



ASSOCIATION
FRANÇAISE
DES MARCHÉS
FINANCIERS

FINANCIAL MARKET PROFESSIONALS

AMAFI / 20-16
18 February 2020
Replaces and supersedes **AMAFI / 18-60**

MiFID 2 PRODUCT GOVERNANCE

Manufacturer/Distributor Relations

IMPLEMENTATION GUIDE

DISCLAIMER

Readers are reminded that the sole purpose of this Implementation Guide (the Guide) is to share with members the discussions conducted within AMAFI's committees and working groups on the questions raised by implementation of MiFID 2 Product Governance provisions.

Although it draws on discussions with the AMF, it has not been approved by the Authority. The guidance contained here must therefore be treated with care at all times. Under no circumstances may AMAFI be held liable for this guidance.

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1. INTRODUCTION

1.1 Definitions

The following abbreviations are used in this document:

- **AMF GR**: AMF General Regulation;
- **Crucial Event**: crucial event likely to have an impact on the potential risk or return expectations of the financial instrument as referred to in article 9.15 of MiFID II DD¹;
- **Distributor**: entity subject to MiFID 2 that offers, markets or recommends the Product as defined in 2.2.b). ISPs, financial investment advisers and crowdfunding advisers are considered to be distributors;
- **EMT**: European MiFID Template – template that standardises the information required by MiFID 2 (specifically regarding Product Governance and Costs and Charges)
- **ESMA Guidelines**: Guidelines on MiFID II product governance requirements (*ESMA35-43-620*) published on 2 June 2017;
- **ISP**: investment services provider – investment firms and credit institutions authorised to provide investment services. Management companies are not covered by this definition, except as regards their distribution activities¹;
- **Manufacturer**: entity subject to MiFID 2 that designs the Product as defined in 2.2.a);
- **Material Event**: event that could materially affect the potential risk to the Product's identified target market or to investors, as referred to in articles 9.14, 9.15 and 10.5 of MiFID II DD¹;
- **MiFID 2**: the entire MiFID 2 regulatory package (Levels 1, 2 and 3);
- **MiFID II**: Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU;
- **MiFID II DD**: Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits;
- **PRIIPs**: Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products;
- **Product**: financial instrument as defined by MiFID 2 (Annex I, Section C) as well as structured deposits;
- **Product Governance**: framework of obligations placed upon the Manufacturer and the Distributor respectively within the meaning of articles 16.3 and 24.2 of MiFID 2.

1.2 About this guide

Product Governance is a key topic of MiFID 2 and one not broached by previous regulations. These provisions, which are detailed in Chapter III of MiFID II DD², govern relations between the Manufacturer and the Distributor.

From the various working groups organised by AMAFI, it became clear that, to standardise practices – a vital step in ensuring the effectiveness of the overall Product Governance framework – discussions needed to be held with professionals to help them apply Product Governance provisions in a uniform manner.

¹ The AMF describes the specific case of asset management companies and their responsibilities under MiFID 2 in its publication [MiFID 2 - Guide for asset management companies](#) (*MiFID 2 - Guide for management companies, Section 1*).

² The MiFID II DD Product Governance provisions have been transposed in France through Chapter III of Book III of the AMF GR.

That is the purpose of this guide. Specially, it seeks to:

- Suggest practical tools to help in implementing these provisions, including:
 - ✓ a standard annex to use when updating distribution agreements between the Manufacturer and the Distributor (see Appendix 1);
 - ✓ standardised criteria to guide the Manufacturer when defining the target market (see Appendix 2);
 - ✓ standardised exchanges of information between the Distributor and the Manufacturer on sales outside the target market (see Appendix 3).
- Make implementation proposals for applying Product Governance requirements in respect of certain types of financial instrument (see Appendixes 4 and 5);
- Clarify the provisions established by MiFID 2 in the area of Product Governance, particularly with respect to Manufacturer / Distributor relations, and gather together the reference texts (see Appendix 6).

1.3 About ESMA's Guidelines

While the aim here is not to reproduce all of the obligations laid down in ESMA's Guidelines, it is worth highlighting a number of points that will have a particularly important bearing on the manufacture and distribution of structured products:

- First, ESMA reiterates throughout the Guidelines that the obligations set down must be applied in a manner that is proportionate and appropriate having regard to the type and complexity of the Product;
- Second, ESMA says that it does not want to call existing distribution strategies into question. Accordingly, it does not require all target market criteria to be assessed if the Product is distributed under a regime that prevents the distributor from assessing the service's suitability. Thus, where the ISP does not have to test suitability or appropriateness (execution-only situation), it shall be required to assess only the first criterion (Client Type). If the ISP has to perform an appropriateness test, in the case of order execution or order reception/transmission services for example, only the first two criteria may be assessed (Client Type and Knowledge and Experience). If the distributor has to test the Product's suitability, all criteria should be assessed³ ;
- Third, ESMA recognises the need to be able to conduct sales outside the target market for diversification or hedging purposes. These do not have to be reported to the Manufacturer as long as they are outside the negative target market (see 6.2 below).

³ "It is therefore expected that when distributors define their product assortment, they pay particular attention to situations where they might not be able to conduct a thorough target market assessment by virtue of the type of services they provide. In particular, where distributors only carry out execution services with the assessment of appropriateness (for example through a brokerage platform), they should consider that they will usually be able to conduct an assessment of the actual target market which is limited to the sole categories of clients' knowledge and experience (see paragraph 18(b)); where they only conduct execution services under the execution-only regime, not even the assessment of clients' knowledge and experience will usually be possible. In this respect, firms should pay particular attention to the distribution strategy suggested by the manufacturer (see paragraphs 26, 49 to 51)" (ESMA Guidelines, § 45).

2. SCOPE / DEFINITIONS

2.1 Scope

The provisions on Product Governance are established at Level 1 by MiFID 2 (*MiFID II, arts. 16-3 and 24-2*) and detailed in MiFID II DD (*MiFID II DD, arts. 9 and 10*). As such, these provisions do not apply to institutions that are established outside the European Union and that do not provide investment services within the Union (*MiFID II, art. 1*).

Product Governance applies to **all client types**, regardless of their classification, and to **all Products**, irrespective of their level of complexity or trading venue (*MiFID II DD, recital 18*).

That being said, the **rules may be applied in a proportionate manner**, meaning that ISPs may adapt obligations to suit specific client categories and/or the nature of the Products in question and/or the investment service provided (*MiFID II DD, recital 18*).

Given that the purpose of Product Governance is to identify the types of investor whose needs and characteristics are compatible with a specific product, it seems reasonable to assume that the various obligations are applicable only when a client is investing in a product⁴, and not divesting⁵ it. Indeed, given that the client would have every interest in divesting a product that is or has become incompatible with its profile, applying the Product Governance obligations would not make sense in this case.

2.2 Identification of the Manufacturer and the Distributor

Product Governance establishes the respective responsibilities of the Manufacturer and Distributor. Accordingly, the first step is to identify which entities are considered to be the Manufacturer and Distributor respectively.

a. Identification of the Manufacturer

ISPs are considered to be Manufacturers if they engage in "*manufacturing financial instruments, which encompasses the creation, development, issuance and/or design of financial instruments*" (*MiFID II DD, art. 9.1⁶*).

The Manufacturer is the entity that creates, designs or issues the Product.

AMAFI considers the entity that "designs" a Product to be the one which determines the main Product characteristics with a direct or indirect economic influence, including how the Product works, its underlying assets, guarantees, mechanisms and risk/reward trade-off, as well as the legal nature of the Product or the issuer (and where applicable, the affiliation to the Manufacturer).

When manufacturing is performed by several entities that collaborate to determine the Product's main characteristics, the Manufacturer's responsibilities shall be shared by these entities, which are considered under MiFID 2 to be co-Manufacturers and must establish a written agreement identifying each party's responsibilities (*MiFID II DD, art. 9.8⁷*).

⁴ Purchase, opening of position, etc.

⁵ Sale, reduction of position, etc.

⁶ Provision transposed into the AMF GR (*AMF GR, art. 313-1*).

⁷ Provision transposed into the AMF GR (*AMF GR, art. 313-11*).

b. Identification of the Distributor

An ISP, financial investment adviser (FIA)⁸, crowdfunding adviser (CA)⁹ or asset management company¹⁰ is considered to be a Distributor if it "offers", "markets" or "recommends" Products (MiFID II, arts. 16.3 and 24.2).

Accordingly, this covers all entities "deciding the range of financial instruments issued by themselves or other firms and services they intend to offer or recommend to clients [...]" (MiFID II DD, art. 10.1¹¹).

The Distributor is the entity that determines the range of Products that may be acquired by its clients and is thus the entity that sells or recommends these Products to them. ESMA says that an ISP is also regarded as a Distributor if it decides which Products will be offered to clients at their own initiative without active marketing (ESMA Guidelines, § 31).

As such, conversely, the Distributor does not determine the Product's characteristics.

However, the Distributor may participate in defining the Product's characteristics and may thus cooperate with the Manufacturer on defining a single target market¹² (MiFID II DD, art. 9.9).

Furthermore, when the Manufacturer creates a bespoke Product at the Distributor's request to meet explicit or implicit demand among the Distributor's clients, a single target market corresponding to the client who ordered the product may be identified unless the distribution of the Product to other clients is also foreseen (ESMA Guidelines, § 24).

In accordance with article 10.10 of MiFID II DD, the responsibility for respecting the obligations of the Distributor is incumbent upon the ISP having a direct relationship with the client. The sole ISP considered as the Distributor in terms of Product Governance is the entity having a direct relationship with the end client.

In this respect, the following situations need to be clarified:

- where an ISP directly receives an order from an end client, for example a legal person or corporate investor, it is the Distributor;
- where an initial ISP receives an order from another ISP that provides a reception and transmission of orders service to end clients, the Distributor is the latter ISP and not the former;
- where an initial ISP receives an order from a private bank that provides a reception and transmission of orders service to its end clients, the Distributor is the private bank;
- where an ISP receives an order from a fund manager acting on a mandated basis, it is the fund manager that deals directly with the end client and, as such, is considered as the Distributor. The ISP that receives the order is not the Distributor;
- where an ISP receives an order from an institutional client acting on its own account, for example a hedge fund, the hedge fund is the end client of the ISP which is the Distributor;

⁸ French FIAs are regarded as Distributors subject to MiFID 2 obligations applicable to Distributors (Monetary and Financial Code, art. L. 541-8-1 6°).

⁹ French CAs are regarded as Distributors subject to MiFID 2 obligations applicable to Distributors (Monetary and Financial Code, art. L. 547-8-1 2°).

¹⁰ The AMF describes the specific case of asset management companies and their responsibilities under MiFID 2 in its publication MiFID 2 - Guide for asset management companies (MiFID 2 - Guide for management companies, Section 1).

¹¹ Provision transposed into the AMF GR (AMF GR, art. 313-18).

¹² Noting that, in general, while the Distributor defines its own target market (MiFID II DD, art. 10.1; AMF GR, art. 313-18), ESMA considers that it is good practice for this market to be as close as possible to the target market identified by the Manufacturer (ESMA Guidelines, § 36). Thus, and beyond the specific case referred to here, as a rule, the target market of the Distributor may be the same as that of the Manufacturer.

- where an ISP directly receives an order from an end client advised by a financial investment advisor (FIA), the ISP and FIA are both Distributors (the former for the order execution service and the latter for the investment advice service).

c. Framework for the distribution of responsibilities between the Manufacturer and the Distributor

The responsibilities of the Manufacturer and the Distributor are shared.

Case where the Manufacturer and the Distributor are linked (directly or indirectly)

In some cases, the Manufacturer has direct or indirect links to the Distributor because they are part of the same Group or, more generally, because they have signed a contractual agreement whereby the Distributor undertakes to market Product(s) of one or more Manufacturers.

In this case, the procedures for sharing information and the reciprocity of commitments are based on this agreement or, where no such agreement exists, on the Group's internal procedures containing the Product Governance obligations.

Typically, structured products fall within this type of arrangement.

Case where the Manufacturer and the Distributor are not linked

In other cases, the Manufacturer has no particular link to the Distributor(s) of its Product. Typically, in the case of Products admitted to trading on a platform (regulated market or MTF¹³) and marketed by various counterparties, these counterparties do not necessarily have any links to the Manufacturer.

In these cases, in practice, the procedures for sharing information and the reciprocity of commitments are not based on a contractual agreement.

Specific case of Distributors that are not subject to MiFID 2

Distributors not subject to MiFID 2 are not required to provide information on sales¹⁴.

A Distributor shall be regarded as not subject to MiFID 2 because it has no activities in the EU (for example, a financial investment adviser advising Swiss clients in Switzerland¹⁵), or because it does not provide investment services or because it is not authorised to provide such services (for example, a French insurer).

