ESMA
European Securities and Markets Authority
201-203 rue de Bercy
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Per online submission filed on 7 October 2022

Subject: response to Consultation on review of the Guidelines on MiFID II Product Governance Requirements.

Dear Sirs,

the aim of this document is to provide AIPB answers to the consultation launched by ESMA on the 8th of July 2022 on the review of the Guidelines on MiFID II Product Governance Requirements.

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.

Neutral approach

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.

In its proposal for amending its Guidelines, ESMA suggests to concretely identify the sustainability-related objectives through their alignment with the "sustainability

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preferences" used within the suitability evaluation framework pursuant to Delegated Regulation 565/2017.

In its answers to the questions of ESMA's Consultation Paper on suitability requirements, AIPB has already emphasized how important it is that the information regarding sustainability preferences may be provided to the clients in a simple, clear and transparent manner, avoiding technical language, in order to ensure that clients fully and correctly understand the topic.

Conversely, the strategy that was adopted so far to convey the sustainability preferences to the customers requires referring to categories of financial products which can be identified only by reference to specific parameters as well as technical and regulatory definitions of difficult comprehension for the clients, thus carrying the risk that the clients are unable to express their actual sustainability preferences in a clear and granular manner precisely because they are not able to insert them correctly in the complex and rigid regulatory categories.

In order to avoid such risk, AIPB believes that investment firms should provide their clients with information regarding the concept itself of "sustainability preferences" without limiting them too much to the categories of financial instruments laid down in the reference framework, allowing therefore a generic collection of the clients' investment preferences with reference to specific objectives (environmental, eco-sustainable, socially relevant) chosen by them.

These remarks become even more relevant due to the misalignment between the product scope covered by the SFDR on the one side, and the one of Mifid under an objective profile given that the latter, unlike the former, covers all financial instruments.

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.

AIPB holds that the concept of "minimum proportion" is not only far from being clear, but can also be misinterpreted in an inconsistent and contradictory manner, especially by the client.

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For example, “minimum proportion” can be interpreted both in terms of portfolio percentage to be invested in sustainable financial instruments, and also as a qualitative model (either as a high-medium-low approach or neutral-balanced-sustainable under the sustainability scope), so that the client is able to correctly state their desired level of sustainability-related ambitions.

The concept of “minimum proportion”, as defined in the sustainability preferences laid down in Commission Delegated Regulation (EU) 565/2017, must be applied to all financial instruments.

Such obligation is in contradiction with the objective difficulty encountered by the intermediaries to identify a “minimum proportion” of sustainable investments in some financial instruments such as shares and bonds, whose nature does not allow to identify with precision the economic sectors that can be affected by the investment. In the case of shares and bonds, for example, there are no transparency documents (such as the KID) that could help understand better the areas of scope of the investment.

The concept of “minimum proportion” is, therefore, misleading for the clients as well, due to the factual impossibility of applying it to all financial products and, in particular, to the most renowned ones, namely shares and bonds.

Given that the client might understand such a concept only with extreme difficulty and that it could jeopardize the correct and effective manifestation of their preferences, AIPB believes that firms should be allowed to:

- autonomously establish minimum proportion as an internal criterium without posing a double series of questions to the clients (concerning the product, as well as the portfolio);
- provide to their clients clear information without the use of technical jargon and without asking them for a quantitative manifestation of their sustainability preferences;
- provide the clients with an *ad hoc* report on the financial instrument sold and the provided service, which would explain the quantitative approach and the strategy of minimum proportion adopted by the firm itself.

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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.

The clustering approach is usually applied, both by the manufacturer and the distributor, with the purpose of assessing the target market of those products for which certain information are missing and which should, therefore, be compared to those of similar features, with the purpose of assessing the target market in a more accurate manner. Within the scope of the Italian market and provided that sufficient information is available, in some cases the assessment of the target market is performed for each instrument individually. We believe it is important that the manufacturers/distributors keep the possibility of assessing the target market both through a clustering approach as well as individually for each financial product.

The new paragraph 27 of the Draft Guidelines provides 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*". In this respect, we observe that substantial work has been done by manufacturers and distributors in the last years to build clusters of structured products having like-for-like characteristics which are assigned to the same target markets. Such mechanism works particularly well for frequent issuers/distributors of financial instruments. The clustering approach has been conducted taking into account the features of those products, for example, their level of complexity, risks, underlying level of capital protection, duration etc., and it resulted in very granular categories which are working well and the functioning of which is constantly assessed in the context of annual reviews of financial instruments conducted by the manufacturers and distributors. Furthermore, when a manufacturer/distributor decides to issue a new type of structured product whose characteristics may, in theory, fall into one of the already established clusters, firms typically determine whether or not such products of the new type fall within the existing clusters.

In light of the above, we ask that ESMA reconsider the wording of the Draft Guidelines above by deleting references to structured products or by limiting the circumstances where the clustering approach is not expected to be appropriate only to those cases of certain structured products with particular or bespoke characteristics (in line with the wording used for OTC derivatives).

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.

Neutral approach

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.

Neutral approach

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.

Neutral approach

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.

