ESMA
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By ESMA ‘Form to Reply’

July 31, 2014

Dear Sir/Madam

JAC Response to the ESMA Consultation Paper on MiFIDII/MiFIR

This response is from the Joint Associations Committee on Retail Structured Products[1] (the JAC) and is endorsed by ISDA, AFME, ICMA and the BBA. The response to this question represents the position of the members of the JAC in relation to retail structured products.

Yours faithfully,

Mr. Alderman Timothy R Hailes, JP

Chairman – Joint Associations Committee on Retail Structured Products

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[1] The members of the JAC comprise a large proportion of the major firms involved in the creation, manufacturing and distribution within the European Union of retail structured products.

Paragraph 2.7 of Consultation Paper (Product Governance)

Q14. Should the proposed distributor requirements apply in the case of distribution of products (e.g. shares and bonds as well as over-the-counter (OTC) products) available on the primary market or should they also apply to distribution of products on the secondary market (e.g. freely tradable shares and bonds)? Please state the reason for your answer.

Subject to the rest of this answer, we think that in the context of retail structured products the application of the proposed governance obligations for distributors should apply where the distributor is actively marketing the product or selling on an advised basis. In such circumstances we consider that the proposed distributor requirements should apply regardless of whether the products are being distributed on the primary market or the secondary market. However, where the distributor is merely acting as a broker and not actively marketing the product or selling on an advised basis (for example, in the case of a secondary market transaction on an exchange instigated by an investor or where a distributor offers an exit opportunity from a "buy to hold" investment product) we consider that the proposed product governance obligations for distributors should not apply to secondary market sales. Imposing distribution obligations on secondary market trading where a distributor is acting as a broker will render such secondary market trading uneconomical, destroying liquidity. The proposed distributor requirements should apply to distribution not brokerage.

The concern that the application of distributor requirements to distributors acting as brokers will destroy liquidity is particularly relevant in the retail structured products market as retail structured products are often designed for 'buy and hold' investment strategies targeted to investors whose investment horizon is consistent with the term of the relevant product. When a liquid secondary market for a complex financial product does not exist, as envisaged by the IOSCO report below, the only prices available may be from the intermediary that sold the customer the product. Application of product governance obligations for distributors acting as brokers may restrict the ability of a distributor to offer such exit opportunities to investors which could inhibit investor protection.

Significantly, ESMA's opinion of 27 March 2014 relating to product governance arrangements for structured products sold to retail clients contains very limited provisions in relation to secondary market sales (primarily indicating (i) good practice in relation to disclosure where a secondary market exists and (ii) good practice for firms to offer and disclose appropriate exit opportunities to investors who may need to sell a structured retail product before its end term where products are not listed on a liquid secondary market). Similarly, very limited provisions in relation to secondary market sales are contained in IOSCO's Final Report on Suitability Requirements with Respect to the Distribution of Complex Financial Products[2], which flags that when a liquid secondary market for a complex financial product does not exist, the only prices available may be from the intermediary that sold the customer the product and states that the intermediary should "*know and disclose ahead of time how these prices will be computed (using models, other markets for similar products, etc.) and what the price represents (mid-market theoretical value, re-purchase prices, etc.). The customer should have access to enough information to know that the product is illiquid, including information about the means and range of timing for disinvestment*". We strongly believe that product governance arrangements for distributors acting as brokers on the secondary market should not extend beyond such recommendations for good practice in relation to exit opportunities and providing price transparency etc. as additional or concrete obligations applicable to secondary market trading are likely to destroy liquidity.

We also consider that in the absence of the application of distributor product governance obligations to distributors acting as brokers, sufficient levels of investor protection would still exist (particularly as a result of obligations elsewhere in MiFID e.g. suitability/appropriateness assessments which can and should be enforced) and existing disclosure regimes.

[2] Page 13 of FR01/13, January 2013

Q15. When products are manufactured by non-MiFID firms or third country firms and public information is not available, should there be a requirement for a written agreement under which the manufacturer must provide all relevant product information to the distributor?

In order to reduce potential risks of misselling by distributors it is important that distributors understand the products that they plan to distribute in order to enable them to satisfy product governance obligations and suitability, appropriateness assessments etc. In this regard we note Principle 6 of IOSCO's Final Report on the Suitability Requirements With Respect To the Distribution of Complex Financial Products as follows:

"*Principle 6: An intermediary should have sufficient information in order to have a reasonable basis for any recommendation, advice or exercise of investment discretion made to a customer in connection with the distribution of a complex financial product*."

Distributors should not distribute a product where they do not understand it sufficiently and/or do not have all relevant information to enable them to do so – this is part of a distributor's regulatory obligation (including under the proposed "product governance obligations for distributors" in the draft technical advice)[3]. In this regard we consider that it is important that where products are manufactured by non-MiFID firms or third country firms and public information is not available, the distributor should have arrangements in place to obtain such relevant information including where applicable from the manufacturer. The distributor should ensure that the information is sufficient and comprehensible in substance and form for it to perform its duties. We consider that this is important to maintain a common EU standard for investor protection and to create a level playing field for EU investment firms.

However, we do not consider that it is necessary for MiFID II to contain an obligation for the distributor to enter into "a written agreement" with the manufacturer or its agent that the manufacturer or its agent will provide all relevant information. It should be for the distributor and the manufacturer to agree amongst themselves the manner in which the distributor obtains the information it requires (which may or may not include entry into a written agreement). In many cases sufficient public information will be available as a result of the existence of a Prospectus Directive compliant prospectus (which a distributor should obtain, read and understand).

Furthermore, paragraph 26 of the draft technical advice refers to the distributor needing to obtain an "an agreement with the manufacturer or its agent that **the manufacturer or agent will provide all relevant information**". As indicated, in many cases a prospectus will exist which a distributor should not need to be provided with (as it is publicly available) and which it can rely on. Otherwise, it is important that distributors do not simply rely on the information provided by the manufacturer, but conduct their own analysis of the product and what information they require[4] and we consider that as currently drafted paragraph 26 of the draft technical advice places an obligation on manufacturers which goes beyond the level 1 text applicable to MiFID firms which states a manufacturer "shall **make available** to any distributor all **appropriate** information **on the financial instrument and the product approval process, including the identified target market of the financial instrument[5]".**

Similarly, in relation to paragraph 6 of the "Product governance obligations for manufacturers" where an investment firm collaborates with a third party based in a non-EEA Member State to create or manage a product, we do not consider that it is necessary for investment firms to enter into a "written agreement" outlining their mutual responsibilities, rather the parties should agree amongst themselves the manner in which responsibilities are allocated.

Q16. Do you think it would be useful to require distributors to periodically inform the manufacturer about their experience with the product? If yes, in what circumstances and what specific information could be provided by the distributor?

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[3] See paragraph 29 of ESMA's opinion of 27 March 2014 on "Structured Retail Products – Good practices for product governance arrangements" (**ESMA's Product Governance Opinion**)

[4] "See paragraph 28 of ESMA's Product Governance Opinion

[5] Article 16(3) of MiFID II

Yes we consider that it would be useful to require distributors to periodically inform the manufacturer about their experience with the product. However, it is important that both the information distributors must provide and the frequency of reporting is appropriately defined and manageable (it is not clear what is meant by the reference to "experience with the product") and that any reporting is consistent with distributors' confidentiality obligations and protects their proprietary interests.

We would suggest that distributors should be required to inform manufacturers of any complaints and/or misselling claims in respect of the product in a timely manner and also to provide high-level management information on a periodic basis (annually or bi-annually). The exact content of such high-level management information may differ depending on the product in question. This could, for example, take the form of generic information on the categories of end investor that the distributor has sold a product to which would enable the manufacturer to properly assess whether the products are ending up in the hands of the target market. Otherwise, the manufacturer typically has no visibility in relation to the categories of end investors or the complaints which a distributor receives in respect of a product[6].