Specific case of Manufacturers that are not subject to MiFID 2

If the Manufacturer is not subject to MiFID 2, the Distributor must itself identify the target market for the Product by obtaining the necessary information (<i>MiFID II DD, art. 10.2¹⁶</i>).
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However, the Distributor is not required to provide information on sales to a non-MiFID 2 Manufacturer.

A Manufacturer shall be regarded as not subject to MiFID 2:

- either because the investment services it provides are not delivered in the EU in the sense that the directive governs this supply (e.g. an entity located outside the EU that does not do business in the EU¹⁷),

¹³ Multilateral Trading Facility.

¹⁴ See Part 6 of this Guide.

¹⁵ Provided it has the necessary authorisations to do so.

¹⁶ Provision transposed into the AMF GR (*AMF GR, arts. 313-18 and -19*).

¹⁷ Notably because it does not provide services to EU clients or exclusively at the request of such clients.

- or because it does not provide investment services while being subject to MiFID 2 (for example, a French asset management company¹⁸).

3. MANUFACTURER OBLIGATIONS

The obligations placed on a Manufacturer as a result of MiFID 2 Product Governance provisions may be summarised as follows:

<p>Conflicts of interest (<i>MiFID II DD, arts. 9.2 and 3¹⁹</i>)</p>	<ul style="list-style-type: none"> • Products must comply with the requirements on management of conflicts of interest and must not adversely affect end clients or market integrity.
<p>Staff expertise (<i>MiFID II DD, arts. 9.2 and 3²⁰</i>)</p>	<ul style="list-style-type: none"> • Staff involved in manufacturing Products shall possess the necessary expertise to understand their characteristics.
<p>Target market (<i>MiFID II DD, arts. 9.9 and 9.11²¹</i>)</p>	<ul style="list-style-type: none"> • The target market identified by the Manufacturer shall take account of the needs, characteristics and objectives of end clients for whom the Product is compatible.
<p>Negative target market (<i>MiFID II DD, art. 9.9²² and ESMA Guidelines, § 67</i>)</p>	<ul style="list-style-type: none"> • The Manufacturer shall identify clients whose needs and objectives are not compatible with the Product.

¹⁸ Sheet 1 of the AMF's MiFID 2 guide for asset management companies.

¹⁹ Provision transposed into the AMF GR (*AMF GR, art. 313-4*).

²⁰ Provision transposed into the AMF GR (*AMF GR, art. 313-7*).

²¹ Provision transposed into the AMF GR (*AMF GR, art. 313-11*).

²² Provision transposed into the AMF GR (*AMF GR, art. 313-11*).

<p>Scenarios (<u>MiFID II DD, art. 9.10²³</u>)</p>	<ul style="list-style-type: none"> When creating the Product, the Manufacturer must assess the possible consequences for the Product to see what would happen, for example, in the following adverse scenarios: <ul style="list-style-type: none"> the market environment deteriorates; the Manufacturer or a third party involved in the manufacturing and/or functioning of the Product experiences financial difficulties or other counterparty risk materialises; the Product fails to become commercially viable; demand for the Product is much higher than anticipated, putting a strain on the firm's financial resources and/or on the market of the underlying instrument.
<p>Costs / Charges²⁴ (<u>MiFID II DD, art. 9.12²⁵</u>)</p>	<ul style="list-style-type: none"> The Manufacturer shall ensure that costs and charges: <ul style="list-style-type: none"> are compatible with the needs, objectives and characteristics of the target market; "do not undermine the financial instrument's return expectations"; are transparent and understandable.
<p>Review of the target market's relevance (<u>MiFID II DD, art. 9.14²⁶ and ESMA Guidelines, § 57</u>)</p>	<ul style="list-style-type: none"> During the marketing period, the Manufacturer must check the relevance of the target market to ensure that its Products remain compatible therewith; The Manufacturer must take Material Events into account; The Manufacturer must ensure that the Product is distributed to its target market.
<p>Monitoring of Products and Identification of Crucial Events (<u>MiFID II DD, art. 9.15²⁷</u>)</p>	<ul style="list-style-type: none"> Each time it issues or re-launches a Product, the Manufacturer must first check whether a Material Event has occurred. Depending on the complexity and level of innovation of its existing Products, the Manufacturer must regularly: <ul style="list-style-type: none"> check that the Product is functioning as intended; identify any Crucial Events that could have an impact on the Product's potential risk or return expectations.
<p>Relations with the Distributor (<u>MiFID II DD, art. 9.13²⁸</u>)</p>	<ul style="list-style-type: none"> The Manufacturer shall provide the Distributor with all appropriate information concerning the Product, including the Product approval process and target market²⁹.
<p>Internal governance (<u>MiFID II DD, art. 9.6³⁰</u>)</p>	<ul style="list-style-type: none"> The management body must have effective control over the firm's Product Governance process; Compliance reports to the management body must include information about this process.

²³ Provision transposed into the AMF GR (AMF GR, art. 313-12 II).

²⁴ The obligation to ensure that charges "do not undermine the financial instrument's return expectations" is understood to mean a requirement to make sure that charges remain below the Product's return expectations under normal market conditions. As Manufacturers, only an estimation of costs about which they may have knowledge is included in this analysis. This point should be stipulated in the agreements (by means of a disclaimer of the following type: "The impact of charges on the Product's return expectations does not take account of any additional charges applied by the Distributor").

²⁵ Provision transposed into the AMF GR (AMF GR, art. 313-14).

²⁶ Provision transposed into the AMF GR (AMF GR, art. 313-16).

²⁷ Provision transposed into the AMF GR (AMF GR, art. 313-17).

²⁸ Provision transposed into the AMF GR (AMF GR, art. 313-15).

²⁹ Depending on the Products' category, this exchange can be done through the EMT.

³⁰ Provision transposed into the AMF GR (AMF GR, art. 313-8).

4. DISTRIBUTOR OBLIGATIONS

The obligations placed on the Distributor as a result of MiFID 2 Product Governance provisions may be summarised as follows:

<p>Relations with non-MiFID 2 manufacturers (<i>MiFID II DD, art. 10.1³¹</i>)</p>	<ul style="list-style-type: none"> The Distributor shall comply with Product Governance requirements even when it offers or recommends Products designed by entities that are not subject to MiFID 2; Accordingly, it shall have in place arrangements that ensure that it obtains sufficient information about these Products from non-MiFID 2 manufacturers; it shall determine the target market for each Product even if it was not defined by the Manufacturer.
<p>Relations with the Manufacturer (<i>MiFID II DD, art. 10.2³²</i>)</p>	<ul style="list-style-type: none"> The Distributor shall obtain from the Manufacturer information to gain the understanding and knowledge of the Products to ensure that these Products will be distributed in accordance with the needs, characteristics and objectives of the identified target market.
<p>Target market (<i>MiFID II DD, art. 10.2³³</i>)</p>	<ul style="list-style-type: none"> The identified target market shall take account of the needs, characteristics and objectives of end clients; The Distributor shall identify and assess the circumstances and needs of clients that it intends to target.
<p>Negative target market (<i>MiFID II DD, art. 10.2³⁴</i> <i>and ESMA Guidelines, § 67</i>)</p>	<ul style="list-style-type: none"> The Distributor shall identify clients whose needs and objectives are not compatible with the Product.
<p>Staff expertise (<i>MiFID II DD, art. 10.7³⁵</i>)</p>	<ul style="list-style-type: none"> Staff involved in distributing Products shall possess the necessary expertise to understand their characteristics.
<p>Review of the target market's relevance (<i>MiFID II DD, art. 10.5³⁶</i>)</p>	<ul style="list-style-type: none"> During the marketing period, the Distributor shall review Products on a regular basis, taking into account any event that could materially affect the potential risk for the identified target market; The Distributor shall reconsider the target market and/or update the Product Governance arrangements if it becomes aware that it has wrongly identified the target market for a specific Product or that the Product no longer meets the criteria of the identified target market.
<p>Client information (<i>ESMA Guidelines, § 47, 55 and 70</i>)</p>	<ul style="list-style-type: none"> The Distributor must inform clients if it is unable to assess all target market criteria, i.e. if it is not providing the service of investment advice; The Distributor must inform clients if it makes sales within the negative target market; If it makes sales outside the positive target market, but not necessarily within the negative target market, the Distributor must provide justification for such sales in the suitability report when it is drawn up.

³¹ Provision transposed into the AMF GR (*AMF GR, arts. 313-18 and -19*).

³² Provision transposed into the AMF GR (*AMF GR, art. 313-19*).

³³ Provision transposed into the AMF GR (*AMF GR, art. 313-19*).

³⁴ Provision transposed into the AMF GR (*AMF GR, art. 313-19*).

³⁵ Provision transposed into the AMF GR (*AMF GR, art. 313-24*).

³⁶ Provision transposed into the AMF GR (*AMF GR, arts. 313-21 and -22*).

<p>Information on sales (<i>MiFID II DD, art. 10.9³⁷</i>)</p>	<ul style="list-style-type: none"> The Distributor shall provide the Manufacturer with information on sales³⁸ and, where appropriate, information on the above reviews to support Product reviews carried out by the Manufacturer.
<p>Chain of responsibility (<i>MiFID II DD, art. 10.10³⁹</i>)</p>	<ul style="list-style-type: none"> Where different Distributors work together in the distribution of a Product, the firm with the direct client relationship has ultimate responsibility to meet the Product Governance obligations; However, intermediary Distributors shall: <ul style="list-style-type: none"> ensure that relevant Product information is passed from the Manufacturer to the final Distributor in the chain; and enable the Manufacturer to obtain information on sales.
<p>Internal governance (<i>MiFID II DD, art. 10.8⁴⁰</i>)</p>	<ul style="list-style-type: none"> The management body must have effective control over the firm's Product Governance process; Compliance reports to the management body must include information about this process.

5. TARGET MARKET AND DISTRIBUTION STRATEGY

The Manufacturer shall have (*MiFID II, arts. 16.3 and 24.2*) a process for Product preparation and approval that shall define:

- the Product's **target market**: categories of end clients and other criteria compatible with the characteristics of the Product;
- the **distribution strategy** appropriate to the target market, notably recommended investment services to distribute the Product.

The Manufacturer shall take reasonable steps to ensure that the Product is distributed to the target market (*MiFID II, art. 24.2*).

The distribution strategy should promote the sale of the Products to targeted clients (*MiFID II DD, art. 9.13⁴¹*).

When the Manufacturer can choose the Distributors of its products, the Manufacturer makes its best efforts to select Distributors whose type of clients and services offered are compatible with the target market (*ESMA Guidelines, § 25*).

The Manufacturer may follow a common approach to identify the five target market criteria for Products with sufficiently comparable features (*ESMA Guidelines, § 22*).

It shall determine the information necessary to ensure that its Products are appropriately distributed and determine accordingly (*ESMA Guidelines, § 26*):

- investment services appropriate for their sale (particularly investment advice);
- preferred channels (for example, online sales may be inappropriate for some Products).

³⁷ Provision transposed into the AMF GR (*AMF GR, art. 313-26*).

³⁸ AMAFI's proposals to standardise information on sales outside the target market are detailed in **Annex 3**.

³⁹ Provision transposed into the AMF GR (*AMF GR, art. 313-27*).

⁴⁰ Provision transposed into the AMF GR (*AMF GR, art. 313-25*).

⁴¹ Provision transposed into the AMF GR (*AMF GR, art. 313-19*).

5.1 Criteria used to define the target market

The Manufacturer and the Distributor must identify a target market for each Product. However, in accordance with the proportionality principle, they may apply common principles to identify target markets for broad asset categories (*ESMA Guidelines, § 22*).

It is the responsibility of each ISP to determine the level of granularity applied in connection with the proportionality principle (the ISP must be able to explain its choice).

The target market for a Product shall be identified using at least the five criteria defined by ESMA. This shall be done in an appropriate and proportionate manner, considering the nature of the Product (*ESMA Guidelines, § 16 and 21*).

1	<p>The type of clients to whom the product is targeted This specification should at least be made according to the MiFID 2 client categorisation of retail client, professional client and/or eligible counterparty.</p>
2	<p>Knowledge and experience The Manufacturer should specify which knowledge the target clients should have to understand the Product.</p>
3	<p>Financial situation with a focus on the ability to bear losses The Manufacturer should specify the amount of losses target clients should be able and willing to afford and if there are any additional payment obligations that might exceed the amount invested (for example, a margin call for a CFD).</p>
4	<p>Risk tolerance and compatibility of the risk/reward profile The Manufacturer should specify the general attitude that target clients should have in relation to risk.</p>
5	<p>Client objectives and needs The Manufacturer should specify the investment objectives of target clients, their wider financial goals and overall investment strategy.</p> <p>Where relevant, the Manufacturer shall indicate specific aspects of the investment with regard to the expectations of targeted clients⁴².</p>

This process of identifying the target market follows a pyramid approach, i.e. a Product that is compatible with broader categories will necessarily be compatible with narrower categories (*ESMA Guidelines, § 19*).

