

The Consumer Voice in Europe

## ESMA GUIDELINES ON MiFID II PRODUCT GOVERNANCE REQUIREMENTS

Response to consultation



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EC register for interest representatives: identification number 9505781573-45



Co-funded by the European Union

Ref: BEUC-X-2022-107 - 12/10/2022

## Why it matters to consumers

The product governance requirements regulate how the financial industry must design and distribute its products to consumers. This matters to consumers because products must be designed to fit consumer needs and they must be distributed in a responsible, suitable way to the consumer the products are intended for.

## Summary

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BEUC largely agrees with ESMA's proposals for changes to the product governance guidelines. While we are suggesting improvements in a few sections, the changes overall contribute to a more consumer friendly interpretation of the MiFID II framework. However, we would like to stress that the MiFID II framework is often not suitable to produce adequate results for consumers in many cases. We therefore also highlight where the framework is unsuitable to accomplish this goal, so that these points may be taken into account in future reviews.

Complex financial products present several challenges from a consumer perspective. These products are not just very difficult for consumers to understand but they are also often inflexible. When too many financial objectives, such as savings but also insurance, are tied up in a single product it becomes very difficult to adjust to new situations in life, such as terminating the insurance without harming the investment. Complex financial products are also frequently very expensive, which means they are of lower quality as investment products. BEUC therefore welcomes that complex products are subjected to higher levels of scrutiny.

### 1. Questionnaire

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*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.*

BEUC agrees with the suggested clarifications. The changes make it more likely that retail investors will be provided with an adequate understanding of the product's total costs. It is also important to reinforce the granularity of risk assessment for products and BEUC appreciates the effort to this effect represented in this proposal.

BEUC also agrees with the assessment that the investment horizon should always be considered. The sale of products which sacrifice returns for a reduction in volatility over long horizons is one of the primary sources of harm done to consumers, considering the corresponding loss of compounding interest over decades. While this action will not solve mis-selling it may lead to greater awareness of the issue.

*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.*

While this may be out of ESMA's control, BEUC would like to note that the level 2 rules for sustainability assessments are poorly done to a degree that undermines most of their purpose. There are two main issues:

1. Advisors do not have to compare the sustainability of their offerings against others available on the market.
2. If no product matching the consumers stated preferences is available at the respective point of sale, consumers can be asked to adapt their preferences to the products available.

Between these two flaws it is nearly impossible to provide consumers with an appropriate overview of sustainable options. This bullwhips back into the product governance because there is no incentive for product providers to compete for sustainability aspects because products are not sold based on consumer choice but the providers market power. Introducing consumer preferences in the target market assessment will not provide much benefit so long as the quality and extent of such considerations becomes a factor.

That said, BEUC believes ESMA is doing what is possible to enable consumers to make sustainable choices within the deeply flawed framework it is beholden to. If the framework was functional, the changes proposed here would be effective. We encourage ESMA to use its technical acumen and standing with the EU decision-making bodies to recommend a review of the level 1 and 2 regulations to solve the issues outlined above, at the earliest opportunity.

*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.*

N/A

*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.*

BEUC agrees that a dichotomy of complex and non-complex products is insufficiently granular and that charging structure should be a factor to be considered in the complexity assessment.

We need to stress that products like Contracts for Difference (CFDs) should have no legitimate target market in retail finance, at all.

The proposal of establishing sufficiently granular clusters of complexity level and making the range for these clusters smaller seems workable. However, high levels of complexity should always be regarded as a negative factor in terms of suitability. It is an important principle of consumer finance that overly complex products are inferior; therefore, a question emerges on the high-end of complexity clusters: what target market could be set for these products where such levels of complexity would be deemed appropriate?

*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.*

BEUC agrees with the direction of these proposals and appreciates that it mentions the always harmful nature of some forms of gamification aimed at maximising the number of trades. It remains unclear which other forms of gamification exist at relevant volume.

Integrating the distribution channels and methods in the target market assessment is a meaningful step forward. In future efforts, it would be wise to combine these assessments with the suitability assessments and judge this against the quality enhancement rules introduced in MiFID II. Product providers should be obliged to demonstrate how their product is in the target markets best interest, when compared to similar products which are also available on the market if the product is to be sold using inducements.

*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.*

N/A

*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.*

N/A

*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.*

BEUC fully agrees with the new guideline Nr. 64 as written in the draft.

It is important to leave open the possibility of a product to supplement a portfolio so that the latter may be more appropriate even if the added product itself would not be. Such uses must be monitored to avoid abuse of the exemption. However, we are not aware that this would require any products that are outside the scope of "type of client" or the "knowledge and experience" to provide consumers with a suitable portfolio.

*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.*

N/A

*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.*

BEUC agrees with this assessment and solution given the current legal framework.

As a comment adjacent to this question: It would be an improvement to the legal framework, if it mandated negative target market assessments regarding sustainability based on principle adverse impacts as defined in the Sustainable Finance Disclosure Regulation (SFDR). In this way consumers may be enabled to filter against "sustainable" products that are heavily invested in fossil fuels, for example. BEUC would advise ESMA to consider this recommendation in its interactions with the political bodies.

*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.*

N/A

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

BEUC supports the inclusion of best practices examples but disagrees on not including bad examples. We believe including adverse examples to be avoided would in many cases be more applicable to rectifying widespread abuses when combined with an explanation of why such things are to be avoided.

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

BEUC generally considers derivatives – even comparatively simple and benign ones like options – to be unsuitable to most consumers. Admittedly, consumers who can make good use of such instruments exist but the risk of mis-selling such tools to the large majority of consumers who don't understand them, or their implications is disproportionately large.

These products should not be actively distributed to consumers. Those consumers who do wish to access them of their own volition should be warned of the danger.

An additional case study regarding these instruments may be helpful, provided it acknowledges that consumers, who only learned of the existence of derivatives through marketing are not a suitable audience for their use. The study should then carefully define use cases, preferably in a closed list style, rather than an open list of examples.

