

## CNMV WILL ADOPT THE ESMA GUIDELINES ON MIFID II PRODUCT GOVERNANCE REQUIREMENTS

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On 2 June 2017, the [Guidelines on MiFID II product governance requirements](#) were published in English on the website of the European Securities and Markets Authority (hereinafter ESMA), which will apply from 3 January 2018.

These Guidelines develop the requirements established in Articles 16(3) and 24(2) of MiFID II and Articles 9 and 10 of the MiFID II Delegated Directive. The purpose of these new requirements is to ensure that entities which manufacture and distribute financial instruments and structured deposits (hereinafter, products) act in the best interests of clients from the beginning of the life cycle of the products and services. To this end, entities must maintain, manage and review a process for the approval of each product before its sale to clients.

Manufacturers must ensure that products are designed to meet the needs of an identified target market of end-clients. Furthermore, distributors must gather information from the manufacturer on the product's design and understand its characteristics and risks, as well as assess the compatibility between the products and the needs of the clients to whom they provide investment services, taking into account the identified target market, and ensure that the products are offered or recommended only when it is in their interests.

The Guidelines focus primarily on two specific aspects of the new product governance requirements: (i) the categories to be taken into account by manufacturers and distributors for the purpose of identifying the target market and defining the distribution strategy, and (ii) the method of assessing the compatibility between the products and the needs of the group of end-clients to whom the products are going to be offered or recommended.

Without prejudice to all the content of the Guidelines, those aspects that are considered particularly relevant are highlighted below.

***1. Aspects that manufacturers and distributors must take into account to identify target clients and define the distribution strategy.***

The following are the aspects that both manufacturers and distributors must consider when identifying target clients.

- Identification of the potential target market by the manufacturer. There are five categories to be considered by the manufacturer for the

purposes of identifying the target market: type of client, knowledge and experience, financial situation, especially the ability to absorb losses, risk tolerance and compatibility between the performance-risk product profile and the client's objectives and needs. None of these five categories can be excluded when identifying the target market. However, the level of granularity in the definition of these categories may be modulated according to the product's nature.

- Identification of the target market by the distributor. The distributor must specify the target market defined by the manufacturer on the basis of the information at its disposal on the clients in its database. For this purpose, distributors should use the information that has been gathered through the provision of investment or ancillary services. Additionally, they could use the information available to them which has been obtained through means other than the provision of investment services.

In the case of products that have been designed by entities that are not subject to the MiFID II product governance requirements, distributors should define the target market and distribution strategy themselves.

Time and relationship of the assessment of the distributor's target market with other areas of product governance. The identification of the target market by the distributor should be carried out as part of the general decision-making process for the range of products and services to be distributed. Entities should place particular focus on the investment services through which the products will be offered to their respective target markets.

- Negative target market. Manufacturers and distributors must also define the client group that is incompatible with the product (negative target market).

## ***2. Assessment of the compatibility of the products with the needs of the end-client group to whom the products are going to be offered or recommended.***

Distributors must identify and assess the circumstances and needs of the client group to whom they are going to offer or recommend a product and ensure the compatibility of the product with that client group. Likewise, they must indicate the distribution strategy that they consider compatible with the identified target market. To comply with these obligations, the guidelines may be applied according to the nature of the product and the type of investment services provided by the entity. As part of this process, they must consider the following issues:

*2.1 Individual assessment of the compatibility of the product with the identified target market.* When distributors define their product offer they must take into account to what extent they will be able to carry out the individual assessment of the product's compatibility with the identified target market. If distributors only provide services that require their appropriateness to be assessed or "execution only" services, they will normally assess the

compatibility of the category of knowledge and experience, or they will not perform an assessment respectively.

- Complex or risky products, innovative products, or products which involve the possibility of a significant conflict of interest. The consideration of these circumstances is especially important for complex or risky products when they are innovative products and in situations where there could be significant conflicts of interest (for example, when the products are issued by group entities, or when the distributors receive payments from third parties).

In these cases it is very important that distributors take into consideration all the information provided by the manufacturer. For example, if the manufacturer indicates that the product requires specific knowledge and experience, as well as a specific financial situation and investment needs and objectives, and with the investment services provided by the distributor, it will not be possible to individually assess the product's compatibility with its clients, the distributor should: i) consider adopting a prudent approach by not including the product in its product offer for clients or for a group of them, or ii) could also decide to allow clients to operate through services other than advisory services once they have been informed that the entity is not in a position to fully assess the compatibility of these products with their profile.

- Active marketing. If distributors intend to approach clients or potential clients in any way to actively market a product (or consider the product for the purposes of providing portfolio management or investment advisory services), a thorough assessment of the compatibility between the product and the needs of the identified target market must always be performed.

## 2.2 Deviations from the distribution strategy or the target market.

- The guidelines provide for the possibility of the distributor deviating from the distribution strategy established by the manufacturer after having conducted a comprehensive analysis of the product and its clients that duly justifies its decision. Deviations from the target market are allowed, in certain circumstances. For example, when the advisory service is provided at portfolio and portfolio management level, sales could be made outside the target market, for diversification or hedging reasons, provided that the portfolio is globally suitable for the client.
- Sales could also be made outside the target market, provided that all legal requirements are met (information provided to clients, suitability or appropriateness assessment, identification and management of conflicts of interest). These situations should be justified individually. However, if there were a significant volume of sales outside the target market, the distributor should consider it for the purpose of periodically reviewing the products and services offered.

- However, sales should rarely be made within the negative target market and, if they are, the entity should analyse this situation and consider how to deal with it responsibly. One possible approach would be for the entity not to allow clients to operate.

### 3. *Other salient features of the Guidelines.*

Regarding the application of these obligations, the Guidelines establish that in the case of products which are designed prior to 3 January 2018 but distributed after that date, the product governance obligations will apply to distributors, and they will be responsible for identifying the target market (for these purposes, manufacturers will be considered non-MiFID entities). However, a target market shall be assigned by the manufacturer to the product, at the latest, during the first periodic product review process that is conducted pursuant to Article 16(3) of MiFID II from 3 January 2018.

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The Guidelines have been issued under Article 16 of Regulation No. 1095/2010 of the European Parliament and of the Council, of 24 November 2010, regulating the creation of ESMA, which establishes that the competent authorities and financial market participants will do everything possible to adhere to these guidelines. Additionally, the ESMA Regulation also establishes the obligation of competent authorities to confirm whether they intend to comply with the guidelines published by ESMA, within two months of the publication by ESMA of the translation of the guidelines into the various official EU languages.

Although the translations of the ESMA Guidelines have not yet been published, CNMV has decided to make public in advance its intention to comply with them and communicate this information to the sector concerned. In order to give this statement maximum publicity, a letter has been sent to the associations in the sector so that they can communicate it to their associates.