The reader's attention is drawn to the proposals currently under consideration at European level⁴³ aimed at adding an "ESG" criteria when identifying a product's target market. If and once approved, these proposals are expected to be the subject of an amendment to MiFID II DD and the ESMA Guidelines.

⁴² Such specific aspects may include currency protection, green investment, ethical investment, etc. (*ESMA Guidelines, § 18.e*).

⁴³ ESMA's technical advice to the European Commission on integrating sustainability risks and factors in MiFID II, 30 April 2019 ([ESMA35-43-1737](#)).

a. Identification of the target market by the Manufacturer

To avoid any misinterpretations or misunderstandings, the Manufacturer should clearly define the concepts and terminology used when defining the target market (*ESMA Guidelines, § 20*).

The Manufacturer should base its target market identification on its theoretical knowledge and experience of the Product (*ESMA Guidelines, § 17*).

For bespoke or tailor-made products, the target market of the Product will usually be the client who ordered the Product unless the distribution of the Product to other clients is also foreseen (*ESMA Guidelines, § 24*).

b. Identification of the target market by the Distributor

Whereas the Manufacturer has to specify the potential target market based on its theoretical knowledge of the Product, the market identified by the Distributor also has to consider information about the Distributor's client base and prior experience (*ESMA Guidelines, § 35 and 38*).

In accordance with the proportionality principle, in the case of simple Products, the Distributor may keep the target market identified by the Manufacturer (*ESMA Guidelines, § 42*).

The Distributor must however ensure that the selected target market is appropriate to its clients' profile.

5.2 Distribution strategy

a. Identification of the distribution strategy by the Manufacturer

The Manufacturer shall propose to the Distributor the investment services that it recommends for distribution of the Product in order to favour sales to the positive target market. As far as possible, the Manufacturer needs to take reasonable steps to ensure that the Product is distributed to the identified target market (*ESMA Guidelines, § 25*).

The Manufacturer should in particular inform the Distributor about the Product's compatibility with non-advised sales (*ESMA Guidelines, § 26*).

b. Identification of the distribution strategy by the Distributor

To identify its distribution strategy, the Distributor must take account of the distribution strategy identified by the Manufacturer and modify it if necessary (*ESMA Guidelines, § 49*). In particular, the Distributor shall take into consideration its ability to identify all target market criteria as a function of the authorised investment services and the type of clients targeted (*ESMA Guidelines, § 50 and 51*):

- In the case of more complex Products, ESMA recommends selecting investment services that afford a higher level of protection, such as investment advice, especially when dealing with less experienced investors;
- Conversely, in the case of simpler Products or more experienced types of clients, such as professional clients, the Distributor could select investment services that afford a lower level of protection, such as execution services.

5.3 AMAFI proposals to standardise the criteria used to identify the target market and distribution strategy

AMAFI's proposals to standardise target market and distribution strategy criteria are set out in detail in **Appendix 2** of this Guide.

5.4 Negative target market

The Manufacturer and the Distributor shall identify “any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible” (DD MiFID II, arts. 9.9 and 10.2⁴⁴).

The Distributor needs to review the theoretical negative target market identified by the Manufacturer and also identify any groups of clients whose needs, characteristics or objectives are not compatible with certain distribution strategies (ESMA Guidelines, § 67).

The Distributor must disclose to clients if those sales are within the negative target market (ESMA Guidelines, § 55).

ISPs, whether they act as Manufacturer or Distributor, are required to analyse every target market criterion to determine whether the Product is incompatible with a certain category of investors. Where applicable, a “negative target market” should be identified and will be composed of clients with whom the Product is incompatible. Accordingly, it does not constitute the exact opposite of the positive target market in every case.

6. EXCHANGES OF INFORMATION BETWEEN THE MANUFACTURER AND THE DISTRIBUTOR

“[Any Manufacturer] which manufactures financial instruments shall make available to any Distributor all appropriate information on the financial instrument and the Product approval process, including the identified target market of the financial instrument” (MiFID II, art. 16.3).

The Manufacturer shall provide all appropriate information concerning the Product, including the Product approval process and target market (MiFID II DD, art. 9.13⁴⁵).

The Distributor shall provide the Manufacturer with information on sales and, where appropriate, information on the above reviews to support Product reviews carried out by the Manufacturer (MiFID II DD, art. 10.9⁴⁶).

6.1 Product Information

Regarding the information that the Manufacturer is required to provide to the Distributor about the Product, its approval process and target market, AMAFI considers that several methods of transmission are possible, including exchanging emails and making files available through a website, a shared system for exchanging information or a data provider.

To facilitate this transmission, in August 2017, the EWG – which in February 2019 became FinDaTex – made a file available to all financial sector stakeholders to standardise the exchange of information related to MiFID 2, in particular to Product Governance and Costs and Charges: the EMT (version 1.0, followed by versions 2.0 and 3.0). This file is upgradeable: the latest version is available on the FinDaTex [website](#).

Regarding the approval process, the Manufacturer must establish a prior approval policy for Products that must comply in particular with the requirements set out in article 16.3 of MiFID 2 and article 9 of MiFID II DD⁴⁷.

⁴⁴ Provisions transposed into the AMF GR (AMF GR, art. 313-11 and -19).

⁴⁵ Provision transposed into the AMF GR (AMF GR, art. 313-15).

⁴⁶ Provision transposed into the AMF GR (AMF GR, art. 313-26).

⁴⁷ Provisions transposed in France through Section 1 of Chapter III of Title I of Book III of the AMF GR.

The Manufacturer shall provide information about this policy at the express request of the Distributor.

6.2 Information on sales

The Manufacturer should determine, on a proportionate basis, the information it needs the Distributor to provide it with in order to complete its Product review, such as the proportion of sales made outside the target market or a summary of client complaints (*ESMA Guidelines, § 57*).

In addition, the Distributor must provide the Manufacturer with information on sales and any other relevant information that may be the outcome of the Distributor's own review. The Distributor should also provide any information that may give an indication that the Manufacturer has wrongly identified the target market or that the target market is no longer appropriate. Any such information shall be provided in a manner that is proportionate and appropriate considering the nature of the Product (*ESMA Guidelines, § 58*).

a. Generic information on sales

The Manufacturer must ask the Distributor to provide it with information about sales that it deems relevant in order to complete its Product review (see 7).

b. Information on sales outside the target market

The Distributor should provide the Manufacturer with information on sales that are outside the target market or the recommended distribution strategy.

However, sales outside the target market do not have to be reported if these sales are for diversification or hedging purposes and if these sales are suitable given the client's total portfolio or the risk being hedged (*ESMA Guidelines, § 54*).

Sales of products into the negative target market should always be reported, even if those sales are for diversification or hedging purposes (*ESMA Guidelines, § 55*).

The Distributor is required to provide the Manufacturer with information requested by the Manufacturer on sales outside the target market where this is relevant to the Product Governance process.

There might be situations and circumstances where the Product could be sold outside the target market, i.e. to clients who do not meet the criteria used to identify the target market (*ESMA Guidelines, § 71*). It is especially important for information in this regard to be taken into account by the Manufacturer if it is "recurrent" (*ESMA Guidelines, § 73*). For this reason, when it distributes a Product outside the target market, the Distributor must inform the Manufacturer of this.

However, sales conducted outside the target market for diversification or hedging purposes do not need to be reported to the Manufacturer. If the Distributor conducts transactions in such situations, it must ensure that these sales are still suitable given the client's total portfolio or the risk being hedged (*ESMA Guidelines, § 54*).

Diversification is understood here as an objective aimed at allowing a portion of the transactions carried out on behalf of the client or the Products sold to the client or a portion of the client's portfolio to deviate from the client's pre-determined profile, in order to diversify the client's overall exposure in terms of risk, performance or the nature of financial instruments.

As regards the service of discretionary management, which is moreover subject to an obligation to assess the suitability of transactions with respect to the management agreement, this diversification objective may be assumed to apply to sales outside the positive target market, except in special cases.

Hedging is understood here as an objective aimed at mitigating or removing the risk taken on a position.

Thus, by way of exception, these sales outside the target market for diversification or hedging purposes do not provide useful information to the Manufacturer for its review process if they cannot be used to determine whether the target market should be redefined.

However, sales conducted outside the positive target market because they do not comply with the “Client type” and/or “Knowledge and Experience” criteria cannot be justified on diversification or hedging grounds. They therefore have to be reported in all instances (*ESMA Guidelines, Annex, 3.3, § 42*).

Finally, sales into the negative target market should always be reported, even if those sales are for diversification or hedging purposes (*ESMA Guidelines, § 55*). ESMA considers moreover that such sales should be a “rare occurrence” and their justifications should be more substantiated (*ESMA Guidelines, § 71*).

Diagram – Summary of sales to be reported

POSITIVE TARGET MARKET	OUTSIDE POSITIVE TARGET MARKET		NEGATIVE TARGET MARKET
<ul style="list-style-type: none"> - Client type - Knowledge and experience - Ability to bear losses - Risk tolerance - Client objectives and needs 	"GREY AREA"	<ul style="list-style-type: none"> - Ability to bear losses - Risk tolerance - Client objectives and needs 	DIVERSIFICATION AND HEDGING

- Report required
- Applicable criteria
- Diversification and hedging

It is important to note that "without legitimate reasons" (*Consumer Code, art. L. 121-11*), the Distributor may not refuse an express request from a client to invest in a Product. In AMAFI's view, the mere fact that the client is outside the target market would not appear to constitute a "legitimate reason"⁴⁸.

AMAFI's proposals to standardise information on sales outside the target market are detailed in **Appendix 3** of this Guide.

⁴⁸ The consequences of this situation will doubtless need to be clarified later, notably as regards information to be provided to the client.

7. PRODUCT AND TARGET MARKET REVIEW PROCESS

7.1 Review of the target market's relevance (MiFID II DD, arts. 9.14 and 10.5)

The Manufacturer and the Distributor should regularly review Products⁴⁹, taking into account any events that could affect risk ("Material Events"), to make sure that the target market and distribution strategy remain appropriate (*MiFID II DD, arts. 9.14⁵⁰ and 10.5⁵¹*).

To do this, the Manufacturer should determine, in a manner that is appropriate and proportionate considering the nature of the Product, the information it needs the Distributor to provide it with in order to complete its Product review (*ESMA Guidelines, § 57*).

The Manufacturer may use as its basis information obtained from the Distributor on which distribution channels have been employed, the proportion of sales made outside the target market defined for the Product, or any complaints received (*ESMA Guidelines, § 57*).

The Manufacturer and the Distributor⁵² must review the Products regularly, making sure in particular that they remain compatible with the target market

This review of the target market's relevance must notably take into account any events that could have a material impact on the potential risk to the identified target market ("Material Events").

This regular review of the target market's relevance must be conducted in a proportionate and appropriate manner having regard to the type and complexity of the Product. For example, in the case of structured products, it would be appropriate to carry out a review at least once a year. For simpler flow products, less frequent reviews might be considered, while taking account of "Material Events" or client complaints.

This review of the target market's relevance should be performed only for Products that are still being marketed. Accordingly, a review does not have to be performed for bespoke Products or for Products that are no longer being marketed (including bid-only Products).

Pursuant to the provisions in Appendix 4, para. I.4 and Appendix 5, para. III.2 below, this review is not necessary for plain vanilla products (equities, bonds and equity-linked products) or listed derivatives.

⁴⁹ Including if the Manufacturer is not a "MiFID 2" manufacturer.

⁵⁰ Provision transposed into the AMF GR (*AMF GR, art. 313-16*).

⁵¹ Provision transposed into the AMF GR (*AMF GR, art. 313-21*).

⁵² The Distributor should make arrangements to update its Product Governance procedures as soon as the Product no longer meets the identified target market's criteria or "becomes illiquid or very volatile due to market changes" (*MiFID II DD, art. 10.5*).

7.2 Product monitoring by the Manufacturer and identification of Crucial Events (MiFID II DD, art. 9.15)

Each time it issues or re-launches a Product, the Manufacturer must first check whether any event has occurred that could materially affect the potential risk to investors (“Material Event”). It must also regularly assess whether the instruments are functioning as intended (*MiFID II DD, art. 9.15⁵³*).

The Manufacturer must also identify any crucial event that would affect the Product’s potential risk or return expectations (“Crucial Event”) (*MiFID II DD, art. 9.15⁵⁴*).

In accordance with this Article, the Manufacturer must:

- review the Products before any new issue or reissue;
- regularly assess all existing Products, the frequency of these assessments being dependent on the type of Product;
- identify Crucial Events.