It is important however that any such obligation for distributors to periodically provide information to the manufacturer does not create points of uncertainty as to where legal or regulatory liabilities may fall as between the manufacturer and the distributor (for example, the fact that a distributor reports a complaint in relation to a product to a manufacturer should not result in any shift of the burden of liability in relation to the subject matter of that complaint or the handling of that complaint). In order to avoid unnecessary red-tape, members also consider that it is important that manufacturers and distributors are not required to enter into an agreement (whereby the distributor is required to periodically inform the manufacturer about their experience with the product) and that the obligation remains a MiFID obligation as opposed to a contractual obligation.

Q17. What appropriate action do you think manufacturers can take if they become aware that products are not sold as envisaged (e.g. if the product is being widely sold to clients outside of the product's target market)?

Action should only be necessary where a product is being sold to clients outside of the product's target market to the extent such product is not suitable for such clients. If a manufacturer is aware of a regulatory breach by a distributor or vice versa it will typically be subject to an obligation to report to its national competent authority. Otherwise, any appropriate action a manufacturer can take should not be prescribed by law or regulation so as to permit the manufacturer and the distributor to find a solution or strategy which is in the best interests of investors. In practice the manufacturer (where it is creator, designer or developer of the product) will engage directly with the distributor and/or if necessary and available pursue contractual remedies pursuant to the terms of any agreement with the relevant distributor.

Where the distributor refuses to intercede in a product distribution where such product was not sold as envisaged, it should be for the manufacturer to determine what action it wishes to take in such circumstances in light of its knowledge of the facts on a case-by-case basis.

Q18. What appropriate action do you think distributors can take, if they become aware of any event that could materially affect the potential risk to the identified target market (e.g. if the distributor has mis-judged the target market for a specific product)?

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[6] In this regard, we note the positive duty ESMA proposes to impose on manufacturers to conduct product reviews includes an obligation: "to check that products function as intended". It is not clear to us what is meant by this obligation. Is it intended to stipulate that it is good practice for manufacturers to have a review process that considers appropriate information as to the performance of a product with a view to improving product design, to better frame the product to the needs of the target market, to improve product governance arrangements and (if there is a significant difference between the actual and expected performance of the product) to review product governance arrangements where necessary and to consider what appropriate action(s) could be taken to mitigate detriment to investors when the product does not perform as expected (in line with ESMA's paper of 27 March 2014 entitled: "Structured Retail Products – Good practices for product governance arrangements")? If so, it would be helpful to clarify this and align with ESMA's good practices paper. Receiving periodic information from distributors would assist with this review process.

If the action a distributor can take in such circumstances is to be prescribed by regulation, it is important that there is flexibility. What constitutes appropriate action is likely to be fact specific (for example, depending on whether the event that could materially affect the potential risk to the identified target market is due to an error of the distributor or due to an external event or circumstances). It is key in this context however that the distributor reports the event(s) to the manufacturer.

Further action may not be necessary in all circumstances (e.g. if the distributor has mis-judged the target market but notwithstanding this the product is still suitable for the clients to whom it has been sold). Where further action is necessary, other appropriate actions by the distributor (depending on the circumstances) may include:

- to reconsider the target market and/or update the product governance arrangements already put in place (as per paragraph 20 of the draft technical advice)

- to inform investors (and where relevant sub-distributors) of this event and its consequences on clients and of their option to seek advice through appropriate channels (for example, an exchange)

- to facilitate an active secondary market in the product allowing investors to exit the product in an orderly way (this should not be an obligation as it would not always be reasonable/possible for a distributor to facilitate this)

- to assess whether it should cease selling the product

In relation to the requirement for a distributor to inform investors of the event, it should however be noted that they may not have an on-going relationship with investors and in such circumstances their ability to communicate with investors may be limited to a publication on their website/in the press rather than a direct communication to the investor.

Q19. Do you consider that there is sufficient clarity regarding the requirements of investment firms when acting as manufacturers, distributors or both? If not, please provide details of how such requirements should interact with each other.

General comments

Achieving sufficient clarity regarding the requirements of investment firms when acting as manufacturers, distributors or both is key to enable investment firms to understand ESMA’s proposals fully and to determine where it is proposed responsibility should lie. We consider that it is important ESMA takes into account the diversity of origination processes and in particular responsibility for determining product features when creating and allocating regulatory obligations around product origination, and also when exercising supervisory and enforcement powers. A pure manufacturer of a product should bear responsibility for ensuring the product 'does what it says on the tin' (i.e. performs in accordance with the reasonable expectations of end investors) and that it complies with disclosure regulation to the extent applicable to a product manufacturer, for example, applicable requirements of the Prospectus Directive[7]; the person or persons who undertake product design (which may be the manufacturer, or the distributor, or both the manufacturer and the distributor - see below) should bear responsibility in relation to the design of the product to meet identified consumer needs; and the distributor should continue to bear point of sale responsibilities. To the extent both the manufacturer and distributor are involved in the design of the product, it should also be clear how product governance obligations will be allocated consistently with MiFID II.

It is key that product governance obligations are proportionate and targeted appropriately to follow these responsibilities and to establish who has the responsibility for and relationship with the end investor, as to do otherwise risks penalising manufacturers for the failings of their distributors or vice versa. The reputational implications for a product provider of being involved in disciplinary action as a result of

[7] Directive 2003/71/EC (as amended)

distribution failures are very substantial: it is important that action be targeted at the party responsible for any failings.

Specific comments

- The term "manufacturer" is not defined in the Level 1 text and market participants will need clarity on this definition to enable appropriate allocation of responsibilities and an audit trail (similar to the allocation of responsibilities parties currently undertake in a bilateral distribution agreement). In this regard it would be useful to make the distinction between "product provider" and "pure manufacturer" used in the regulatory guide contained in the Financial Conduct Authority's Handbook on "The Responsibilities of Providers and Distributors for the Fair Treatment of Customers" (the **RPPD**). Product "providers" are defined as including "persons who offer services such as portfolio management (through distributors or otherwise) as well as those who develop, manage or package products such as life insurance, general insurance or investment products or who develop or enter into home finance transactions". The product provider role is contrasted in the guidance with the pure manufacturer[8]. This is a person who creates a product to meet criteria or designs specified by the distributor (who will be the "**retail manufacturer**" and as such a product provider for these purpose). Pure manufacturers are still subject to Principle 2 of the RPPD[9], but not to the wider requirements of the RPPD. It is important that the obligations of a "manufacturer" are triggered by participation in the development and design of a product (not simply the manufacturing of a product). The division of responsibility (as between manufacturer and distributor) should flow from the actual roles or functions undertaken in a transaction. Whether a particular role or function is fulfilled by the distributor or manufacturer (or both the distributor and the manufacturer) may vary based on the product or service, or particular arrangements in place. The Consultation Paper/draft technical advice does not make such a distinction. For example, it states that obligations for manufacturers should include requirements for "procedures and arrangements to ensure that conflicts of interest…are properly managed as part of the product design, creation and development process[10]" however a manufacturer may, for example, simply create a product and not be responsible for its design and development.

- "Distributor" is defined in the RPPD at 1.13 as "persons who then make up the rest of the supply chain taking the product or service to the customer. This could include, for example, financial advisers, third party administrators, appointed representatives, banks, building societies, and those who sell insurance as a secondary part of their business". In the context of MiFID II/MiFIR, given the fact that a positive obligation is placed on investment firms who manufacture financial instruments to make available to "any distributor all appropriate information on the financial instrument and the product approval process, including the identified target market of the financial instrument[11]", it is also important that the term distributor is understood as a distributor that the manufacturer has appointed (as opposed to any distributor even if it is not one the manufacturer appointed) to avoid significant reputational/legal risks for the manufacturer.

