Deutsche
Schutzvereinigung für
Wertpapierbesitz e.V.

Public consultation: Draft guidelines on MiFiD II product governance requirements

DSW, Germany's largest association of individual investors, welcomes the opportunity to comment on ESMA's "Draft guidelines on MiFiD II product governance requirements".

In principle, DSW is very supportive of the draft guidelines which provide a good framework for determining the target market without being overly complicated. We therefore focus on certain aspects where we see a need for improvement or clarification.

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

DSW considers it important that the concepts used by the manufacturer in defining the target market are clearly specified to avoid misinterpretations, misunderstandings or different national interpretations. For example words as "retail client", "professional client" or "eligible counterparty" could lead to a misunderstanding if they are not well explained. Therefore, DSW would favour if ESMA would develop a common conceptual framework and definitions over the long-term.

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

Another key aspect for DSW is the categorisation used by manufacturers. We are concerned that the list of categories does not explicitly address toxicity, the key aspect of investment product governance for individual investors.

A toxic investment product, i.e. a product that is not likely to at least protect the real value of the clients' savings over the advised or needed time horizon, should not be designed by a manufacturer - at least should the target market exclude individual investors. To enhance transparency, the manufacturer therefore should at least be required by ESMA's guidelines to determine (and document) if the overall fee weight still allows for this key requirement, especially taking into account the current low yield environment.

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

The approach is not incorrect but leaves room for improvements. Firstly, the respective responsibilities in case of instruments that are generally traded on secondary markets are not clearly described. In case of shares, for example, we would welcome guidance on who is considered as manufacturer and distributor. More clarity with regard to instruments traded on the secondary market, with possible differentiation among the type of instruments (ranging from shares, bonds, UCITs to ETFs etc.), illustrated by examples/case studies, would therefore be welcome. Secondly, the sentence "the target market should be identified at a sufficiently granular level" (no. 19) should be better explained in order to avoid misinterpretations.

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

DSW has several concerns regarding the proposed method for the identification of the target market by the distributor:

- The draft guidelines state that "the manufacturer makes its best efforts to select distributors whose type of clients and services offered are compatible with the target market of the product" (no. 21). We do not believe this point is clear enough. The words "best efforts" are a very subjective term which could lead to misunderstandings and should therefore be clarified.
- The draft guidelines state that "the manufacturer should propose the type of investment service through which the targeted clients should or could acquire the financial instrument. If the product is deemed appropriate for a sale without advice, the firm should also specify the preferred acquisition channel (face-to-face, via telephone, online etc.) and the specific design of the acquisition channel, if relevant" (no.22). We consider this guideline as very far reaching for manufacturers as we deem that the acquisition channel rather belongs to the distributor's scope of duties. We would therefore recommend that the guidelines clearly state that it is the responsibility of the distributor to determine the appropriate acquisition channel, within the target market definition given by the manufacturer.
- The draft guidelines state that "even firms providing investment services under appropriateness or execution-only regime, could be in the position to conduct a more thorough assessment of the target market" (footnote to no. 39). We would welcome a clarification whether this also refers to brokers which act on an "execution-only" basis and which – under level 1 legislation – have no obligation to collect information on their clients.

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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.

DSW fully agrees with ESMA's clarification that the target market assessment is product-related and is aimed at a group of target clients, especially at manufacturer level. The manufacturer has no direct contact with clients and no detailed information about the client base and therefore his target market assessment needs to be abstract. Consequently, the personal features of clients, taking into account a portfolio approach, are to be considered at the point of sale. We agree that a distributor should sell outside the target market only where the deviation is duly justified and explained and the product is suitable in the individual case of the client.

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?

DSW understands that these guidelines assume that, on the one hand, the manufacturer has knowledge about the features of the product and, on the other hand, the distributor is informed about the characteristics of the client. And therefore the interaction among them would decrease the risk of mis-selling. Nevertheless, there is a relevant gap of interaction. This gap, however, does not result from the guidelines but from the level 1 legislation. Many asset managers (for example UCITS or AIF) are not included in MiFiD II. Since the target market description is a MiFiD II requirement, the mentioned asset managers are not obliged to define the target market, and then the responsibility is transferred to the distributor (see no. 39 of the draft guidelines). This fact contradicts the reasoning behind these guidelines.

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

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

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

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

DSW believes that a sale outside the positive target market could be allowed in restricted cases but not on a regular basis (to make sure that investors are not fully deprived from certain products which may be suitable for them). A sale to investors falling within the negative target market, however, should be even more restricted and possible only on a very exceptional basis while duly justified by the distributor. We need to take into account that

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

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

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

Moreover, the draft guidelines could be improved by way of more clarity on the requirements stemming from monitoring and supervision. We assume that the supervision will be carried out by the National Competent Authorities. In this respect, more information on procedures and methods that are going to be used would be welcome.

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