By contrast to the review of the target market, it must identify Crucial Events for all existing Products, including those that are no longer marketed, until their maturity

a. What is a Crucial Event in this context?

MiFID 2 DD lists as crucial events “*that would affect the potential risk or return expectations of the financial instrument, such as:*

- (a) *the crossing of a threshold that will affect the return profile of the financial instrument;*
- or
- (b) *the solvency of certain issuers whose securities or guarantees may impact the performance of the financial instrument.”*

Again, this identification must be done proportionately and in keeping with the type and complexity of said Products and the client categories in question.

These events vary depending on the Product type, and the factors used to describe them are of varying degrees of relevance: solvency and significant change in the issuer’s credit rating, significant fall in valuation, corporate events⁵⁵, ISDA credit events⁵⁶, etc.

Pursuant to the provisions in Appendix 4, para. I.4 and Appendix 5, para. III.3 below, this review is not necessary for plain vanilla products (equities, bonds and equity-linked products) or listed derivatives.

b. What action should be taken as a result?

The Manufacturer should define appropriate measures to be put in place if a Crucial Event occurs, such as:

- Providing relevant information to the client or Distributor;
- Changing the Product approval process;
- Stopping further issuance of the Product;
- Changing the Product to avoid unfair contract terms;
- Making sure the distribution channels used are appropriate;
- Contacting the Distributor to discuss a modification of the distribution process;

⁵³ Provision transposed into the AMF GR (*AMF GR, art. 313-17*).

⁵⁴ Provision transposed into the AMF GR (*AMF GR, art. 313-17*).

⁵⁵ Such as mergers, spin-offs or product restructurings.

⁵⁶ Bankruptcy, payment default, restructuring, repudiation, moratorium, obligation acceleration and obligation to pay the underlyings of the target product.

- Terminating the relationship with the Distributor;
- Informing the competent authority.

AMAFI considers that information relevant to the client should be identified notably on the basis of said client's classification.

7.3 Summary

Subject	Who	Factors to take into account	Reference period	Appendix 4		Appendix 5			Complex product (EMTN)
				Primary plain vanilla product	Secondary plain vanilla product	Listed derivative	Standard OTC derivative	Bespoke OTC derivative	
Review of target market's relevance	Manufacturer (<u>art. 9.14</u>) & Distributor (<u>art. 10.5</u>)	Material Event	Marketing period	NO	NO	NO	YES	NO	YES
Product monitoring	Manufacturer (<u>art. 9.15</u>)	Material Event Functioning of Product	Before any new issue/reissue + Regularly during Product's lifetime (until maturity)	NO	NO	NO	YES	YES	YES
Identification of Crucial Events	Manufacturer (<u>art. 9.15</u>)	Crucial Event	Regularly during Product's lifetime (until maturity)	NO	NO	NO	YES	YES	YES

8. INFORMATION PROVIDED TO CLIENTS BY THE DISTRIBUTOR

8.1 Information on the lack of verification of some criteria of the target market

The Distributor is required to inform clients where it is not in a position to verify all the criteria of the target market, i.e. where it is not obliged to verify the suitability of the service provided (*ESMA Guidelines, § 47*).

AMAFI considers that this information can be provided at an early stage (for example, when entering the business relationship), for example through a contractual clause in service agreements or in the terms of business, and not necessarily before each transaction.

8.2 Information on sales outside the target market

The Distributor is required to inform clients when it makes a sale on a negative target market (ESMA Guidelines, § 55). AMAFI considers that this information should be provided before the transaction, on a transaction by transaction basis.

When the Distributor makes a sale outside the positive target market, but not necessarily on the negative target market, justifications for the deviation must be included in the suitability report where this last is provided (ESMA Guidelines, § 70).



APPENDIX 1 STANDARD CONTRACTUAL APPENDIX TO DISTRIBUTION AGREEMENTS

"MiFID 2 Product Governance Annex"

Article 1 – Purpose

This Annex supplements the [Distribution Agreement] put in place between [A] (hereafter "the Manufacturer") and [B] (hereafter "the Distributor").

The Manufacturer and the Distributor undertake to comply with all Product Governance provisions applicable to them, including those set out in Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 (MiFID II) and its implementing measures.

Article 2 – Process for prior approval of Products

The Manufacturer states that it has put in place a prior approval process for each [Products / - identify, as applicable] distributed by the Distributor.

If an express request is made, the Manufacturer will provide the Distributor with information about the process for prior approval of Products and its conclusions.

Article 3 – Appropriate information about the Product, its target market and distribution strategy

For each Product, the Manufacturer shall provide the Distributor, by any means, on a durable medium and in a timely fashion, the information required by the rules on Products, their target markets and distribution strategies.

Accordingly, information about the criteria used to identify the target market and distribution strategy shall be provided [*in accordance with Annex 2 of the AMAFI Product Governance Implementation Guide (AMAFI/20-16)*].

Article 4 – Regular review of marketed Products

A marketed Product is [*...to be determined*].

The Manufacturer shall review marketed Products regularly to make sure that they remain compatible with the target market and that the adverse situation scenarios remain relevant.

If the Manufacturer changes the target market of a marketed Product, notably following material events that could call the initial target market into question, it shall advise [*promptly – or indicate deadline*] the Distributor about the changes by any means and on a durable medium.

The Distributor shall review the marketed Product regularly, taking account of events that could affect risk for the target market, in order to ensure that:

- the Product remains consistent with the target market; and
- the distribution strategy remains consistent and appropriate.

As applicable, the Distributor shall inform the Manufacturer of modifications made to the target market.

Article 5 – Exchanges of information on sales outside the Product's target market

The Distributor shall provide the Manufacturer with appropriate information on sales outside the target market as defined by the Manufacturer and made other than for diversification or hedging purposes, provided these diversification- or hedging-related sales are not conducted on the negative target market. Non-compliance with “Client type” and “Knowledge and experience” criteria may not be used to justify a diversification objective.

[If applicable, establish a contractual agreement for these exchanges in accordance with Appendix 3 of the AMAFI Product Governance Implementation Guide (AMAFI/20-16)]

Article 6 – Other exchanges of information

Article 6.1 – Exchanges of information on sales

The Manufacturer shall tell the Distributor which information it wishes to receive from the Distributor about sales other than those referred to in Article 5.

Article 6.2 – Exchanges of information on complaints

The Manufacturer shall tell the Distributor which information it wishes to receive from the Distributor about client complaints. Such information shall be provided in an anonymous format to preserve professional secrecy.

The Distributor shall provide the Manufacturer with this information in the requested format.



APPENDIX 2

AMAFI PROPOSALS TO STANDARDISE THE CRITERIA USED BY MANUFACTURERS TO IDENTIFY THE TARGET MARKET AND DISTRIBUTION STRATEGY

I. Target market

To identify the target market for one or several Products, the Manufacturer shall use the criteria suggested below, which correspond to the categories established by ESMA.

Thus, for example, the Manufacturer shall examine the Product(s) in question and, for each of the five categories proposed below, select the criterion or criteria that correspond to the Product(s) and that may be used to identify clients with whom the Product(s) is(are) compatible (hereafter referred to as the “(positive) target market”).

Where applicable, the Manufacturer may also identify the criterion or criteria that may be used to identify clients with whom the Product(s) is(are) not compatible (the “negative target market”). Depending on the Product’s characteristics, there may not be a negative target market, i.e. there is no group of clients to whom sales of the Product are not recommended.

1) Client type

This criterion is determined based on the compatibility of the Product with the client categories defined by article 4.9) and 10) of MiFID 2.

No	Client type
1.a	Retail
1.b	Professional
1.c	Eligible counterparty

2) Knowledge and experience of financial markets and/or the asset class

The goal is to draw a distinction between general knowledge or experience of markets, and specific knowledge or experience of the Product's asset class or of the Product itself.

Products are classified according to the knowledge or experience of the end client required to understand their characteristics. Generally speaking, it is proposed to have three main investor categories:

- those with basic knowledge and little or no experience of financial markets;
- those with some knowledge or moderate experience of financial markets; and,
- those with good knowledge or experience of financial markets.

No	Knowledge and experience	Definition
2.a	Basic investor	Basic investors have both of these characteristics: <ul style="list-style-type: none"> - Basic knowledge of the financial instruments in question (a basic investor can take investment decisions based on regulatory documents or basic information provided by the Distributor); - No experience of financial markets.
2.b	Informed investor	Informed investors have at least one of these characteristics: <ul style="list-style-type: none"> - Some knowledge of the financial instruments in question; - Moderate experience of financial markets.
2.c	Experienced investor	Experienced investors have at least one of the following characteristics: <ul style="list-style-type: none"> - Good knowledge of the financial instruments in question; - Experience of financial markets.

This approach based on having three broad categories does not rule out the possibility of further dividing each one into two sub-categories to further refine the analysis where relevant (for example, by separating in Category 2.a Products that do not require any knowledge from those that require some basic knowledge).

In addition, the fact that the sale of a Product is accompanied by the provision of information and a detailed explanation of the characteristics of the Product may make it possible, as applicable and depending on the organisation and activities of the ISPs in question, to consider that the client's initial knowledge has been improved, provided that steps are taken to make sure that the client has properly understood the Product.

3) Ability to bear losses

This criterion is used to capture the end client's ability to bear losses. For example, only Products whose capital is fully guaranteed at maturity are compatible with an end client who is considered to have a very poor ability to bear losses.

Accordingly, the following assumptions shall be made based on the potential losses (at maturity) to which the client is exposed following the investment:

No	Categories	Potential losses
3.a	Investor cannot bear any capital loss	Strictly equal to 0% of the invested amount
3.b	Investor can bear partial losses or losses up to a level determined by the structure of the Product	Between strictly above 0% and strictly below 100% of the invested amount
3.c	Investor can bear capital losses	Strictly equal to 100% of the invested amount (risk of losing all invested capital)
3.d	Investor can bear losses exceeding the invested amount	Above 0% of the invested amount

4) Risk tolerance

In the case of Products for which a KID is prepared under the PRIIPs Regulation⁵⁷ or for which a KIID is prepared under the UCITS Directive⁵⁸, this criterion is determined based on the Product's risk rating. The SRI/SRRI⁵⁹ should be used (*ESMA Guidelines, § 18.e*).

No	Indicator	Affected Products
4.a	SRI	Products subject to PRIIPs rules
4.b	SRRI	Products subject to UCITS rules

⁵⁷ Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

⁵⁸ Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions.

⁵⁹ **SRI**: Summary Risk Indicator – **SRRI**: Synthetic Risk and Reward Indicator, which is a synthetic indicator with an alphanumeric scale from 1 to 7 reflecting the risk level of a Product.

In the case of other Products for which neither a KID nor a KIID is prepared, the criterion is determined based on a "Low", "Medium" and "High" classification according to the corresponding risk profile of the end client, as follows:

No	Risk tolerance	Risk profile	Definition
4.c	Low	Conservative	Client has low risk tolerance
4.d	Medium	Balanced	Client has moderate risk tolerance
4.e	High	Risk oriented or speculative	Client has high risk tolerance

5) Client objectives and needs

AMAFI believes that the "Client objectives" criterion may be addressed by the following criteria:

- Client investment profile;
- Client investment horizon; and
- Specific client needs, if any.

Regarding the client's investment objectives, Products are classified as a function of the following four objectives, which correspond to the longer-term investment objectives of the end client: preservation, growth, income and hedging. These objectives are not mutually exclusive and may be combined.

No	Client objectives / Investment profile
5.a	Preservation
5.b	Growth
5.c	Income
5.d	Hedging
5.e	Option or leveraged return profile

The client's investment horizon should correspond to the Product's investment horizon (i.e. the recommended holding period), in accordance with the following table:

No	Client investment horizon	Product investment horizon
5.f	Very short term	< 1 year
5.g	Short term	1 to 3 years
5.h	Medium term	3 to 5 years
5.i	Long term	> 5 years

Where applicable, the Manufacturer may also indicate the Product's maturity date.

Where applicable, the Manufacturer may also indicate an "ESG" characteristic of the Product (relating to an environmental and/or social and/or governance theme) (*see Guide § 5.1*).

II. Distribution strategy

The distribution strategy is understood to be the identification of the investment service or services defined by MiFID 2 that are compatible with the pre-determined target market.

The Manufacturer can define the distribution strategy only from a theoretical perspective because it is not in direct contact with clients.

No	Distribution strategy
6.a	Execution only (without appropriateness test)
6.b	Order execution – Reception and transmission of orders (with appropriateness test)
6.c	Investment advice (with suitability test)
6.d	Portfolio management (with suitability test)

III. Case study: Positive target market for a structured product

Using the criteria defined in parts I and II of this Appendix, the following example draws on a case study contained in ESMA's Guidelines (*ESMA Guidelines, Annex V, Case study 1*) and is provided for illustrative purposes.