- Importantly, the RPPD recognises that the respective responsibilities of product providers and distributors will flow from the actual roles or functions undertaken in each transaction and not merely the label given to a firm in respect of a particular transaction. Therefore, for example, if a bank has a limited role in the structuring of a product, the RPPD obligations may fall on the distributor as opposed to the bank. Typically it will be a question of fact whether the bank is a product provider or a pure manufacturer. This will depend in broad terms on who is responsible for the origination of the product in question – in particular the creation, development, design and determination of economic terms. It is increasingly common for distributors to be responsible for this aspect, namely in the reverse-enquiry context where a distributor has already identified a

[8] 1.15(1) of the RPPD
[9] "A firm must conduct its business with due skill care and diligence" paragraph 1.5 of the RPPD
[10] Paragraph 12(i) on page 43 of the Consultation Paper
[11] Article 16(3) of MiFID II

target-market in its client base, and decided upon the exact exposures it wishes to deliver to those clients and is using the bank merely to create what it has designed.

Critically, the RPPD also permits product providers and distributors to agree between themselves how to apportion the various responsibilities under the RPPD in many circumstances[12]. In the same vein we consider that it is important that each party should be able to agree (contractually or otherwise) its responsibilities consistent with MiFID II/MiFIR such that responsibilities flow from the actual role or functions being undertaken and that firms should be able to decide between themselves which party or parties will take on the "manufacturer" responsibility. For example, where a commissioning distributor is structuring the product for its clients then approaching an issuer with the terms of the product on a "reverse enquiry" basis as described above we think it should be made clear that the parties can agree that the distributor will take on both the distributor and manufacturer responsibilities (as it is the product provider rather than the issuer who is the pure manufacturer).

- In addition, the draft technical advice appears to assume greater contact between product manufacturers and investors than is actually the case leading to the suggestion that product manufacturers assume a greater level of responsibility for investor outcomes than is feasible or appropriate. Examples of this are as follows:

    - the statement that "when an investment firm develops a new product, it should be reviewed to ensure that the product design, including the product features, does not adversely affect clients.[13]" Does the reference to "clients" here refer to "the identified target market"? Pure manufacturers generally have no contact at all or knowledge of the actual clients who invest in the investment products they design and produce.

    - the obligation relating to analysing potential conflicts of interest considering "whether the product creates a situation where the client may be adversely affected[14]". Does the reference to "client" here refer to "the identified target market"? If so, any such analysis could only be carried out by product manufacturers on a generic basis by reference to the target market and not on a personalised basis by reference to an investor's individual circumstances/investment portfolio.

    - the obligation on the manufacturer to consider "if the product is being distributed to the target market, or is reaching clients for whose needs, characteristics and objectives the product is compatible[15]" suggests that manufacturers will have knowledge of the end investors and their needs, characteristics and objectives. In general, only the distributor will have the necessary information in relation to end investors to make such an assessment.

    - The draft technical advice refers to identifying "the potential target market for each product and be[ing] able to specify the type(s) of client for whose needs, characteristics and objectives the product is compatible"[16] and requires that investment firms consider the charging structure proposed for the product, checking for example that "product costs and other charges are compatible with the needs, objectives and characteristics of the target market"[17.] In relation to this obligation we note the following points:

[12] See 1.16 of the RPPD which states: "Whether providers and distributors can agree between themselves how to apportion responsibilities between themselves will depend on the circumstances. In particular, it depends on the nature of the regulatory responsibility, the extent to which such an agreement would be reasonable, whether the arrangement is clear to both parties and properly recorded and the systems and controls used to monitor whether the agreement continues to be appropriate in the circumstances."

[13] Paragraph 2 of the draft technical advice

[14] Paragraph 3 of the draft technical advice

[15] Paragraph 14 of the draft technical advice

[16] Paragraph 7 of the draft technical advice

[17] Paragraph 10 of the draft technical advice

- ➢ We consider that the requirement for manufacturers to have regard to the "characteristics" and "objectives" of an identified target market goes beyond the requirement in the Level 1 text for "firms which manufacture financial instruments to ensure that those products are manufactured to meet the needs of an identified target market[18]" and to conduct regular reviews to ensure that financial instruments "remain consistent with the needs of the identified target market[19]".

- ➢ It is not clear to us how a manufacturer will be in a position to determine whether a product/service's costs and charges are compatible with the characteristics and objectives of an identified target market. Is the term "characteristics" here intended to be a proxy for sophistication?

- ➢ We would recommend that "target market" be specifically defined at an appropriately consistent level given the asymmetries of information available to a manufacturer. For example, characteristics of a target market such as whether investors in that target market are seeking growth over income, safe principal over principal at risk, long-term outlook over short-term outlook, are characteristics that a manufacturer can appropriately design and process. However, characteristics such as effective tax rate, years until retirement and other sources of emergency liquidity are not and are most suitable as part of the normal distributor suitability analysis.

- ➢ Provided product costs and other charges are clearly disclosed, we believe investors should assume responsibility for checking that product costs and charges are compatible with their needs.

- It would be helpful to further clarify the product scope of the proposed product governance requirements applicable to manufacturers and distributors. For example:

  - We note that the obligations for distributors are stated to apply to "investment firms when deciding the range of products (issued by itself or other investment firms) and services they intend to offer clients". It would be helpful to clarify exactly which products are intended to be caught by the term "products". For example, it does not seem appropriate that the obligations for distributors should apply to over the counter products which are by definition bilateral agreements.

  - We note ESMA states at Section 2.7, paragraph 5(ii) of the Consultation Paper that "product governance arrangements should be considered broadly, meaning that they should also apply, where relevant to the provision of investment services" and that the draft technical advice refers to "services" in various places. We cannot see that MiFID II/MiFIR contemplate such an extension of product governance to "services" or empower secondary legislation to extend the scope of the product governance arrangements in this way.

Q20. Are there any other product governance requirements not mentioned in this paper that you consider important and should be considered? If yes, please set out these additional requirements.

We consider that the product governance arrangements are already extensive. In relation to the delineation of who is responsible for fulfilling these we note:

[18] Recital 71 of MiFID II and Article 24(2) of MiFID II
[19] Article 16(3) of MiFID II

- It is key that product governance obligations are proportionate and targeted appropriately to take into account the diversity of origination processes and in particular responsibility for determining product features when creating and allocating regulatory obligations around product origination, and also when exercising supervisory and enforcement powers (as further detailed in our response to Q19 above).

- Throughout the Consultation Paper a firm's management body is identified as being responsible for overseeing many of the aspects of product governance. Whilst we agree that a company's board of directors has ultimate oversight over the affairs and governance of the firm, it should be left to that firm to decide which employee, department, committee or other governance structure it deems appropriate to oversee its governance strategy. It is important that the board of directors is aware of and receives information about the functioning of these governance proposals, but it would be impractical to place the responsibility for implementation specifically on that group of individuals.

Q21. For investment firms responding to this consultation, what costs would you incur in order to meet these requirements, either as distributors or manufacturers?

The increase in scope and nature of the obligations for both manufacturers and distributors is likely to result in increased compliance costs to ensure systems and processes are in place at an investment firm and at a product level. Further, if pure manufacturers need to take on additional responsibilities when they create a product on behalf of a distributor/developer this can again can be expected to increase costs for the pure manufacturer and ultimately the end-investor through the pricing of the product. It is however difficult to quantify at this stage what the likely costs of meeting these requirements would be.

Paragraph 2.12 of Consultation Paper (Fair, clear and not misleading information)

Q65. Do you agree that the information to retail clients should be up-to-date, consistently presented in the same language, and in the same font size in order to be fair, clear and not misleading?

