REVIEW OF MiFID II
Investor protection
-
AMAFI proposals

In 2019 and 2020, AMAFI participated fully in the European-level discussions on the MiFID II general review referred to in its position paper *AMAFI / 20-03*, which covers the market structure and investor protection elements of the framework.

Following on from this, AMAFI responded to the European Commission ("EC") consultation launched in March 2020 (*AMAFI / 20-32*) in preparation for the review of the MiFIR / MiFID II framework. AMAFI was thus able to pinpoint the issues where adjustments to the MiFID 2 framework are felt to be needed, the goal being to ensure that European markets are able to contribute sufficiently to financing the European economy, to introduce greater proportionality and to better reflect the specific features of the wholesale market, for which the challenges of an integrated European market are real and immediate.

In light of the crisis caused by the COVID-19 pandemic, the EC subsequently decided to split the review of the MiFID/MiFIR framework into two phases: (1) a "quick fix" phase to make swift changes in areas that are problematic and where there is broad consensus among Member States (this phase will be incorporated into the broader package of regulatory measures aimed at restarting the economy in the post-COVID 19 period) and; (2) at a later stage, a more comprehensive, in-depth review of the whole framework. On 24 July 2020, the European Commission published a package of regulatory measures (the post-Covid "Capital Markets Recovery Package" including a proposal for a directive to amend MiFID 2[1] (the "MiFID II Quick Fix" or simply "Quick Fix").

Broadly speaking, while some of the reforms proposed by the EC in July 2020 on a number of the investor protection issues (with the exception of Product Governance) are consistent with the positions held by AMAFI (*AMAFI / 20-03 and AMAFI / 20-32*), certain areas remain problematic (particularly regarding Product Governance) and justify further work by the AMAFI on the review of MiFID II[2].

On 26 February 2021, Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 amending MiFID II as regards information requirements, product governance and position limits to help the recovery from the COVID-19 crisis was published in the Official Journal of the European Union (OJEU)[3].

[1] 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 (link), known as "MiFID II".

[2] It should be noted that AMAFI worked mainly in coalition with other organisations on the MiFID II Quick Fix, namely with several members of EFSA on Investor Protection matters (*AMAFI / 20-56*) and with German (DDV and DSGV) and French (FBF and AFPDB) associations on all issues addressed in the MiFID Quick Fix as well as on STO/DTO matters (link). AMAFI also co-signed a specific position paper with the Italian association ASSOSIM (*AMAFI / 20-55*) on this same subject.

[3] Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 amending Directive 2014/65/EU as regards information requirements, product governance and position limits, and Directives 2013/36/EU and (EU) 2019/878 as regards their application to investment firms, to help the recovery from the COVID-19 crisis (link).

In this context, this document is intended to recap and discuss the areas of the Investor Protection provisions that AMAFI has identified as priorities for the general review of the MiFID II/MiFIR framework (and that the MiFID II Quick Fix does not address), in light of Directive (EU) 2021/338 of the European Parliament and of the Council published in the OJEU on 26 February 2021 ("latest version" or "final version" of the "Quick Fix").

The priorities that AMAFI has identified in this document aim to address issues in the following areas associated with the **Investor Protection provisions of the MiFID II framework**:

(1) Product Governance;
(2) Inducements regime;
(3) Costs and charges;
(4) Opt-in procedure[4];
(5) Best execution;
(6) Intervention measures;
(7) 10% loss warning;
(8) Suitability assessment (ESMA suitability guidelines);

Summary and level of priority of AMAFI requests

Topic	AMAFI priority requests[5]	Level of law impacted	Priority
Product governance	Remove ordinary shares from the scope of application	1	High
Inducements	Maintain the legitimacy of inducements Align costs and charges disclosures with those required for inducements	1	High
Costs and charges	Simplify and clarify the current regime	2	Medium
Opt-in procedure[6]	Review of the opt-in procedure	1	High
Best execution	Deletion of RTS 28 and 27 reports	1	High
Intervention measures	Clarify the link between European and national measures Strengthen consultation requirements	1	Low
10% loss alert	Clarify the current regime Exclude derivative financial instruments used for hedging purposes	2	Low
Suitability	Necessary adjustments in the Guidelines	3	Low

[4] See below. MiFID II procedure to become an elective professional client specified in paragraph II.2 of Annex II of MiFID II (opt-in procedure).
[5] The request(s) considered to be a priority for each particular topic are identified, although other issues with associated proposals for amendments are also discussed in this document.
[6] See below. MiFID II procedure to become an elective professional client described in paragraph II.2 of Annex II of MiFID II (opt-in procedure).

1. Product Governance

Priorities and summary of proposed amendments to Level 1

Remove ordinary shares from the scope of Product Governance

- See amendments to the new Article 16a introduced by the Quick Fix

MiFID II adopts new investor protections by introducing a mandatory framework for the design and distribution of financial instruments. These new provisions, which are set out in Chapter III of the MiFID II DD[7] under the heading "Product Governance", are one of the major advances of MiFID II. Implementation of these provisions by the relevant institutions is a significant challenge due to the legal, organisational and IT consequences they entail. They raise key commercial issues because Product Governance regulates the supply and distribution of ISPs' financial instruments.

The new Product Governance requirements oblige "Manufacturers" and "Distributors" of financial instruments to prevent conflicts of interest and to control the risks of inappropriate marketing of products or the creation of products without any defined interest for clients. Accordingly, these provisions contribute to improving investor protection because their aim is to better target investors compatible with each product marketed by defining "Target Markets", more fully informing clients about the nature of the product or service offered and manufacturing only products that meet the needs and objectives of clients targeted. The Product Governance provisions define the responsibilities of each actor in the distribution chain, from the designer to the seller, as well as the exchanges between the two. The scope of this Product Governance system, as originally defined, is nevertheless very broad, and its obligations applied to all clients, regardless of their classification, as well as to all financial instruments[8].

The EC consequently considered whether this point should be included in a consultation held in March 2020. In its response (*AMAFI / 20-32*), specifically as regards Product Governance issues, AMAFI stressed the need to simplify the system as much as possible and to introduce greater proportionality depending on the financial instruments and the category of clients involved.

In its first proposal for a directive amending MiFID II, as regards the Product Governance regime, various amendments were proposed to exclude corporate bonds with make-whole clauses[9] from the scope of Product Governance requirements (see the amendments to Articles16(3) and 24(2) of MiFID II proposed in the first version of the Quick Fix).

The EC is proposing this exclusion because, in its opinion, the system is inappropriate for these instruments, which do not pose a problem in terms of "investor protection" and which directly finance the economy. It should be noted that the Commission ultimately aims to exclude them from PRIIPs requirements as well. While this proposal seemed relatively limited compared to AMAFI's request for exclusion (or at the very least a substantial reduction in the relevant requirements for all ordinary shares and bonds), it was nevertheless a step in that direction.

[7]The provisions of Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing MiFID II ("MiFID II DD") on Product Governance have been transposed in France in Book III, Chapter III, of the AMF General Regulation.
[8] As defined by MiFID II (Annex I, Section C), as well as structured deposits. However, the provisions may be applied in a proportionate manner depending on the category of clients and the nature of the financial instruments (see MiFID II DD 2017/593, Recital 18). Finally, AMAFI also draws the reader's attention to the exemption for bonds with make-whole clauses introduced by the MiFID II Quick Fix (see below).
[9] A "make-whole" clause is a clause allowing early redemption of the securities by the issuer with, in return, payment of the nominal amount plus a premium to the investor.

Following the EC's release of the draft Quick Fix, AMAFI reiterated its position in the following months[10]. It highlighted (i) the importance of excluding transactions between eligible counterparties from the scope of the Product Governance regime; and (ii) the necessity of also excluding all ordinary shares and bonds from the scope of the regime for the same reasons cited by the Commission to exclude (only) corporate bonds with make-whole clauses.

Finally, the new Article 16a introduced by the Quick Fix states that investment firms shall be exempt from the obligations provided for in sub-paragraphs 2 to 5 of Article 16(3) and Article 24(2) of MiFID II where the investment service relates to ordinary corporate bonds[11] or bonds with make-whole clauses or when financial instruments are produced or distributed exclusively to eligible counterparties.

In conclusion, while the request to exclude eligible counterparties has been adopted, along with the request to exclude plain vanilla bonds, and not only those with a make-whole clause[12], **the issue of maintaining ordinary shares within the scope of Product Governance requirements remains** and should be challenged as a matter of priority. AMAFI has made a number of other requests as set out below.

Remove ordinary shares from the scope of Product Governance requirements

The Product Governance system is, firstly, very (perhaps overly) ambitious given its extremely broad scope. While this has the advantage of covering all possible situations, it quickly became apparent from the implementation work carried out that, in a number of cases, its objectives are not particularly or not at all pertinent.

Product Governance obligations have so far applied to all types of clients, all investment services and all products regardless of their complexity. However, as mentioned previously, when the latest version of the MiFID II Quick Fix comes into force, investment firms will be exempted from the Product Governance regime where the investment service relates to plain vanilla corporate bonds or corporate bonds with a make-whole clause. Meanwhile, ordinary shares remain within the scope of the requirements.

However, AMAFI notes that the Product Governance requirements were primarily designed for structured products, which are actually "manufactured"[13] by ISPs.

On the other hand, in the case of so-called "plain vanilla" products[14], 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. Therefore, AMAFI proposes excluding ordinary shares from the scope of the Product Governance obligations for the reasons set out below.

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[10] It should be noted that AMAFI worked mainly in coalition with other organisations on the MiFID II Quick Fix, namely with several members of EFSA on Investor Protection matters (*AMAFI / 20-56*) and with German (DDV and DSGV) and French (FBF and AFPDB) associations on all issues addressed in the MiFID Quick Fix as well as on STO/DTO matters (link). AMAFI also co-signed a specific position paper with the Italian association ASSOSIM (*AMAFI / 20-55*) on this same subject.

