



MiFID II Product Governance Requirements



Introduction

The European Securities and Markets Authority's ("ESMA's") Guidelines on MiFID II Product Governance Requirements ("the Guidelines") became effective on 3 January 2018. The purpose of the Guidelines is to provide firms with greater clarity on product governance obligations and thereby increase investor protection. The Guidelines include requirements relating to the target market for products, suitability, distribution strategy and portfolio management.

In February 2021, EMSA launched the common supervisory action ("CSA") to assess how firms across the European Union ("EU") comply with the Guidelines. The CSA assessment framework reviewed firms' compliance with these key investor protection requirements. ESMA noted that the initiative would achieve the following:

- Help ensure consistent application of rules across firms;
- Increase protection of investors; and
- Improve National Competent Authorities' ("NCAs") understanding of the supervisory approaches.

Findings

In July 2022, ESMA published a statement announcing the findings of the CSA. The results are based on an overall sample taken in 2021 of 214 firms across 26 EU and European Economic Area ("EEA") member states involving product manufacturers, distributors and firms acting both as manufacturers and distributors. The sample firms included 115 credit institutions and 99 investment firms.

The results showed that while firms do define a target market, the definition of a target market is approached as a **tick box exercise** and is not completed with sufficiently clearly defined terms. Additionally, a firm's definition of a target market **does not necessarily correlate to the distribution strategy** applied by firms.

Areas for Improvement

The following are four key areas for improvement that have been identified by ESMA:

1. Scenario analysis

It is important that scenario analysis is performed for all products to **ensure that the risk posed to customers of poor outcomes is assessed and managed**. This analysis includes consideration of customer outcomes as a result of:

- The impact of a **deteriorating market environment**;
- The impact of any **financial difficulties** experienced by the manufacturer;
- The failure of the product to be **commercially viable**; and
- High demand for the product, resulting in **pressure on firms' resources**.

The results of this analysis should clearly align to the methodology used by firms to identify a target market for a product.

Key considerations for firms:

- Do you have guidelines on how to apply the scenario analysis to your products?
- Do you have controls in place to ensure this methodology is applied consistently and correctly?
- Does the methodology to complete the scenario analysis follow regulatory requirements?
- Do you have a clearly defined target market for each of your products?
- Does your target market clearly align to the results of your scenario analysis?

2. Cost structure analysis

It is important that cost structure analysis is performed for all products in order to **comply with MiFID II requirements**. This analysis should consider the following:

- If the costs and charges are compatible with the **needs, objective and characteristics** of the identified target market;
- If the costs and charges **undermine the expected return from / benefit** of the product; and
- If the costs and charges are appropriately **transparent**.

Firms must ensure that they have clear procedures in place to evaluate how the product's costs and charged structure corresponds to each specific product's target market.

Key considerations for firms:

- Do you have clear procedures in place which outline the methodology for completing the cost structure analysis?
- Do you have controls in place to ensure this methodology is applied consistently and correctly?
- Has the target market been considered when designing the cost structure of your product?
- How have you ensured that your costs and charges structure is appropriately transparent, so that it can be clearly understood by customers?

3. Product reviews

Ongoing monitoring and review of firms' products with adequate scope to ensure that the products remain **consistent with the needs, characteristics, and objectives of the defined target market** for that product is essential. Firms should establish **appropriate governance** whereby the firm would complete these in-depth reviews regularly and within pre-established timelines.

Key considerations for firms:

- Do you have key performance indicators ("KPIs") in place for each product to ensure it is operating as intended?
- Do you have an approach in place to continuously monitor products and ensure that the target market is still consistent with the defined target market for that product?
- Is this approach in line with ESMA's Guidelines?
- Does your product review process assess your costs and charges structure to ensure it is in line with MiFID II requirements?
- Do you have regular interaction with Senior Management to communicate updates on products and if any, potential changes to them?



4. Proactive exchange

The exchange of information between manufacturers and distributors needs to be **completed on a proactive basis**, not just when it is requested by the manufacturer. It is important that product manufacturers have **access to the appropriate information** required to design / update products in line with the needs of the target market.

Key considerations for firms:

- Do you clearly outline what information should be shared between manufacturers and distributors of products?
- Do you have processes in place to ensure the appropriate information is gathered to ensure that the product continues to meet the needs of its target market?
- Do you have an established platform whereby the two entities can share information efficiently?

Next Steps

ESMA has launched a Consultation Paper on the Guidelines and the consultation closed on 7 October 2022. Feedback will be considered in Q4 of 2022, with a final report expected in Q1 2023.

How can KPMG help?

KPMG's comprehensive Product Services offering provides assurance that the customer remains at the heart of your business, while also ensuring product efficiencies and robust oversight. This includes:

Product Assurance

KPMG has designed a bespoke Product Assurance Framework to arm firms with tools and techniques to control their product set and align with the evolving and Product Governance and investor protection expectations. Using this bespoke methodology, we can assist you with developing a robust Product Assurance Framework which will enhance the current product review processes in place, by moving to a data-led and highly automated product review process which will be preventative in nature and move away from a labour intensive assurance approach.

For more information on our Product Assurance Framework, visit our website: <https://home.kpmg/ie/en/home/insights/2020/12/product-assurance.html>

Compliance by Design

By considering compliance as part of your product design, KPMG can help you identify early warnings of product issues: reducing the potential for future restitutions, increasing operational efficiencies and driving better outcomes for consumers. Firms that take the opportunity to update their approach are likely to make significant progress within their POG activities and reduce the risk of negative outcomes for consumers.

For more information on Compliance by Design, visit our website: <https://home.kpmg/ie/en/home/insights/2022/01/compliance-by-design-risk.html>

Product Simplification

Firms can reduce the operational costs of servicing their products, meet changing customer demands and help drive sustainable growth by engaging in Product Simplification. Firms require a detailed understanding of their product suite to remove unnecessary complexity. We will help your firm by establishing a clear plan that will ensure that the right decisions are made regarding your product suite and that the appropriate POG requirements are maintained.

For more information on Product Simplification, visit our website: <https://home.kpmg/ie/en/home/insights/2022/01/product-simplification-risk.html>

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