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On 5 October 2016, this Authority published a paper setting out for public consultation “Draft guidelines on MiFID II product governance requirements (hereinafter the “**Consultation Paper**”). The present Association intends to submit a number of considerations with reference to the aforesaid Consultation Paper.

**1) The Italian Association of Private Banking (“Associazione Italiana Private Banking” or AIPB<sup>1</sup>)**

Our non profit professional Association, established in 2004 by private banking operators in Italy, represents a place for aggregation, sharing and development of private banking business culture in order to support the enhancement of quality regarding services offered to clients within this sector.

Private Banking is an activity which has developed over the years within the financial markets and that has now reached its own operational independence within the private saving sector.

Such activity is characterised by a level of service tailored to the needs of a selected client base, particular attention for clients’ assets with a broader approach than that applied to investment portfolios and a close interrelation between the private banker and the client.

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<sup>1</sup> AIPB represents the interests of the private banking operators in Italy, that manage assets around EUR 700 billions (as per 30 September 2016). Its members own financial advisors networks with an high-level portfolio’s mean size (EUR 72 millions) and low number of clients per advisor (only 70).

As far as concerns legislative developments, our Association considers the implementation of initiatives aiming at an effective client protection as its priority objective, being at the same time a precondition for maintaining a high level of confidence in the financial industry and the correct functioning of financial markets.

On behalf of the institutions we represent and in the event of this public consultation, we believe that there is a strong need of harmonisation of client protection measures with the possibility to seize any enhancement opportunities, taking into account both risk evaluation and clients' expectations.

**2) Analysis of the draft guidelines - Guidelines for manufacturers – definition of the type of client: the presence of private banking**

The Association welcomes the circumstance that, in accordance with paragraph 16 of the draft guidelines, within the description of the product governance requirements applying to manufacturers, it is stated with reference to the type of clients that *“The firm should specify to which type of client the product is targeted. This specification should at least be made according to the MiFID II client categorisation of “retail client”, “professional client” and/or “eligible counterparty”. The firm may use additional descriptions commonly used in the respective market like “private wealth clients” or “sophisticated clients” to refine the categorisation but should specify the criteria that must be met in order to categorise clients in this way”*.

Indeed, in accordance with the considerations set out under par. 1 above, a private banking client has a number of specific characteristics that prevent the latter from falling entirely under one of the categories set out under MiFID II (e.g.: retail clients, professional clients on request; *per se* professional clients and eligible counterparties). The identification of this independent category, defined as “Private Clients” is extremely relevant surely as a general consideration but also, in particular, with reference to its relation with product governance requirements.

In this market segment, the evaluation of the client's overall portfolio composition and distribution is a key element for the client's best interest protection: any recommendation issued takes into account not only the personal characteristics of the client (in terms of knowledge and experience in investments, financial situation, investment objectives, risk profile) but also the general situation of its investment portfolio, in terms of underlying financial risks, degree of diversification and financial efficiency.

A portfolio approach would consider as suitable for a specific client some financial products whose target market – being based on the individual product – would not fully fit with the characteristics of the client, and this would not be an exceptional event.

Indeed, financial instruments recommended to clients might have some specific features (e.g. liquidity degree or risk profile) that, in the context of the client's portfolio, would grant the consistency of the portfolio itself, considered as a whole, with the financial profile of the client, while individually considered, they would not be fully aligned with each of the personal characteristics of the client.

With respect to the target market identified by the manufacturer, the Guidelines should grant more flexibility, to those investment firms performing investment advice according to a portfolio approach, that should be promoted and not inhibited; deviations from the target market that result from a proper portfolio diversification should not be taken as exceptional but fundamental for investor protection.

### **3) General considerations on the draft guidelines – The private banking prospective**

The European legislative framework regulating *product governance* requirements and, therefore, the Consultation Paper, move from the assumption that the assessment on the suitability of an investment for a certain *target market* is to be carried out on a “single product basis” and not on “a portfolio basis”.

European legislation and the Consultation Paper trace a connection between the distribution strategy of the product and the identification of the relevant target market . In such a context, it would be for the manufacturer also to define the distribution strategy for the single product. The assessment of the target market and of the distribution strategy is expected from both the *manufacturer* and the *distributor*. Obviously the aforesaid assessment is carried out in different ways depending on whom performs it: the manufacturer carries out a more abstract assessment while the distributor is able to assess its own distribution strategy at a deeper level and the type of relation established with its clients.

The specific features of *private banking* have an impact on both the identification of the target market and the definition of the distribution strategy, triggering therefore a number of consequences for the *manufacturer* and the *distributor*.

On the side of the *manufacturer*, due to the objective characteristics of private banking, the latter has an impact on the definition of clients and their relevant needs and, furthermore, on the identification of the distribution strategy.

Private banking activities have an impact also on the distributor for the same reasons indicated above and furthermore due to the fact that there is a fiduciary relationship with the client that has an impact in any case on the performance of investment services and allows the distributor to provide a specific assessment of the target market for each proposed investment.