[11] An AMAFI paper is being finalised which will set out the reasons why the Quick Fix legislation should be interpreted as already excluding "plain vanilla" bonds, i.e. bonds without embedded derivatives, in addition to the exclusion of bonds with a "make-whole" clause.

[12] *Ibid*.

[13] "(…) *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*).

[14] **"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 II, 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.

1) The lack of objective added value provided by the exercise of classifying the ISP that advises an issuer as a Manufacturer of plain vanilla products

A Manufacturer is an ISP that manufactures financial instruments, which encompasses the "*creation, development, issuance and/or design of financial instruments*"[15]. However, in the case of issues of plain vanilla products, if the issuer is not subject to MiFID II (for example, a corporate issuer), it does not itself meet the prerequisites of the definition of Manufacturer.

A commonly accepted interpretation of Recital 15[16] of the MiFID II DD considers that the issuer's ISP adviser in connection with an issue of plain vanilla products is the "Manufacturer" of such products for Product Governance purposes.

However, it bears noting that the advice provided by the ISP in this context does not concern the product as such or its functioning but, rather, the characteristics of the issue (terms and conditions, timetable, etc.). Moreover, in practice, it has proved very complicated to harmonise the identification of Target Markets, for Product Governance purposes, with the types of investors targeted for a given issue in accordance with the Prospectus Regulation. In particular, a number of Product Governance provisions seem inapposite for these financial instruments, especially the obligations that apply over time, given the fungible nature of these instruments[17].

For the foregoing reasons, **these ISPs should not be classified as "Manufacturers" of plain vanilla products** because practice has shown that this provides no added value apart from a purely formal exercise to identify a Target Market that, by its nature, is very broad and identical for the same type of financial instrument[18].

2) The inapplicability or ineffectiveness of the main Product Governance provisions to plain vanilla products

Even in the absence of a MiFID II Manufacturer, plain vanilla products that are both distributed on the primary market and traded on the secondary market are subject to the Product Governance provisions. In this case as well, given the inherent nature of these products, which by their nature must be accessible to as many people as possible, the current system is unsuitable, in particular with regard to the following:

a) **Identification of the positive Target Market**: it should be possible to define a "single" Target Market. For example, such market could include, on the one hand, all shares and, on the other hand, all bonds with similar characteristics.

b) **Identification of the negative Target Market**: in light of the nature of these products, the need to identify a negative Target Market should be acknowledged to be rare[19] or non-existent.

c) **Costs**: by nature, plain vanilla products do not incur a product "manufacturing" costs. Therefore, the obligations to verify the compatibility of these costs and charges should be deemed to have been met.

d) **Regular review of the product**: given the nature of these products, AMAFI considers that it is disproportionate, unnecessary and perhaps impossible (particularly on the primary market) to conduct regular reviews.

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[15]MiFID II DD, Article 9(1).
[16] "*Investment firms that* (...) *advise issuers on the launch of new financial instruments should be considered as manufacturers* (…) ".
[17]See AMAFI Guide No. 18-60, "MiFID II Product Governance", Annex 4, 7 Nov. 2018.
[18] See *Ibid*.
[19] On this point, the example ESMA gives in its Guidelines of a negative target market for a share encompassing clients looking for full capital protection, who are fully risk averse and want a fully guaranteed income (*ESMA Guidelines (English version), Annex V, Case study 4*) is particularly regrettable and harmful and should be deleted.

e) **Scenarios**: similarly, the obligation to undertake analyses of various scenarios seems to be apposite for structured products, but not particularly pertinent for shares and bonds.

f) **Reports of sales outside the target market**: given the very broad target markets for these products, a limited number of sales outside the target market is generally to be expected.
Moreover, given the limited scope of its obligations, the "Manufacturer" will not perform a regular review of the product (or its Target Market) and, therefore, these reports on sales outside the Target Market would be pointless in any event.

3) An objective constraint on the distribution of ordinary shares

Finally, AMAFI believes it is important to emphasise that the activity of distributing plain vanilla products amounts to financing the economy. However, the Product Governance provisions for plain vanilla products place objective constraints on the distribution of ordinary shares to as many investors as possible.

This is the rationale for **AMAFI's proposals to remove ordinary shares from the scope of Product Governance requirements.**

Lessen the obligations of "passive" distributors that are not linked to the Manufacturer

"Passive distribution" concerns, in particular, ISPs that provide an RTO or order execution service enabling their clients to process financial instruments available on the secondary market via trading venues or OTC transactions. Should an ISP that provides such a service be considered as a Distributor in all cases? In particular, if it receives an order "passively" (i.e. if receipt is not preceded by any of the following actions: a marketing campaign, providing recommendations or advice to clients on the product in question, sending promotional communications about the product to its clients, providing advice to clients etc.) for a product to which it has no ties (it does not know the "Manufacturer" and receives no remuneration therefrom to market the Product), and the only service provided to the client is to transmit this order for execution or to execute the order, should the ISP be considered to "market" the Product and therefore that it is the Distributor of the financial instrument?

ESMA[20] answered this question affirmatively and considers that an ISP is also a Distributor if it decides on the products offered to clients acting at their own initiative, even if such ISP does not actively market these products.

Precisely because these "distributors" have only limited information, a legitimate question arises as to the benefit of considering that they are Distributors. Moreover, these arrangements are most often specific to "plain vanilla" products (*see Section (2) above*) such as shares or bonds. Under proportionality principle, it should be fairly simple to identify the Target Markets for products that are, by their nature, suitable for "mass" retail clients. However, the question this raises is what benefit would accrue by identifying such a "target" market, which by definition would be very broad.

It is also important to note that Product Governance requirements are not limited to the identification of the Target Market and that Distributors are subject to other obligations, such as regularly reviewing the products distributed and providing information on sales.

In these cases as well, **these provisions appear to be of limited utility, whereas they have a significant regulatory cost for these firms** that provide execution services only, but no investment advisory or discretionary management services.

[20] "(…) *Distributors should also decide which products will be made available to (existing or prospective) clients at their own initiative through execution services without active marketing, considering that in such situations the level of client information available may be very limited.*" (*Guidelines on MiFID II product governance requirements* (*ESMA35-43-620*) issued on 2 June 2017 "*ESMA Guidelines", § 31*).

Lastly, the feedback from professionals shows that it is extremely complicated from a practical point of view for Distributors to have the exchanges of information required by the Product Governance system with a multitude of Manufacturers with whom they do not have an established relationship.

Requiring Distributors to identify in advance all products on which their clients could potentially place orders seems disproportionate. The number of financial instruments concerned is enormous. Moreover, commercially speaking, the Distributor cannot refuse to accept an order from a client for a product that it has not identified in advance, especially if the order is placed by telephone.

The system should therefore focus on the Distributor's distribution policy, i.e. through what channel and with what service it provides or does not provide access to certain markets to certain of its clients because, in this context, a product-by-product approach is not pertinent. If an ISP provides only an RTO or simple execution service, its role from a product governance standpoint is limited solely to determining to what market(s) or venue (s) it will provide access to its clients because it does not receive from the Manufacturer of each financial instrument referenced by the market or venue detailed information on the Target Market for each financial instrument, if in fact any exists. **Product Governance obligations should therefore be applied proportionately to the service provided and not on a product-by-product basis**, as European regulated markets should generally be considered to be accessible to all investors.

This is the rationale for **AMAFI's proposals to reduce the Product Governance obligations that apply to "passive" distributors by making a number of clarifications in this regard to both the Level 2 and Level 3 texts.**

Simplifying and clarifying reports of sales outside the Target Market

Distributors are required to provide Manufacturers with information on sales made outside the Target Market, and Manufacturers must ensure that the product is in fact distributed to the Target Market[21].

An ambiguity remains about the Distributor's responsibility for this report. It would be helpful to clarify, for example in the Level 2 text, that the Distributor is solely responsible for this obligation. Therefore, Manufacturers that have used their best endeavours to actually obtain this information but have nevertheless not received any reports should be able to validly assume that no sales have been made outside their Target Market or that such sales are not sufficiently relevant to report.

Moreover, the nature of the sales to be reported is complex.

ESMA has specified the scope of the sales to be reported.

As a welcome exception, sales made outside the Target Market for diversification or hedging purposes need not be reported[22] provided such sales are compatible with the client's total portfolio or the risk being hedged (however, this exception cannot apply to deviations from the first two criteria[23] of the Target Market). However, sales into the negative Target Market must always be reported[24] even if they are made for diversification or hedging purposes.

Ultimately, the scope of sales to be reported is based on a complex combination of statements and exceptions that should undoubtedly be simplified. **In fact, under the principle of proportionality, should it not be above all the sales made into the negative Target Market that should be identified?**

[21] MiFID II DD, Article 9(14) "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."
[22] ESMA Guidelines, § 54.
[23] Therefore, sales made outside the positive target market because they do not meet the "Type of client" and/or "Knowledge and experience" criteria cannot be justified for diversification or hedging reasons. Accordingly, they must be reported in all cases.
[24] ESMA Guidelines, § 55.

Therefore, on the basis of the same concern for proportionality, it should be made clear that the reporting requirement is not systematic and that only a certain volume of sales outside the Target Market triggers the obligation to report them. If a Distributor identifies a few sales outside the Target Market to be reported, but such sales are very small or marginal in relation to the total volume of sales made (including sales made within the Target Market), is it worthwhile to require the Distributor to report them anyway? Furthermore, if this departure from the Target Market is perfectly justified in a particular case, for example because the client has requested to invest in a product at their own initiative, is it really necessary to report it to the Manufacturer? It would seem both more consistent with the original objective of this report (i.e. to confirm the pertinence of the defined target market) and the principle of proportionality, which should be re-emphasised, to give the Distributor certain discretion to determine if it is necessary to report sales outside the Target Market.

