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Swedish Securities Markets Association

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SSMAs response to ESMAs consultation on review of the Guidelines on MiFID II product governance requirements

1. General comments

- In order to ensure an orderly implementation of the amended ESMA guidelines on product governance, it is very important that investment firms are allowed sufficiently long time to implement the new requirements. According to SSMA, the implementation period should not be shorter than 12 months.

- Since the rules on product governance and suitability are closely linked it is important to ensure that the guidelines are aligned in terms of substance so that unnecessary costs and frustration for both staff and clients can be avoided.

- As ESMA guidelines will start to apply several months after the MiFID II delegated directive, investment firms will not have access to all necessary information when implementing the binding level 2-rules. In order to avoid legal uncertainty and unwanted compliance risks, it would therefore be helpful if ESMA could clarify in a supervisory statement that it does not expect NCAs to prioritize supervision of the level 2 rules until ESMAs guidelines on suitability and product governance have become applicable.

- The SSMA considers that it is very important to keep the level of detail at a reasonable level and to avoid drafting guidelines that will significantly increase the complexity of the MiFID II framework. Therefore, as a general rule, whenever there is uncertainty regarding the cost/benefit analysis or where there is a risk of unintended consequences for retail investors or the EU capital market as a whole, ESMA should take a cautious approach and refrain from proposing the guideline in question. ESMA can always revise the guidelines at a later stage, when more ESG-data and sustainable products are available on the market and both industry and NCAs have a clearer picture in which respects there is actually a need for more guidance. It should be recalled that complex rules and information overload can discourage retail investors from investing in sustainable products and also contribute to greenwashing, which would be counterproductive.

  The SSMA notes that the scope of the product governance requirements is highly dependent on terms that are not defined in the guidelines. One important example is the term ”actively market” (see point 38, 57, 59, 86). The SSMA would like to underline that it would be most unfortunate if investment firms and NCAs interpret this term differently and therefore proposes that ESMA provides additional guidelines.

- The SSMA notes that the consultation paper does not address the much debated question regarding review obligations for firms that are deemed to be “manufacturers” when advising corporates issuers on the primary market e.g., in connection with a bond or share issue

(recital 15 delegated directive). For the well-functioning of the EU capital markets, it is of outmost importance that the product governance obligations for primary market services are applied in a proportionate manner. It is simply not reasonable to require that a "manufacturing" investment firm should keep track of subsequent distribution of a share on the secondary market e.g., on an exchange. The SSMA suggest that ESMA confirms this approach in the final report.

- The SSMA wants to underline that the product governance rules in MiFID II relates to the internal procedures of investment firms and should not be used as a tool for ESMA or NCAs to restrict clients access to certain types of products. In fact, MiFID II stipulates that ESMA and NCAs should follow a specific procedure if they want to restrict distribution of a type of product to retail clients, i.e. the "product ban". It is in our view not appropriate for ESMA to circumvent these procedural rules through the use of level 3 guidelines. We therefore propose that **point 26 of the guidelines** (page 30) should be deleted or rephrased.

- The SSMA considers that it is important that ESMA GL does not introduce a terminology that differs from the terminology used on the market e.g. FinDatEx EMT.

- The SSMA is generally hesitant to the inclusion of "good and poor" practices in ESAs guidelines since the legal status of such examples is uncertain. If kept, we agree that it should be limited to good practices, as proposed by ESMA.

2. Specific questions

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 SSMA understands that it from a supervisory perspective and from a compliance perspective is important that investment firms document their product governance process. However, we consider that the scope of the new obligations in **point 13 of the guidelines** (page 26) "substantiate and document" is unclear, in particular considering that the background information point 20 only speaks of documenting "choices" and "monitoring" whereas point 13 appears to be much broader. It would be helpful if the guidelines relating to documentation would explicitly refer to the principle of proportionality.

- As regards **point 19 d)** (page 28) the SSMA notes that the PRIIPs indicator does in fact include considerations regarding currency risk. We therefore interpret the example as referring to other products than PRIIPs. Please confirm.

- As regards **point 19 e)** (page 28) the SSMA suggests that the guidelines are aligned with the Findatex EMT terminology and refer to "minimum investment horizon". As mentioned under General Comments, it is important that the ESMA GL does not introduce terminology that deviate from this widely used industry standard.

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 SSMA generally agrees with the proposal to align "sustainability objectives" with "sustainability preferences" as proposed by ESMA in **point 20 of the guidelines** (page 28-29). However, in order to increase legal certainty, we propose that the bullets, where relevant, explicitly refer to article 2(7) a-c in MiFID delegated acts.

  The SSMA notes that the third bullet is not reflected in article 2 (7) MiFID delegated acts. The SSMA welcomes this flexibility but would like to ask for some more clarity. For instance, what is the intention behind this addition, what type of products does the third bullet cover? Please provide some examples. Also, is there a reason for the placing of this bullet, i.e. as number 3?

- The SSMA finds it difficult to understand the different methodologies in **point 27** (page 10) i.e. reference of the sustainability data of (i) the issuer or (ii) the product itself. It is important with flexibility and that firms have access to <u>both</u> methods (which can be applied separately or in combination) and decide on a case-by-case basis which to apply. ESMA should also take into consideration that there is work ongoing in the industry relating to methodologies e.g. EUSIPA and FinDatEx.

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.

- The SSMA considers that the consultation paper is unclear as regards ESMAs proposal on "minimum proportion". For instance, the distinction between minimum proportion (SFDR) and actual proportion (Taxonomy) should be further explained and not be hidden in a footnote (nr 13).

- The SSMA agrees with ESMA that bonds and shares could be instruments for which an SFDR concept of minimum proportion would not be applicable, as well as derivatives.

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.

