

EFPA's Response on ESMA's Consultation Paper on Draft guidelines on MiFID II product governance requirements

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

According to Article 16(2) of Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), ESMA has set out for consultation draft guidelines on product governance requirements in the context of MiFID II rules on organisational requirements and conduct of business.

Despite the product governance requirements laid down in Articles 16(3) and 24(2) of MiFID II, as well as in Articles 9 and 10 of the MiFID II Delegated Directive, cover a broad range of topics, the ESMA draft guidelines mainly address the target market assessment.

ESMA will consider the feedback it received to the Consultation for the development of a final report on the matter. Therefore, EFPA would like to express its gratitude in having the opportunity to contribute in this important task.¹

Preliminary remarks

One of MiFID II main innovations is the requirement that investment institutions ensure and prove that persons who provide investment advice and information about financial products and services are adequately trained and have the necessary knowledge in order to be competent to fulfil their obligations set out in Article 25 of MiFID II.

As we have already remarked in EFPA's Response on ESMA's Consultation Paper on MiFID II/ MiFIR (ESMA/2014/549), professional standards within ethics codes, which need to be lifted, are the most effective way of ensuring the compliance with these requirements. These governance requirements must be applied to the different stages of product creation and distribution, and to the different financial services. The product design itself must be conditional on the possibility of its appropriate distribution. Therefore, as it is stated in the Consultation Paper, Article 16(3) and Article 24(2) of MiFID II establish product governance obligations for manufacturers and distributors (further specified in Articles 9 and 10 of the MiFID II Delegated Directive), with the objective of ensuring that firms, which manufacture and distribute products, enhance the level of protection of investors by way of taking responsibility, from the beginning, that products are only offered in the interest of clients.

Moreover, as we have already stated in EFPA's Response on ESMA's Consultation Paper on the Draft guidelines for the assessment of knowledge and competence requirements (ESMA/2015/753), EFPA, as a professional standards setting and certification organization for financial services' professionals in Europe, has always pursued high requirements on knowledge and competence for financial advisors. Our over 15 years' experience has shown us and the market that high level requirements have usually resulted in better professionalism, compliance and customer service and protection.

¹ The European Financial Planning Association (EFPA) is a standards' setting, an accrediting qualifications and certifying institution operational in the financial services sector in Europe and which was created in the interest of both professional financial advisers and users of their services. EFPA's main objective is to make the general public aware of the activities of their members and to oversee their members' compliance with the profession's legal requirements and ethical codes.

According to this approach, EFPA is pleased to response to ESMA's Consultation.

Guidelines for manufacturers

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

Yes, we agree with the list of categories that manufacturers should use as a basis for defining the target market for their products, as they clarify the definition of the target market.

However, it would be important to clarify that, for any of the categories, a relevant element to take into account is the weight each product has in each client's investment portfolio. Thus, at a very low portfolio percentage or share, investment in a product not strictly appropriate for a particular customer should be tolerated, as far as the rest of the portfolio is adequately invested and diversified.

In addition, EFPA would like to add a category to the list that issuers should use as a basis for defining the potential market for their products. This is the compatibility between the time horizon of a client's investment and the expected or recommended time horizon of the product. The consistency between the two should serve as an additional filter for distributors.

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.

Yes, we agree with the approach proposed in paragraphs 18-20 of the draft guidelines on how to take the products' nature into account.

EFPA would just like to point out the importance of considering the share in the total portfolio that a specific product will take, when deciding if this product will be or not appropriate for a sale without or with advice.

Guidelines for distributors

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

We agree with the proposed method for the identification of the target market by the distributor. Nevertheless, the complexity of the assessment of each category has to be noted. Consequently, we would like to remark that the said assessment requires that distributors have a broad knowledge of the market and specific criteria to fulfil this requirement.

Moreover, as for the relation between the assessment of suitability and appropriateness and the product governance requirements, we support that the obligation of identifying the actual target market must not be substituted by the assessment of suitability or appropriateness and have to be conducted in addition to and before such assessment.

Furthermore, the identification of the target market has to be adapted to the service provided and the distribution channel, considering that the staffs is required to certify its knowledge and experience on product and product governance.

EFPA believes that the distributor, when identifying the target market, should take into account the weight that a particular investment in a product is going to have in the customer's portfolio, as well as its level of diversification.

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

We agree with the suggested approach on hedging and portfolio diversification aspects. Nevertheless, we would like to remark that permissible deviation between general target market identification and the individual eligibility of the client have to be developed in the Guidelines with as much clarity as possible, specifically considering the overall wealth and portfolio of each client.

