

## **ESMA CONSULTATION PAPER ON REVIEW OF THE GUIDELINES ON MIFID II PRODUCT GOVERNANCE REQUIREMENTS (ESMA35-43-3114)**

### **EUSIPA response (FINAL)**

On EUSIPA: The European Structured Investment Products Association (EUSIPA) was founded in 2009 by the main trade bodies that at the time represented already the interests of structured product issuers in Europe's leading markets. Currently, EUSIPA's full members are the national structured products issuer associations from Austria, France, Germany, Italy, Sweden, Belgium, UK, Switzerland, The Netherlands and Luxembourg. Most commercial banks active across the EU can be found amongst the national association membership population. EUSIPA is an international non-profit association registered under Belgian law, listed in the EU transparency register under number 37488345650-13. **Contact details** can be found at the last page.

#### **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)?**

EUSIPA would consider the newly introduced guidelines number 13 obliging the issuer to substantiate and document the target market choice to be acceptable, provided they are applied in practice in a proportionate manner (i.e., only requiring what is necessary to understand the central reasoning for the choices made).

However, with regard to the newly introduced guideline number 14 setting out the obligation to take into account performance scenarios, EUSIPA suggests replacing this provision with an obligation to reflect the pay-out structure of the product catering for the fact that, particularly for frequent and well-known product types and underlyings, manufacturers may already be fully aware of the relevant information without any further testing.

With regard to the consideration of costs, EUSIPA would argue that such aspect is **not** relevant for the target market definition while it may well be considered in the frame of the wider product governance of MIFID.

#### **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?**

EUSIPA agrees with the approach on identifying sustainability objectives.

The specification of sustainability-related objectives for products not covered by SFDR such as structured products for purpose of delivering information according to categories 7a-7c MIFID DA is well feasible from the point of EUSIPA and her members. Currently, EUSIPA would not see the need for further clarifying the circumstances relating to approaches i) and ii) mentioned in point 27.

### **Q3: What are the financial instruments for which the concept of minimum proportion would not be practically applicable?**

#### **(Minimum proportion)**

As for the use of the minimum proportion, EUSIPA would argue that the concept's feasibility depends on how it is precisely to be understood. In case it is being understood simply as the minimum threshold that a financial instrument needs to fulfill to be eligible for an investor, EUSIPA would see no need to modify it for products with a more static percentage.

EUSIPA wishes to stress that with regard to structured investment products there is no methodological difficulty in terms of applying a customer-defined minimum threshold to its single components and hence to the product as such.

### **Q4: Do you agree with the suggested guidance on complexity in relation to the target market assessment and the clustering approach?**

EUSIPA wishes to reiterate the known doubts regarding the usefulness of referring to an assumed or real "complexity" as part of regulatory mechanisms. EUSIPA again takes recourse to the commonly known arguments in this debate that centre on complexity being of a highly subjective nature and not necessarily working out to the detriment of an investor – on the contrary, almost all features adding elements to a product that seek to minimise certain risk aspects for the investor (capital protection, issuer default protection, currency conversion risks) necessarily also increase the product's complexity.

With a particular regard to the ESG features of financial products it should be noted that all methodologies currently used to capture and indicate ESG qualifications and quantitative aspects are very obviously of a highly complex nature thus confirming the above notion that complexity is not suited to define distribution limits such as the eligible investor audience in the format of the target market as is in question here.

In case however, complexity was to be used, it should be properly defined and be done so avoiding a biased preference of certain asset classes. This relates in particular to the notion of the non-complexity definition set out under MIFID which has a very specific objective and is not fit to be generalised - which can also be seen in the fact that this summarily exempts UCITs from being complex, something that is simply not understandable for the purposes of a general concept of "complexity".

In line with the before, EUSIPA further wishes to express its conviction that complexity should not necessarily be interwoven with the target market definition. If complexity leads however to a narrowing of the target market it should apply only to some elements of the target market. To illustrate the before, as for the category of clients' objectives and needs (e) and (c), there is no narrowing needed due to the complexity of a product in question.

**EUSIPA** wishes to make a general reference at this point also at the findings of the "Study on disclosure, inducements and suitability rules for retail investors" (hereinafter "Study") published by the European Commission in 2022 whose findings clearly indicate that the existing (disclosure) rules, such as the EU PRIIPs Regulation, lead to **structured products having shown no misleading potential while performance and cost information as rather easily understandable (see Study, page 188).**

Above finding is clearly evidencing above assumption upheld and defended by EUSIPA for many years now, that **complexity alone does not justify a tighter regulatory corset** may it be through the target market rules or other provisions.

**(Clustering)**

Insofar as clustering of products or product types is being envisaged by the guidelines, EUSIPA wishes to outline its view that any clustering rules should not be set out in a way that the size (or better spread) of a cluster is linked to complexity or risk of the financial products at stake.

