



MiFID2

PRODUCT GOVERNANCE

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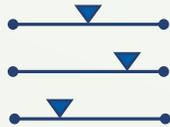
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THE BACKDROP FOR MIFID2 IN ITALY

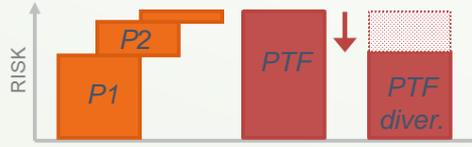
Multi-dimensional, quantitative suitability models following MiFID I, with **advisory** the prevailing business model

- Risk tolerance
- Investment horizon
- Knowledge & experience
- etc.



Gradual movement to **portfolio suitability models** in search of diversification and commercial flexibility

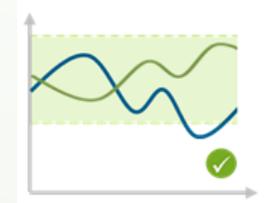
All major distributors now use a portfolio model



Portfolio suitability lends itself to **portfolio advisory** models, which have proliferated

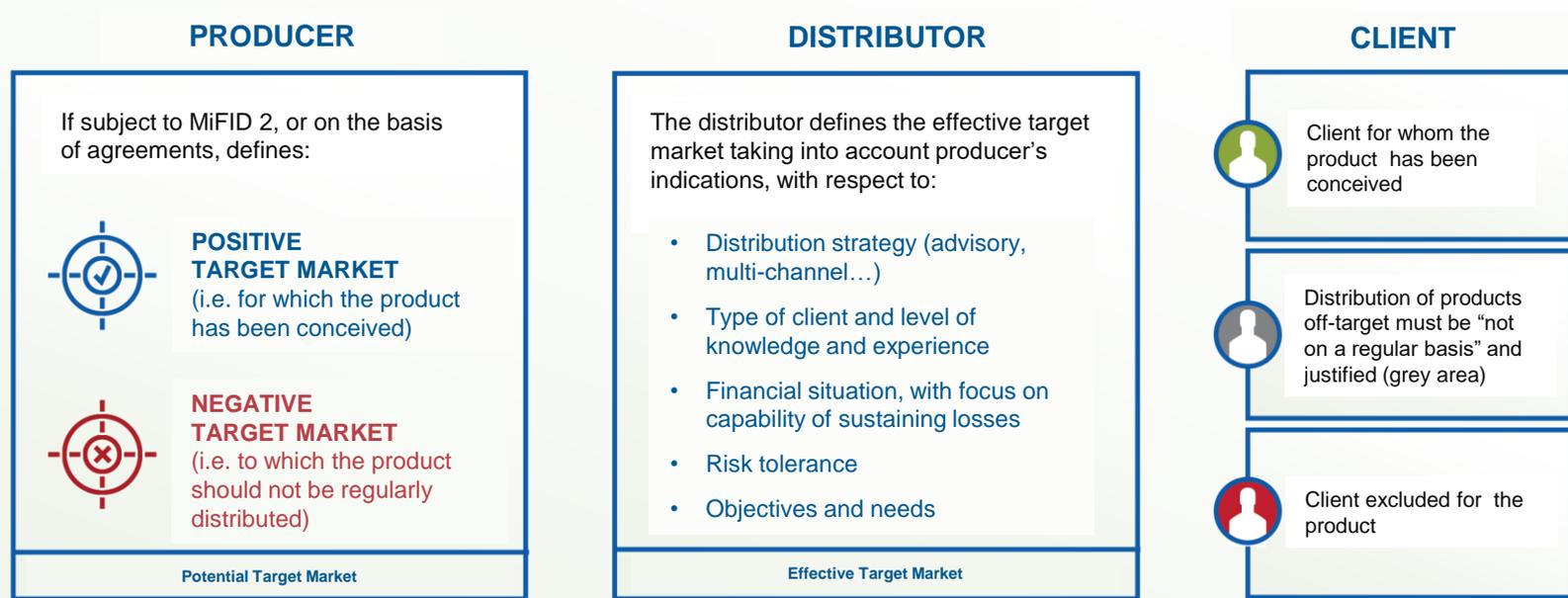
KPIs like:

- adherence to model PTF
- diversification KPI
- partitions by financial needs



In Italy, MiFID II product governance requirements are being embedded into this environment

TARGET MARKET: IS THE PORTFOLIO APPROACH IN QUESTION?