The approach set out under the product governance provisions does not seem to take into account an overall assessment by the distributor of the client's portfolio when identifying the target market, with certain exceptions that seem likely to remain limited.

Based on current experience in the provision of Private Banking services, an investment evaluation that takes into account the overall composition and distribution of the client's assets creates an added value for the client. For this reason, we believe that an evaluation of the client's overall portfolio must be one of the central elements to be taken into account in order to identify the target market and not, on the contrary, be considered only by way of exception to product governance rules.

4) **Responses to questions set out in the Consultation Paper under the prospective of private banking**

**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.**

The Consultation Paper sets out a list of six categories that manufacturers should use as a basis for defining the target market, which are the following: the type of client to whom the product is targeted; knowledge and experience; financial situation, with a focus on the ability to bear losses; risk tolerance and compatibility of the risk/reward profile of the product with the target market; clients' objectives; clients' needs.

We believe that it would be extremely useful if the manufacturers take also into account the "Private Client" when considering the "type of client" category.

A client should be caught in the definition of “Private Client” when a number of predefined and generally frequent characteristics are met that, by way of example, are in whole or in part the following:

- clients whose personal or family assets or assets connected to their professional activity or business are of a medium-high level;
- sophisticated clients with a variety of needs ranging from personal to familiar and corporate ones;
- clients that, due to the variety of needs to be managed, request in terms of both complexity and professionalism, the provision of a medium-high level service;
- clients receiving a medium high level of service customisation;
- clients that have entered into a plurality of banking relations, also of different nature and type, with several intermediaries;
- clients that frequently require financial instruments, products or services tailored to their personal needs, therefore not standardised.

Furthermore, it is to be noted that the definition of “Private Client” may be better identified referring to a certain number of needs (and a full description of the latter) that are typical of the aforesaid category of clients.

An incorrect definition of the “Clients’ needs” category, which follows the “Clients’ objectives” category, may trigger difficulties in assessing correctly the information provided by the Client in order to define the *target market*. In this respect, it is worth noting that other than needs arising from socio-cultural aspects recalled by ESMA (e.g. “*green investment*” and “*ethical investment*”), also private banking itself should be considered among the clients’ needs.

Indeed, private banking services, are based on the following categories:

- high customisation of investments;
- asset protection;
- management of generational transition;
- tax planning;
- financial, insurance and social security planning;
- optimising the portfolio asset allocation based on a global understanding of the client’s assets.

Private banking, also in terms of distribution strategy, retains its own independence in respect of other distribution methods adopted on the markets. Indeed, private banking is characterised by high quality services, constant advisory activities, customised assistance

carried out by private bankers, quality controls of the service provided to the client that confers uniformity and ensures minimum standard of the private banking services.

**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 Association shares the approach set out by ESMA in paragraphs 18-20 of the Consultation Paper providing a differentiated approach by the manufacturer when defining the target market depending on the level of complexity and risk of the products.

The aforesaid consideration is even more valid for private banking when taking into account the type of client and the fiduciary relation with the latter that characterises the provision of investment services.

While simpler products have a very broad target market, it is to be noted that more the complexity of products increases, the more restricted the target market becomes. The understanding of the typical elements characterising Private Banking leads to the view that also very complex and structured products may be allocated in this sector.

The completion of the aforesaid argument is set out in paragraph 20 where it is stated that *“for bespoke or tailor-made products, the target market of the product will usually be the client who ordered the product unless the distribution of the product to other clients is also foreseen.”*. In Private banking it is usual that a client, in consideration of its size, needs and characteristics, shall require the issuance of a certain financial instrument or the assembling of a specific tailor-made product.

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

According to the draft guidelines for the identification of the target market, the distributor should use the same list of categories used by manufacturers, and carry out a more granular analysis of clients' characteristics using any available information and data that may be at the distributors' disposal.

In this respect, the draft guidelines refer to information gathered through investments services (e.g.: suitability/appropriateness questionnaires) or in addition to any information and data deemed reasonably useful for this purpose.

In this connection, we would like to recall our answer under question Q1 above. Furthermore we believe that the criteria for assessing the target market by the distributor should be supplemented by a further category, referring to the overall composition of the client's portfolio: indeed such criteria would allow the distributor to define the target market of a specific product also taking into account the overall assessment of the client's investments, on a portfolio advisory support basis consistent with ESMA's guidelines on the assessment of adequacy issued in 2012 (where it is pointed out that *"In order to match clients with suitable investments, investment firms should (...) consistently take into account: (a) all available information (...), including the client's current portfolio of investments (and asset allocation within that portfolio); A firm should (...) ensure inter alia that: (a) the advice and portfolio management services provided to the client take account of an appropriate degree of risk diversification"*).

