

POSITION PAPER on MiFID II Quick Fix¹: Investor Protection issues

Overall, the undersigned associations² very much welcome the European Commission (EC) “MiFID II quick fix” proposing targeted amendments to the Directive.

Concerning **Investor Protection issues in particular**, we fully support the point that overall, many MiFID II requirements are unnecessary or overly burdensome and we share the target to recalibrate specific requirements to strike a more appropriate balance between the protection of investors and the provision of high quality investment services, with the ultimate objective to facilitate the financing of the economy.

While most of the proposed amendments in the quick fix fully contribute to achieving this goal, we believe that two of them should be re-assessed and pushed further. In this paper, (i) we highlight the main reasons why product governance rules should be amended, and best execution reports suspended and (ii) we propose specific amendments detailed in appendix 1.

➤ **(1) Introducing a more proportionate approach to Product Governance rules**

Like the EC detailed in the description of the measures, the product governance requirements currently apply to all financial instruments “*even though there seems little benefit in assessing the particularities of a plain vanilla bond when transactions take place between eligible counterparties*”.

ESMA has already partially addressed this lack of proportionality by explicitly recommending further flexibility for “non-complex products”. We consider that what should be contemplated is excluding plain vanilla bonds and shares from the scope or, at least, providing substantial alleviations from the requirements for simplest financial instruments that finance the economy.

It has been identified by the EC and many stakeholders that “*product governance rules for certain instruments, which are often referred to as “plain vanilla” issuances, have prevented an optimal allocation of capital by means of vibrant secondary markets. In the light of the current crisis caused by the COVID-19 pandemic, it is indispensable to facilitate the issuing of capital. Issuers and investors must be equipped with the right tools to easily issue new capital and to easily get access to an increased investor base. The earlier these tools are operational, the better for companies and investors alike*”.

However, while we support the proposal to lift the product governance requirements for simple **corporate bonds with make-whole clauses**, we do not understand why the exclusion should be so narrow, considering that all ordinary shares and plain vanilla bonds issuance are similarly important for the financing of companies.

¹ On Commission Proposal of 27/01/2020 for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2014/65/EU as regards information requirements, product governance and position limits to help the recovery from the COVID-19 pandemic.

² More information about each association is available in Appendix 2.

Also, we do not understand whereas it has been made clear that “*transactions take place between eligible counterparties*” should not be in the scope, no amendment has been proposed consequently. As a conclusion, we consider it is crucial to extend the exclusion from the product governance rules to both (i) transactions between eligible counterparties (already excluded from Article 24(2) anyway) and (ii) transactions on **all ordinary shares and plain vanilla bonds (and not only corporate bonds with make whole clause)**.

➤ **(2) Suspending best execution reports**

While we **fully agree with the EC conclusion** that “*In their current form best execution reports are not read by investors, while buy-side investment firms receive all the relevant information via other means (e.g. via brokerage meetings). To reduce the burden of producing those reports, this obligation will be suspended, pending a thorough analysis with regard to a possible streamlining of the reports*”, **and therefore the decision to suspend best execution reports required by Article 27(3), we regret that the same conclusion has not been reached for the “top five execution venues report” required by Article 27(6), for which the exact same criticisms have been made.**

We wish to suggest suspending as well best execution reports required by Article 27(6) and further described in Delegated Regulation (EU) 2017-576 (“RTS 28”).

Appendix 1

(1) Product Governance

➤ *Negotiations solely between eligible counterparties outside distribution channels*

When an eligible counterparty purchases or trades a financial instrument with another ISP for its own account without any intention of reselling it to its own clients, the counterparty does not act as a Distributor for Product Governance purposes (“Distributor”). If an eligible counterparty places an order for its own account with another ISP, both counterparties have similar roles vis-à-vis each other: each one is both a client and a supplier, and no other “end client” can be considered to be a target. Therefore, Product Governance requirements should not apply to negotiations conducted exclusively between eligible counterparties.