"Up to date" relevant to the method of communication used

- We agree that information to retail clients should be up-to-date **as of the date of production of the information** (and dated accordingly) and should be updated in accordance with existing regulation (for example, the requirements of the Prospectus Directive and the PRIIPs Regulation (once applicable)) or where the producer of such information has committed to updating it.

- For products that are PRIIPs, we consider it important that the obligations imposed by the PRIIPs and MiFID regimes to review and revise information in relation to the product, including the triggers for such information to be updated and communicated, as well as the means for providing and communicating the updated information, should be considered by ESMA so as to avoid any potential duplication and inconsistencies between the two regimes. Taking into account the fact that the requirement to review and update the KID will place a significant administrative burden on firms, we believe that any requirement in MiFID II/MiFIR to ensure information provided to retail clients is "up-to-date" should be harmonised with the PRIIPs regime and should not require any more frequent/extensive updates. The PRIIPs Regulation requires that: "In order to ensure that the key information document contains reliable information, this Regulation should require PRIIPs manufacturers to keep the key information document up to date[20]". In practice this means that the manufacturer is required to review and update the KID regularly and publish a revised version where a review indicates that changes need to be made (Article 10). Further detail as to the extent of the obligation to update the KID will be provided at Level 2 (including: (i) the conditions for reviewing the information contained in the KID; (ii) the conditions under which information contained in the

[20] Recital 15 of the PRIIPs Regulation

key information document must be revised; (iii) the specific conditions under which information contained in the key information document must be reviewed or the key information document revised where a PRIIP is made available to retail investors in a non-continuous manner; and (iv) the circumstances in which retail investors are to be informed about a revised KID for a PRIIP purchase by them, as well as the means whereby retail investors are to be informed). The PRIIPs Regulation also places an indirect obligation on distributors to update marketing communications (as it requires that marketing materials must not contain any statement that conflicts with information in the KID).

- ESMA acknowledges that there will be a time lag before printed media is updated. Similarly, whilst information provided online may be updated more quickly than printed media, we consider that there will always be some time-lag even in the context of online media given that in practice online updates are likely to require someone with appropriate expertise amending information provided in relation to a number of different products.

Consistently presented in the same language

- We understand that it is ESMA's intention that the requirement for "the same language" to be used in client communications should be interpreted as referring to the "same member state language" e.g. Spanish or French rather than to the same terminology (which would not work in practice). Subject to this being changed, we agree that it is helpful if all forms of information an individual investor receives in relation to a product are in the same member state language.

- If it is being proposed that information be "consistently presented" (as a stand-alone criteria separate for the requirement for information to be in the same language) we have the following comments:

    - For different product types we would urge ESMA to encourage flexibility in terms of content and presentation in order to acknowledge the different nature of the products and ultimate benefits for investors. We also note that whilst consistent presentation may assist in some cases with comparability across products, the overriding principle should be to ensure that any information is meaningful in the context of the product, even if this may be at the expense of absolute comparability across products.

    - In the context of a single product, we agree that it is important that the information presented in offer/marketing documents should be factually consistent, however we note that consistent presentation of information may not always be in the best interests of investors. For example, a distributor may choose to present certain performance scenarios in a different way to how they are presented in the KID/prospectus prepared by the manufacturer/issuer as they may consider this to be more effective in in light of their knowledge of a particular client's key concerns/risk appetite.

    - In addition, any requirement for information to be consistently presented should take into account the fact that different materials (e.g. the prospectus, the issue specific summary, the KID, the marketing materials) may be updated at different points in time and this may result in some minor inconsistencies.

Same font size (the draft technical advice indicates that "Information addressed to or likely to be received by retail clients …shall use a font size in the indication of relevant risks that is at least equal to the predominant font size used throughout the information provided, as well as a layout ensuring such indication is prominent")

- We agree that the font size for indicating the relevant risks should be at least equal to the predominant font size used throughout the information provided. Information in relation to the relevant risks should also use characters of a readable size (in line with the PRIIPs Regulation for the KID to use characters of a readable size).

- It is important however that this requirement in relation to font size is not overly restrictive such that, for information not related to the relevant risks of a product, firms may choose different font sizes where appropriate to give additional/less prominence to certain content or to give prominence to headings etc.

Q66. Do you agree that the information about future performance should be provided under different performance scenarios in order to illustrate the potential functioning of financial instruments?

Members are generally supportive of the use of performance scenarios along with appropriate warnings regarding the limitations of the data used and that the scenarios are not equally probable. However, we note the following points:

- We do not consider that there should be a prescribed or exhaustive disclosure of scenarios. The JAC members are of the view that allowing the producer flexibility to present scenarios analyses in a variety of formats would assist accessibility (e.g. numerically, graphically and/or in chart format). We consider that a degree of flexibility with regard to the approach taken for the preparation of scenario analyses would improve the utility of the data prepared. However, prescribing rigid calculation methodologies risks generating inappropriate results for certain products. Some products will only require limited scenario analysis as there are only a few different potential outcomes so there should not be a requirement to provide a fixed number of scenarios in all cases. A general requirement that the scenario analyses are presented in a manner which is fair, clear and not misleading should ensure appropriate standards are maintained.

- In order to avoid any duplication of obligations for retail structured products, we consider it important that any obligation to provide performance scenarios is aligned with the obligation under the PRIIPs Regulation to provide "appropriate performance scenarios, and the assumptions made to produce them" in the KID. We also note that in the context of the PRIIPs Regulation, regulatory technical standards are to be produced to give the methodology underpinning the presentation of risk and reward referred to in this section.

- It would also be helpful to receive further detail on what is meant by this requirement in the draft MiFID technical standards as this is not clear as currently drafted (e.g. is the requirement to present a low, medium and high return scenario (where applicable))? Is the intention to focus on scenarios that aim to give the investor insight into the product's possible return rather than performance scenarios intended to give the investor insight into the risks involved? We assume that where a product references a number of different instrument types/asset classes, it would not be necessary to produce different performance scenarios for each asset class (as this could result in lengthy disclosure which may be difficult to understand)? It would be important to clarify that performance scenarios should be based on the product being held to maturity. Structured products are designed to be held to maturity. Consequently, if an investor decides that they no longer wish to hold the product to the designated expiry date, then in many cases they will be effectively trading an illiquid product. It would be very difficult to show as a performance scenario how a product might perform if an investor looks to exit early.

- Our view is that caution should be exercised in requiring forecasting and forward looking analysis for products where the outcomes may not provide a meaningful comparison to investors. A one size fits all approach in relation to performance scenarios is not appropriate. For some products it could be challenging to produce a statement of this sort given the range of variables – particularly where the product does not operate by reference to a simple pre-set formula or variations of a single factor or where there is a dynamic pool of assets. Where such product scenarios do not take into account all the variables that can affect the product, the scenarios may not provide a meaningful comparison to investors and may even be misleading (given the number of assumptions and qualifications underlying the output) or that investors may place undue reliance on them. We therefore do not think that it would be appropriate to stipulate that performance information should always be included. Distributors may be best placed to gauge their investor's level of understanding and requirements for performance information and whether or not to include such information in any advice, educational or other materials they provide to their clients. It is more important to seek to ensure that investors understand the key factors that will generate the investment performance and how much risk they involve. Hence if information about future performance is to be provided under different performance scenarios we would suggest that it is not included as a rigid stipulation but rather as a factor that an intermediary should take into account when assessing whether its communication with a given client satisfies the requirement of being fair, clear and not misleading.

