

Diamonds are forever?

Product governance & product intervention under MiFID II/ MiFIR

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Product governance

- **MiFID II distinguishes between firms that**
 - manufacture the product (manufacturer), and
 - those that distribute the product (distributor)
- **Manufacturer:**
 - the manufacturing of products ‘encompasses the creation, development, issuance and/or design of financial instruments’
- **Distributor:**
 - product governance rules apply ‘irrespective of the type of service provided and of the requirements applicable at point of sale’

Product governance

- **Manufacturers must ensure that**
 - **products are manufactured which meet the needs of an identified target market of end clients within the relevant category of clients**
 - **the strategy for distribution of the products is compatible with the identified target market, and**
 - **they take reasonable steps to ensure that the product is distributed to the identified target market**

Product governance

- **Distributors must**
 - understand the products they offer or recommend
 - assess whether the products are compatible with the needs of the clients to whom they provide investment services, and
 - ensure that the products are offered or recommended only when this is in the interests of the client

Target market

- **ESMA/2016/1463, CP – Draft guidelines on MiFID II product governance requirements (5 October 2016)**
- **Assessment target market by the manufacturer:**
 - the type of clients to whom the product is targeted
 - knowledge and experience
 - financial situation with a focus on the ability to bear losses
 - risk tolerance and compatibility of the risk/reward profile of the product with the target market
 - clients' objectives
 - clients' needs
- **In a proportionate manner, considering the nature of the investment product**
- **articulation between the distribution strategy of the manufacturer and its definition of the target market**

Target market

- **Distributors should use the same list of criteria**
- **But they should define target market on more concrete level and should take into account**
 - the type of clients they provide investment services to
 - the nature of the financial instrument and
 - the type of investment services they provide
- **Relationship with KYC rules and other MiFID II/MiFIR provisions**
- **Product approach <-> portfolio approach?**

Product intervention

- **A distinction is made in this connection between**
 - **product intervention by NCAs, and**
 - **the intervention powers of ESMA and EBA**
- **NCAs can impose permanent product ban**
- **ESMA & EBA can only impose a temporary product ban**

Scope product governance & product intervention rules

- **Investment services + financial instruments**
- **Selling OR advising structured deposits**

Gap 1: 'manufacturers' of UCITS and AIF's

- **ESMA/2014/1569, *Final Report – ESMA's Technical Advice to the Commission on MiFID II and MiFIR* (19 December 2014), p 52 (No. 9)**
- **ESMA50-1215332076-23, *Opinion – Impact of the exclusion of fund management companies from the scope of the MiFIR Intervention Powers* (12 January 2017)**

Gap 2: banks selling diamonds

- **Several Italian banks distribute diamonds for diamond brokers, an unusual partnership that generated around 300 million euros (\$332.88 million) in sales for the brokers last year**
- **Several banks sold diamonds as financial products in bank branches at twice the market price.**
- **Bank officials advising a customer to make the investment without spelling out the risks and promising the diamond would appreciate consistently above the inflation rate in the long run**

Evaluation

- **Step forward in protecting investors**
- **Identification of the target market bound to pose difficulties in practice**
- **Important gaps remain**
- **Rules must be viewed within the broader context**

Thank you for your attention!

- **Contact details**

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