For these reasons, AMAFI proposes to **simplify the reporting of sales outside the Target Market by focusing on sales made into the negative Target Market and giving Distributors certain discretion to determine the need to report such sales to the Manufacturer.**

Moreover, feedback received tends to show that Manufacturers generally receive few reports from Distributors on this subject. On average, AMAFI Manufacturers report a reporting rate of around **only 50%** from all their Distributors, a significant share of which is attributable solely to French Distributors. From a qualitative point of view, the majority of Manufacturers agree that in a number of cases the information does not really enable reliable conclusions to be drawn as to whether or not the definition of the Target Market needs to be revised. Many Distributors also point to operational obstacles – chief among them, information systems and IT tools – that make the task as currently required by the laws in force extremely complex, difficult and burdensome.

Finally, and to echo the issue raised in Section *(3)* concerning scope ("broad distribution"), the complexity of this reporting is further increased if there is no contractual relationship between the Distributor and the Manufacturer.

The principle of proportionality should be re-emphasised with respect to the requirement to monitor products throughout their lives

Article 9(15) of MiFID II DD requires Manufacturers to identify "*crucial events that would affect the potential risk or return expectations*" of the product, such as:

(a) The crossing of a threshold that will affect the return profile of the product;
(b) The solvency of certain issuers.

Feedback obtained on the implementation of this obligation shows that **it cannot be applied consistently due to the variety of situations concerned.** For example, depending on the level of granularity the Manufacturer decides for the purposes of applying it, this obligation may become quite onerous even if not justified by the category of end clients targeted. Although this review is particularly beneficial if the end client is a retail investor, it seems much less useful in the case of sophisticated clients.

Furthermore, the factors chosen to identify such reviews and their frequency vary considerably depending on the type of financial instrument. By their nature, these reviews will not be carried out based on whether the product is a structured product such as an EMTN sold to retail clients or an OTC derivative traded with a professional client who frequently trades in these financial instruments. Similarly, they will not have the same objective if the product is a derivative financial instrument contracted for risk hedging purposes. Moreover, such review will be meaningless for plain vanilla products[25].

Therefore, it is essential to provide legal certainty to Manufacturers by **explicitly stipulating that this obligation is to be applied in a manner appropriate and proportionate to the nature of the relevant financial instrument** and the category of the end client, i.e. to the nature of the Target Market identified.

[25] *See above.*

Proposed amendments to the laws

Level 1 text

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") as amended by Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 ("Quick Fix")

Article 16a
Exemption from product governance requirements

An investment firm shall be exempted from the requirements set out in the second to fifth subparagraphs of Article 16(3) and in Article 24(2), where the investment service it provides relates to **shares or** bonds with no other embedded derivative than a make-whole clause or where the financial instruments are marketed or distributed exclusively to eligible counterparties.

The proposed amendment aims to exclude ordinary shares from the scope of Product Governance requirements.

Level 2 text

Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU ("MiFID II")

Recitals

(…)
(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 instruments and services to clients should be considered distributors.

This proposal addresses the need for consistency with the proposal made in the Level 1 text to remove ordinary shares from the scope of Product Governance requirements.

Article 9
Product governance obligations for manufacturers

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, **in a manner appropriate and proportionate to the nature of the financial instrument and its target market**, 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.

This addition makes clear that the monitoring obligation during the life of the products laid down in Article 9 should be applied in a manner appropriate and proportionate to the nature of the product and the category of targeted end clients.

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.

<u>In particular, Member States shall take into account the fact that investment firms offer financial services and instruments without marketing or recommending them.</u>

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.
(…)
<u>11. ESMA is developing draft regulatory technical standards clarifying the extent to which the requirements in paragraph 1 apply to investment firms that offer financial instruments without marketing or recommending them.</u>

These proposals address the need to apply the Product Governance provisions to passive distributors in a proportionate manner.

- ***Level 3 text***

ESMA Guidelines on MiFID II product governance requirements

V.3. Guidelines for distributors

Timing and relationship of target market assessment of the distributor with other product governance processes
(…)
31. Specifically, distributors should decide which products are going to be recommended (also through the provision of portfolio management) or offered or actively marketed to certain groups of clients (characterised by common features in terms of knowledge, experience, financial situation, etc.).
Distributors should also decide which products will be made available to (existing or prospective) clients at their own initiative through execution services without active marketing, considering that in such situations the level of client information available may be very limited. **<u>In these cases, again, only criteria (a) and (b) defined in paragraph 18 will be taken into account.</u>**
(…)
Identification of the target market by the distributor: categories to be considered
34. Distributors should use the same list of categories used by manufacturers (see paragraph 18), as a basis for defining the target market for their products. **<u>However, distributors that offer financial instruments without recommending or marketing them need only use criteria (a) and (b) defined in paragraph 18.</u>** However, distributors should define the target market on a more concrete level and should take into account the type of clients they provide investment services to, the nature of the investment products and the type of investment services they provide.
(…)

Portfolio management, portfolio approach, hedging and diversification

(…)

54. The distributor is not required to report sales outside of the positive target market to the manufacturer, **<u>as long as they are not made within the negative target market</u>.** ~~if these sales are for diversification and hedging purposes and if these sales are still suitable given the client's total portfolio or the risk being hedged.~~

55. Sales of products into the negative target market should always be reported to the manufacturer ~~and disclosed to the client~~, even if those sales are for diversification or hedging purposes. Moreover, even if for diversification purposes, sales into the negative target market should be a rare occurrence (see also paragraphs 67-74).

Regular review by the manufacturer and distributor to respectively assess whether products and services are reaching the target market

(…)

59. In relation to the reporting of information on sales outside the manufacturer's target market, distributors should be able to report any ~~decisions they have taken to sell outside the target market or to broaden the distribution strategy recommended by the manufacturer and information on sales made outside the target market (including~~ sales within the negative target market~~), taking into account the exceptions as noted in paragraph 54~~.

(…)

V.4. Guidelines on issues applicable to both manufacturers and distributors

Identification of the "negative" target market and sales outside the positive target market

(…)

74. Deviations from the target market ~~(outside the positive or~~ within the negative) which may be relevant **<u>in the distributor's opinion</u>** for the product governance process of the manufacturer (especially **<u>if</u>** ~~**those that**~~**<u>they</u>** are recurrent) should be reported to the manufacturer ~~taking into account the exceptions as noted in paragraph 54~~.

<u>Manufacturers that have used their best endeavours to obtain this information from their distributors, but despite such endeavours have not received any reports in this respect, may validly assume that no sales have been made outside or that such sales are not sufficiently relevant to report.</u>

These proposals address the following needs: - to apply the rules in a proportionate manner to the passive distributor (and in particular to require only the first two criteria of the target market to be taken into account, i.e. (1) client category and (2) knowledge and experience); - to simplify the reporting of sales outside the target market and take into account the principle of proportionality to a greater degree; - to remove the obligation to alert the client in the event of a sale into the negative target market.

Application of the target market requirements to firms dealing in wholesale markets (i.e. with professional clients and eligible counterparties)

Professional clients and eligible counterparties as part of the intermediation chain

75. The requirements set out in Article 16(3) MiFID II **<u>do not</u>** apply ~~irrespective of the nature of the client (retail, professional or~~ to eligible counterpart~~y~~**<u>ies</u>**).

(…)

The rest of these paragraphs will have to be revised to reflect the addition of Article 16(3) to the exclusions set out in Article 30 of the Level 1 text. This paragraph and the following ones must in any event be amended to take account of the Quick Fix which has excluded from the scope of Product Governance requirements financial instruments that are marketed exclusively to **eligible counterparties** or distributed exclusively to eligible counterparties (*<u>MiFID II Quick Fix, Article 16a</u>*).

2. INDUCEMENTS REGIME

PRIORITIES AND SUMMARY OF PROPOSED AMENDMENTS TO LEVEL 1

(1) Maintain the legitimacy of inducements
(2) Align costs and charges disclosures with those required for inducements

- See amendments to new Article 29a(1) introduced by the Quick Fix

Ensure that disclosure exemptions are consistent with the costs and charges regime

The new article 29a as written in the latest version of the Quick Fix provides that the obligations regarding costs and associated charges laid down in point (c) of Article 24(4), "*shall not apply to services provided to professional clients except for investment advice and portfolio management*."

In accordance with Article 50 of MiFID II Delegated Regulation 2017/565, which governs information on costs and associated charges, communication on inducements paid or received[26] is a "standard" element of disclosures to clients on all costs and associated charges. This information on inducements will no longer need to be disclosed to professional clients and eligible counterparties under this new Article 29a(1) of MiFID II. However, Article 24(9) of MiFID II still requires the disclosure of such inducements under the client information regime provided for by MiFID II.

For reasons of consistency, AMAFI proposes to **amend Article 29a(1) to specify that information on inducements is required insofar as information on costs and charges is required.**

The disclosure of information on inducements to clients will in any event continue to apply under the conflicts of interest regime, as provided for in Article 23 of MiFID II, which has not been impacted by the Quick Fix (i.e. it has been kept unchanged to date).

The legitimacy of inducements needs to be maintained under the conditions provided for by the current framework

AMAFI is very clear on the value of the inducements scheme, which is well-established in the European system and in the practice of French financial sector institutions.

This position is supported by the preliminary results of the market study carried out in 2021, which is expected to be released in the coming months.

AMAFI believes that the **current system is sufficiently robust to prevent conflicts of interest and poor marketing practices and recommends that the MiFID II rules on inducements in the context of product marketing should not be amended.**

[26] See MiFID II, Article 24(9). "*Inducements*" means any fee or commission paid or received, or any non-monetary benefit provided or received by an investment firm in connection with the provision of an investment service or an ancillary service, to or by any party, except the client or the person acting on behalf of the client.

