DUFAS

Dutch Fund and
Asset Management
Association

info@dufas.nl
www.dufas.nl

Consultation response on the ESMA review of the MiFID product governance guidelines

To	ESMA
From	Dutch Fund and Asset Management Association (DUFAS)
Date	7 October 2022
Subject	**ESMA Consultation Paper Review of the Guidelines on MiFID II product governance requirements**
Contact details	Randy Pattiselanno, Manager strategy & regulatory affairs, rp@dufas.nl

DUFAS (the Dutch Fund and Asset Management Association) welcomes the opportunity to respond to the ESMA Consultation Paper Review of the Guidelines on MiFID II product governance requirements, as published by ESMA on 8 July 2022.

Executive summary

Timing

- In terms of timing, it is needless to say that the expected publication of the ESMA final guidelines in Q1 2023 does not match the timing of the entering into force of the MiFID Commission Delegated Act (EU) 2021/1253 of 21 April 2021 ("MiFID DA"). These product governance requirements, where sustainability-objectives are embedded, are also a corresponding piece of rules that are necessary for an investment firm to be able to obtain and meet the MiFID sustainability preferences.

Alignment with sustainability preferences

- **DUFAS supports the proposal and possibility to align the sustainability-related objectives under the product governance requirements with the definition of "sustainability preferences"** set forth in article 2(7) of the MiFID II Delegated Regulation and as further detailed in the ESMA Guidelines on certain aspects of the MiFID II suitability requirements.

- It is worthwhile mentioning that we do believe that sustainability-related objectives may entail much more than the products that matching the MiFID sustainability preferences only. From that perspective, a target market of a product with sustainability-related objectives, may also refer to certain sustainability themes, such as themes focused on either environmental, social or governance criteria or a combination of thereof.

Review of the Guidelines on MiFID II product governance requirements

2.2 APPROACH TAKEN

Identification of the potential target market by the manufacturer: categories to be considered

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.

No comments.

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.

Alignment with sustainability preferences

- **DUFAS supports the proposal for the possibility to align the sustainability-related objectives under the product governance requirements with the definition of "sustainability preferences" set forth in article 2(7) of the MiFID II Delegated Regulation and as further detailed in the ESMA Guidelines on certain aspects of the MiFID II suitability requirements.**

- **We do believe that sustainability-related objectives may entail much more than the products that matching the MiFID sustainability preferences only.** From that perspective, a target market of a product with sustainability-related objectives, may also refer to certain sustainability themes, such as themes focused on either environmental, social or governance criteria or a combination of thereof. We recommend to clarify and explicitly state that this is compatible with the **sustainability-related objectives** product governance rules, as already clarified by ESMA in its open hearing on 14 September.

- As we believe that target market sustainability-related objectives, should be sufficiently flexible and may relate to both the categories of the MiFID sustainability preferences, and relate to for example thematic ESG objectives, **we stress that the same flexibility should exist when obtaining sustainability preferences under the ESMA suitability guidelines.**

- Where ESMA refers to MiFID sustainability preferences in paragraph 20 of the Guidelines, reference is also made to "*Whether, where relevant, the product has a focus on either environmental, social or governance criteria or a combination of them*" (third bullet). Reference hereto is confusing as this seems to imply this is part of the sustainability preferences as defined in MiFID. **This is not the case; hence we suggest deleting this.**

- Furthermore, **we doubt whether** references **in terms of percentages of taxonomy aligned investments or sustainable investments is practical for the purposes of defining** sustainability-related objectives**, unless the manufacturer offers a**n article 9 SFDR investment product. In such case, the manufacturer can include as target market e.g., investors that wish invest in sustainable investments only, given the fact that art. 9 products may only consists of sustainable investment, besides cash and hedging derivatives.

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.

Identification of the potential target market: differentiation on the basis of the nature of the product manufactured

- In general, for investment funds, both AIFs and UCITS funds, **we believe that the concept of minimum proportion as defined in MiFID sustainability preferences, should not be part of the target market.** The minimum proportion as defined in MiFID sustainability preferences relates to the minimum proportion of the client's individual portfolio. It is up to the advisor or portfolio manager how to meet this minimum portion. In case where investment funds are selected to build up a sustainable portfolio, the applicable SFDR disclosures (expressed in % in amongst others sustainable investment funds and taxonomy aligned investments) enables the advisor or portfolio manager to meet the minimum proportion of sustainable investments or taxonomy-aligned investments as expressed by the client. Hence, there is no need to define this minimum proportion concept into the target market of the product. It may only create confusion and maybe misleading.

