ESMA Response to EFMLG Letter and new ESMA opinions

EFMLG 48th meeting

June 2014
1. Guidelines, Recommendations & Opinions by ESMA

**LEGAL BASIS**

| Art. 288 TFEU | "recommendations and opinions have no binding force" |
| Art. 16 Regulation 1095/2010 | Guidelines and Recommendations |
| | • **Purpose:** "establishing consistent, efficient and effective supervisory practices" |
| | "ensuring the common, uniform and consistent application of Union law" |
| | • **NCA and participant:** "shall make every effort to comply with" but they have the possibility not to comply if explained |

**PROBLEM**

ESMA has issued Guidelines without consensus of all the NCA → unlevel playing field

**REQUEST**

Prior to final publication, consensus should be reached with NCA

**ANSWER**

• Prior consensus = veto power to every NCA
• Will report to EU institution - on non-compliant NCA

**WHAT ABOUT LEVEL PLAYING FIELD?**
2. Q & A

### LEGAL BASIS

| Art. 29.2  
Regulation 1095/2010 | ESMA may develop “new practical instruments and convergence tools to promote common supervisory approaches and practices” |

### PROBLEM

- Interpretations without stakeholders opinion nor public consultation

### REQUEST

- Not to create a new source of “soft regulation”

### ANSWER

- Q & A are covered by Art. 29.2 and contribute to prevent regulatory arbitrage
- Are non-bindy
- Are not soft regulation nor go beyond underlying legislation

### WHAT ABOUT IF NOT COMPLIED WITH?
3. ESMA opinions

**ADDRESSEE**

Art. 29.1. (a) Regulation 1095/2010

“providing opinions to NCA”

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1. **FEBRUARY: PRACTICES FOR FIRMS SELLING COMPLEX PRODUCTS**

- **New concept of** "complex product" different from "complex financial instrument" (paragraph 27)

- **BEST PRACTICES:**
  - Organization / Internal Control: Conflict of interest when selling entity is the issuer or counterparty
  - Suitability: attitude to risk, time horizon, capacity to afford losses
  - Appropriateness (i.e. warning that "the client is not likely to understand the risks")
  - Disclosures:
    - Outlay of costs and charges: not mentioned in Art. 33 of MiFID ID but mentioned in Art. 24.4 MiFID II
    - "indication of disinvestment value immediately after the transaction, assuming market conditions remain unchanged"
    - Consequences of seeking to sell or exit
    - Avoiding jargon
    - National compensation scheme
  - On-going monitoring
  - Execution of client order: "sale of any complex product meets the firm’s best execution obligations"
3. ESMA opinions (ii)

2. MARCH: GOVERNANCE FOR SRP

- **New set of definitions used in, but not even covered in MiFID II**: manufacturer, product governance arrangements, distribution...

- **Product governance arrangements**
  - General organisation: *“product governance arrangements should be transparent, consistent and auditable”* (Art. 16.3 MiFID II)
  - Product design:
    - Manufacturer to ensure products meet
    - Best interest of the investor in pricing: - Benchmark with 3rd parties
    - 3rd party to challenge SRP pricing
  - Product testing: - back testing
    - fair "risk – reward" trade off
  - Target market of investors: - "conduct robust research to understand investors need, objectives and ability to understand SRP so as to enable firms to reject inadequate SRP’s targeting a markets segment”
    - provision of 3 market scenarios: performs well, no returns, performs poorly + counterparty fails
    - potential action if an SRP fails to function as investors had been led to expect
  - Distribution strategy
  - Value at the date of the issuance and transparency on costs, as per the manufacturers accounts, and at "fair value"
  - Secondary market and redemption: - Offer exit opportunities
    - Using objective and predefined methodologies informed to investors in advance
  - Review process: *“actions could be taken to mitigate detriment to investors when an existing SRP does not perform as expected”*
4. Conclusion

What importance does your NCA give to these opinions?

What to do?

• Complying is:
  - very burdensome
  - not based on legal grounds
  - a potential source of uncompetitiveness
  (if competitors do not comply and are not sanctioned)

• Not complying is:
  - opposing NCA
  - source of “problems” with NCA
  - capable of being sanctioned? Should not but...
  - source of investors complaints

Common industry approach