Proposed amendments to the laws

Level 1 text

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") as amended by Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 ("Quick Fix")

Article 29a
Services provided to professional clients

1. The requirements laid down in point (c) of Article 24(4), **and in the second subparagraph of Article 24(9)** shall not apply to services provided to professional clients except for investment advice and portfolio management.

2. The requirements laid down in the third subparagraph of Article 25(2) and in Article 25(6) shall not apply to services provided to professional clients, unless those clients inform the investment firm either in electronic format or on paper that they wish to benefit from the rights provided for in those provisions.

3. Member States shall ensure that investment firms keep a record of the client communications referred to in paragraph 2.

The proposed amendment seeks to harmonise exemptions from disclosure requirements regarding costs and charges and regarding inducements.

3. Costs and Charges

Priorities and summary of proposed amendments to Level 1

- **No amendments to Level 1, other than those already confirmed by the Quick Fix**

Simplify and clarify the current regime
- See amendments to Article 50 of the MiFID II DR 2017/565

MiFID II (and in particular Articles 24(4)(c) of MiFID II and 50 of MiFID II DR 2017/565 - "MiFID II DR") requires ISPs to inform all investors[27], in a timely manner, of the costs and charges associated with the services provided and, where applicable, with the products marketed or recommended. An estimate of these expected costs must be provided to the client prior to the transaction or service provision (*ex-ante* information); this estimate must be supplemented by information on the costs actually incurred by the client and provided, at a minimum, annually when certain conditions are met (*ex-post* information).

AMAFI fully supports this obligation to inform investors, particularly retail investors, of the costs and charges incurred. Disclosure of costs is indeed absolutely essential for investor protection purposes. However, this obligation, as it is currently worded, is difficult to implement given the complexity caused by the number of parameters to be taken into account in identifying the obligation applicable to each situation. It does not take sufficient account of the principle of proportionality underlying MiFID II and the very heterogeneous levels of complexity between the various financial instruments.

This obligation, which has been difficult for ISPs to implement and which has not yet been stabilised, as evidenced by numerous ESMA question-and-answer publications, is, in AMAFI view, one of the priority topics for review for investor protection rules.

This is why the EC has questioned whether it is appropriate to ease the requirements to disclose costs and charges for services to wholesale clients, including eligible counterparties and professional clients. In its response (*AMAFI / 20-32*), which set out its own positions on this topic (*AMAFI /109*), AMAFI set out a comprehensive argument why the obligation to disclose costs and charges should not apply to services to wholesale clients. It also called for differentiated application for the costs of providing an execution service by telephone.

Finally, the new Article *29a* introduced by the Quick Fix states that investment firms shall be exempted from all costs and charges obligations for services provided to eligible counterparties and professional clients (except for investment advice and portfolio management) (*Article 29a*). For telephone orders, *ex ante* disclosure may be provided, by email or by post if requested by the retail client, without delay after the transaction (*Article 24 (4))*.

In conclusion, while the request for the disapplication of costs and charges disclosure requirements for wholesale clients has been adopted, as has the case of telephone orders, there are other issues related to the lack of proportionality (for the simplest products), the complexity of the system and its lack of harmonisation with PRIIPs that need to be highlighted and are discussed in detail below.

[27] With the exception of professional clients who are provided with services other than investment advice or portfolio management (*MiFID II, Article 29a*); and eligible counterparties (*MiFID II, Article 30(1)*). Indeed, with the latest version of the proposal for a directive of the European Parliament and of the Council amending MiFID II as regards information requirements, product governance and position limits of 15 December 2020 ("Quick Fix"), further relief from the requirement provided for in Article 24(4)(c) of MiFID II were introduced by the Quick Fix in a new Article 29*a* (*Services provided to professional clients*) and through a redrafting of the first subparagraph of Article 30(1) (*Transactions with eligible counterparties*) of MiFID II (i.e. full exemption from costs and charges disclosure requirements for services provided to eligible counterparties and professional clients (except for investment advice and portfolio management).

Proportionality for the simplest products (tariff grids)

To ensure effective protection for retail clients and professional clients to whom advisory and management services are provided, without imposing requirements on ISPs that do not add any value, it seems appropriate to introduce greater proportionality in the implementation of these information obligations depending on the type of financial instruments and the complexity of the product.

Indeed it would make sense to provide information on a trade-by-trade basis where the product is complex and the investor is non-professional but disproportionate when the product is very simple and the costs are substantially the same from one trade to another. In this latter situation, information provided through a tariff grid, rather than on a trade-by-trade basis, would be one way of meeting this requirement for proportionate transparency.

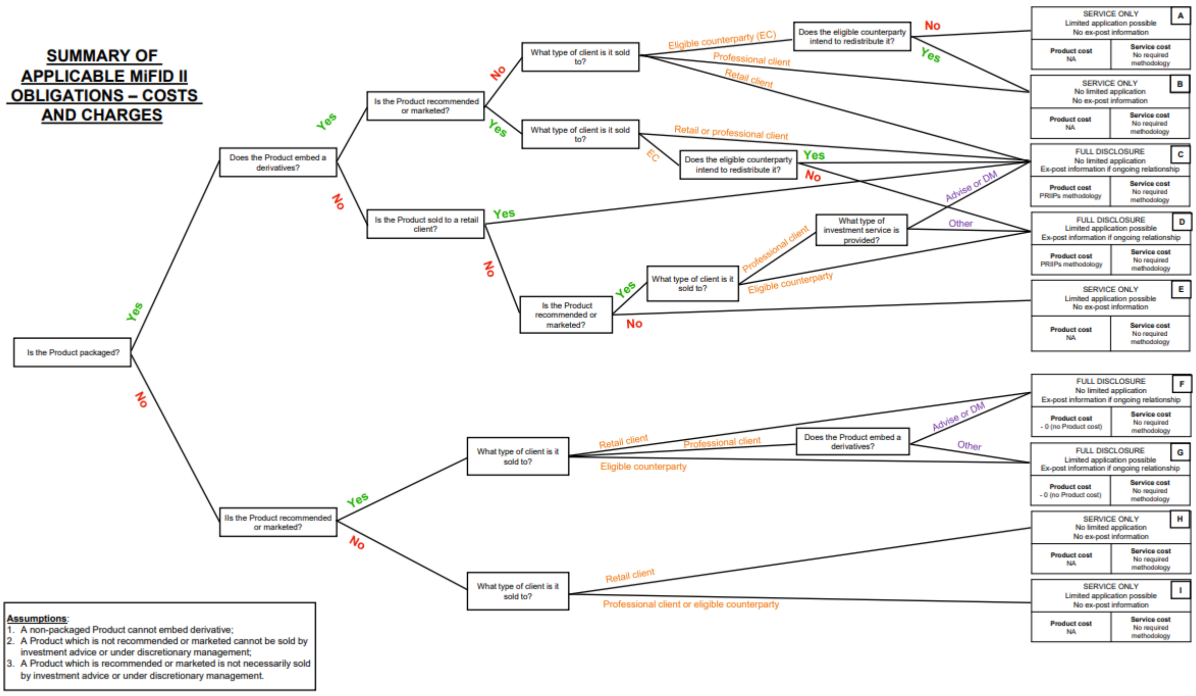
Therefore, AMAFI proposes to **amend Article 50 of the MiFID II DR to recognise in the Level 2 text the legitimacy of using tariff grids for simple financial instruments**.

Simplification and clarification of the system

As it is currently drafted, Article 50 of the MiFID II DR is difficult to understand because of the need to link several regimes that cannot be superimposed:

1. *ex-ante* information: total (i.e. both service and product costs) or only service costs;
2. *ex-post* information; and
3. limited application.

As illustrated in the diagram below (which reflects the current content of Article 50 of the MiFID II DR, without prejudging any amendments already introduced by the Quick Fix, this means having to differentiate between nine situations, which seems difficult to implement and disproportionate given the objectives pursued.



Therefore, it seems appropriate to simplify this system for both *ex-ante* and *ex-post* information.

For *ex-ante* information, AMAFI proposes a two-tier regime:

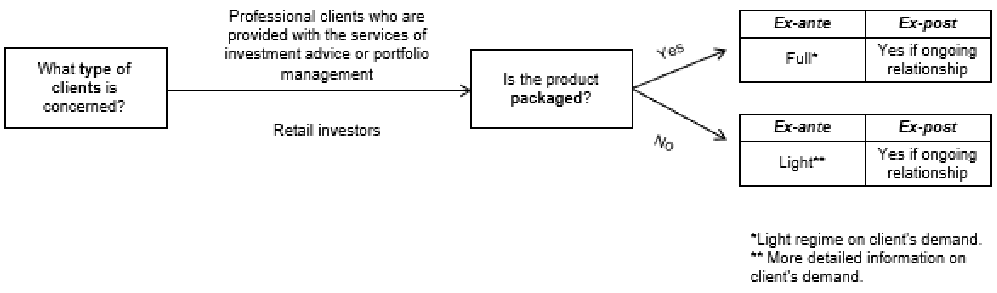
- "Full" regime: **disclosure on both product costs and service costs on a trade-by-trade basis**;
- "Proportionate" regime: **disclosure only on service costs through a tariff grid**. This tariff grid should be broken down by asset class; the amounts shown in it may be fixed amounts or, where applicable, ranges or maximum amounts (provided that the latter reflect the economic reality of the costs as closely as possible). This grid, which must be sufficiently granular to reflect the activities of the ISP, must be communicated at the time of entering into the relationship or concluding the first transaction. It must be updated at least annually.

These regimes would be applicable according to the types of customers and products involved:

- Full regime: where the product is a **packaged product** within the meaning of the PRIIPs Regulation[28], regardless of the service provided;
- Proportionate regime: where the product **is not a packaged product** within the meaning of the PRIIPs Regulation, regardless of the service provided unless the client has requested more detailed information.