Product:

- Matures in: 6 years;
- Linked to the performance of three companies (one bank, one oil company and one technology stock);
- At the end of the term:
 - o if all three shares are priced at above the initial value, the product aims to repay the investor's initial capital plus the average capital return of the three shares;
 - o if one or more of the shares has fallen below the initial value by the end of the term (but not by more than 50%), the product aims to return the initial capital at the end of the term;
 - o if the final price of any of the three shares is below 50% of its initial value, the investor suffers capital loss in line with the worst performing company.
- The underlying components (derivatives and fixed interest securities) are issued by the same investment bank, which has a credit rating of BB-;
- The product has a legal structure of notes issued by the same EU-based bank;
- A prospectus is issued in accordance with the Prospectus Directive.

Proposed positive target market for the Product (based on the standardised criteria described in part I):

No	Client type
1.a	Retail client

No	Knowledge and experience
2.b	Informed investor

No	Ability to bear losses
3.c	Investor can bear capital losses

No	Risk tolerance
4.d	Medium

No	Client objectives / Investment profile
5.b	Growth
5.bis	<i>ESG? Neutral [optional]</i>

No	Client investment horizon
5.i	Long term

The pyramid-based approach to identifying the positive target market means that investor categories that satisfy at least the above criteria shall also be considered to be part of the positive target market for the product in question. For example, the product in this case study is considered to be compatible with retail clients. It will therefore also be regarded as compatible with professional clients and eligible counterparties. Similarly, the product is considered to be compatible with informed investors and so is also considered to be compatible with experienced investors but not with basic investors.

All the criteria must also be examined to determine a negative target market for the Product, where applicable.



APPENDIX 3

AMAFI PROPOSALS TO STANDARDISE INFORMATION ON SALES MADE OUTSIDE THE TARGET MARKET

1. Content of information to be provided by the Distributor

The Distributor shall provide the Manufacturer with complete information on sales outside the target market that are not made for diversification or hedging purposes, unless such diversification- or hedging-related sales were executed on the negative target market, for all target markets defined by the Manufacturer from 3 January 2018 onwards. This information shall include the proportion of sales made outside the target market relative to total sales.

The assessment of target market criteria may be conducted more or less thoroughly depending on the level of information available about the profile of end clients, which in turn depends on the nature of the service provided (ESMA Guidelines § 45).

- Diversification is understood here as an objective aimed at allowing a portion of the transactions carried out on behalf of the client or the Products sold to the client or a portion of the client's portfolio to deviate from the client's pre-determined profile, in order to diversify the client's overall exposure in terms of risk, performance or the nature of financial instruments.

Thus, because in the context of providing the service of discretionary management an ISP is taking an approach based on an overall view of the client's portfolio and because the ISP is required to assess the suitability of the financial instrument, this diversification objective may be assumed to apply to sales outside the positive target market, except in special cases (ESMA Guidelines, § 53 and 54).

- Hedging is understood here as an objective aimed at mitigating or removing the risk taken on a position.
- It is important to note that hedging or diversification purposes cannot justify non-compliance with "Client type" and "Knowledge and experience" (Guide, 6.2.b).

Pursuant to the principle of proportionality, in certain circumstances, information about sales outside the target market does not have to be provided on a Product-by-Product basis but may be provided in aggregate form. Conversely, in other circumstances and depending on the nature of the Product, Product-specific information may have to be provided (for example if the Distributor believes that Manufacturer has wrongly identified the target market for a particular Product) (ESMA Guidelines, § 58).

If the Distributor chose a "less prudent" distribution strategy than the Manufacturer (for example, if the Manufacturer recommended that the Product should be offered through investment advice service and the Distributor made it available to clients through execution services, without investment advice), he must then indicate⁶⁰ this to the Manufacturer as part of the sales information (ESMA Guidelines, § 51).

AMAFI suggests using a standardised format such as that set out below, both for information on sales outside the target market provided Product by Product and for those provided in aggregate format.

This information is compiled in a "Report on sales outside the target market" (hereafter "the Report"). This report shall be provided even if there are no sales outside the target market⁶¹.

⁶⁰ See below, question 1.c).

⁶¹ Respondents should merely give a negative answer to the first question (see below).

2. Reference Period

The sales contained in this Report are those made during the calendar year (from January 1st to December 31st of the same year) preceding the sending of the Report⁶².

3. Products included in the scope of the Report

AMAFI considers that all Products marketed during the Reference Period (see above) must be reported to the Manufacturer, even if they were issued before the Reference Period or when they would no longer be marketed at the end of this period (as long as these Products were marketed during the Reference Period).

4. Presentation of information

To standardise the presentation of this information on sales outside the target market, the report shall be presented according to the format detailed below, which will make it possible for the information to be entered and read automatically by the Distributor and Manufacturer respectively.

Depending on the respective needs of the Manufacturer and Distributor, the information contained in the report below shall be presented in aggregate form covering all sales of a Product.

⁶² For the first report, taking into account the date of application of MiFID 2, the reference period will be from January 3, 2018 to December 31, 2018. Thus, this first report on sales outside the target market will be sent by Distributors to Manufacturers at the beginning of the year 2019. The first Manufacturers' target market reviews can only begin after receipt of these reports.

REPORT ON SALES OUTSIDE THE TARGET MARKET

Questionnaire to be completed by the Distributor

The following questions are based on sales made, during the Reference Period, outside the target market as defined and notified by the Manufacturer, and not the target market as potentially modified by the Distributor.

Where applicable, based on the data provided, the Manufacturer may contact the Distributor to obtain a more qualitative analysis of the data in the report.

Question 1:

1.a) Have you made sales outside the target market for reasons other than diversification or hedging?

Answer:

- Yes
- No

1.b) If a negative target market has been identified, have you conducted sales on that negative target market?

Answer:

- Yes
- No

The questions 2 and 3 must be answered unless you answered “No” to the two preceding questions.

1. c) Have you applied a “less prudent” distribution strategy than the one defined by the Manufacturer?

Answer:

- Yes
- No

If yes, for which product(s): ...

Question 2:

2.a) Total number of Product sales

Answer: ...

2.b) What proportion of sales was attributable to sales outside the target market for reasons other than diversification or hedging?

Answer: ... % of the total number of sales made and/or
XX (number of sales outside the target number as an absolute value)

2.c) Only if you answered Yes to question 1.b), please say what proportion was attributable to sales on the negative target market?

Answer: ... % of the total number of sales made and/or
XX (number of sales on the negative target number as an absolute value)

Question 3: If relevant, state the proportion of sales made outside the target market for each of the criteria, as a function of the distribution regime (with a suitability test, with an appropriateness test or without either test):

Answer:

	Proportion of sales	Proportion of reported sales ⁶³	Proportion of sales for which the criterion was not satisfied				
			Client type	Knowledge and experience	Ability to bear losses	Risk tolerance	Client objectives
Execution only	... %	... %	... %	NA	NA	NA	NA
With appropriateness test	... %	... %	... %	... %	NA	NA	NA
With suitability test⁶⁴	... %	... %	... %	... %	... %	... %	... %
Total	100 %	... %					



⁶³ It being understood that these data do not include sales executed outside the target market for diversification or hedging reasons provided such sales were not conducted on the negative target market.

⁶⁴ Where appropriate, a higher level of granularity may be required for information on sales made outside the target market through the provision of an investment service requiring the performance of a Suitability test (e.g. separating the sales made with the provision of the investment advice service from those made with the provision of the portfolio management service).

APPENDIX 4

AMAFI PROPOSALS ON THE APPLICATION OF PRODUCT GOVERNANCE OBLIGATIONS FOR VANILLA PRODUCTS

Product Governance obligations apply to all client types, to all investment services and to all Products, regardless of their complexity (*MiFID II DD, recital 18*). However, AMAFI observes that these obligations were designed above all for structured products, which are in effect "manufactured"⁶⁵ by ISPs, this being the reason why the Guide was devised as a priority for this type of Product.

But for "vanilla" Products, the introduction of Product Governance obligations is more difficult to grasp.

The Association has thus initiated work to identify the specific characteristics to be taken into account when implementing Product Governance obligations applying to vanilla Products.

In this respect, AMAFI considers that the term "vanilla Products" used in this Appendix concerns:

- (1) shares and bonds admitted to trading on a regulated market or equivalent or on an MTF⁶⁶, categorised as non-complex financial instruments within the meaning of article 25.4 (a) of MiFID II; and
- (2) equity-linked products such as convertible bonds and/or exchangeable bonds, admitted to trading on a regulated market or equivalent or on an MTF, even where they are not categorised as non-complex financial instruments within the meaning of article 25.4 (a) of MiFID II.

I. Primary market

1) Identification of the Manufacturer

As set out in 2.2.a. of this Guide, in accordance with article 9.1 of MiFID II DD, the Manufacturer is the ISP that produces the financial instrument, encompassing the creation, development, issuance and/or design of the instrument.

But regarding the issue of Vanilla Products, a distinction needs to be made between two situations:

- (1) where the issuer is itself an ISP subject to MiFID II, it is considered as the sole Manufacturer of the Product within the meaning of MiFID II as part of the issue;
- (2) where the issuer is a company not subject to MiFID II, for example a corporate, it does not itself fulfil the conditions set out in article 9.1 of MiFID II DD.

Regarding this last situation, the only initial response to the question is to be found in recital 15 of MiFID II DD, whereby: "*investment firms [...] advising corporate issuers on the launch of new financial instruments, should be considered as manufacturers [...]*". This is why [the AMF/ESMA] tend to consider that it is the ISP-advisor of the issuer as part of the issue of vanilla Products that is the "Manufacturer" of these vanilla Products, within the meaning of Product Governance, and that only in the case of new financial instruments (*see below*).

For syndicated vanilla Product issuance, AMAFI considers that the role of Manufacturer should be assumed by the ISP(s) with the most senior role in the syndication. Where the senior-most role is undertaken jointly by several ISPs, their responsibilities should be outlined in a written agreement (*MiFID II DD, art. 9.8*).

⁶⁵ "[...] ensure that the investment firms which manufacture financial instruments ensure that those products are manufactured to meet the needs of an identified target market of end clients [...]" (*MiFID II, Recital 71*).

⁶⁶ Multilateral Trading Facility.

AMAFI would also like to point out that this recital solely concerns ISP-advisors acting as part of an issue of "new financial instruments"⁶⁷. Consequently, ISPs advising issuers on the issuance of financial instruments equivalent to already existing Products (for example, a tap bond or the issuance of new shares equivalent to the existing shares of an already listed company) are not considered as the Manufacturers. Instead, they are considered as Distributors of an existing vanilla Product under the conditions set out in II. of this Appendix. The same applies to the disposal of shares or bonds in "blocks" as part of accelerated bookbuilding or as part of a marketed offering, since this does not concern the issuance of a new financial instrument but the sale of existing financial instruments by a holder of such instruments (shareholder or bondholders).

2) Identification of the Distributor

As explained in 2.b. of this Guide, in accordance with article 10.1 of MiFID II DD, the Distributor is the entity that proposes, markets or recommends the Product.

In terms of the issuance of vanilla Products, a distinction needs to be made between two situations:

- (1) the issue takes the form of a private placement with institutional investors;
- (2) the issue takes the form of a public offering (including IPOs made in France in which a part of the offer is reserved for retail investors).

In the first case, the Distributors are the ISPs that are members of the private placement syndicate and referred to by name in the documentation accompanying the placement, as well as the ISPs participating in the placement on behalf of one or more members of the syndicate. They are informed through the documentation accompanying the placement.

In the second case, the Distributors are both the ISPs that are members of the placement syndicate for the institutional placement and all the ISPs liable to collect subscription orders from investors (banking networks, brokers, etc.) or those providing investment advice concerning the subscription. These Distributors are informed through a circular disseminated by Euroclear France to which they all have access.

3) The cases in which Product Governance obligations apply

AMAFI considers that the obligations of these players, Manufacturers and Distributors alike, apply only during the Offer Period (i.e. the period in which the order book of the institutional placement is open and/or the public offering is open). At the end of this period, the ISP-advisor of the issuer not subject to MiFID II (and notably the corporate issuer) having played the most senior role in the syndication ceases being a Manufacturer in that the offer has terminated, the issued securities are no longer marketed and it is no longer possible for an investor to subscribe to the issue.

As such, the ISP-advisor can no longer be considered as a "Manufacturer" within the meaning of Product Governance and thus may not be obliged to apply the related obligations.

Likewise, the Distributors of a vanilla Product as part of such an offer stop distributing it at the close of the Offer Period. From that moment on, they are no longer required to apply the Product Governance obligations relative to Distributors.

⁶⁷ By extension, and insofar as it concerns offering shares that have yet to be offered, neither as part of a private placement nor as part of a public offering, an IPO through the disposal of existing shares would also fall within the scope of these obligations.