At the very least, the principle of proportionality, adapted to the wholesale market, should be taken into account to a greater degree for these situations. In accordance with current practice, eligible counterparties are already informed of the characteristics of the financial instruments in which they trade (for example, by providing a term sheet). Transactions that involve only eligible counterparties, who do not subsequently redistribute the products to end clients, do not require furnishing all information intended for less sophisticated clients. Concerning the information about products that Manufacturers must provide to Distributors, since eligible counterparties are both knowledgeable and experienced with respect to the products, and the knowledge and experience of the counterparties is equivalent, why should one counterparty be required to furnish this information to the other? Concerning the information required to monitor transactions in relation to the identified target market, which of the two counterparties should submit a report to the other? With respect to the obligation to regularly review these target markets, in the case of eligible counterparties, for what purpose?

These obligations should not apply in these cases. Hence, the amendment proposed in article 30 below.

➤ *Issues of financing products: ordinary shares and bonds*

Product Governance obligations apply to all types of clients, all investment services and all products regardless of their complexity. However, we note that these obligations were primarily designed for structured products, which are actually “manufactured”³ by ISPs. On the other hand, in the case of so-called “vanilla” products⁴, the application of Product Governance obligations is more difficult to understand, in particular in the primary market where the added value is, in principle, very low or non-existent.

³ “... 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 2, recital 71).

⁴ “Ordinary” shares and bonds admitted to trading on a regulated or equivalent market or MTF, which are classified as non-complex financial instruments within the meaning of Article 25(4)(a) of MiFID 2, and equity-linked products, such as bonds that are convertible and/or exchangeable into shares that are admitted to trading on a regulated or equivalent market or MTF, even if they are not classified as non-complex financial instruments within the meaning of the article referenced above.

That is why, in consistency with the EC proposal to exclude corporate bonds with make whole clause, we suggest excluding all ordinary / plain vanilla shares and bonds as well. To do so, we propose amendments to articles 16(3) and 24(2) to exclude not only corporate bonds with make whole clause but all plain vanilla shares and bonds.

(2) Suspend (all) best execution reports

For the same reasons that the EC decided to suspend best execution reports required by Article 27(3), we wish to suggest suspending as well best execution reports required by Article 27(6) and further described in Delegated Regulation (EU) 2017-576 (“RTS 28”).

Hence, the proposed amendment of article 27(6) in consistency with EC proposal amendment of article 27(3).

PROPOSED AMENDMENTS

<p>Directive 2014/65/EU as amended by DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL as regards information requirements, product governance and position limits to help the recovery from the COVID-19 pandemic</p>	<p>Proposed amendment (in bold, red and <u>underlined police</u>)</p>
<p style="text-align: center;"><i>Article 16</i> Organisational requirements</p> <p>[...]</p> <p>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.</p> <p>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.</p> <p>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</p>	<p style="text-align: center;"><i>Article 16</i> Organisational requirements</p> <p>[...]</p> <p>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.</p> <p>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.</p> <p>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</p>

<p>to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>“The requirements laid down in the second to fifth subparagraphs of this paragraph shall not apply to corporate bonds with make-whole clauses.” [...]</p>	<p>to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>“The requirements laid down in the second to fifth subparagraphs of this paragraph shall not apply to <u>ordinary shares and plain vanilla</u> corporate bonds <u>including when they provide</u> with make-whole clauses.” [...]</p>
<p style="text-align: center;"><i>Article 24</i> General principles and information to clients [...]</p>	<p style="text-align: center;"><i>Article 24</i> General principles and information to clients [...]</p>

<p>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.</p> <p>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.</p> <p>“This paragraph shall not apply to corporate bonds with make-whole clauses.” [...]</p>	<p>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.</p> <p>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.</p> <p>“This paragraph shall not apply to <u>ordinary shares and plain vanilla</u> corporate bonds <u>including when they provide</u> with make-whole clauses.” [...]</p>
<p style="text-align: center;"><i>Article 27</i></p> <p>Obligation to execute orders on terms most favourable to the client [...]</p> <p>3. Member States shall require that for financial instruments subject to the trading obligation in Articles 23 and 28 Regulation (EU) No 600/2014 each trading venue and systematic internaliser and for other financial instruments each execution venue makes available to the public, without any charges, data relating to the quality of execution of transactions on that venue on at least an annual basis and that following execution of a transaction on behalf of a client the investment firm shall inform the client where the order was executed. Periodic reports shall include details about price, costs, speed and likelihood of execution for individual financial instruments.</p> <p>“The reporting requirement laid down in this paragraph shall however not apply until [date</p>	<p style="text-align: center;"><i>Article 27</i></p> <p>Obligation to execute orders on terms most favourable to the client [...]</p> <p>3. Member States shall require that for financial instruments subject to the trading obligation in Articles 23 and 28 Regulation (EU) No 600/2014 each trading venue and systematic internaliser and for other financial instruments each execution venue makes available to the public, without any charges, data relating to the quality of execution of transactions on that venue on at least an annual basis and that following execution of a transaction on behalf of a client the investment firm shall inform the client where the order was executed. Periodic reports shall include details about price, costs, speed and likelihood of execution for individual financial instruments.</p> <p>“The reporting requirement laid down in this paragraph shall however not apply until [date</p>