The obligation to provide *ex-post* information should be limited solely to investors who have an "**ongoing relationship**" with the ISP. Taking into account the feedback on this topic, it seems important to clarify the scope of the "ongoing relationship" to limit it to the provision of truly "ongoing" investment services: ongoing advice that involves providing a periodic assessment of suitability, portfolio management and safekeeping services.

This proposal for simplification, which would differentiate between two situations (versus nine currently), is illustrated in the diagram below.



The following proposed amendments to Article 50 of the MiFID II DR **are intended to achieve this simplification**

[28] An investment, including instruments issued by special purpose vehicles as defined in point (26) of Article 13 of Directive 2009/138/EC or securitisation special purpose entities as defined in point (an) of Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council where, regardless of the legal form of the investment, the amount repayable to the investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor.

The confusion created by the "impact of aggregate costs on return"

The current Article 50(10) of MiFID II DR 2017/565 requires ISPs to provide their clients with an illustration of the impact of aggregate costs on return. Experience shows that this concept (also used in the current PRIIPs KID) is not well understood by investors, especially retail investors.

In line with the current European-wide discussions questioning the presentation of the effect of aggregate costs in PRIIP KIDs, it seems opportune to **remove this requirement** from MiFID II, as it creates more confusion than transparency for retail investors.

Methodology for calculating product costs

It seems inappropriate to import the PRIIPs cost methodology into MiFID II to calculate the costs of all financial instruments. Indeed, while it seems consistent to allow ISPs to use the cost information contained in the PRIIPs KIDs to disclose the product cost information required under MiFID II where the product is within the scope of PRIIPs (i.e. packaged products made available to retail investors), it does **not seem acceptable to require ISPs to use the cost methodology set out in the PRIIPs regulations** when the transaction is out of scope. MiFID II must not bring into the scope of PRIIPs products and/or transactions that were not initially included in it.

Additionally, for situations covered by both PRIIPs and MiFID II, AMAFI considers that the methodology used to present costs in PRIIPs KIDs should be changed to a Total Expense Ratio (TER) approach, which then enables the addition of service costs. Indeed, the current PRIIPs KID methodology, which looks at the impact on yield (Reduction in Yield or RiY method) leads to inconsistencies in the figures disclosed to investors in PRIIPs KIDs and the required disclosures under MiFID II (*see AMAFI /19-54 "AMAFI Position on PRIIPs KID revision"*)

Proposed amendments to the laws

Level 2 text

Article 2 of MiFID II Delegated Regulation 2017/565
Definitions

(…)

7) "packaged financial instruments": an investment, including instruments issued by special purpose vehicles as defined in point (26) of Article 13 of Directive 2009/138/EC or securitisation special purpose entities as defined in point (an) of Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council (2) where, regardless of the legal form of the investment, the amount repayable to the investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor.

(…)

Article 50 of MiFID II Delegated Regulation 2017/565
Information on costs and associated charges

1. For the purposes of providing information to **retail clients and professional** clients **who are provided with the services of investment advice or portfolio management** on all costs and charges pursuant to Article 24(4) of Directive 2014/65/EU, investment firms shall comply with the detailed requirements in paragraphs 2 to 10.

~~Without prejudice to the obligations set out in Article 24(4) of Directive 2014/65/EU, investment firms providing investment services to professional clients shall have the right to agree to a limited application of the detailed requirements set out in this Article with these clients. Investment firms shall not be allowed to agree such limitations when the services of investment advice or portfolio management are provided or when, irrespective of the investment service provided, the financial instruments concerned embed a derivative.~~

~~Without prejudice to the obligations set out in Article 24(4) of Directive 2014/65/EU, investment firms providing investment services to eligible counterparties shall have the right to agree to a limited application of the detailed requirements set out in this Article, except when, irrespective of the investment service provided, the financial instruments concerned embed a derivative and the eligible counterparty intends to offer them to its clients.~~

When providing investment services to retail clients, investment firms shall comply with the requirements of paragraph 2, unless the financial instruments concerned are not packaged financial instruments. In the latter situation, investment firms shall comply with the requirements of paragraph 3 unless the retail client requests more detailed information.

2. For ex-ante and ~~ex-post~~ disclosure of information on costs and charges to clients, investment firms shall aggregate the following:

   a) all costs and associated charges charged by the investment firm or other parties where the client has been directed to such other parties, for the investment service(s) and/or ancillary services provided to the client; and
   b) all costs and associated charges associated with the manufacturing and managing of the financial instruments.

   Costs referred to in points (a) and (b) are listed in Annex II to this Regulation. For the purposes of point (a), third party payments received by investment firms in connection with the investment service provided to a client shall be itemised separately and the aggregated costs and charges shall be totalled and expressed both as a cash amount and as a percentage.

   Where any part of the total costs and charges is to be paid in or represents an amount of foreign currency, investment firms shall provide an indication of the currency involved and the applicable currency conversion rates and costs. Investments firms shall also inform about the arrangements for payment or other performance.

3. **Under the conditions provided for in paragraph 1, i**~~I~~nvestment firms ~~that do not recommend or market a financial instrument to the client or are not obliged to provide the client with a KID/KIID in accordance with relevant Union legislation~~, shall inform their clients about all costs and charges **only** relating to the investment and/or ancillary service provided.

   This information may be communicated to clients, at the time of entering into the relationship or concluding the first transaction, through tariff grids by asset classes, sufficiently granular according to the investment firm's activities.

   These tariff grids must be updated regularly and at least annually. The figures in this grid correspond to the best possible cost estimates and may, in some situations, correspond to the maximum costs and charges incurred by the client, provided that they are as close as possible to the actual costs to be incurred by the client.

4. In relation to the disclosure of product costs and charges that are not included in the UCITS KIID, the investment firms shall calculate and disclose these costs, for example, by liaising with UCITS management companies to obtain the relevant information.

5. ~~The obligation to provide in good time a full ex-ante disclosure of information about the aggregated costs and charges related to the financial instrument and to the investment or ancillary service provided shall apply to investment firms in the following situations:~~

   ~~a) where the investment firm recommends or markets financial instruments to clients; or~~
   ~~b) where the investment firm providing any investment services is required to provide clients with a UCITS KIID or PRIIPs KID in relation to the relevant financial instruments, in accordance with relevant Union legislation~~.

6. Where more than one investment firm provides investment or ancillary services to the client, each investment firm shall provide information about the costs of the investment or ancillary services it provides. An investment firm that recommends or markets to its clients the services provided by another firm, shall aggregate the cost and charges of its services together with the cost and charges of the services provided by the other firm. An investment firm shall take into account the costs and charges associated with the provision of other investment or ancillary services by other firms where it has directed the client to these other firms.

7. Where calculating costs and charges on an ex-ante basis, investment firms shall use actually incurred costs as a proxy for the expected costs and charges. Where actual costs are not available, the investment firm shall make reasonable estimations of these costs. Investment firms shall review ex-ante assumptions based on the ex-post experience and shall make adjustment to these assumptions, where necessary.

8. Investment firms shall provide **<u>retail and professional clients to whom the services of investment advice or portfolio management are provided</u>** with annual ex-post information about all costs and charges related to both the financial instrument(s) and investment and ancillary service(s) where they ~~have recommended or marketed the financial instrument(s) or where they have provided the client with the KID/KIID in relation to the financial instrument(s) and~~ they have or have had an ongoing relationship with the client during the year. Such information shall be based on costs incurred and shall be provided on a personalised basis.

   Investment firms may choose to provide such aggregated information on costs and charges of the investment services and the financial instruments together with any existing periodic reporting to clients.

   <u>An investment firm shall be considered to have an ongoing relationship with its client where it provides the client with the safekeeping service referred to in Section B(1) of Annex I of Directive 2014/65/EU, the portfolio management service referred to in Section A(4) of Annex I of Directive 2014/65/EU or a service that involves providing a periodic assessment of suitability within the meaning of Article 24(4) of Directive 2014/65/EU and Article 52 of this Regulation.</u>

9. ~~Investment firms shall provide their clients with an illustration showing the cumulative effect of costs on return when providing investment services. Such an illustration shall be provided both on an ex-ante and ex-post basis. Investment firms shall ensure that the illustration meets the following requirements:~~

   ~~a) the illustration shows the effect of the overall costs and charges on the return of the investment;~~
   ~~(b) the illustration shows any anticipated spikes or fluctuations in the costs; and~~
   ~~c) the illustration is accompanied by a description of the illustration.~~

These proposals for amendments address/reflect: - the amendments to the Level 1 text introduced by the Quick Fix; - the proposals to simplify the regime (full regime versus proportionate regime) depending on whether or not the product is a PRIIPs; - the wish to clarify the concept of ongoing relationship that triggers the *ex-post* disclosure requirement.

➢ *Level 3 text*

ESMA questions and answers document

In line with the amendments proposed by AMAFI in the Level 1 and 2 texts, it seems necessary to review certain questions and answers published by ESMA. The table below summarises AMAFI's position on each of the questions and answers published to date.

***"Costs and charges" section of ESMA Q&As on MiFID II investor protection topics*[29]**

Q&A	Amendments to be made?	Reasons
1	NA	
2	To be deleted	Removal of the obligation to disclose the cumulative effect of costs on return.
3	To be deleted	Removal of the obligation to disclose the cumulative effect of costs on return.
4	To be retained	
5	To be retained	
6	To be deleted	Removal of the importation of the PRIIPs cost methodology into MiFID II.
7	To be deleted	Removal of the importation of the PRIIPs cost methodology into MiFID II.
8	To be deleted	Removal of the importation of the PRIIPs cost methodology into MiFID II.
9	To be deleted	Removal of the importation of the PRIIPs cost methodology into MiFID II.
11	To be amended	Answer retained except for the part that imports the PRIIPs cost methodology into MiFID II.
12	To be deleted	Removal of the importation of the PRIIPs cost methodology into MiFID II.
13	To be amended	Need to specify that this question and answer only applies where trade-by-trade information ("full regime") is disclosed to the client.
14	To be retained	
15	To be deleted	Removal of the importation of the PRIIPs cost methodology into MiFID II.
16	To be retained	
17	To be deleted	Removal of the importation of the PRIIPs cost methodology into MiFID II.
18	To be deleted	This question and answer will no longer be relevant if AMAFI's proposals are adopted.
19	To be deleted	This question and answer will no longer be relevant if AMAFI's proposals are adopted.