4) The respective obligations of Manufacturers and Distributors

All the obligations set out in parts 3 and 4 of the Guide apply respectively to Manufacturers and Distributors.

However, it is important to stress that these obligations are applicable in accordance with the proportionality principle depending on the client type, the nature of the Product (here, a Vanilla Product) and the service provided (*MiFID II DD, recital 18*).

In accordance with this proportionality principle, AMAFI considers that the following aspects must be taken into account:

- a) **Identification of the positive target market:** a "single" target market per major asset class could be established. Here, it would group all vanilla Products, distinguishing between shares, bonds and convertible and/or exchangeable bonds. However, AMAFI stresses that such a "single" target market is relevant with respect to shares and bonds for those admitted to trading on a regulated EU market or a market recognised as equivalent (*see below, III*).
- b) **Identification of the negative target market:** given the nature of the Products envisaged here, a negative target market would be identified rarely or never (*see below, III*). Yet it should be noted that ESMA in its Guidelines provided an example of a negative target market for an equity including clients seeking the full protection of their capital, with no risk tolerance and looking for totally guaranteed revenue (*ESMA Guidelines, Annex V, Case Study 4*). That said, and given the level of detail of this definition, AMAFI considers that such a negative target market could not be systematically identified in the standard target market format proposed here. Considering that in theory it is unlikely that a client with these characteristics (totally guaranteed revenue and no risk tolerance) would possess a securities account, in real life it would appear that such a target market would in any case be an "empty set". However, where applicable, and depending on the nature of its clients, the Distributor could assess the need to effectively identify a negative target market for these vanilla Products.
- c) **Costs:** vanilla Products by nature have no Product cost (*see AMAFI / 18-30*). Consequently, obligations concerning the verification of the accounting of these costs and fees are considered as fulfilled.
- d) **Review of the relevance of the Product's target market:** given the nature of these Products, AMAFI considers that it is not necessary to make regular reviews of the relevance of the target markets of vanilla Products. Such a review could in any case be made only following the Offer Period. The ISP no longer being the Manufacturer or Distributor at this point, such a review could not be carried out. As such, the main objective of the review is to identify the need to review, where applicable, the target market of the Product (*MiFID II DD, art. 9.14*). The target market for shares and bonds admitted to trading on a regulated EU market or a market recognised as equivalent, and equity-linked products, is defined based on a standard proposed here and not subject to review. And so, in this respect, reviewing the relevance of the target market is pointless.
- e) **Product monitoring and identification of Crucial Events:** similarly, because the Manufacturer is only a Manufacturer for a very short time – the Offer Period – it is not for it to be bound by this monitoring obligation nor one of identifying Crucial Events. In any event, given the type of products in question, such identification seems disproportionate.
- f) **Scenarios:** similarly, the obligation to carry out tests on a range of scenarios would appear relevant above all for structured products and ill adapted to shares and bonds. The obligation to assess the risk of the Product to generate poor results in the event of negative situations – for example, "*putting a strain on [...] the market of the underlying instrument*" – does not apply to shares and bonds that have no underlying instruments.

However, other situations may be relevant, including when "the market environment deteriorate[s]" or when the issuer experiences "financial difficulties". Because these situations will always be relevant for such products, it is not necessary to analyse scenarios to identify as such.

- g) **Reporting on sales outside the target market:** given the extremely broad target markets of these Products, a limited number of sales outside the target market is generally to be expected. In addition, as explained above, the Manufacturer will not make regular reviews of the Product (or its target market) owing to the limited application of its obligations; its reporting on sales outside the target market would in any case be pointless.

The table below summarises the obligations applying to the Manufacturer and the Distributor in the marketing of vanilla Products on the primary market:

MANUFACTURER		DISTRIBUTOR	
<u>Requirements</u>	<u>Application to vanilla Products</u>	<u>Requirements</u>	<u>Application to vanilla Products</u>
Conflicts of interest (<u>MiFID II DD, arts. 9.2 and .3</u>)	Yes	Chain of responsibility (<u>MiFID II DD, art. 10.10</u>)	Yes
Staff expertise (<u>MiFID II DD, arts. 9.2 and .3</u>)	Yes	Staff expertise (<u>MiFID II DD, art. 10.7</u>)	Yes
Target market (<u>MiFID II DD, arts. 9.9 and 9.11</u>)	Yes (light)	Target market (<u>MiFID II DD, art. 10.2</u>)	Yes (light)
Negative target market (<u>MiFID II DD, art. 9.9 and ESMA Guidelines, § 67</u>)	Yes (light)	Negative target market (<u>MiFID II DD, art. 10.2 and ESMA Guidelines, § 67</u>)	Yes (light)
Scenarios (<u>MiFID II DD, art. 9.10</u>)	No	Client information (<u>ESMA Guidelines, § 47, 55 and 70</u>)	Yes (upstream)
Costs / Fees* (<u>MiFID II DD, art. 9.12</u>)	Yes (presumed)	NA	NA
Review of the target market's relevance (<u>MiFID II DD, art. 9.14 and ESMA Guidelines, § 57</u>)	No (neither updating of target market)	Review of the target market's relevance (<u>MiFID II DD, art. 10.5</u>)	NA
Product monitoring and identification of Crucial Events (<u>MiFID II DD, art. 9.15</u>)	No	NA	NA
Relations with the Distributor (<u>MiFID II DD, art. 9.13</u>)	Yes	Information on sales (<u>MiFID II DD, art. 10.9</u>)	Yes (rare)
Internal governance (<u>MiFID II DD, art. 9.6</u>)	Yes	Internal governance (<u>MiFID II DD, art. 10.8</u>)	Yes

II. Secondary market

1) Identification of the Manufacturer

On the secondary market, given the fungible nature of previously issued securities, and because the obligations of the Manufacturer on the primary market cease at the end of the Offer Period, it is not possible to identify, for the secondary market, a Manufacturer in respect of Product Governance.

2) Identification of the Distributor

The ISP that trades these securities on the secondary market by executing buy or sell orders on behalf of its investor clients shall be considered as the Distributor of the share or bond concerned, this last "*offering*", "*marketing*" and or "*recommending*" said Products.

As pointed out in part 2.2.b of the Guide, the Distributor is the entity that decides on the Product offer that can be acquired by its clients, and thus the entity that sells them these Products or recommends these Products to them. ESMA specifies that an ISP is also considered as a Distributor where it decides on the Products proposed to clients on their own initiative, even where the ISP in question does not actively market these Products (*ESMA Guidelines, § 31*). As such, ISPs providing RTO for these Products are considered as Distributors even though they propose them only on a passive basis.

In addition, as stipulated in the same part of the Guide, only the ISP in contact with the end client is subject to the Product Governance obligations applying to Distributors.

3) The respective obligations of each party

In the absence of a MiFID 2 Manufacturer, the Distributor(s) shall be the sole entity (entities) to implement Product Governance obligations.

Consequently, they must determine alone the target market of these Products. It is important here to stress that vanilla Products are standard products marketed with a large number of investors, all categories combined, and by a large number of Distributors with varied profiles. It is crucial, then, that a standardised target market format be established regarding shares and bonds, for those admitted to trading on a regulated EU market or a market recognised as equivalent, the aim being to facilitate convergence in the application of these obligations and to avoid distortion between the various players.

Also of note, in the absence of a MiFID II manufacturer, the obligations of the Distributor to report information to the Manufacturer do not apply. The Distributor is thus not required to produce reporting on sales outside the target market for the Manufacturer or transmit to it the conclusions of regular reviews.

As explained above, given the nature of vanilla Products, AMAFI considers that it is not necessary to make regular reviews of these last.

The table below summarises the obligations applying to the Distributor in the marketing of vanilla Products on the secondary market:

MANUFACTURER		DISTRIBUTOR	
<u>Requirements</u>	<u>Application to vanilla Products</u>	<u>Requirements</u>	<u>Application to vanilla Products</u>
Conflicts of interest (<i>MiFID II DD, arts. 9.2 and .3</i>)	NA	Chain of responsibility (<i>MiFID II DD, art. 10.10</i>)	Yes
Staff expertise (<i>MiFID II DD, arts. 9.2 and .3</i>)	NA	Staff expertise (<i>MiFID II DD, art. 10.7</i>)	Yes
Target market (<i>MiFID II DD, arts. 9.9 and 9.11</i>)	NA	Target market (<i>MiFID II DD, art. 10.2</i>)	Yes (light)
Negative target market (<i>MiFID II DD, art. 9.9 and ESMA Guidelines, § 67</i>)	NA	Negative target market (<i>MiFID II DD, art. 10.2 and ESMA Guidelines, § 67</i>)	Yes (light)
Scenarios (<i>MiFID II DD, art. 9.10</i>)	NA	Client information (<i>ESMA Guidelines, § 47, 55 and 70</i>)	Yes
Costs / Fees (<i>MiFID II DD, art. 9.12</i>)	NA	NA	NA
Review of the target market's relevance (<i>MiFID II DD, art. 9.14 and ESMA Guidelines, § 57</i>)	No (neither updating of target market)	Review of the target market's relevance (<i>MiFID II DD, art. 10.5</i>)	NA
Product monitoring and identification of Crucial Events (<i>MiFID II DD, art. 9.15</i>)	No	NA	NA
Relations with the Distributor (<i>MiFID II DD, art. 9.13</i>)	NA	Information on sales (<i>MiFID II DD, art. 10.9</i>)	No
Internal governance (<i>MiFID II DD, art. 9.6</i>)	NA	Internal governance (<i>MiFID II DD, art. 10.8</i>)	Yes

III. Proposal on standard target markets

The table below summarises AMAFI's proposals on target markets and the distribution strategy to be determined for vanilla Products by the Manufacturer and the Distributor on the primary market and by the Distributor on the secondary market.

These were established on the basis of AMAFI proposals on the standardisation of criteria for identifying the target market and distribution strategy, as set out in Appendix 2 of the Guide.

However, AMAFI stresses that such a "single" target market is relevant with respect to shares and bonds above all for those admitted to trading on a regulated EU market or a market recognised as equivalent.

The approach developed here is merely a general framework on the basis of which each ISP is responsible for carrying out a specific assessment with regard to the vanilla Products that it manufactures and/or distributes, making adjustments as and where needed.

To recap, regarding the identification of the distribution strategy as specified in 5.2 of the Guide:

- The Manufacturer must propose to the Distributor the investment services it recommends for the distribution of the Product so as to favour sales on the positive target market. As much as it is possible, it must take reasonable measures to ensure that the Product is distributed on the identified target market (*ESMA Guidelines, § 25*);
- The Distributor must take into account the distribution strategy communicated by the Manufacturer, and review it if necessary (*ESMA Guidelines, § 49*). The Distributor must take into account its ability to identify all the criteria of the target market in terms of the investment services authorised and the type of clients targeted (*ESMA Guidelines, § 50 and 51*).

As explained in Part 1.3 of the Guide, the scope of the verification to be made by the Distributor of the compatibility between the target market and the profiles of its clients depends on the nature of service provided:

- *Execution only*⁶⁸ (no verification of the suitable or appropriate nature): only the first criterion ("Type of client") needs to be checked;
- Services requiring a verification of appropriate nature (i.e. an appropriateness test - order execution or reception and transmission of orders services): the first two criteria ("Type of client" and "Knowledge and experience") need to be checked;
- Services requiring the verification of suitable nature (i.e. a suitability test - investment advice and portfolio management services): all the criteria must be assessed.

⁶⁸ The provision of order execution or reception and transmission of orders services (with or without an auxiliary) not requiring checks of appropriate nature where the four following conditions are fulfilled:

- The financial instrument is considered as non-complex (as set out in article 25.4.a of MiFID II);
- The client itself is behind the transaction request;
- The client has been informed that there will be no check of the appropriate nature of the service or Product;
- The ISP complies with the obligations of article 23 of MiFID II (Conflicts of interest).