<p>of entry into force of this amending Directive + 2 years].” [...]</p> <p>6. Member States shall require investment firms who execute client orders to summarise and make public on an annual basis, for each class of financial instruments, the top five execution venues in terms of trading volumes where they executed client orders in the preceding year and information on the quality of execution obtained. [...]</p>	<p>of entry into force of this amending Directive + 2 years].” [...]</p> <p>6. Member States shall require investment firms who execute client orders to summarise and make public on an annual basis, for each class of financial instruments, the top five execution venues in terms of trading volumes where they executed client orders in the preceding year and information on the quality of execution obtained. <u>“The reporting requirement laid down in this paragraph shall however not apply until [date of entry into force of this amending Directive + 2 years].”</u> [...]</p>
<p style="text-align: center;"><i>Article 30</i> Transactions executed with eligible counterparties</p> <p>1. Member States shall ensure that investment firms authorised to execute orders on behalf of clients, to deal on own account, or to receive and transmit orders, have the possibility to bring about or enter into transactions with eligible counterparties without being obliged to comply with Article 24, with the exception of paragraph 5a, Article 25, Article 27 and Article 28(1), in respect of those transactions or in respect of any ancillary service directly relating to those transactions.”</p>	<p style="text-align: center;"><i>Article 30*</i> Transactions executed with eligible counterparties</p> <p>1. Member States shall ensure that investment firms authorised to execute orders on behalf of clients, to deal on own account, or to receive and transmit orders, have the possibility to bring about or enter into transactions with eligible counterparties without being obliged to comply <u>with Article 16(3) with the exception of paragraph 1</u>, Article 24 with the exception of paragraph 5a, Article 25, Article 27 and Article 28(1), in respect of those transactions or in respect of any ancillary service directly relating to those transactions.”</p>

* **Justification: The Product Governance provisions are set out in both Article 16(3), paragraphs 2 to 6 and Article 24(2).** Article 30, which is the basis for the principle that investor protection provisions do not apply to transactions between eligible counterparties, already excludes Article 24(2). Therefore, the exclusion of Article 16(3) should be added to make fully clear that investor protection provisions do not apply to transactions between eligible counterparties.

Appendix 2

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities. Nearly one-third of members are subsidiaries or branches of non-French institutions.

Italian Financial Markets Intermediaries Association (Associazione Intermediari Mercati Finanziari – ASSOSIM) ASSOSIM represents the interests of the intermediaries active on the Italian financial markets, namely, Italian investment firms, investment banks and subsidiaries of foreign investment services providers. Its members account for nearly the entire amount of the transactions carried out on the Italian stock markets as from Italy, and more than 80% when considering cross border transactions.

The Danish Securities Dealers Association (DSDA) is the trade organization for members of a regulated market and other companies which main activities are related to the Danish securities market. The organization consists of 11 members and represents a broad range of Danish securities dealers.

The Chamber of Brokerage Houses (IDM) is the largest independent nongovernmental organisation of employers of brokerage houses and offices in Poland. The mission of the Chamber of Brokerage Houses is to support development of a competitive capital market where businesses are free to raise capital in order to promote economic growth, create jobs, and protect investors in Poland.

The Swedish Securities Markets Association (SSMA) represents the common interest investment firms which are active on the Swedish securities market. The association was founded in 1908 and currently has 23 banks and investment firms as members. The mission of the SSMA is a sound, strong and efficient Swedish securities market. In order to achieve this, the SSMA carries out lobbying activities on both a national and EU-level within areas which are of interest to our members, e.g. by responding to consultations, participating as experts in different forums and through international collaborations.