[29] Questions and answers on MiFID II and MiFIR investor protection and intermediaries topics (*ESMA35-43-349*).

20	To be amended	Need to specify that this question and answer only applies where trade-by-trade information ("full regime") is disclosed to the client.
21	To be retained	
22	To be deleted	This question and answer will no longer be relevant if AMAFI's proposals are adopted.
23	To be deleted	This question and answer will no longer be relevant if AMAFI's proposals are adopted.
24 to 27	To be retained	
28	To be deleted	This question and answer will no longer be relevant if AMAFI's proposals on *ex-ante* disclosures for telephone orders is adopted.
29	NA	
30	To be deleted	This question and answer will no longer be relevant if the two regimes proposed by AMAFI are adopted.
31, 32 and 33	To be retained	

"Other issues" section of ESMA Q&As on MiFID II investor protection topics[30]

Q&A	Amendments to be made?	Reasons
1	To be deleted	The concept of "ongoing relationship" should be clarified by an exact reference to the relevant investment services. This question and answer would therefore no longer be relevant.

[30] *Questions and answers on MiFID II and MiFIR investor protection and intermediaries topics* (ESMA35-43-349) - latest version dated 21 December 2021.

4. OPT-IN PROCEDURE

PRIORITIES AND SUMMARY OF PROPOSED AMENDMENTS TO LEVEL 1

Review of the opt-in procedure
- See amendments to Annex II of MiFID II

As reported by AMAFI in its response to the European Commission's consultation on the MiFID II refit *(AMAFI / 20-32)*, several issues have been identified concerning the opt-in procedure as currently defined in Annex II of MiFID II ("Annex").

Specifically, the "non-professional clients" category covers a large variety of client profiles: some of these clients are in a strong financial position and have a very good knowledge of the financial markets while others have few resources or a very limited knowledge of the financial markets. This heterogeneity raises several issues.

Firstly, the current categorisation may in some cases prevent access to certain products (i.e. those designed for professional clients and eligible counterparties). This is the case for wealth management or private banking clients who may have a good (or very good) knowledge of the financial markets and a significant amount of money to invest (to diversify their portfolios) but who do not have access to sophisticated products (such as private equity funds or hedge funds).
Secondly, this situation also poses problems with certain corporate clients, which do not meet the criteria of professional clients per se, but sometimes carry out a large number of transactions, particularly for hedging purposes. For example, since these clients are considered non-professional investors, investment firms must provide them with a "suitability report" pursuant to Article 25(6) of MiFID II for each transaction, even though the transactions may be very similar, which is time-consuming.

More generally, the retail investor protection rules under MiFID II are very restrictive and, while they are generally well-suited to retail clients with low-to-intermediate knowledge, AMAFI considers them to be overly burdensome and restrictive for these more sophisticated clients.

AMAFI believes the most appropriate solution to this issue would be the ability to treat these clients as "elective" professional clients. However, feedback shows that the current opt-in procedure[31] too often prevents this for the reasons discussed below, which is why AMAFI is proposing **a review of the procedure**.

As a reminder, this opt-in procedure requires the ISP to verify that the client meets at least two of the three criteria set out in the Annex, i.e. that the client has carried out a minimum number of transactions, meets the minimum portfolio size requirements and works or has worked in the financial sector.

Unfortunately, experience shows that this opt-in procedure is very onerous and is difficult to comply with in reality:
- firstly, the current wording of the legislation limits the possibility for ISPs to offer this solution to their clients, since the request must come from the client, which is a difficult requirement in practice;
- secondly, the combination of criteria that clients must partly fulfil are in fact fairly hard to come by, which limits the ability to opt-in to professional client status in practice.

Finally, the wording of the procedure in the Annex is ambiguous as to whether the legal entity itself or the natural person representing it should be assessed on the basis of these criteria.

[31] As specified in paragraph II.2 of Annex II of MiFID II.

Amend the conditions for implementing the procedure

Firstly, it is specified that this procedure must be initiated solely at the client's request and not be prompted by the ISP. However, for obvious reasons, very few clients will take the initiative to request this change in treatment, first and foremost because they are unaware of this provision in the regulations and because they are categorised when they first enter into a relationship with the ISP and not upon each transaction. This condition is at odds with the operational reality of customer relations.

AMAFI proposes to simplify the process for changing categories by **enabling ISPs to propose this option**. Obviously, all clients must then be free to decide whether or not to request this differential treatment.

Review the opt-in criteria

The criteria currently proposed, which must be partly met in order to be eligible for this differential treatment, are difficult to achieve in practice, which undermines ISP's ability to effectively implement the procedure. AMAFI therefore proposes to review these criteria to make them more operational but still restrictive enough to ensure that the option is reserved for "sophisticated" clients.

Criterion 1: the client has carried out an average of 10 transactions of a significant size per quarter in the past year

The first criterion, which requires the client to have carried out an average of 10 transactions of a significant size per quarter over the previous four quarters, poses several problems: it limits the possibility of being treated as a professional client on "new" products and the fixed number of transactions to be carried out is not suited to the specific characteristics of certain products.

Indeed, question and answer 11.4 of ESMA's Q&A on investor protection[32] states that the significant size of these transactions must be assessed with regard to the specificities of the product concerned, which tends to indicate that the 10 transactions must involve the type of product for which the client wishes to be treated as an "elective" professional client. However, the client may not have any products of that type in the portfolio since professional client status is required for such products. At the same time, to be treated as a professional client for these products, the client must have already traded in them.

Furthermore, for certain asset classes such as private equity, the requirement to carry out 10 transactions per quarter is completely disproportionate and perhaps unrealistic. The use of this rule to classify clients as "professionals" for all asset classes also raises questions: in such a situation, how do we verify compliance with this criterion across all asset classes, especially at the onboarding stage.

Furthermore, from an operational standpoint, rather than referring to the number of transactions carried out per quarter, it seems more appropriate to look at the "annual" frequency, particularly for clients who only submit orders at certain times of the year.

Finally, in order to maintain a sufficient level of protection and ensure that only "sophisticated" non-professional clients may be treated as professional clients, we might consider asking clients to complete a special expanded questionnaire to check that they have the necessary knowledge (through personal experience or through the transfer of knowledge from their ISP) to understand the risks and complexity of the new types of products that they would have access to.

[32] Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics (link).

AMAFI proposes to review this criterion to allow transactions to be carried out on other asset classes and, in particular, to give clients access to new products.
It also proposes adapting the required number of transactions to the specific characteristics of each asset class, based on an average frequency per year rather than per quarter.
Lastly, this modified criterion could be combined with or replace a more qualitative approach to substantiate the client's experience through greater reliance on the client's actual knowledge (whether gained from personal experience or from training delivered by the ISP) and which could then be verified using a special expanded questionnaire.

Criterion 2: size of the client's financial portfolio

The second criterion requires the client to hold a portfolio of financial instruments of more than €500,000. Only cash deposits and financial instruments can be included in the calculation. AMAFI considers this to be overly restrictive; it excludes, for no apparent reason, investments with similar characteristics such as life insurance policies, employee savings plans and retirement savings plans.

AMAFI proposes that this criterion be reviewed to broaden the valuation of the client portfolio to include all financial vehicles and in particular life insurance policies, employee savings plans and retirement savings plans.

Criterion 3: employment in the financial sector

The third criterion states that the client must have worked in the financial sector for at least one year. This criterion is too restrictive. It excludes a number of professional clients who nevertheless have a high level of financial knowledge. For example:

- people with higher training in Finance;
- persons who hold positions in industry requiring advanced financial knowledge (chief financial officers and company directors, for example).

As in the previous proposal (*see criterion 1*), a dedicated questionnaire for "sophisticated" products could be created to check the knowledge and experience of these clients. This questionnaire would be produced by each ISP so that it could be adapted to the firm's particular products and services.

AMAFI proposes to expand the scope of accepted roles to include, for example, people with higher training in finance and/or professional positions in industry that require financial skills. As in criterion 1, this expansion may be tied to a new obligation to complete a special expanded questionnaire.

AMAFI's proposals for changes to the criteria for the opt-in procedure may be summarised as follows:

Opt-in criteria	Annex II of MiFID II	AMAFI Proposals
1) Number of transactions that need to have been carried out	Transactions, in significant size, at an average frequency of 10 per quarter over the past year	- Adapt the average frequency/number of transactions during the past year according to the specific features (type/category) of each asset class
2) Size of the client's financial portfolio - amount in euros (threshold) - scope	- €500,000 - Investments in financial instruments	- €500,000 - Investments in financial instruments, life insurance products, employee savings plans and retirement savings plans
3) Employment in the financial sector	The client works (or has worked) in the financial sector for at least one year	- The client works in the financial sector or has undergone higher training in finance and/or holds professional positions in industry requiring financial expertise - Anyone who has completed a special expanded questionnaire
Number of criteria to be met (minimum)	2 out of 3	2 out of 3

- **Do not differentiate between "elective" professional clients and "per se" professional clients**

Considering that only "sophisticated" clients are eligible to become professional clients, the current differentiation in the legislation between "elective" professional clients and "per se" professional clients, which is difficult to manage from an operational point of view, no longer seems relevant.