Another important point to be considered is the need of proportionality, depending on the governable nature of the products, where "governable products" means those offered by the investment firm either on the basis of a pre-selection effected in advance and of distribution agreements with the manufacturers, in which the latter's rights and obligations are also formalized. Indeed, an investment firm, in order to be classified as a "distributor" in relation to a financial product, shall be somehow connected to and/or integrated with the manufacturer of the product; this happens when there is a distribution agreement between the manufacturer and the investment firms. Reporting obligations and similar requirements may only apply to distributors that have a relationship with the manufacturer.

For non-governable products a target market assessment may not be as deep as that of governable products, as the distributor misses a direct dialogue and a complete information set, and it is self evident that he can not collect in advance deep information on any existing products that might be requested by a client (otherwise, there would be a serious risk of trade restriction and illiquidity, as only certain fully screened products would be negotiated). What might be acceptable is a target market definition run by kinds of products, based on their common features (required knowledge and experience, risk level, liquidity, ...), but not for each single product.

**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.**

The advisory support approach concerning the client's portfolio does not seem to be in line with the rationale that is behind product governance requirements. Despite it is made clear that any deviation between the product and the target client should not occur on a regular basis,

ESMA has indicated as an example of “legitimate deviation” the diversification purposes inherent in a portfolio perspective *“The perspective of the target market assessment is the individual product.(...) the advisor may recommend the product for diversification purposes where this is compliant with the MiFID suitability requirements and in particular, the client’s investment objectives”*.

Based on current experience in the provision of Private Banking services, an investment evaluation that takes into account the overall composition and distribution of the client’s assets creates an added value for the client. For this reason, we believe that an evaluation of the client’s overall portfolio must be one of the central elements to be taken into account by the distributor when defining the target market and not be considered on the contrary only by way of exception to product governance rules.

We therefore propose to include also the assessment of the client’s portfolio overall composition among the criteria to be taken into account by the distributor when defining the target market: in such context, the distributor may, for example, take into account the concentration of the client’s portfolio in certain investments or its diversification in order to optimise the portfolio management or the advisory activities related thereto.

Furthermore within the private banking context, it may be useful and reasonable also to include the portfolio diversification within the client’s objectives, just like the inclusion of hedging aspects that are indicated in the draft guidelines as one of the elements to be taken into account when defining the target market.

**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?**

With reference to product governance requirements that the distributor should apply for products manufactured by entities falling outside the scope of MiFID II, we believe that no further guidance is needed. In these cases, product governance requirements must be applied by each distributor on the basis of the criteria set out by the distributor itself, in accordance with the criteria already used by the distributor as a basis for defining the target market of products manufactured by entities falling within the scope of MiFID II.



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

According to the Consultation Paper, the identification of the “negative” target market by manufacturers and distributors consists in identifying clients for whom the investment products they manufacture and/or distribute are not compatible.

There may be cases in which, depending on certain circumstances and provided that all legal requirements are met, the product may be sold outside its target market. However ESMA asks that such instances should be justified by the individual facts of the case and properly documented.

As the “negative” target market is an explicit indication of those clients for whose needs, characteristics and objectives the product is not compatible and to whom therefore, the product should not be distributed, the sale to investors within this group should be, according to ESMA, a “rare occurrence” and the justification for the deviation should be accordingly significant and is generally expected to be more substantiated than a justification for a sale outside the positive target market.

We agree with the approach adopted by ESMA for the identification of the “negative” target market provided that the assessment of the overall composition of the client’s portfolio is included among the criteria used as a basis to define the “positive” target market by the distributor.

Indeed, in such case, it would be useful to adopt a number of criteria in order to exclude clients from such target market based on certain subjective characteristics (e.g. related to the complete lack of knowledge and/or experience on a certain type of product), balancing the definition of “positive” target market with an approach also based on the assessment of the overall investments carried out by the client.

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

We agree with the indications set out in the Consultation Paper with reference to professional clients and eligible counterparties. We stress the importance of the statement according to which the target market needs to be identified for end-clients.

In this respect, we deem it appropriate to further specify that communication duties relating to the target market apply to the manufacturer and the intermediary distributing products to

end-clients only, while any further entities not acting as end-clients but passing on products as resellers do not need to be specified as target clients.

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

The draft guidelines deal with the “distribution chain”, but do not address any issues connected to the “production chain” that, at least in principle, might arise frequently considering the broad scope of the definition of manufacturer.

A typical case of production chain is the distribution of a product issued by an entity and structured by another entity (typically an investment bank). In such case, the identification of the governing manufacturer (*i.e.*: the entity that effectively is aware of the characteristics of the product offered to clients) would allow the distributor to identify the subject required to define the potential target market.

However it would be appropriate to clarify, in the case indicated above, who is to be considered as the governing manufacturer: in this respect, certain circumstances might come into consideration as, for example, the impact that the indications provided by the issuer to the “structurer” have on the definition of the product, the identification of the potential client target by the issuer, the major awareness of the characteristics of the product by the “structurer”.

Yours sincerely,

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President