Rather, as stated by ESMA itself, the similarity of relevant products as regards the elements relevant for defining the target market (e.g., two products are practically identical other than having different barrier levels) needs to be the guiding principle of for establishing clusters. In consequence, product complexity or riskiness can result in products being dissimilar with regard to the setting of clusters, but that will not necessarily be the case, and does not justify a general rule as proposed by ESMA.

As a result, EUSIPA pleads for regarding the requirement stated in first two sentences under new no. 27 as sufficient guidance for a clustering approach.

More generally, EUSIPA also wishes to voice its discomfort with the target market definition being used for purposes unrelated to its actual legislative purpose. Doing the contrary (using target market definitions to push back against assumingly complex products) might actually result in unwanted side effects such as retail investors being herded to low-yield (“capital protection-only”) products, cash deposits or direct investment in shares with exposure to the full downside market risk.

EUSIPA would like to stress again that the MIFID suitability rules are to be seen as core concept to probe/capture the retail investor specifics, especially at the knowledge and experience end.

With regard to the newly introduced number 28 EUSIPA suggests clarifying that the mentioned factors might need to be considered, but not necessarily all reflected in separate clusters. More generally these factors should be understood as non-exhaustive and non-binding examples, also as the cluster-related information is not visible to retail investor but distributors only for whom this approach should be easily understandable.

EUSIPA wishes to further hint at the unclarity as for the question what “optionality” specifically means for products with embedded derivatives, such as many structured products that have an option as a component. Within that context, EUSIPA would want to repeat the argument that clustering essentially is possible also for more complex products.

Finally and for the sake of clarity, we would like to stress that in any case clustering is not to be confused with sorting of pay-offs/product types at the point-of-sale (such as, for example, product filtering functions on distribution websites used by retail customers).

**Q7: Do you agree with the suggested approach on the determination of distribution strategy by the distributor?**

With regard to the newly introduced number 56 (no. 44), EUSIPA wishes to stress that distributors should not de facto be banned from distributing products on a non-advised basis even if they cannot for certain assume that a product will reach target market, due to clients not paying attention to warning by distributor. Doing so, would not only overburden the verification duties of the distributor in a non-advised sales situation but also take away the right to freely decide about an investment that also retail customers fully enjoy.

With regard to the newly introduced no. 72 (no. 48), EUSIPA wishes to outline that there should not be a requirement for distributors that are engaging in a non-advised sale, to obtain additional information from clients on a general basis to assess their target market compliance. Introducing such additional verification requirements would fundamentally impede and ultimately alter the non-advised sales situation into a background suitability vetting. This could, as indicated in the section's last sentence, only be justified in exceptional cases where there is proven evidence for a danger that the target market is likely to be missed. Requiring such vetting on a general basis would be excessive and extend beyond what is required under MiFID rules.

#### **(Self-responsibility of retail investors)**

More generally, EUSIPA would wish to outline with regard to any new rules or their interpretation as is (also) done by way of this ESMA guidance, that a nucleus of self-responsibility must never be taken away from the retail investor. While a lot can be achieved, as is thus rightly aimed at by law-makers and regulators through the tools of disclosure, explanation and verification of knowledge and understanding at the end of an investor related to a product, its functioning, the risk aspects and its portfolio context, it is in the end always and only the investor who bears the ultimate responsibility of finally deciding about his/her engagement on the capital market by investing in a specific financial product, thereby exposing him/herself to a specific market risk.

Insofar as there is no clear evidence for specific retail investments having been broadly engaged upon in an erroneous or misguided way, rules and regulation should thus, as a principle, not interfere with the essential risk-taking decision at the end of the retail investor.

#### **Further comment:**

##### **(Omission of annual coupon payment in samples)**

With regard to the product samples which are given on structured products in Annex 3.5. EUSIPA wishes to stress that both of the product variations would have in practice likely been offered with an **annual coupon payment** whose level reflects the market risk level of the index/basket being at the end maturity below a certain threshold.

Such an annual coupon is a fixed income source for the investor and, as is typical for structured products as passive investment products, clearly defined at the launch date of the product. It is mostly unconditional and serves as an additional safeguard (quantifiable as a percentage made up by the cumulated/added guaranteed annual coupons at the end of maturity) for the investor. The annual coupon payment would have been higher of course in the non-capital protected variation ("worst of basket" – case study 1) than in the capital protected variation (structured deposit – case study 2).

EUSIPA makes particular mentioning of this aspect as the absence of such market-usual annual coupon payments in the given samples runs the danger to unintentionally blurring the market attractiveness of structured investment solutions in the eyes of the unknowledgeable reader.

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EUSIPA is listed in the transparency register of the EU under number 37488345650-13.