- We also consider that to the extent it is helpful to provide performance scenarios, it is important not to attach too much significance to these. Diverse risk profiles often apply to retail structured products and risk is often investor specific. For example, an investor investing in a product denominated in a currency other than that of his home member state takes significant foreign exchange risk which may not be factored into the performance scenarios. Consequently, narrative risk explanations are far more useful to investors allowing them to assess the relevance of each risk factor identified in the context of their investment holdings.

Paragraph 2.13 of Consultation Paper (Information to clients about investment advice and financial instruments)

Q68. Do you agree with the objective of the above proposals to clarify the distinction between independent and non-independent advice for investors?

We note that the Level 1 text already prescribes the distinction between independent and non-independent advice and that it makes no distinction between retail and wholesale clients (whereas in jurisdictions where similar advice models have been applied, the focus has been on retail clients). We agree that investors should have a proper understanding of the basis on which products are sold to them and this includes the nature of advice provided to them. However, we believe the ESMA advice is over-prescriptive e.g. by specifying that firms must provide descriptions of the total number of financial instruments and providers analysed per each type of instrument.

Q69. Do you agree with the proposal to further specify information provided to clients about financial instruments and their risks?

Members are generally supportive of the proposal to further specify information provided to clients about financial instruments and their risks. However, we note the following points:

- It would be helpful to clarify who has the responsibility to provide such information and how and when such information should be provided. We consider it important that ESMA takes into account disclosure obligations under existing Union law in order to avoid any potential duplication and inconsistencies and to ensure investors receive concise and consistent disclosure, particularly given that disclosure documents are increasingly limited in size and format.

- Whilst we agree it is important investors fully understand the risks of any product they invest in, we note that complexity does not necessarily equate to risk.

- In relation to paragraph 8 of the draft Technical Advice and the requirement to inform clients about the functioning and performance of financial instruments in different market conditions, please see our response to Q66[21]. We consider that the same difficulties arise in the context of a requirement

[21] For ease of reference the JAC's response to Q66 is as follows:

"Members are generally supportive of the use of performance scenarios along with appropriate warnings regarding the limitations of the data used and that the scenarios are not equally probable. However, we note the following points:

to provide functioning and performance information to clients in different market conditions as those that arise in the context of a requirement to provide information about future performance under different performance scenarios in order to illustrate the potential functioning of financial instruments.

- Indeed regulators have long acknowledged that back-testing/historical performance information is not a reliable indicator of future performance and we consider that other performance scenarios (whether illustrative of future performance or the functioning and performance of financial instruments in different market conditions) will suffer from the same deficiencies. We reiterate that requiring such functioning and performance information where the outcomes may not provide a meaningful comparison to investors (given the number of assumptions and qualifications underlying the output) could result in misleading information and investors may place undue reliance on it. If information about the functioning and performance of financial instruments in different market conditions is to be recommended we would suggest that it is not included as a rigid stipulation but rather as a factor that an investment firm should take into account when assessing whether information about a financial instrument satisfies the requirement of being fair, clear and not misleading. We note that the requirement to inform clients about the functioning and performance of financial instruments in different market conditions is not one of the

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• We do not consider that there should be a prescribed or exhaustive disclosure of scenarios. The JAC members are of the view that allowing the producer flexibility to present scenarios analyses in a variety of formats would assist accessibility (e.g. numerically, graphically and/or in chart format). We consider that a degree of flexibility with regard to the approach taken for the preparation of scenario analyses would improve the utility of the data prepared. However, prescribing rigid calculation methodologies risks generating inappropriate results for certain products. Some products will only require limited scenario analysis as there are only a few different potential outcomes so there should not be a requirement to provide a fixed number of scenarios in all cases. A general requirement that the scenario analyses are presented in a manner which is fair, clear and not misleading should ensure appropriate standards are maintained.

• In order to avoid any duplication of obligations for retail structured products, we consider it important that any obligation to provide performance scenarios is aligned with the obligation under the PRIIPs Regulation to provide "appropriate performance scenarios, and the assumptions made to produce them" in the KID. We also note that in the context of the PRIIPs Regulation, regulatory technical standards are to be produced to give the methodology underpinning the presentation of risk and reward referred to in this section.

• It would also be helpful to receive further detail on what is meant by this requirement in the draft MiFID technical standards as this is not clear as currently drafted (e.g. is the requirement to present a low, medium and high return scenario (where applicable))? Is the intention to focus on scenarios that aim to give the investor insight into the product's possible return rather than performance scenarios intended to give the investor insight into the risks involved? We assume that where a product references a number of different instrument types/asset classes, it would not be necessary to produce different performance scenarios for each asset class (as this could result in lengthy disclosure which may be difficult to understand)? It would be important to clarify that performance scenarios should be based on the product being held to maturity. Structured products are designed to be held to maturity. Consequently, if an investor decides that they no longer wish to hold the product to the designated expiry date, then in many cases they will be effectively trading an illiquid product. It would be very difficult to show as a performance scenario how a product might perform if an investor looks to exit early.

• Our view is that caution should be exercised in requiring forecasting and forward looking analysis for products where the outcomes may not provide a meaningful comparison to investors. A one size fits all approach in relation to performance scenarios is not appropriate. For some products it could be challenging to produce a statement of this sort given the range of variables – particularly where the product does not operate by reference to a simple pre-set formula or variations of a single factor or where there is a dynamic pool of assets. Where such product scenarios do not take into account all the variables that can affect the product, the scenarios may not provide a meaningful comparison to investors and may even be misleading (given the number of assumptions and qualifications underlying the output) or that investors may place undue reliance on them. We therefore do not think that it would be appropriate to stipulate that performance information should always be included. Distributors may be best placed to gauge their investor's level of understanding and requirements for performance information and whether or not to include such information in any advice, educational or other materials they provide to their clients. It is more important to seek to ensure that investors understand the key factors that will generate the investment performance and how much risk they involve. Hence if information about future performance is to be provided under different performance scenarios we would suggest that it is not included as a rigid stipulation but rather as a factor that an intermediary should take into account when assessing whether its communication with a given client satisfies the requirement of being fair, clear and not misleading.

• We also consider that to the extent it is helpful to provide performance scenarios, it is important not to attach too much significance to these. Diverse risk profiles often apply to retail structured products and risk is often investor specific. For example, an investor investing in a product denominated in a currency other than that of his home member state takes significant foreign exchange risk which may not be factored into the performance scenarios. Consequently, narrative risk explanations are far more useful to investors allowing them to assess the relevance of each risk factor identified in the context of their investment holdings."

recommendations in ESMA's recent opinion on "MiFID practices for firms selling complex products.[22]"

- We note that paragraph 12 of the draft technical advice states that "Information on financial instruments may be provided in a standardised format such as a product fact sheet. If a product fact sheet becomes a requirement, it will be important to consider how this interacts with the PRIIPs KID. In the context of products offered to retail we consider that it would place a considerable burden on manufacturers and distributors to require a product fact sheet in addition to the requirement to produce a prospectus with an issue specific summary (in accordance with the Prospectus Directive, as amended), a KID (in accordance with the PRIIPs Regulation once in force) and any short form disclosure document that may be required under national legislation (for example, the German "Produktinformationsblatt" or the Italian "scheda prodotto"). We note that Recital 78 of MiFID II states: "Where sufficient information in relation to the costs and associated charges or to the risks in respect of the financial instrument itself is provided in accordance with other Union law that information should be regarded as appropriate for the purposes of providing information to clients under this Directive." We strongly believe that in the context of structured retail products, no additional disclosure documents should be required. A product fact sheet would detract from and devalue the disclosure documents already mandated.