- The exception to the above concerns the manufacturer that offers an article 9 SFDR investment product. In such case, the manufacturer can include as target market e.g., investors that wish invest in sustainable investments only, given the fact that art. 9 products may only consists of sustainable investment, besides cash and hedging derivatives.

- For certain financial instruments application of the minimum percentages may in its nature to hard to assess, for example in relation to 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.

- In general, DUFAS supports the clustering approach as proposed in the guidelines. The question arises however, how one should apply the guideline that "in any case, when using a clustering approach, manufacturers should consider the outcomes of the charging structure and scenario analyses of each product". It may be well the case, that fund managers may cluster a variety of ESG products. One cluster may consist of ESG impact funds which partially invests in taxonomy-aligned investments. The charging structure and scenario analyses of each product may however vary. Does this prevent this from being part of one cluster? We recommend to provide more guidance when because of the charging structure and scenario analyses of each product, products cannot be part of one cluster.

- Furthermore, where ESMA suggests in paragraph 27 that 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, we suggest to clarify that for (non-structured) UCITS funds is generally accepted that clustering is allowed, as suggested in paragraph 47 of the Guidelines.

- Where the guidelines refer to OTC derivatives, we propose to clarify what are considered to be OTC derivatives. We understand that all derivatives that are not traded on a regulated market, OTF or MTF qualify as OTC derivatives. In addition, likewise we understand that derivatives that are traded on a bilateral basis via a SI are OTC derivatives as well.

- Paragraph 47 of the Guidelines reflects that (…) *In ensuring that only UCITS with sufficiently comparable characteristics are clustered for the purposes of the target market identification, differentiating factors would be the types of asset classes the UCITS invests in, its investment strategy, risks, charging structure (e.g., level and types of costs), any leverage used, and so on. Such factors should be used in a cumulative manner*." Although, we appreciate that UCITS may vary from product to product, by referring to differentiating factors, this may suggest that possibilities for UCITS clustering is limited. We suggest providing more clarification as to the type of clustering which may not be allowed, apart from e.g., making a distinction between structured UCITS and non-structured UCITS.

Timing and relationship of the target market assessment of the distributor with other product governance processes

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.

In general, we agree with the approach of ESMA. However, more clarification may be needed in order to assess what type of gamification techniques are allowed and which are not.

Identification of the target market by the distributor: categories to be considered

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.

In general, we agree with the approach of ESMA.

Distribution strategy of the distributor

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.

Portfolio management, portfolio approach, hedging and diversification

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.

Where a product is intended for professional clients only, we can follow the logic that such product cannot be included in retail investment portfolios, not even for hedging or diversification purposes. However, where a retail client may only have basic knowledge and experience of a certain product, whilst the target market is defined a client with advanced knowledge and experience, we believe this should be allowed in discretionary portfolio management, as the portfolio manager has such knowledge and experience.

Regular review by the manufacturer and distributor to respectively assess whether products and services are reaching the target market

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.

Yes, we agree with the approach of ESMA.

Identification of the "negative" target market and sales outside the positive target market

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.

Yes, we agree with the approach of ESMA, which is consistent with Recital 7 of the MiFID II Delegated Directive.

Application of the target market requirements to firms dealing in wholesale markets (i.e. with professional clients and eligible counterparties)

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.

No comments.

Annex with good practices

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

We suggest to also include ‘bad practices’ in addition to good practices.

Case study on options

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

No comments.

DUFAS: Dutch Fund and Asset Management Association
Since 2003, DUFAS has been committed to a healthy asset management sector in the Netherlands. DUFAS has more than 50 members: from large asset managers who invest Dutch pension and insurance assets to smaller, specialist asset managers. DUFAS increases awareness of the social relevance of investing, helps to develop sector standards and represents the sector in the implementation of new laws and regulations. In addition, DUFAS is committed to a single European market with equal regulations.

More information
Would you like to respond, or should you have any questions? I would be pleased to hear from you. Please feel welcome to e-mail Randy Pattiselanno, DUFAS manager strategy & regulatory affairs, at rp@dufas.nl.