This differentiation is underpinned by the following sentence: "*Those clients shall not, however, be presumed to possess market knowledge and experience comparable to that of the categories listed in Section I.*" (*MiFID II, Annex II, II. (II.1. Identification criteria), §2*). However, if, as proposed by AMAFI, in order to be treated as professional clients, non-professional investors must pass a test enabling the ISP to ensure that they have sound financial knowledge, the test will ensure that the client has comparable knowledge and experience of the market to professional clients. Therefore, both the original presumption and the principle of maintaining a difference in treatment between elective professional clients and per se professional clients are no longer relevant.

This differentiation is also extremely complex to manage in IT systems and, in fact, creates a sub-category within the category of professional clients, which was not the original goal of the opt-in procedure.

AMAFI proposes that ISPs be subject to the **same obligations when dealing with both per se and elective professional clients.**

Clarify the rules for assessing legal entity clients

AMAFI has noted that the wording of the current text is ambiguous as to whether the legal entity itself or the natural person representing it should be assessed on the basis of these criteria.

Indeed, while there is little doubt that the third criterion can only refer to the natural person representing the legal entity, the answer is less obvious for the first criterion and counterintuitive for the second criterion. It would therefore be useful to amend the text to clarify this point.

AMAFI's view is as follows:
- The person who must demonstrate appropriate experience through a sufficient number of transactions is/should be the natural person representing the legal entity;
- The financial instruments portfolio (whose size must exceed €500,000) is that managed by the natural person representing the legal entity (but not necessarily the portfolio belonging to this natural person);
- The financial training or professional occupation is necessarily that of the natural person representing the legal entity.

In addition, the clarification made in the fourth paragraph of the Annex that the assessment relates to the natural person representing the legal entity client should be extended to all companies and municipalities/local public authorities, and not only to "small entities".

Proposed amendments to the laws

Level 1 text

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")

ANNEX II

II. CLIENTS WHO MAY BE TREATED AS PROFESSIONALS ON REQUEST

II.1. Identification criteria

Clients other than those mentioned in section I, including public sector bodies, local public authorities, municipalities and private individual investors, may also be allowed to waive some of the protections afforded by the conduct of business rules.

Investment firms shall therefore be allowed to treat any of those clients as professionals provided the relevant criteria and procedure mentioned below are fulfilled. ~~Those clients shall not, however, be presumed to possess market knowledge and experience comparable to that of the categories listed in Section I.~~

Any such waiver of the protection afforded by the standard conduct of business regime shall be considered to be valid only if an adequate assessment of the expertise, experience and knowledge of the client, undertaken by the investment firm, gives reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making investment decisions and understanding the risks involved.

The fitness test applied to managers and directors of entities licensed under Directives in the financial field could be regarded as an example of the assessment of expertise and knowledge. In the case of ~~small~~ entities**, and of municipalities and local public authorities**, the person subject to that assessment shall be the person authorised to carry out transactions on behalf of **t**~~hat~~**ose entities**.

In the course of that assessment, as a minimum, two of the following criteria shall be satisfied:

~~—the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;~~
the client shows appropriate experience by having carried out a sufficient number of transactions in financial instruments for the nature of the services and transactions envisaged.

—the size of the ~~client's~~ financial instrument portfolio **managed by the client**, defined as including cash deposits **life insurance products and employee savings or retirement plans** and financial instruments exceeds EUR 500,000;

—the client **has undergone higher training in the area of finance or works or has worked in an industry requiring financial expertise for at least one year in a professional position**, which requires knowledge of the transactions or services envisaged.

Member States may adopt specific criteria for the assessment of the expertise and knowledge of municipalities and local public authorities requesting to be treated as professional clients. Those criteria can be alternative or additional to those listed in the fifth paragraph.

II.2. Procedure

Those clients may waive the benefit of the detailed rules of conduct only where the following procedure is followed:

—they must state in writing to the investment firm, **if applicable at the proposal of the investment firm**, that they wish to be treated as a professional client, either generally or in respect of a particular investment service or transaction, or type of transaction or product;

—the investment firm must give them a clear written warning of the protections and investor compensation rights they may lose;

—they must state in writing, in a separate document from the contract, that they are aware of the consequences of losing such protections.

Before deciding to accept any request for waiver, investment firms must be required to take all reasonable steps to ensure that the client requesting to be treated as a professional client meets the relevant requirements stated in Section II.1. **Investment firms may ascertain this by asking the client to complete a special evaluation questionnaire.** (…)

These amendments are intended to reflect the proposals for amendments to the opt-in procedure.

5. Best execution: deletion of the reports required under RTS 27 and RTS 28

Priorities and summary of proposed amendments to Level 1

Deletion of RTS 28 and 27 reports
- See amendments to Article 27 of MiFID II

Deletion of reports required under RTS 28 and 27

The Quick Fix provides that the requirement under the old RTS 27[33] for investment firms, trading venues and liquidity providers to submit reports on the quality of execution of transactions (i.e. best execution reports) is suspended for two years from the date of entry into force of the MiFID II Amending Directive (*MiFID II Quick Fix, Article 27(3)*), i.e. from 27 February 2021 to 28 February 2023. The EC considers that the cost/benefit ratio of the RTS 27 reporting is insufficient and proposes to suspend this obligation. It will have to submit a report to the European Parliament and the Council on the relevance of this RTS within one year of the date of entry into force of the Quick Fix (*MiFID II Quick Fix, Article 27(3), i.e. by 28 February 2022*).

The Quick Fix further provides that the EC shall also submit a report on the appropriateness of the requirement under the old RTS 28[34] for investment firms to provide best execution reports on the top five execution platforms within one year of the entry into force of the Directive (*MiFID II Quick Fix, Article 27(6), i.e. by 28 February 2022*).

AMAFI is surprised, however, that the EC did not include the reports required under RTS 28 in the suspension of the obligation to issue the reports required under RTS 27 given that the same criticisms regarding the former were made in the response to the EC consultation held in March 2020 (see *AMAFI / 20-32, pp. 44 and 45*).

Based on practical and operational feedback from its members, AMAFI has found that the execution reports required under RTS 28 are not really taken into consideration by the clients of investment firms. AMAFI believes that these best execution reports cannot be considered to be "useful information" for investors since they do not factor them into their decisions. In practice, wholesale investors – particularly large institutions – already have their own trading cost analysis tools for their own analysis. Buy-side investment firms receive all relevant information through other channels (e.g. brokerage meetings). Lastly, these reports seem too technical to be properly understood by and useful for retail clients.

Therefore, AMAFI **proposes to remove the best execution and quality of execution reports** required respectively under Article 27(6) of MiFID II and the old RTS 28 and Article 27(3) of MiFID II and the old RTS 27.

[33] Commission Delegated Regulation (EU) 2017/575 of 8 June 2016 supplementing MiFID II with regard to regulatory technical standards concerning the data to be published by execution venues on the quality of execution of transactions (link), formerly "RTS 27" ("RTS" refers to "regulatory technical standards").
[34] Commission Delegated Regulation (EU) 2017/576 of 8 June 2016 supplementing MiFID II with regard to regulatory technical standards for the annual publication by investment firms of information on the identity of execution venues and on the quality of execution (link), formerly "RTS 28".

Proposed amendments to the laws

Article 27 of MiFID II as amended by Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 ("Quick Fix")

Obligation to execute orders on terms most favourable to the client

(…)

~~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.~~
~~The periodic reporting requirement to the public laid down in this paragraph shall not apply until 28 February 2023. The Commission shall comprehensively review the adequacy of the reporting requirements laid down in this paragraph and submit a report to the European Parliament and the Council by 28 February 2022.~~

(…)

~~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.~~
~~The Commission shall comprehensively review the adequacy of the periodic reporting requirements laid down in this paragraph and submit a report to the European Parliament and the Council by 28 February 2022.~~

These proposals for amendments aim to reflect the request to remove the best execution reports required under Article 27, paragraphs 3 and 6 of MiFID II and described in detail in the old RTS 27 and RTS 28.

6. Intervention measures

Priorities and summary of proposed amendments to Level 1

Clarify the link between European and national measures and strengthen consultation requirements

- See amendments to Article 40 of MiFIR

Clarify the link between European and national measures and strengthen consultation requirements

Pursuant to Article 40 of MiFIR[35], ESMA may take temporary intervention measures to prohibit or restrict the marketing of certain financial instruments. As the name suggests, these restrictions are meant to be "temporary" and may be imposed for a maximum period of three months (*MiFIR, Article 40(6)*). However, these measures are renewable and no limit is set on the number of possible renewals (ESMA's website states: *"There is no limit to the number of times ESMA could renew product intervention measures"*).

At the same time, competent authorities also have the option of taking intervention measures to prohibit or restrict the marketing of certain financial instruments (*MiFIR, Article 42*).

Therefore, an investment firm may be subject to two similar but not totally identical measures: a measure adopted by ESMA and a measure adopted by the regulator of the Member State in which it markets its products.

AMAFI acknowledges that the principle of adopting intervention measures is legitimate and beneficial in order to properly protect retail investors, especially in light of the very aggressive marketing practices that have developed in recent years with respect to certain particularly risky products. Nevertheless, it also considers that the fact that different intervention measures may potentially coexist indefinitely is not justified and creates legal uncertainty for financial operators.

Accordingly, AMAFI proposes **that if a Member State has implemented national measures equivalent to measures that ESMA has published and recognised, ESMA's measures should cease to apply in that Member State**, thereby avoiding the coexistence of divergent measures[36].

Moreover, given the temporary and exceptional nature of this power of intervention granted to ESMA, it seems indispensable that **ESMA consult the various stakeholders** affected by its intervention measures before implementing them or deciding to renew them.

[35] Regulation (EU) N° 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) N° 648/2012 (link), known as "MiFIR".
[36] MiFIR Article 40(7) only resolves the situation where a competent authority has implemented national measures prior to those adopted by ESMA.