- In relation to paragraph 9 of the draft technical advice and the requirement specifically to address the risk of financial instruments involving impediments or restrictions for disinvestment, we agree with this requirement in principle. In fact this requirement is also the subject of Principle 7 (*Liquidity/Secondary Market*) of the JAC's Principles for managing the Distributor-individual investor relationship[23]. However, in the context of retail structured products, we consider that it will be very difficult to accurately illustrate the consequences of an early exit and the estimated time frame as this is largely based on market conditions at the time that the investor wants to exit which are impossible to predict at the outset. We think that the proposal in Paragraph 9 of the draft technical advice should, therefore, be limited to a clear description of the risks of disinvestment, including the fact that sales in the secondary markets may be at prices that are below the amount payable on the product at maturity, the original offering price, or the price at which investors acquired the product. For "principal-protected" products it should be made clear to investors that the principal protection only applies at maturity, and the costs of unwinding the product mean that an earlier redemption value may differ materially from the potential value at maturity.

Paragraph 2.14 of the Consultation Paper (Information to clients on costs and charges).

Q72. Do you agree with the scope of the point of sale information requirements?

Members are generally supportive of the point of sale information requirements. However, we note the following points:

[22] ESMA/2014/146

[23] Principle 7 of the JAC's Principles for managing the Distributor-individual investor relationship states:

"**Liquidity/Secondary Market**

Investors should be informed before investing of the likelihood of their being able to sell a particular structured product prior to maturity, and of the ways in which this might be done. Any secondary market to be provided by the distributor itself or through an exchange, or otherwise, should be disclosed. If there is little likelihood of such sale or other liquidation being possible, that fact should be clearly disclosed. Investors should be made aware that sales in the secondary markets, even where possible, may be at prices that are below the amount payable on the product at maturity, the original offering price, or the price at which they acquired the product. In addition, distributors should make a clear distinction between an investment in the structured product and a direct investment in the underlying asset, and that the return on the structured product may not reflect the return of a direct investment in the underlying asset, noting in particular that these respective returns may not necessarily move in tandem. For principal-protected products, it should be made clear to investors that the principal protection applies only at maturity, and the costs of unwinding the product mean that an earlier redemption value may differ materially from the potential value at maturity."

- Please see our comments in response to Q74 in relation to the proposed costs and charges to be disclosed to clients[24].

- A limited application of the requirements in relation to disclosure of detailed information on costs and charges to professional investors and eligible counterparties is only possible in certain circumstances. We consider that firms should be able to agree a limited application of these requirements in all situations where investment services are provided to professional clients and eligible counterparties.

- Paragraph 5 of the draft technical advice states that "When more than one investment firm provides investment or ancillary services to the client, each investment firm should provide information about the costs of the investment or ancillary services it provides". We agree with this but consider that in the context of retail structured products it is important that a firm is only required to disclose fees to its MiFID client and in particular a manufacturer is not obliged to disclose any costs imposed by the distributor (or any party to whom the distributor may direct the client etc.) as the manufacturer will not be privy to details of any such costs/charges. This is in line with the PRIIPs Regulation which states: "The KID shall include a clear indication that advisors, distributors or any other person advising on or selling the PRIIP will provide information detailing any cost of distribution that is not already included in the costs specified above.[25]"

Q73. Do you agree that post-sale information should be provided where the investment firm has established a continuing relationship with the client?

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[24] For ease of reference, the JAC's response to Q74 is as follows:

"The JAC has been a proponent of transparent disclosure of fees for some time and considers that it is very important for investors to understand the costs and fees of different products in order to make informed investment decisions. With regard to the specific proposed costs and charges to be disclosed to clients listed in the Annex to chapter 2.14 of the Consultation paper, the JAC members broadly agree with these but note the following comments:

• We note that the proposed costs and charges to be disclosed include "mark up embedded in the transaction price". It is not fully clear to us what this is intended to cover however in relation to retail structured products we note the following:

  o We think there is an important distinction to be made between different types of products. In particular there is a distinction between: (a) packaged products based on collective management of a pool of assets for which a fee is charged pro rata between those whose assets are being managed, which would include some forms of life assurance products; and (b) those products which simply operate by reference to a pay-out formula or which pay a form of fixed return.

  o In the context of a product with a simple charges profile (for example, a set management fee), the question of what should be disclosed may be relatively straightforward. Fees are deducted from the performance of the underlying assets and charged directly to the customer, so the customer cannot calculate expected returns unless he knows the level of such costs which should be disclosed.

  o For defined return products, the investor's key interest is in receiving the promised pay-out. A product manufacturer's fees and costs may be reflected in the pay-out formula and the profit or loss made by the manufacturer may vary depending on market conditions. As profit or loss made on a retail structured product is therefore related to underlying market risk we therefore consider it should fall into the exemption in Article 24(4) of MiFID II for information about costs and charges which are caused by the occurrence of underlying market risk.

  o Defined return products are often marketed as "hold to maturity" products. As an accommodation to the needs of consumers, there may be a secondary market in the product. The basis on which the secondary market is provided should be made clear to investors and the fact that the price an investor may receive for their product on the secondary market may not be the price the investor paid for the product (or the price payable at maturity). It is, therefore, essential to ensure that investors understand the secondary market.

• Further, member feedback indicates that several items relating to the disclosure of costs and charges when providing investment and/or ancillary services will be problematic to ascertain ex-ante. In particular, firms would have difficulty disclosing ex-ante any type of costs relating to events whose magnitude cannot be anticipated, for example:

  o FX costs;

  o where an investment firm is providing RTO services (i.e. receiving and transmitting orders) on a broker-neutral basis but subject to best execution selection obligations, it will not be possible to anticipate which brokers will be used to execute client transactions and which fees would apply; and

  o taxes (as the application of these may depend on factors such as where the transaction is executed). An RTO service provider would have no way of anticipating whether and to what extent taxes may be due."

[25] Article 8(3)(e) of the PRIIPs Regulation

In the context of retail structured products we consider that a requirement to make post sale periodic disclosure about costs is unnecessary, for the following reasons:

- First, in some circumstances, complete information in relation to costs and charges may be available upfront so the requirement to make transparent point of sale disclosure should provide sufficient protection for investors. The requirement to provide post sale information should only be applicable where such information is relevant to determining the investment return.

- Second, we consider that in the context of retail structured products it is important that the obligations under the PRIIPs regime to provide post sale information are considered by ESMA so as to avoid any potential duplication and inconsistencies between the two regimes. We note that the PRIIPs Regulation includes a requirement for the manufacturer to review and update the KID regularly and publish a revised version promptly where a review indicates that changes need to be made.[26] The KID also includes a section entitled "What are the costs" requiring disclosure of direct and indirect costs to be borne by the investor (among other things)[27]. In the context of PRIIPs we do not consider that any further post sale information on costs and charges should be necessary. In fact, any requirement to provide additional post-sale information on costs would detract from and devalue the information to be received by investors through the KID.

- Further, it is not clear what is meant by establishing a "continuing" relationship:

    - The Consultation Paper[28] states that ESMA considers that investment firms that offer a one-off investment service (such as execution of orders on one occasion or advice on a particular transaction) should not be required to provide their clients with periodic information about costs. This implies however that providing execution only services more than once might automatically result in a continuing relationship with the client.

    - It is not clear that such a relationship with the client requires the investment firm to establish a continuing commercial relationship where the investment firm recommends or markets investment products to clients (as opposed to where the investment or ancillary service offered is not connected to investment advice but nonetheless requires entry into certain derivatives with the client e.g. FX and interest rate swaps which are not intended to form part of an investment strategy but are necessary for the provision of those services, as for example, in the case of global custody services and asset servicing).

    - Other factors (such as the amount of business conducted) should also be relevant in order to establish the nature of such a client relationship.

    - A narrow definition of "continuing" relationship could result in new system requirements (with resulting costs) to flag transactions with the same client. In order to overcome such operational challenges some firms may simply choose to classify all relationships as "continuing" but thereby significantly increasing administration costs as a result of the requirement to provide such information to all clients.

