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Consultation on Review of Guidelines on MiFID II Product Governance Requirements

Background

MiFID II introduced product governance requirements for firms that manufacture and distribute financial instruments and structured deposits (“products”). The product governance requirements have proved to be one of the most important elements of the MiFID II investor protection framework, aiming at ensuring that firms act in their clients’ best interests during all stages of the investment product’s life cycle and preventing mis-selling.

In June 2017, ESMA published Guidelines on certain aspects of the MiFID II product governance requirements (“Guidelines”), mainly providing guidance on the application of the product governance obligations. While the Guidelines remain relevant, several recent regulatory and supervisory developments have triggered a review of the Guidelines. The main proposals referred to in the [Consultation Paper](#) relate to:

- The Commission’s Capital Markets Recovery Package and subsequent MiFID II Amending Directive;
- The sustainability-related amendments to the MiFID II Delegated Directive;
- The recommendations on the product governance guidelines by ESMA’s Advisory Committee on Proportionality (“ACP”); and
- The findings of ESMA’s 2021 Common Supervisory Action (“CSA”) on product governance.

The Consultation Paper also includes good practices identified in the 2021 CSA to complement the existing guidelines, as well as an additional case study. ESMA believes that these practical examples will help firms comply with the relevant product governance requirements.

Main Proposals in the Consultation Paper

The main proposals can be summarised as follows:

[i] Sustainability-related objectives

Commission Delegated Directive (EU) 2021/1269 requires manufacturers and distributors to specify, as part of their target market assessment, any sustainability-related objectives

the product is compatible with. In its Consultation Paper, ESMA is recommending the possibility to align “sustainability-related objectives” with “sustainability preferences” as used in the suitability context.

[ii] Clustering approach

The results of the 2021 CSA indicate that firms often identify the target market per cluster of products rather than per individual product. While a clustering approach is already allowed under the existing guidelines, limited guidance is provided on how this can be done. ESMA proposes to expand the guidance on the clustering approach because the 2021 CSA revealed that firms tend to use significantly varying levels of granularity when clustering products for the purpose of the target market assessment, sometimes resulting in too broad clusters containing financial instruments with insufficiently comparable product features.

The Consultation Paper also clarifies that a clustering approach can be used for both simpler and more complex products, provided that firms use a sufficient level of granularity when clustering products. To facilitate an appropriate level of granularity, the Consultation Paper includes a non-exhaustive list of multiple key factors to be considered when defining the clusters.

[iii] Distribution strategy

The Consultation Paper includes additional guidance on the determination of a compatible distribution strategy for a specific product, which is a key requirement enabling products to reach the identified target market. The 2021 CSA showed that firms often limit the identification of the distribution strategy to the specification of the investment service under which the product should be distributed (e.g. advised versus non-advised sales). While this might be sufficient, for example, for relatively simple products with broad target market, in other cases such an approach will not be sufficient for determining a compatible distribution strategy.

[iv] Target market assessment for CFDs and other products with similar characteristics

Proper adherence to product governance requirements help prevent mis-selling of products. Mis-selling risk is more pronounced for more complex and risky products and in these cases the target market and distribution strategy assessment should be carried out in a diligent manner for such products. Indeed, because of their particularly complex and risky nature, certain products, such as CFDs or products with similar characteristics, only have a very narrow compatible target market, or no compatible target market at all. The Consultation Paper clarifies that this principle should be reflected in the outcome of firms’ target market assessments for such products.

[v] Periodic review

Based on the 2021 CSA results, the Consultation Paper includes various additional clarifications on the requirement to review products. For instance, the Consultation Paper explains that for certain simpler products distributed under the execution-only regime, product

reviews can be less frequent and would require less depth. Furthermore, the Consultation Paper includes a clarification that a distributor no longer offering, selling or recommending a product is no longer obliged to review the target market of that product (including when a client may still hold the relevant product).

Target Audience

The content of this document is aimed at investment firms and credit institutions performing investment services and activities, especially firms which manufacture financial instruments or structured deposits as well as firms which distribute these financial instruments to clients.

Way Forward

ESMA invites industry participants to provide their contributions online at www.esma.europa.eu under the heading 'Your input – Consultations' by not later than **7 October 2022**. ESMA will consider the feedback it receives on the consultation in Q4 2022 and expects to publish a final report in Q1 2023.

We appreciate if any feedback that is sent to ESMA is also sent to the Conduct Supervision Investments Team on offsiteinv@mfsa.mt.