		SHARES*	BONDS		
			Senior or subordinated*	Highly subordinated*	Convertible and/or exchangeable**
1	Client type	- Retail client - Professional client - Eligible counterparty	- Retail client - Professional client - Eligible counterparty	- Retail client - Professional client - Eligible counterparty	- Retail client - Professional client - Eligible counterparty
2	Knowledge and experience	- Basic investor - Informed investor - Experienced investor	- Basic investor - Informed investor - Experienced investor	- Basic investor - Informed investor - Experienced investor	- Informed investor - Experienced investor
3	Ability to bear losses	- The investor can bear partial capital losses or losses up to a level determined by the structure of the Product - The investor can bear capital losses - The investor can bear losses exceeding the invested amount	- The investor cannot bear any capital loss - The investor can bear partial capital losses or losses up to a level determined by the structure of the Product - The investor can bear capital losses - The investor can bear losses exceeding the invested amount	- The investor can bear partial capital losses or losses up to a level determined by the structure of the Product - The investor can bear capital losses - The investor can bear losses exceeding the invested amount	- The investor cannot bear any capital loss - The investor can bear partial capital losses or losses up to a level determined by the structure of the Product - The investor can bear capital losses - The investor can bear losses exceeding the invested amount
4	Risk tolerance	- Medium - High	- Low - Medium - High	- Medium - High	- Low - Medium - High
5	Client objectives	Investment profile	- Growth - Income	- Income - Preservation	- Growth - Income - Preservation
		Investment horizon	- Medium term - Long term	- Short term - Medium term - Long term	- Medium term - Long term
Negative target market***		-	-	-	-
Distribution strategy		- Execution only - EO / RTO - Investment advice - Portfolio management	- Execution only - EO / RTO - Investment advice - Portfolio management	- Execution only - EO / RTO - Investment advice - Portfolio management	- EO / RTO - Investment advice - Portfolio management

* Mainly concerning equities and bonds admitted to trading on a regulated EU market or a market recognised as equivalent.

** Here concerning only senior tranches of convertible and/or exchangeable bonds. Subordinated or highly subordinated tranches of convertible and/or exchangeable bonds shall be subject to a target market on a case-by-case basis.

*** See I.4.b).

APPENDIX 5

AMAFI PROPOSALS ON THE INTRODUCTION OF PRODUCT GOVERNANCE OBLIGATIONS FOR DERIVATIVES

Product Governance obligations apply to all types of client and all types of financial instruments (*MiFID II DD, recital 18*).

Given the specific characteristics of derivatives, the implementation of Product Governance obligations requires for some adjustments.

The Association has thus initiated work to identify the specific characteristics to be taken into account when implementing Product Governance obligations applying to the marketing of derivatives.

For AMAFI, the term "derivatives" used in this Appendix refers to financial instruments that are option contracts, forward contracts, swaps and any other derivative contracts as set out in points 4 to 10 of Section C of Annex I of MiFID II concerning:

- (1) derivatives listed on regulated markets and issued by these last (hereinafter referred to as "listed derivatives"); and
- (2) derivatives traded OTC between two counterparties (hereinafter referred to as "OTC derivatives"), encompassing both standardised and bespoke OTC derivatives.

I. Identification of the Manufacturer and the Distributor

1) Identification of the Manufacturer

As set out in 2.2.a. of this Guide, the Manufacturer is the ISP that produces the financial instrument, including the creation, development, issuance and/or design of the instrument.

As listed derivatives are created by the companies managing regulated markets, it is these companies that are considered as "Manufacturers" in respect of Product Governance. However, because these last are not investment firms, they are not subject to MiFID 2 obligations and thus are considered as "non-MiFID 2 Manufacturers". Consequently, regarding listed derivatives, there is no MiFID 2 Manufacturer and the Distributor alone is required to comply with Product Governance obligations (*Guide, 2.2.c*).

Concerning OTC derivatives, a distinction needs to be made between two situations depending on the category of the two counterparties:

- (1) If the two counterparties are ISPs, both contribute to the design of the Product and shall thus be considered as "co-Manufacturers" (*Guide, 2.2.a*);
- (2) If one of the counterparties is an ISP and the other is not, only the ISP shall be considered as the Manufacturer within the meaning of MiFID 2, even though the two counterparties would determine together all the main characteristics of the Product.

2) Identification of the Distributor

As set out in 2.b. of the Guide, the Distributor is the entity proposing, marketing or recommending the Product.

For listed derivatives, the ISPs proposing, marketing or recommending the Product to end clients are considered as the Distributors in respect of Product Governance. If several ISPs work together on distributing the Product to the end client (as with the distribution chain for intermediary distributors), only the ISP in contact with the end client is required to apply the obligations of the Distributor in respect of Product Governance (Guide, 2.2.b).

For OTC derivatives, a distinction needs to be made between two situations depending on the category of the two counterparties:

- (1) If the two counterparties are ISPs and both are considered as "marketing" the Product, and in this respect are thus both Distributors (and both considered as the Manufacturer and the Distributor alike);
- (2) If one of the counterparties is an ISP and the other is not, only the ISP shall be considered as the Distributor of the Product (with said ISP being both the Manufacturer and the Distributor).

II. Identification of the target market

The Manufacturer and the Distributor are obliged to identify a target market and a distribution strategy for each Product (MiFID II, arts. 16.3 and 24.2). However, in accordance with the proportionality principle, they may adopt common principles for identifying target markets for large asset classes (ESMA Guidelines, § 22).

1) Listed derivatives

For listed derivatives, given that there is no MiFID 2 manufacturer and that the market is standardised, there is in theory no exchange of information between the non-MiFID 2 manufacturer and the Distributor, in which case the use of an EMT is not necessary.

As such, for listed derivatives, AMAFI considers that as these last have similar characteristics, two generic target markets may be determined according to the transaction: the taking of a long position on a listed derivative or the taking of a short position on a listed derivative.

AMAFI stresses that the Distributor must ensure that this generic target market is suitable to its clients' profile.

		Taking of a long position on a listed derivative	Taking of a short position on a listed derivative
1	Client type	- Retail client - Professional client - Eligible counterparty	- Retail client - Professional client - Eligible counterparty
2	Knowledge and experience	- Informed investor - Experienced investor	- Informed investor - Experienced investor
3	Ability to bear losses	- The investor can bear capital losses - The investor can bear losses exceeding the capital invested	- The investor can bear losses exceeding the capital invested
	Negative target market		- The investor can bear no loss of capital
4	Risk tolerance	- SRI: 7 - Average - High	- SRI: 7 - High
	Negative target market		- Low
5	Client objectives	- Hedging - Profile purely optional or leverage effect	- Hedging - Profile purely optional or leverage effect
	Investment horizon	- Very short term - Short term - Medium term - Long term	- Very short term - Short term - Medium term - Long term
Distribution strategy		- EO / RTO - Investment advice - Portfolio management	- EO / RTO - Investment advice - Portfolio management

2) OTC derivatives

To determine the target markets for OTC derivatives, AMAFI considers that a distinction needs to be made between standardised OTC derivatives (which are fairly generic products) and "case-by-case" derivatives designed to meet the needs of a particular client.

For standardised OTC derivatives, i.e. those with common characteristics (type of underlying instrument, currency of derivative, par value, barrier, etc.), AMAFI suggests an approach similar to that developed by ESAs in their Q&A on the PRIIPs KID⁶⁹. Accordingly, a "common" target market could be established for these OTC derivatives.

However, for "bespoke" OTC derivatives, which by their nature are unique products intended for a unique transaction, as set out by ESMA in its Guidelines, the target market defined is considered as the client having ordered the Product (*ESMA Guidelines, § 24*). Consequently, there will be no formalised target market, this last being deduced from the profile of the client having carried out the transaction.

Regardless of the type of OTC derivative, standardised or bespoke, and considering that the ISP is both Manufacturer and Distributor, no exchange of information is expected. And so there shall be no need to use the EMT.

⁶⁹ "it could be acceptable, to draw up a single KID for a class or group of OTC derivatives that share the same relevant product characteristics, [...]. Equally, a separate KID can be drawn up for each OTC derivative contract reflecting the bespoke offer to the retail investor" (*Q&A on the PRIIPs KID, ESAs, JC 2017 49, 18 August 2017, Question-answer 41*).

III. Other Product Governance obligations

1) Information on sales

For listed derivatives, considering that, in principle, there is no MiFID 2 manufacturer (*see above I.1*), the Distributor is not required to transmit sales information to the non-MiFID 2 manufacturer, notably concerning sales made outside the target market (*Guide, § 2.2.c*).

For OTC derivatives, given that ISPs are considered both as the Manufacturer and the Distributor of the Product (whatever the type of the other counterparty), no exchange of information is expected.

Regarding verifications of the target market, AMAFI would like to point out that where distribution requires appropriateness tests, only the first two criteria need to be verified by the Distributor (*Guide, 1.3*).

2) Review of Products' target markets

Consistent with part 7 of the Guide, the Manufacturer and the Distributor are required to make regular reviews of Products, taking into account any events with an impact on risk, to ensure that the target market and the distribution strategy remain adapted (*MiFID II DD, arts. 9.14 and 10.5*).

Listed derivatives

Given the nature of listed derivatives, AMAFI considers that in this case it is not necessary for the Distributor to carry out regular Product reviews. The main objective of the regular review is to identify the need to review, where applicable, the target market of the Product (*MiFID II DD, art. 9.14*). The target market for listed derivatives is defined on the basis of a standard proposed here that is not subject to review. Carrying out a regular review is therefore pointless in this case.

OTC derivatives

As discussed above, the distinction should be made here between standardised OTC derivatives, for which the review will concern a defined common target market, and bespoke OTC derivatives, for which the target market will not be reviewed (as such transactions will not be marketed a second time because by nature they consist of a single, one-off transaction).

3) Product monitoring and identification of Crucial Events (*MiFID II DD, art. 9.15*)

The Manufacturer must review the Product before any new issue or re-launch of said Product or a similar Product if it becomes aware of a Material Event.

The Manufacturer must also identify any Crucial Events.

As regards listed derivatives, as discussed above, given that the ISP is not the Manufacturer, it has no obligation to identify such Crucial Events.

This obligation is applicable, however, in the case of OTC derivatives. Of the factors that make it possible to identify such Crucial Events as detailed in the Guide, ISDA credit events seem particularly relevant here (*see Guide, § 7*).

APPENDIX 6 MiFID 2 RULES GOVERNING PRODUCT GOVERNANCE

MiFID 2

(71) Member States should ensure that investment firms act in accordance with the best interests of their clients and are able to comply with their obligations under this Directive. Investment firms should accordingly understand the features of the financial instruments offered or recommended and establish and review effective policies and arrangements to identify the category of clients to whom products and services are to be provided. Member States should ensure that the investment firms which manufacture financial instruments ensure that those products are manufactured to meet the needs of an identified target market of end clients within the relevant category of clients, take reasonable steps to ensure that the financial instruments are distributed to the identified target market and periodically review the identification of the target market of and the performance of the products they offer. Investment firms that offer or recommend to clients financial instruments not manufactured by them should also have appropriate arrangements in place to obtain and understand the relevant information concerning the product approval process, including the identified target market and the characteristics of the product they offer or recommend. That obligation should apply without prejudice to any assessment of appropriateness or suitability to be subsequently carried out by the investment firm in the provision of investment services to each client, on the basis of their personal needs, characteristics and objectives.

In order to ensure that financial instruments will be offered or recommended only when in the interest of the client, investment firms offering or recommending the product manufactured by firms which are not subject to the product governance requirements set out in this Directive or manufactured by third-country firms should also have appropriate arrangements to obtain sufficient information about the financial instruments.

Article 16 Organisational requirements

(...)

3. An investment firm shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest as defined in Article 23 from adversely affecting the interests of its clients.

An investment firm which manufactures financial instruments for sale to clients shall maintain, operate and review a process for the approval of each financial instrument and significant adaptations of existing financial instruments before it is marketed or distributed to clients.

The product approval process shall specify an identified target market of end clients within the relevant category of clients for each financial instrument and shall ensure that all relevant risks to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market.

An investment firm shall also regularly review financial instruments it offers or markets, taking into account any event that could materially affect the potential risk to the identified target market, to assess at least whether the financial instrument remains consistent with the needs of the identified target market and whether the intended distribution strategy remains appropriate.

An investment firm which manufactures financial instruments shall make available to any distributor all appropriate information on the financial instrument and the product approval process, including the identified target market of the financial instrument.

Where an investment firm offers or recommends financial instruments which it does not manufacture, it shall have in place adequate arrangements to obtain the information referred to in the fifth subparagraph and to understand the characteristics and identified target market of each financial instrument.

The policies, processes and arrangements referred to in this paragraph shall be without prejudice to all other requirements under this Directive and Regulation (EU) No 600/2014, including those relating to disclosure, suitability or appropriateness, identification and management of conflicts of interests, and inducements.

(...)

Article 24
General principles and information to clients

(...)

2. Investment firms which manufacture financial instruments for sale to clients shall ensure that those financial instruments are designed to meet the needs of an identified target market of end clients within the relevant category of clients, the strategy for distribution of the financial instruments is compatible with the identified target market, and the investment firm takes reasonable steps to ensure that the financial instrument is distributed to the identified target market.

An investment firm shall understand the financial instruments they offer or recommend, assess the compatibility of the financial instruments with the needs of the clients to whom it provides investment services, also taking account of the identified target market of end clients as referred to in Article 16(3), and ensure that financial instruments are offered or recommended only when this is in the interest of the client.

(...)