AIPB endorses the need to introduce an effective target market that would represent, as regards product governance, a category of clients identifiable as private banking clients that would meet the following requirements:

(i) minimum size of the client's financial portfolio at the intermediary of not less than 500.000,00 euros;

(ii) individual portfolio management service or investment advice as an enabling factor giving access to certain financial instruments;

(iii) sophisticated investment objectives that meet the clients' specific needs of protection and generational handover of their personal, family, professional and/or corporate assets;

(iv) investment advice that mainly provides for a fee to be paid by the client to the intermediary, either as an exclusive fee or a mixed remuneration (fee plus inducements).

The above criteria are all necessary for the identification of this positive target market. If considered individually, they might not provide sufficient protection to the investors. Conversely, the respect of all these criteria compensates the clients' knowledge and experience in financial markets by virtue of its enabling function as it allows the clients to reach their sophisticated investment objectives.

Only a portfolio of a certain minimum value (500.000,00 €) justifies the provision of high added value services which, due to their cost, would not be justifiable on portfolios of lower investable value.

The low knowledge and experience that the client may have is compensated by the level of professional skills and expertise of the advisor or the portfolio manager. This is the key function of the level of service: clients with scarce knowledge and experience in finance and financial markets but detaining significant assets and with sophisticated and diverse demands and needs due to their position (head of household, entrepreneur, freelance professional) are willing to pay for an adequate service of portfolio management and investment advice in order to meet those demands and needs. Such level of service provides the clients with the much-needed competences they do not have and can pay for them in order to reach the aforementioned sophisticated investment objectives that would otherwise be out of their scope.

That being said, the admissibility, if certain conditions are met, of a possible discrepancy between the positive (potential and/or effective) target market of the instrument and its suitability for the client does not appear to be an efficient solution for the intermediaries to provide their clients with the best possible assistance in terms of private banking services.

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ESMA itself has correctly pointed out that the possibility of a product deviating from the target market for hedging or diversification purposes has often been object of abuse or of excessive extension.

Conversely, it is deemed that creating a set of criteria applied to all Member States and aimed to identify a specific positive target market for private banking clients could be the most efficient solution to ensure adequate acknowledgement to clients detaining considerable assets, in need of a high added value service for their sophisticated investment objectives, and to avoid pretextual deviations from the target market that are only seemingly justified by diversification and hedging requirements.

Indeed, some financial products which, when evaluated individually and autonomously, would not fall under a private banking client's target market, could instead meet their sophisticated needs thanks to the level of service (investment advice or portfolio management) received: a crucial element for identifying the positive target market of private banking clients.

The creation of an effective target market of private banking clients would, therefore, enable to deviate from the negative market exemption of selling a product; a custom which, as emphasized by ESMA, can seem a shortcut and a sign of system malfunction.

Finally, we believe that the identification of such positive target market of private banking clients could be done by means of including the private banking clients, according to the criteria above, in all the categories listed under paragraph 19 of the Guidelines.

Private banking clients constitute an effective target market that can be identified on a wide scale in all the categories listed under paragraph 19 of the Guidelines:

- under category *a,* in which the private banking clients can be easily inserted among the clients' targets for the purposes of product governance;

- the private banking clients constitute an effective target market also in terms of knowledge and experience (category *b*), considering the importance and the enabling function of investment advice and portfolio management for such a type of client;

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- a target market in the figure of private banking clients can also be identified with reference to financial situation (category *c*), considering the significant amount of assets they detain;

- finally, the private banking clients can be identified as target market considering their peculiar risk tolerance (category *d*), further reinforced due to their significant assets, the type of services they receive and considering their investment objectives and needs (category *e*) that are bound to be sophisticated as a consequence of the clients' professional activities and the high value of their assets.

The individuation of an effective target market of private banking clients as part of each of the above-cited categories should take place either by expanding one of the existing definitions, or by inserting a new definition that would describe the target market of private banking clients.

For example, if we observe the EMT (European Mifid Template) which is extensively being used by intermediaries for the individuation of the target markets of financial instruments, it can be noticed that the "distribution strategy" entry under the Target Market section of the EMT, which currently provides for optional entries such as "execution only", "execution with appropriateness test or non-advised services", "investment advice" and "portfolio management", should be either expanded, or recognized as a separate entry defined as "private banking". Indeed, private banking services correspond to a specific distributive strategy which is not ascribable to mere investment advice or portfolio management, but instead presents certain peculiarities by virtue of the level of service provided to the private banking clients.

At the same time, entries such as "*investor type retail", "investor type professional" and "investor type eligible counterparty"* are provided for in the EMT under the definition of "*investor type*". In this case, a new entry that would identify the private banking clients' target market and define an "*investor type private banking client*" should be added. It would represent an autonomous positive target market that would be able to identify a category of investors with specific characteristics.

As another example, the target market that matches the private banking clients' needs could alternatively be included in the "*knowledge and experience*" category which

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includes entries such as "*basic investor*", "*informed investor*" and "*advanced investor*": (i) by means of expanding the "*advanced investor*" entry, or (ii) by creating a separate entry that would match the definition of a "*private banking investor*". It is reasonable to assume that, thanks to the service with which they have been provided, the private banking clients would have a higher degree of knowledge and experience by virtue of the specific competences of the private banker assisting them and from whom they have acquired the technical knowledge they had personally lacked.

We would finally like to point out that the proposal of expanding the categories listed in paragraph 19 of the Guidelines which are applicable to the manufacturers would also apply to those identical categories listed under paragraph 42, therefore also applicable to distributors.

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.

Neutral approach

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.

Neutral approach

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.

Neutral approach

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

Neutral approach

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

Neutral approach

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