therefore fail to understand why sales outside the target market should only rarely be allowed. This would obstruct potential portfolio diversification. We therefore believe that ESMA needs to underline the appropriateness and suitability tests as the right place for focussing on individual client wishes.

7. Financial portfolio management

The assessment underlying the draft guidelines, holding that portfolio management (individual financial portfolio management) is a form of distribution within the meaning of the product governance requirements, must be rejected. This is the result of an incorrect interpretation of Article 10 of the Delegated Directive.

Application of the same criteria would undermine the benefits of portfolio management services. The purpose of portfolio management is to transfer investment decisions to qualified experts within predetermined limits. We should welcome clarification on paragraph 43: If a management company outsources management of a fund's investments to a third party, this third party in principle performs a form of financial portfolio management. Yet in this case there is no end-client on the one side and financial portfolio manager on the other. Furthermore, there is no reason to apply the MiFID protection mechanisms. The portfolio manager complies here with the stringent requirements of the UCITS Directive or fund rules and regulations, so that no further target market is needed. It should thus be made clear that any product governance requirements in this area have already been taken into account through compliance with fund rules and regulations.

8. Case studies

Correctly, ESMA has not proposed any rigid target market concept but is merely drafting the framework for target market identification, the concrete examples of application of the guidelines in Annex IV should be dropped. The definitions there are highly detailed in some cases, so that it is unclear whether the

examples are actually implementable when it comes to the sale of third-party products. This applies particularly in view of the fact that we are not aware of any comparable concepts from other European countries. This would also be consistent with the legislator’s decision to issue the product governance requirements by way of a directive. We stress the need for manufacturers to be able to define the target market in as general and technically standardisable a manner as possible.

As we assume that all national or international target market concepts are discussed with the (respective) national supervisory authorities, we see no added value in including best practice examples.

Q9: What level of resources (financial and other) would be required to implement and comply with the Guidelines (market researches, organisational, 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 organisation and the nature, scale and complexity of the activities of your institution, where relevant.

As a federation of associations we cannot specify the level of resources that would be required to implement and comply with the Guidelines in each bank. Indications from our members imply that the costs for complying with the requirements in the Guidelines will be significant. Every process step that cannot be handled by electronic data processing systems will raise the costs for investment firms drastically.