Q74. Do you agree with the proposed costs and charges to be disclosed to clients, as listed in the Annex to this chapter? If not please state your reasons, including describing any other cost or charges that should be included.

The JAC has been a proponent of transparent disclosure of fees for some time[29] and considers that it is very important for investors to understand the costs and fees of different products in order to make informed

[26] Article 10 of the PRIIPs Regulation

[27] The details of the presentation and the content of the required costs disclosure in the PRIIPs Regulation will be the subject of regulatory technical standards (Article 8(5)(a) of the PRIIPs Regulation).

[28] Paragraph 31 on page 105.

[29] See, for example, Principle 3 of the JAC's "Structured Products: Principles for Managing the Distributor-Individual Investor Relationship" (July 2008): "Investors in a structured product should be informed of the existence of fees,

investment decisions. With regard to the specific proposed costs and charges to be disclosed to clients listed in the Annex to chapter 2.14 of the Consultation paper, the JAC members broadly agree with these but note the following comments:

- We note that the proposed costs and charges to be disclosed include "mark up embedded in the transaction price". It is not fully clear to us what this is intended to cover however in relation to retail structured products we note the following:

    - We think there is an important distinction to be made between different types of products. In particular there is a distinction between: (a) packaged products based on collective management of a pool of assets for which a fee is charged pro rata between those whose assets are being managed, which would include some forms of life assurance products; and (b) those products which simply operate by reference to a pay-out formula or which pay a form of fixed return.

    - In the context of a product with a simple charges profile (for example, a set management fee), the question of what should be disclosed may be relatively straightforward. Fees are deducted from the performance of the underlying assets and charged directly to the customer, so the customer cannot calculate expected returns unless he knows the level of such costs which should be disclosed.

    - For defined return products, the investor's key interest is in receiving the promised pay-out. A product manufacturer's fees and costs may be reflected in the pay-out formula and the profit or loss made by the manufacturer may vary depending on market conditions. As profit or loss made on a retail structured product is therefore related to underlying market risk we therefore consider it should fall into the exemption in Article 24(4) of MiFID II for information about costs and charges which are caused by the occurrence of underlying market risk.[30] .

    - Defined return products are often marketed as "hold to maturity" products. As an accommodation to the needs of consumers, there may be a secondary market in the product. The basis on which the secondary market is provided should be made clear to investors and the fact that the price an investor may receive for their product on the secondary market may not be the price the investor paid for the product (or the price payable at maturity). It is, therefore, essential to ensure that investors understand the secondary market.

- Further, member feedback indicates that several items relating to the disclosure of costs and charges when providing investment and/or ancillary services will be problematic to ascertain ex-ante. In particular, firms would have difficulty disclosing ex-ante any type of costs relating to events whose magnitude cannot be anticipated, for example:

    - FX costs;

    - where an investment firm is providing RTO services (i.e. receiving and transmitting orders) on a broker-neutral basis but subject to best execution selection obligations,

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costs, commissions, discounts ,and any other sums paid to the distributor for acting as such over the life of the product. Distributors should have internal processes and controls in place to consider the appropriateness of fees and other incentives given local market conditions and regulatory requirements. A distributor's internal processes and controls should also consider the level of disclosure regarding such fees and costs in light of their possible impact on the secondary market of the structured product concerned."

[30] We note that Article 24(4) of MiFID II states: "The information about all costs and charges, including costs and charges in connection with the investment service and the financial instrument, which are not caused by the occurrence of underlying market risk, shall be aggregated to allow the client to understand the overall cost as well as the cumulative effect on return of the investment, and where the client so requests, an itemised breakdown shall be provided."

it will not be possible to anticipate which brokers will be used to execute client transactions and which fees would apply; and

- taxes (as the application of these may depend on factors such as where the transaction is executed). An RTO service provider would have no way of anticipating whether and to what extent taxes may be due.

Q75. Do you agree that the point of sale information on costs and charges could be provided on a generic basis? If not, please explain your response.

We note Recital 78 of MiFID II states that: "Where sufficient information in relation to the costs and associated charges or to the risks in respect of the financial instrument itself is provided in accordance with other Union law that information should be regarded as appropriate for the purposes of providing information to clients under this Directive". As noted by ESMA in paragraph 56 of chapter 2.14 of the Consultation Paper if the point of sale disclosure information on costs related to the financial instrument is provided on a generic basis "this would ensure consistency between information provided by UCITS KID and an eventual PRIIPs KID, which is not personalised". We consider that it is important to avoid any potential duplication and inconsistencies between the two regimes.

However, we also note that some members have concerns that the scope of the proposed disclosure will mean that it is difficult to provide this information on a generic basis. The term "generic" is also not defined which could mean that this is interpreted differently by investment firms resulting in different levels of disclosure. Further, it is not clear what is meant by the obligation to provide information "on a generic basis **as long as the investment firm ensures that the costs and charges provided in the disclosure are representative of the costs that the client would actually incur"** [31]**?**

Q76. Do you have any other comments on the methodology for calculating the point of sale figures?

- In relation to paragraph 12 of the draft technical advice[32] the format of the aggregated data, we would suggest that the words ", where applicable" are added at the end of this paragraph as follows:

  "12. The aggregated costs and charges should be expressed in one single figure, both as a cash amount and as a percentage, **where applicable."**

  In situations where investment and/or ancillary services are provided without the sale of a financial instrument or a structured product, there is no underlying investment value. In such a case, a representation as to the total aggregate costs as a percentage cannot be made.

- The methodology for calculating point of sale figures states that "actually incurred costs" should be used as a proxy for the expected costs and charges. However, "actually incurred costs" in relation to a particular product are not necessarily relevant to the investment proposition or return on the investment. Management fees, custody or other running costs may not have been incurred at the point of sale and may be charged over the life of the product.

- A requirement to adjust ex-ante assumptions based on ex-post experience may lead to uncertainty as to what the consequences of such adjustments should be. Investment decisions will be based on cost disclosure available at the point of sale. Is the purpose of such adjustments simply to facilitate post-sale periodic disclosure (which we consider should only be applicable where such information is relevant to determining the investment return)?

- We note that under the PRIIPs Regulation regulatory technical standards will be published setting out the "methodology for calculation of costs, including the specification of summary indicators".

[31] See page 114 of the Consultation Paper.
[32] See page 114 of the Consultation Paper.

As previously indicated, it will be important that there is consistency between cost disclosure requirements in MiFID II/MiFIR and under the PRIIPs Regulation in the context of retail structured products.

Q77. Do you have any comments on the requirements around illustrating the cumulative effect of costs and charges?

Our view is that it is important that the requirements are prescriptive so that all market participants are working from a common standard and presenting the information consistently.

Some members do however have concerns that such an illustration will be difficult to provide concisely and accurately. In the context of some products the accompanying explanation would be lengthy (which would be problematic particularly in the context of disclosure documents restricted in length e.g. KIDs) and may not be read by investors. There are also concerns that investors may place too much reliance on such illustrations and that they may be misleading if estimations (for example, as to "anticipated spikes or fluctuations in cost") used prove to be incorrect and concerns surrounding the potential liability which may attach to investment firms when producing such illustrations if they are not considered to meet the specified requirements which may be difficult to predict.

We note that under the PRIIPs Regulation regulatory technical standards will be published setting out the "methodology for calculation of costs, including the specification of summary indicators". As previously indicated, it will be important that there is consistency between cost disclosure requirements in MiFID II/MiFIR and under the PRIIPs Regulation in the context of retail structured products.

Q78. What costs would you incur in order to meet these requirements?

Member feedback indicated that:

- It is not possible to quantify at this stage what the exact costs of meeting these requirements would be at this stage but given the increase in scope of the disclosure requirements on costs and charges, it is likely significant costs will be incurred.