<u>Complexity</u>

The SSMA finds it difficult to understand **point 24 of the guidelines** (page 30) and the requirement to "*determine with sufficiently level of detail*" and questions how it is intended to work in practice i.e. in the context of the EMT template. In our view, the starting point for the assessment of whether a financial instrument is deemed complex or not should be Article 25(4) of MiFID II as phrased in para 30 on page 11. In para 24 in the draft guidelines, it seems as if other criteria comes first and Article 25 (4) second. Also, it should be sufficient to assess whether a product is complex or not without specifying further levels of complexity.

Please also note that the factors mentioned in point 34 on page 12 in respect of fixed-income products (e.g. credit rating, duration, currency denomination) do not relate to the complexity of the instrument.

As mentioned under General Comments, the product governance rules in MiFID II relates to the internal procedures of investment firms and should not be used as a tool for ESMA or NCAs to restrict clients access to certain types of products. In fact, MiFID II stipulates that ESMA and NCAs should follow a specific procedure if they want to restrict distribution of a type of product to retail clients, i.e. the "product ban". It is in our view not appropriate for ESMA to circumvent these procedural rules through the use of level 3 guidelines. We therefore propose that **point 26 of the guidelines** (page 30) should be deleted or rephrased.

Clustering:
To be able to cluster product categories with similar features is very important from a practical perspective. The SSMA is concerned that the ambition of ESMA to increase the granularity of the clustering approach will significantly increase the complexity of the framework MiFID II product governance regime without regard to the need for proportionality. For example, it is important to clarify that the "multiple key factors" in **point 28 of the guidelines** (page 30) and in point 34 in the background (page 12) should be seen as examples only and not as an exhaustive list.

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.

No comments.

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.

The SSMA agrees with ESMA that to be able to cluster product categories with similar features is very important from a practical perspective also for distributors. The SSMA is concerned that the ambition of ESMA to increase the granularity of the clustering approach will significantly increase the complexity of the framework MiFID II product governance regime without regard to the need for proportionality

The SSMA notes that ESMA in **point 46 of the guidelines** (page 35) proposes that distributors should determine whether they need access to underlying documents from the manufacturer such as the outcome of scenario analysis and charging structure analysis. Such requirements will be very difficult to comply with when firms do not have a contractual relationship with the manufacturer of the products, when distributing third country products and in situations where the distribution takes place though trading on a regulated market and there is no way of knowing which investment firm has been advising on the primary market transaction (see General Comments regarding need for clarification of recital 15 of the delegated directive). We therefore propose that the words "where appropriate" are added to the guidelines. Please also note that business secrecy considerations as well as competition rules may make it difficult to share information on costs structures between firms.

As regards point 42, please note that the FinDatEx EMT template - which is widely used by EU manufacturers to provide information on target market to distributors - refer to client categories such as "basic, informed and advanced" clients. SSMA proposes that the ESMA GL uses the same

terminology as in FinDat Ex e.g. “basic, informed and advanced” rather than “basic, average and advanced”. Nothing in level 1 or 2 suggests that distributors should use different concepts than the manufacturer. In fact the rules for what manufacturers and distributors should consider are very similar. In order to facilitate a practical approach for distributors the concepts and terms used in the target market should correspond to the ones used by the manufacturer (and the market as a whole). In order to ensure that the financial instruments ends up within the correct target market the distributor should then apply those concepts/terms to their client base, but that does not require the distributor to use a different set of terms in the target market than the manufacturer does. It only requires the distributor to interpret and understand the used terms and how they apply to its client base.

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.

No comments at this stage.

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 SSMA notes that ESMA in **point 64 of the guidelines** (page 39) treat investment advice the same way as portfolio management whereas these two services differ in several important ways. In fact, for portfolio management services, the knowledge and experience assessment is made by the portfolio manager and he/she must be able to make investments on behalf of the client even when the client itself does not have knowledge and experience about the specific financial instruments which the portfolio manager invests in on the clients behalf.

Otherwise, it will not be possible to optimize portfolios using e.g. derivatives for hedging.

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.

Point 72 of the guidelines (page 40-41) sets quite a high bar for the suggested review and the measures that may be used to conclude if products are sold within or outside of a target market. In particular, sending a questionnaire to clients that have bought a product under non-advised services is not a proportionate measure and is a new requirement that go beyond the level 1 and level 2 text. Moreover, a requirement that the distributor should send information to the manufacturer on its own initiative can only work for situations where there is a relationship between the manufacturer and distributor e.g. they belong to the same group or have a contractual agreement. It is less clear how to apply such rule where no such relationship exists, for third country products and in respect of distribution on a trading venue where it is not possible for the distributor to know which “manufacturer” at one point in time has helped the corporate issuer (recital 15). Based on the above considerations, the SSMA proposes that the wording of point 72 of the guidelines is removed or softened.

The SSMA notes that the consultation paper does not address the much debated question regarding scope of review obligations for firms that are deemed to be "manufacturers" when advising corporates issuers on the primary market e.g. in connection with a bond or share issue (recital 15 delegated directive). For the well-functioning of the EU capital markets, it is of outmost importance that the product governance obligations for primary market services are applied in a proportionate manner. It is simply not reasonable to require that a "manufacturing" investment firm should keep track of subsequent distribution of a share on the secondary market e.g. on an exchange. The SSMA suggest that ESMA confirms this approach in the final report.

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.

SSMA agrees.

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.

SSMA agrees.

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

As mentioned under General Comments, the SSMA is generally hesitant to the inclusion of "good and poor" practices in ESAs guidelines since the legal status of such examples is uncertain. If kept, we agree that it should be limited to good practices, as proposed by ESMA.

We note that no examples relate to ESG-products and would appreciate if examples concerning sustainability were also to be included in the list of good practices.

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

No comments at this stage.

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