Proposed amendments to the laws

Article 40 of MiFIR
ESMA temporary intervention powers

(…)

3. When taking action under this Article, ESMA shall ensure that the action:

a) does not have a detrimental effect on the efficiency of financial markets or on investors that is disproportionate to the benefits of the action;

b) does not create a risk of regulatory arbitrage; and

c) has been taken after consulting the **different stakeholders who would be affected by this decision, in particular competent authorities, investors and investment firms** ~~public bodies competent for the oversight, administration and regulation of physical agricultural markets under Regulation (EC) No 1234/2007, where the measure relates to agricultural commodities derivatives~~.

Where a competent authority or competent authorities have taken a measure under Article 42, ESMA may take any of the measures referred to in paragraph 1 without issuing the opinion provided for in Article 43.

(…)

6. ESMA shall review a prohibition or restriction imposed under paragraph 1 at appropriate intervals and at least every three months. If the prohibition or restriction is not renewed after that three-month period it shall expire.

Before any renewal, the stakeholder consultation laid down in paragraph 3(c) shall also be carried out.
Prohibitions or restrictions imposed pursuant to paragraph 1 and any extensions thereof shall cease to apply to Member States that have implemented similar national provisions approved by ESMA.

(…)

These proposals for amendments are intended to:
- strengthen consultation requirements;
- improve coordination of national measures and those adopted by ESMA.

7. ARTICLE 62(2): 10% ALERT ("ON LOSSES")

PRIORITIES AND SUMMARY OF PROPOSED AMENDMENTS TO LEVEL 1

- **No amendments to Level 1**

Clarify the current regime – exclude derivative financial instruments used for hedging purposes

- See amendments to Article 62(2) of the MiFID II DR

Exclusion of hedging derivatives from the scope and need for clarifications

Article 62(2) of MiFID II Delegated Regulation 2017/565 ("MiFID II DR") requires ISPs that "*hold a retail client account that includes positions in leveraged financial instruments*" to warn the client where the initial value of these instruments depreciates by 10% (and at each multiple of 10%). Three cumulative conditions must be met for this obligation to apply:

(1) Having a non-professional client;
(2) Holding an account for that client;
(3) Such account includes a "leveraged" financial instrument.

The drafting of condition (1) does not require any comment.

In contrast, the scope of conditions (2) and (3) raises several questions:

- What does "holding a retail client account" refer to?
- Under what circumstances should a financial instrument be considered to be *"leveraged"* within the meaning of Article 62(2) of MiFID II DR? In particular, should a financial instrument marketed for hedging purposes only be considered to be leveraged?

AMAFI therefore proposes to take advantage of the MiFID II revision project to **clarify these issues**.

First, AMAFI proposes to clarify the meaning of "holding an account".

Secondly, AMAFI **proposes to exclude financial instruments marketed solely for hedging purposes from the scope of this obligation**. The very function of a financial instrument used for hedging purposes is to reduce or eliminate an underlying risk, in particular in relation to the business activities of non-professional investors. Therefore, a financial instrument marketed to a client solely for hedging purposes does not increase that client's exposure to the underlying risk but, instead, reduces or eliminates that risk. Furthermore, in this situation, warning clients could lead them to take an investment decision that is contrary to their original objective. Although the "value" of the financial instrument may fluctuate over time, this does not impact the amount of the hedge as defined at the time the investment is made. So long as the hedged risk continues to be hedged it does not seem productive to warn retail investors of changes in the value of their hedge. If an investor were to reduce his position after receiving a warning, he would put himself at risk with regard to his original hedging objective, which, in principle, would not be in his interest.

Lastly, AMAFI is asking for **clarification at Level 3 of the criteria that will determine whether a financial instrument is considered leveraged and therefore covered** by this obligation.

Proposed amendments to the laws

Level 2 text

Article 62 of MiFID II Delegated Regulation 2017/565
Additional reporting obligations for portfolio management or contingent liability transactions

(…)

2. Investment firms that hold a retail client account that includes positions in leveraged financial instruments or contingent liability transactions, **<u>unless such instruments have been marketed or such transactions have been carried out solely for risk hedging purposes,</u>** shall inform the client where the initial value of each instrument depreciates by 10% and thereafter at multiples of 10%. Reporting under this paragraph should be on an instrument-by-instrument basis, unless otherwise agreed with the client, and shall take place no later than the end of the business day in which the threshold is exceeded or, in a case where the threshold is exceeded on a non-business day, the close of the next business day.

(…)

Level 3 text

ESMA questions and answers document

"Post-sale reporting" section of the ESMA Q&A on MiFID II investor protection topics[37]

Question 11 [Last update: 23 March 2018]
What does "hold a retail client account" mean in the context of Article 62(2) of the MiFID II Delegated Regulation?

Answer 11
The phrase "hold a retail client account" could be understood as:
• providing the ancillary service of (1) Section B of Annex 2 of MIFID II of safekeeping and administration of financial instruments for the account of retail clients, or;
• holding an account intended for registering the client's transactions on financial instruments (in the context of an investment service provided to a retail client)
<u>Unless these financial instruments were marketed or the client's transactions were made for the sole purpose of hedging underlying risks.</u>

[37] Questions and answers on MiFID II and MiFIR investor protection and intermediaries topics (*ESMA35-43-349*).

8. Suitability assessment

Priorities and summary of proposed amendments to Level 1

- **No amendments to Level 1 or Level 2**

Required adjustments in the ESMA Suitability Guidelines (Level 3)

- See deletion of Guideline 7 and amendments to § 81 and 91

Redundancy/contradiction with the Product Governance regime

As it made known when the Guidelines were being drafted, AMAFI strongly objects to Guideline 7 "Arrangements necessary to understand investment products" of ESMA's Guidelines on Suitability[38]. Since MiFID II entered into force, and contrary to MiFID I, issues of product knowledge applicable to the ISP that markets such products are now governed by the Product Governance framework and should therefore no longer be included in the Suitability framework.

This Guideline is especially detrimental since the requirements included in it are, at best, redundant and, at worst, in conflict with those of the Product Governance framework: for example, paragraph 72 requires that an investment firm that provides advice (a "distributor" for Product Governance purposes) obtain information on financial instruments from several data providers; however, the Product Governance provisions stipulate that the information to be considered is the information provided by the Manufacturer (i.e. a single data source).

AMAFI therefore proposes to **delete Guideline 7**.

Consideration of concentration risk

Paragraph 81 of ESMA's Guidelines on Suitability requires ISPs to take into account credit risks and, in particular, to verify that the client's portfolio does not have products issued by a single issuer or too few issuers ("concentration risk"). However, firstly, investment firms are not aware of all financial instruments their clients hold with other institutions, so this review of credit/concentration risk will only concern a portion of the client's assets and will be an incomplete review. Secondly, pursuant to the obligations on investor information and the drafting of sales documentation, investors are already fully informed that if they invest in product X they will be exposed to credit risk on issuer Y.

Therefore, AMAFI suggests that ESMA should recommend, as a best practice, that investment firms inform investors when, to their knowledge, investors' credit risk may be deemed overly concentrated. However, firms cannot be required to closely and systematically monitor this risk or to apply methodologies that include threshold mechanisms.

[38] ESMA guidelines on certain aspects of the MiFID II suitability requirements, dated 6 November 2018 (ESMA35-43-1163).

Goldplating on the suitability report

Paragraph 91 of ESMA's Guidelines on Suitability requires ISPs to include in the suitability report "*the reasons why the benefits of the recommended switch are greater than its costs*". However, Levels 1 and 2 of MiFID II do not impose any formal requirements as to the manner in which ISPs are to provide this information to non-professional clients.

As Level 3 cannot create additional obligations, AMAFI proposes that **this paragraph requiring that such information be included in the suitability report be deleted**.

Proposed amendments to the text

ESMA Guidelines on certain aspects of the MiFID II suitability requirements

(…)

Arrangements necessary to understand investment products
Relevant legislation: Articles 16(2) and 25(2) of MiFID II, and Article 54(9) of the MiFID II Delegated Regulation.

~~General guideline 7~~

(…)

I.I MATCHING CLIENTS WITH SUITABLE PRODUCTS
Arrangements necessary to ensure the suitability of an investment
Relevant legislation: Article 16(2) and 25(2) of MiFID II and Article 21 of the MiFID II Delegated Regulation.

General guideline 8

(…)

Paragraph 81

When a firm conducts a suitability assessment based on the consideration of the client's portfolio as a whole, it should ensure an appropriate degree of diversification within the client's portfolio, taking into account the client's portfolio exposure to the different financial risks**. If it deems that credit risk is overly concentrated on too few issuers, it shall inform the client.** ~~(geographical exposure, currency exposure, asset class exposure, etc.). In cases where, for example, from the firm's perspective, the size of a client's portfolio is too small to allow for an effective diversification in terms of credit risk, the firm could consider directing those clients towards types of investments that are "secured" or per se diversified (such as, for example, a diversified investment fund)~~.

~~Firms should be especially prudent regarding credit risk: exposure of the client's portfolio to one single issuer or to issuers part of the same group should be particularly considered. This is because, if a client's portfolio is concentrated in products issued by one single entity (or entities of the same group), in case of default of that entity, the client may lose up to his entire investment. When operating through so called self-placement models, firms are reminded of ESMA's 2016 Statement on BRRD24 according to which "they should avoid an excessive concentration of investments in financial instruments subject to the resolution regime issued by the firm itself or by entities of the same group". Therefore, in addition to the methodologies to be implemented for the assessment of products credit risk (see guideline 7), firms should also adopt ad hoc measures and procedures to ensure that concentration with regard to credit risk is effectively identified, controlled and mitigated (for example, the identification of ex ante thresholds could be encompassed).~~

(…)

Paragraph 91

When providing investment advice, a clear explanation of the reasons why the benefits of the recommended switch are greater than its costs should be provided ~~included in the suitability report the firm has to provide to the retail client before the transaction is made~~.