- Costs would be affected, among other things, by the amount of information related to or coming from third parties that investment firms would have to recover and process before disclosing such information to clients in the required format.

Paragraph 2.15 of Consultation Paper (*The legitimacy of inducements to be paid to/by a third person*).

Q80. Do you agree with the proposed approach for the disclosure of monetary and non-monetary benefits, in relation to investment services other than portfolio management and advice on an independent basis?

**Please note that the JAC's response to the Consultation Paper focuses on selected investor protection questions. In responding to these questions, we concentrate on the implications of the proposals for those firms involved in producing (or in some cases distributing) retail structured products. For other product types, we note that some members have indicated that they do not agree with the proposals in Paragraph 2.15 of the Consultation Paper (The legitimacy of inducements to be paid to/by a third person) and have requested that we refer ESMA to the responses of other industry bodies in relation to this question, in particular AFME.*

In the context of retail structured products, members generally agree with the proposed approach although we note the following points:

- Requirements to provide clients with information on an ex-post basis/on an individual basis should be contingent on the existence of an on-going client relationship.

- We consider that the requirement in paragraph 7(ii) of the draft technical advice should also be stated to be "once a year" to ensure that reasonable limits are placed on the provision of information on an ex-post basis.

  Paragraph 2.24 of Consultation Paper (Product Intervention).

Q107. Do you agree with the criteria proposed?

For the most part we agree with the criteria proposed but we have the following comments/observations:

General comments:

We note that it is stated at paragraph 6 of Chapter 2.24 of the Consultation Paper that "It is essential that intervention powers are dynamic enough to enable NCAs and ESMA or EBA to deal with a range of different exceptional situations…ESMA is therefore of the view that flexibility is required…" Whilst we agree that quantitative definitions of amounts of losses or thresholds would be difficult to set, we consider that it is essential in relation to product intervention powers that:

- the market should have sufficient certainty that legitimate commercial interests are protected;

- they should only be exercised after a careful analysis to ensure that the power is used proportionately (having regard to the protections in the Level 1 text);

- adequate account should be taken of the impact of a ban or restriction on other product-types that are already in the market. It is important to protect against:

  - potential unintended consequences of product intervention in encouraging spurious claims in relation to products which may have similar characteristics to those which are the subject of intervention, but do not represent a significant investor protection concern or threat to the orderly functioning and integrity of financial markets or commodity markets or to the stability of the whole or part of the financial system of the Union or any Member State;

  - the exercise of product intervention powers in relation to a product where sales have already been made to investors which will lead to uncertainty for product providers and distributors in relation to such sales.

Any uncertainty may have the unintended consequences of stifling constructive innovation of new categories of investment products suited to the changing economic climate and changing investor needs; reducing choice for consumers or increasing the costs of investment products to protect against the risk of its being subject to regulatory intervention.

Specific comments

- We agree with ESMA that given the range of factors and criteria it should not be necessary for these to apply cumulatively. However, basing intervention on just one single factor present[33] would appear to be setting a very low threshold for intervention. Furthermore, the draft technical advice indicates that in certain circumstances the authorities may intervene in new instruments or services or activities that may not meet any of these factors or criteria. To specify that none of the criteria need to be taken into account in certain circumstances arguably goes beyond the Level 1 text which states that the Commission shall adopt delegated acts to specify "criteria and factors to be taken into account" in determining when there is a significant investor protection concern or a threat to the orderly functioning and integrity of financial markets and to the stability of the whole or part of the financial system of the Union.

[33] See paragraph 7 of the draft technical advice on page 173 of the Consultation Paper.

- In relation to paragraph 4(i)(f) of the draft technical advice, it would be helpful to understand in more detail what is meant by the "complexity of terms and conditions". The terms and conditions for many structured products will need to properly reflect valuation adjustments and disruption provisions in relation to the underlying and necessarily include proper fallbacks. We do not consider that it would be appropriate for such terms and conditions to be deemed complex under this criteria given that terms and conditions of this nature have been in widespread use for many years and are understood and expected by market participants. We would like to suggest that regulators should not consider the complexity of terms and conditions to be a relevant factor unless the terms and conditions are such that intermediaries that are likely to be involved in distributing such products are not capable of understanding them sufficiently in order to fulfil their role as distributor. This is because we consider that only the intermediary involved in the distribution of a product is sufficiently close both to the product and the client to be able to assess whether the two are suited. The best person to assess whether or not an intermediary understands a product is the intermediary itself. It should be clear that they have that responsibility, something which is reflected in the JAC Principles[34]. This may be achieved through the materials provided by the product provider or generally through the product provider and distributor's communications.

- In relation to paragraph 4(ii) we note that the measures specified are not appropriate in the context of derivatives. We consider that a relevant measure for derivatives would be the "net exposure" of market participants (and not the "notional value" or "volume of the issuance") which are not indicative of risk in a derivatives context. In addition, we consider that for all financial instruments collateral provided should be taken into account in assessing the risk/the size of the potential problem or detriment (and proportionately reducing this).

- In relation to 4(v)(c) it is not clear to us what is meant by "the features of securities financing transactions". This criterion appears to be very broadly drafted and it is not apparent how/why the features of securities financing transactions are relevant to determining the presence of a significant investor protection concern/threat to the orderly functioning of markets.

- In relation to 4(vii) of the draft technical advice in relation to the ease and cost for investors to switch or sell an instrument, we note that in the context of retail structured products there is typically no obligation of a product provider to provide a secondary market in a product for hold to maturity products. This is however made clear to investors. Similarly there is clear disclosure that if an investor is able to sell the product on the secondary market, the price received may not be the price the investor paid for the product (or the price payable at maturity). Provided that the investors are made aware at or prior to purchasing the product of the availability of any secondary market and that the price an investor may receive for their product on the secondary market may not be the same as the price they paid, we do not think these facts should be relevant factors in the context of determining whether there is a "significant investor protection concern or a threat to the orderly functioning and integrity of financial markets or commodity markets and to the stability of the whole or part of the financial system of the Union". Illiquidity should only be a relevant consideration where there has not been clear disclosure of the nature and availability of a secondary market.

- In relation to 4(ix) of the draft technical advice, we consider that including "the degree of innovation of a financial instrument, an activity or practice" as a relevant factor may have adverse effects by stifling constructive innovation of new categories of investment products suited to the changing economic climate/changing investor needs. We do not consider that innovation should not

[34] See Principle 6 (New Product Review) of the JAC's Principles for Managing the Distributor-Individual Investor Relationship: "Distributors should understand the products they distribute. New structured products, whether developed by the distributor or developed by a third-party provider or manufacturer, should be subject to the distributor's product review and assessment process. This process should take into account the nature of the new structured product, the target investors, and an assessment as to whether the product is appropriate for its intended target market. Distributors should also have a process for determining what generally constitutes a "new product". It is not sufficient for a distributor to accept a third-party manufacturer's assessment regarding appropriateness of structured products for individual investors who are ultimately customers of the distributor and not the manufacturer. Distributing firms should conduct an independent assessment."

be a relevant factor of itself. If it is necessary to include this, we consider that it would be more appropriate for this to be included as a subheading under paragraph 4(i) of the draft technical advice (relating to complexity).

- It is also not clear to us what is meant by 4(ix)(a) of the draft technical advice referring to: "the degree of innovation related to the structure of the financial instrument, activity or practice, e.g. embedding, triggering". Embedded derivatives and triggers are used fairly frequently in the structured products market and we do not consider these to be innovative. If these features are considered to be innovative in other markets it is important that innovation is always measured relative to the experience of the market with similar financial instruments.

Q108. Are there any additional criteria that you would suggest adding?

No comment.

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