MiFID II DD

(15) In order to avoid and reduce from an early stage potential risks of failure to comply with investor protection rules, investment firms manufacturing and distributing financial instruments should comply with product governance requirements. For the purpose of product governance requirements, investment firms that create, develop, issue and/or design financial instruments, including when advising corporate issuers on the launch of new financial instruments, should be considered as manufacturers while investment firms that offer or sell financial instrument and services to clients should be considered distributors.

(16) Entities which are not subject to the requirements of Directive 2014/65/EU but which may be authorised to perform investment services under that Directive, should also comply, as regards such services, with the product governance requirements set out under Directive 2014/65/EU.

(17) Where an investment firm that creates, develops, issues or designs financial instruments is also involved in the distribution of those products, both the product governance rules for manufacturers and distributors should apply. While there is no need to duplicate the target market assessment and distribution strategy exercise, firms should ensure the single target market assessment and distribution strategy exercise is sufficiently detailed to meet the relevant manufacturer and distributor obligations in this area.

(18) In light of the requirements set out in Directive 2014/65/EU and in the interest of investor protection, product governance rules should apply to all products sold on primary and secondary markets, irrespective of the type of product or service provided and of the requirements applicable at point of sale. However, those rules may be applied in a proportionate manner, depending on the complexity of the product and the degree to which publicly available information can be obtained, taking into account the nature of the instrument, the investment service and the target market. Proportionality means that these rules could be relatively simple for certain simple, products distributed on an execution-only basis where such products would be compatible with the needs and characteristics of the mass retail market.

(19) The level of granularity of the target market and the criteria used to define the target market and determine the appropriate distribution strategy should be relevant for the product and should make it possible to assess which clients fall within the target market, for example to assist the ongoing reviews after the financial instrument is launched. For simpler, more common products, the target market could be identified with less detail while for more complicated products such as bail-inable instruments or less common products, the target market should be identified with more detail.

(20) For the efficient functioning of product governance obligations, distributors should periodically inform the manufacturers about their experience with the products. While distributors should not be required to report every sale to manufacturers, they should provide the data that is necessary for the manufacturer to review the product and check that it remains consistent with the needs, characteristics and objectives of the target market defined by the manufacturer. Relevant information could include data about the amount of sales outside the manufacturer's target market, summary information of the types of clients, a summary of complaints received or by posing questions suggested by the manufacturer to a sample of clients for feedback.

CHAPTER III
Product Governance Requirements

Article 9
Product governance obligations
for investment firms manufacturing financial instruments

1. Member States shall require investment firms to comply with this Article when manufacturing financial instruments, which encompasses the creation, development, issuance and/or design of financial instruments.

Member States shall require investment firms manufacturing financial instruments to comply, in a way that is appropriate and proportionate, with the relevant requirements in paragraphs 2 to 15, taking into account the nature of the financial instrument, the investment service and the target market for the product.

2. Member States shall require investment firms to establish, implement and maintain procedures and measures to ensure the manufacturing of financial instruments complies with the requirements on proper management of conflicts of interest, including remuneration. In particular, investment firms manufacturing financial instruments shall ensure that the design of the financial instrument, including its features, does not adversely affect end clients or does not lead to problems with market integrity by enabling the firm to mitigate and/or dispose of its own risks or exposure to the underlying assets of the product, where the investment firm already holds the underlying assets on own account.

3. Member States shall require investment firms to analyse potential conflicts of interests each time a financial instrument is manufactured. In particular, firms shall assess whether the financial instrument creates a situation where end clients may be adversely affected if they take:

- (a) an exposure opposite to the one previously held by the firm itself; or
- (b) an exposure opposite to the one that the firm wants to hold after the sale of the product.

4. Member States shall ensure that investment firms consider whether the financial instrument may represent a threat to the orderly functioning or to the stability of financial markets before deciding to proceed with the launch of the product.

5. Member States shall require investment firms to ensure that relevant staff involved in the manufacturing of financial instruments possess the necessary expertise to understand the characteristics and risks of the financial instruments they intend to manufacture.

6. Member States shall require investment firms to ensure that the management body has effective control over the firm's product governance process. Investment firms shall ensure that the compliance reports to the management body systematically include information about the financial instruments manufactured by the firm, including information on the distribution strategy. Investment firms shall make the reports available to their competent authority on request.

7. Investment firms shall ensure the compliance function monitors the development and periodic review of product governance arrangements in order to detect any risk of failure by the firm to comply with the obligations set out in this Article.

8. Member States shall require investment firms, where they collaborate, including with entities which are not authorised and supervised in accordance with Directive 2014/65/EU or third-country firms, to create, develop, issue and/or design a product, to outline their mutual responsibilities in a written agreement.

9. Member States shall require investment firms to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client for whose needs, characteristics and objectives the financial instrument is compatible. As part of this process, the firm shall identify any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible. Where investment firms collaborate to manufacture a financial instrument, only one target market needs to be identified.

Investment firms manufacturing financial instruments that are distributed through other investment firms shall determine the needs and characteristics of clients for whom the product is compatible based on their theoretical knowledge of and past experience with the financial instrument or similar financial instruments, the financial markets and the needs, characteristics and objectives of potential end clients.

10. Member States shall require investment firms to undertake a scenario analysis of their financial instruments which shall assess the risks of poor outcomes for end clients posed by the product and in which circumstances these

outcomes may occur. Investment firms shall assess the financial instrument under negative conditions covering what would happen if, for example:

- (a) the market environment deteriorated;
- (b) the manufacturer or a third party involved in manufacturing and or functioning of the financial instrument experiences financial difficulties or other counterparty risk materialises;
- (c) the financial instrument fails to become commercially viable; or
- (d) demand for the financial instrument is much higher than anticipated, putting a strain on the firm's resources and/or on the market of the underlying instrument.

11. Member States shall require investment firms to determine whether a financial instrument meets the identified needs, characteristics and objectives of the target market, including by examining the following elements:

- (a) the financial instrument's risk/reward profile is consistent with the target market; and
- (b) financial instrument design is driven by features that benefit the client and not by a business model that relies on poor client outcomes to be profitable.

12. Member States shall ensure that investment firms consider the charging structure proposed for the financial instrument, including by examining the following:

- (a) financial instrument's costs and charges are compatible with the needs, objectives and characteristics of the target market;
- (b) charges do not undermine the financial instrument's return expectations, such as where the costs or charges equal, exceed or remove almost all the expected tax advantages linked to a financial instrument; and
- (c) the charging structure of the financial instrument is appropriately transparent for the target market, such as that it does not disguise charges or is too complex to understand.

13. Member States shall require investment firms to ensure that the provision of information about a financial instrument to distributors includes information about the appropriate channels for distribution of the financial instrument, the product approval process and the target market assessment and is of an adequate standard to enable distributors to understand and recommend or sell the financial instrument properly.

14. Member States shall require investment firms to review the financial instruments they manufacture on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Investment firms shall consider if the financial instrument remains consistent with the needs, characteristics and objectives of the target market and if it is being distributed to the target market, or is reaching clients for whose needs, characteristics and objectives the financial instrument is not compatible.

15. Member States shall require investment firms to review financial instruments prior to any further issue or re-launch, if they are aware of any event that could materially affect the potential risk to investors and at regular intervals to assess whether the financial instruments function as intended. Investment firms shall determine how regularly to review their financial instruments based on relevant factors, including factors linked to the complexity or the innovative nature of the investment strategies pursued. Firms shall also identify crucial events that would affect the potential risk or return expectations of the financial instrument, such as:

- (a) the crossing of a threshold that will affect the return profile of the financial instrument; or
- (b) the solvency of certain issuers whose securities or guarantees may impact the performance of the financial instrument.

Member States shall ensure that, when such events occur, investment firms take appropriate action which may consist of:

- (a) the provision of any relevant information on the event and its consequences on the financial instrument to the clients or the distributors of the financial instrument if the investment firm does not offer or sell the financial instrument directly to the clients;
- (b) changing the product approval process;
- (c) stopping further issuance of the financial instrument;
- (d) changing the financial instrument to avoid unfair contract terms;
- (e) considering whether the sales channels through which the financial instruments are sold are appropriate where firms become aware that the financial instrument is not being sold as envisaged;
- (f) contacting the distributor to discuss a modification of the distribution process;
- (g) terminating the relationship with the distributor; or
- (h) informing the relevant competent authority.

Article 10 **Product governance obligations for distributors**

1. Member States shall require investment firms, when deciding the range of financial instruments issued by themselves or other firms and services they intend to offer or recommend to clients, to comply, in a way that is appropriate and proportionate, with the relevant requirements laid down in paragraphs 2 to 10, taking into account the nature of the financial instrument, the investment service and the target market for the product.

Member States shall ensure that investment firms also comply with the requirements of Directive 2014/65/EU when offering or recommending financial instruments manufactured by entities that are not subject to Directive 2014/65/EU. As part of this process, such investment firms shall have in place effective arrangements to ensure that they obtain sufficient information about these financial instruments from these manufacturers.

Investment firms shall determine the target market for the respective financial instrument, even if the target market was not defined by the manufacturer.

2. Member States shall require investment firms to have in place adequate product governance arrangements to ensure that products and services they intend to offer or recommend are compatible with the needs, characteristics, and objectives of an identified target market and that the intended distribution strategy is consistent with the identified target market. Investment firms shall appropriately identify and assess the circumstances and needs of the clients they intend to focus on, so as to ensure that clients' interests are not compromised as a result of commercial or funding pressures. As part of this process, firms shall identify any groups of clients for whose needs, characteristics and objectives the product or service is not compatible.

Member States shall ensure that investment firms obtain from manufactures that are subject to Directive 2014/65/EU information to gain the necessary understanding and knowledge of the products they intend to recommend or sell in order to ensure that these products will be distributed in accordance with the needs, characteristics and objectives of the identified target market,

Member States shall require investment firms to take all reasonable steps to ensure they also obtain adequate and reliable information from manufacturers not subject to Directive 2014/65/EU to ensure that products will be distributed in accordance with the characteristics, objectives and needs of the target market. Where relevant information is not publicly available, the distributor shall take all reasonable steps to obtain such relevant information from the manufacturer or its agent. Acceptable publicly available information is information which is clear, reliable and produced to meet regulatory requirements, such as disclosure requirements under Directive 2003/71/EC or Directive 2004/109/EC. This obligation is relevant for products sold on primary and secondary markets and shall apply in a proportionate manner, depending on the degree to which publicly available information is obtainable and the complexity of the product.

Investment firms shall use the information obtained from manufacturers and information on their own clients to identify the target market and distribution strategy. When an investment firm acts both as a manufacturer and a distributor, only one target market assessment shall be required.

3. Member States shall require investment firms, when deciding the range of financial instrument and services that they offer or recommend and the respective target markets, to maintain procedures and measures to ensure

compliance with all applicable requirements under Directive 2014/65/EU including those relating to disclosure, assessment of suitability or appropriateness, inducements and proper management of conflicts of interest. In this context, particular care shall be taken when distributors intend to offer or recommend new products or there are variations to the services they provide.

4. Member States shall require investment firms to periodically review and update their product governance arrangements in order to ensure that they remain robust and fit for their purpose, and take appropriate actions where necessary.

5. Member States shall require investment firms to review the investment products they offer or recommend and the services they provide on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. Firms shall assess at least whether the product or service remains consistent with the needs, characteristics and objectives of the identified target market and whether the intended distribution strategy remains appropriate. Firms shall reconsider the target market and/or update the product governance arrangements if they become aware that they have wrongly identified the target market for a specific product or service or that the product or service no longer meets the circumstances of the identified target market, such as where the product becomes illiquid or very volatile due to market changes.

6. Member States shall require investment firms to ensure their compliance function oversee the development and periodic review of product governance arrangements in order to detect any risk of failure to comply with the obligations set out in this Article.

7. Member States shall require investment firms to ensure that relevant staff possess the necessary expertise to understand the characteristics and risks of the products that intend to offer or recommend and the services provided as well as the needs, characteristics and objectives of the identified target market.

8. Member States shall require investment firms to ensure that the management body has effective control over the firm's product governance process to determine the range of investment products that they offer or recommend and the services provided to the respective target markets. Investment firms shall ensure that the compliance reports to the management body systematically include information about the products they offer or recommend and the services provided. The compliance reports shall be made available to competent authorities on request.

9. Member States shall ensure distributors provide manufacturers with information on sales and, where appropriate, information on the above reviews to support product reviews carried out by manufacturers.

10. Where different firms work together in the distribution of a product or service, Member States shall ensure the investment firm with the direct client relationship has ultimate responsibility to meet the product governance obligations set out in this Article. However, intermediary investment firms shall:

- (a) ensure that relevant product information is passed from the manufacturer to the final distributor in the chain;
- (b) if the manufacturer requires information on product sales in order to comply with their own product governance obligations, enable them to obtain it; and
- (c) apply the product governance obligations for manufacturers, as relevant, in relation to the service they provide.