

MiFID II Updates:

The purpose of this circular is to provide an update on the following documents issued by ESMA:

- **Final Report on MiFID II Product Governance guidelines**
- **Consultation Paper on the Guidelines on certain aspects of the MiFID II Suitability Requirements; and**
- **MiFID II/ MIFIR Investor Protection Q&A**

I. Final Report on MiFID II product governance guidelines

Background

The product governance requirements were introduced under MiFID II to enhance investor protection by regulating all stages of the life-cycle of products or services in order to ensure that firms which manufacture and distribute financial instruments and structured deposits act in the clients' best interests. These requirements cover arrangements for:

- I. Firms to adopt when manufacturing products – *Product governance obligations for Manufacturers;*
- II. Firms to adopt when deciding the range of products and services they intend to offer to clients and when offering or recommending such products to clients – *Product governance obligations for Distributors.*

ESMA has published the [Final Report](#) on product governance guidelines under the Markets in Financial Instruments Directive II (MiFID II) regarding the target market assessment by manufacturers and distributors of financial products. The proposed guidelines address issues specific to manufacturers and distributors as well as issues common to both. The Final Report follows the Consultation Paper issued on 5 October 2016.

Following the responses to the consultation and advice from the Securities Markets Stakeholder Group (SMSG), ESMA has modified the guidelines in some areas such as the topic of portfolio diversification and has provided further practical examples in the annex.

The [Final Report](#) addresses the under-mentioned topics:

I. Guidelines in relation to *Manufacturers*:

- Identification of the potential target market by the manufacturer: categories to be considered;
- Identification of the potential target market: differentiation on the basis of the nature of the product manufactured; and
- Articulation between the manufacturer's distribution strategy and its definition of the target market.

II. Guidelines in relation to *Distributors*:

- Identification of the target market by the distributor: categories to be considered and differentiation on the basis of the nature of the product distributed;
- Identification and assessment of the target market by the distributor: interaction with the provision of different investment services;
- Regular review by the manufacturer and distributor to respectively assess whether products and services are reaching the target market;
- Distribution of products manufactured by entities not subject to the MiFID II product governance requirements; and
- Application of product governance requirements to the distribution of financial instruments manufactured or issued before the entry into application of MiFID II.

III. Transversal issues applicable to *both Manufacturers and Distributors* are as follows:

- Identification of the negative target market by the manufacturer and distributor – clients for whom the investment products they manufacture and/or distribute are not compatible; and
- Application of the target market requirements to investment firms dealing in wholesale markets (i.e. with professional clients and eligible counterparties).

Applicability

These guidelines will be transposed locally in the Conduct of Business Rulebook and investment services licence holders which manufacture and/or distribute investment products are expected to comply with these requirements.

II. Circular: Consultation Paper on the guidelines on certain aspects of the MiFID II suitability requirements

Background

The assessment of suitability is one of the most important requirements for investor protection under the MiFID framework. It applies to the provision of any type of investment advice (whether independent or not) and portfolio management. In accordance with the obligations set out in Article 25(2) of Directive 2014/65/2014 on Markets in Financial Instruments (MiFID II) and Articles 54 and 55 of the Commission Delegated Regulation (EU) 2017/565 (MiFID II Delegated Regulation), investment firms providing investment advice or portfolio management are required to provide suitable personal recommendations to their clients or have to make suitable investment decisions on behalf of their clients. In accordance with Article 16(2) of the ESMA Regulation, this [paper](#) sets out for consultation draft ESMA guidelines on certain aspects of the MiFID II suitability requirements.

The purpose of these [draft guidelines](#) is to enhance clarity and foster convergence in the implementation of certain aspects of the new MiFID II suitability requirements, replacing the existing ESMA guidelines on the same topic, issued in 2012. By pursuing the objective of ensuring a consistent and harmonised application of the requirements in the area of suitability, the proposed Guidelines will make sure that the objectives of MiFID II can be efficiently achieved.

While the objectives of the suitability assessment, as well as the key principles underpinning the regulatory requirements, have remained unchanged, the obligations have been further strengthened and detailed by including the following main requirements:

- reference to the fact that the use of electronic systems in making personal recommendations or decisions to trade shall not reduce the responsibility of firms;
- the requirement for firms to provide clients with a statement on suitability (the so called ‘suitability report’) prior to the conclusion of the recommended transaction;
- further details on conduct rules for firms providing a periodic assessment of the suitability;
- the requirement for firms performing a suitability assessment to assess, taking into account the costs and complexity, whether equivalent products can meet the client’s profile;
- the requirement for firms to analyse the costs and benefits of switching from an investment to another;
- the strengthened requirement for firms to consider the clients’ risk tolerance and ability to bear losses;
- the extension of suitability requirements to structured deposits.

The guidelines have been partially reorganised and divided in the following main sections:

- I. Information to clients on the purpose of suitability assessment;
- II. “Know your client” and “know your product”;
- III. Matching clients with suitable products;
- IV. Other requirements.

Interested Parties

This paper is primarily of interest to competent authorities and firms that are subject to Directive 2014/65/EU of the European Parliament and of the Council (MiFID II). In particular, this paper is addressed to investment firms and credit institutions providing investment advice or discretionary portfolio management services. This paper is also important for consumer groups, investors and trade associations, because the guidelines seek to implement enhanced provisions to ensure investor protection, with potential impacts for anyone engaged in the dealing with or processing of financial instruments.

Next Steps

ESMA invites comments on this paper and in particular on the specific questions summarised in Annex I. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **13 October 2017**.

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input - Consultations’ and copied to MFSA at csu@mfsa.com.mt. ESMA will consider the responses it receives to this consultation paper in Q4 2017/Q1 2018 and expects to publish a final report, and final guidelines, in Q1/Q2 2018.

III. MiFID II/ MiFIR Investor Protection Q&A

Background

The European Securities and Markets Authority (ESMA) has added 2 new Q&A to its [Questions and Answers \(Q&A\)](#) document on the implementation of investor protection topics under the Market in Financial Instruments Directive and Regulation (MiFID II/ MiFIR).

The new Q&A cover the topics of recording of telephone conversations and electronic communications, and best execution.

The overall MiFID II Q&A provide clarifications on the following topics:

- Best execution;
- Suitability and appropriateness;
- Recording of telephone conversations and electronic communications;
- Post-sale reporting;
- Record keeping;
- Investment advice on an independent basis;
- Inducements (research);
- Information on charges and costs; and
- Underwriting and placement of a financial instrument.

MiFID II applies from 3 January 2018 and will strengthen the protection of investors by both introducing new requirements and reinforcing existing ones. The purpose of this Q&A is to promote common supervisory approaches and practices in the application of MiFID II/ MiFIR for investor protection topics.

ESMA will continue to develop this Q&A on investor protection topics under MiFID II in the coming months, both adding questions and answers to the topics already covered and introducing new sections for other MiFID II investor protection areas not yet addressed in this Q&A.

Contacts

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