Furthermore, we would like to suggest that the Guidelines should not make reference to “significant” conflicts of interest [page 28 (§ 40)], as it might be confusing. Generally speaking, we consider that the correct approach to the management of conflicts of interest entails to speak of “adequate” or “inadequate” management of conflicts of interest, instead of management of “significant” or “not significant” conflicts of interest.

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?

We consider that further guidance on how distributors should apply product governance requirements for products manufactured by entities falling outside the scope of MiFID II would be much appreciated. Generally speaking, we believe that the identification of the target market is extremely complex. Consequently, persons who provide investment advice and information about financial products and services may appreciate concrete guidelines on how to comply with the product governance obligations.

For instance, we consider that the obligation that distributors define their “own” target market even when the firm does not receive a description of the target market from the manufacturer or information on the product approval process constitutes a risk for the correct identification of the target market. In this sense, we strongly support that every product should have a data sheet where the product characteristics, including the target market, are specified. The elaboration of this data sheet is a manufacturer’s responsibility, which must provide it to distributors. The aim of this data sheet is that staff that offer or recommend the product has all the information about it. The use of the data sheet should be part of the knowledge and competences to be included as a requirement of the qualifications requested to the staff providing investment advice or investment information to clients.

By the same token, we feel as a sound approach that distributors, who cannot obtain sufficient information on products manufactured by entities not subject to the MiFID II product governance requirements, should refrain from including them in their catalogues of products on offer.

Guidelines on transversal issues applicable to both manufacturer and distributor

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

We agree with the proposed approach for the identification of the ‘negative’ target market.

However, we would like to remark the importance that staff who provides the financial services and who conducts the suitability or appropriateness assessment should prepare and present their offer or recommendation within the framework of the defined target market. In this sense, we consider that staff can only move away from the positive target market of each product if the divergence is fully justified.

Furthermore, we strongly support that ESMA will consider, in the framework of the development of measures for the implementation of Article 25 of MiFID II, that staff needs to fully understand the target market in order to develop an adequate provision of the services and to meet with the obligations of product governance related to distributors.

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

Yes, we agree with the treatment of professional clients and eligible counterparties in the wholesale market.

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

Staff training and the implementation of standards of professional conduct are essential in product governance. Moreover, product design must be conditioned to adequate staff training. Therefore, distribution of products has to be restricted if there is not a previous adequate verification of the qualification of the staff that is going to distribute them.

In addition, we consider extremely important to assess how advisors receive the information of an specific product. EFPA supports that every product should have a data sheet where the product characteristics, including the target market, are specified. Besides, a work/ training meeting, where advisors are illustrated on the product characteristics, may be convenient.

Furthermore, it is important to distinguish between advised services and non-advised services, as the advice eventually provided completes the client's knowledge and experience, changing therefore the relevance of the target market. Moreover, knowledge and competence requirements (Article 25 of MiFID II) distinguish between investment advisors and other staff giving information, so staff's training on the identification of the target market might vary depending on the type of service provided.

Moreover, we consider that the Guidelines should distinguish between "advised sale" and "pure advice" more clearly, as we feel both services are confused all along the document.

On a separate note, it would be useful to clarify the meaning of "sophisticated clients" [pages 9 (§ 21) and 24 (§ 16.a)]. Generally speaking, we would like to suggest the classification of clients to be the one stated in EU Law.

Finally, we would like to remark that, according to the identification of the target market proposed in the Draft Guidelines, staff's knowledge and competence requirements on product governance needs to include some contents in relation to personal data protection rules.

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 on-going 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.

In relation to the estimation of costs and resources required to adapt the competences and qualifications requirements to the needs of the governance rules, EFPA believes that will not be especially important and, in any case, fully compensated by the benefits connected to it.

The same logic should be applied to other marginal costs to introduce governance requirements to the already foreseen adaptation needs on IT, organisational changes, etc. to comply with MiFID II in general.

Conclusions

To sum up, we consider that the importance of Article 25 of MiFID II is beyond doubt, and may be remarked among the product governance process introduced by MiFID II. Raising professional standards to financial advice, ensuring staff training and the exclusion of persons who lack the appropriate skills, qualifications and experience, constitute a priority in order to achieve a provision of financial services governed by principles of honesty and integrity.

We also think that the manufacturers should participate actively in the distribution procedure and ensure that the clients are getting the adequate products based on their suitability.

Consequently, we consider that persons who provide investment advice and information about financial products and services need to be adequately trained on the identification and understanding of the target market, in order to correctly fulfil product governance requirements stated in MiFID II.