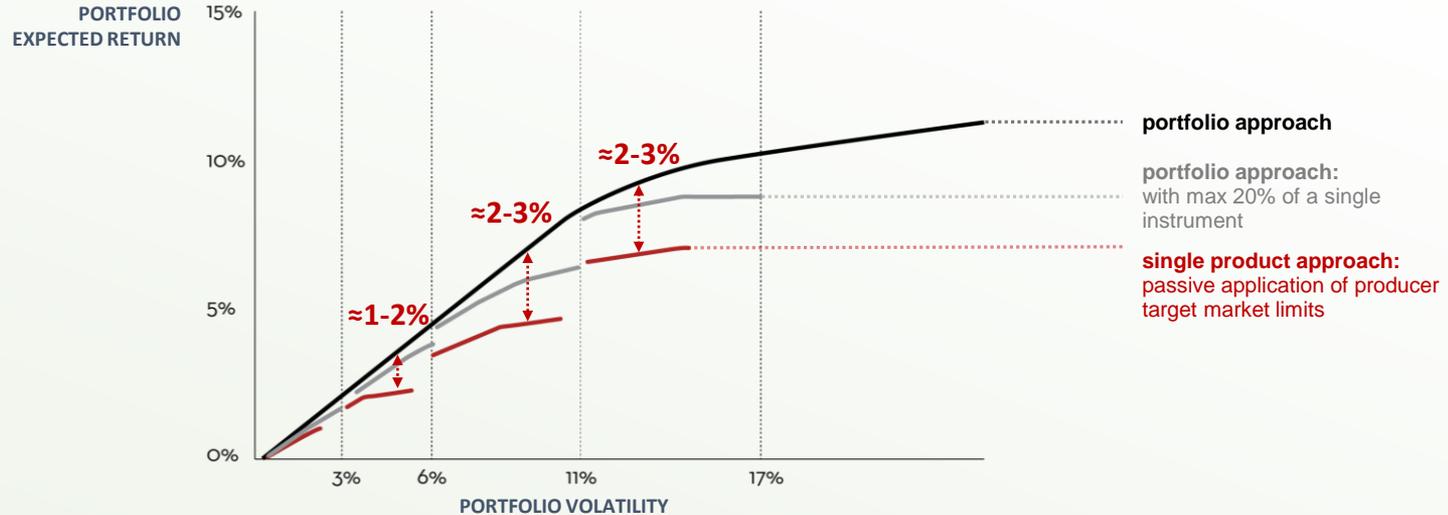
More intensive information exchange

- contracts and agreements
- structured information flows
- annual reporting on distribution
- etc.

ESMA Draft guidelines on MiFID II product governance requirements (5 October 2016)

ESTIMATED COST OF A SINGLE INSTRUMENT APPROACH

Efficient frontier



Mass distribution by risk profile	3%	14%	44%	22%	17%
Client profile	LOW	MEDIUM LOW	MEDIUM	MEDIUM HIGH	HIGH

Underlying hypothesis: 1) 5 risk profiles considered for clients with a wealth >150k€, 2) associated a sample of about 70 funds with different risk/return profile to the respective target market (TM), based on volatility 3) built 3 efficient frontier for each client, in function of several scenarios

UPDATED GUIDELINES CATER SPECIFICALLY FOR THE PORTFOLIO APPROACH

PORTFOLIO / HEDGING APPROACH

SINGLE PRODUCT APPROACH

Recommendations to clients within the TM ⊖ are to be avoided

Recommendations to clients outside of the TM ⊕ are **always allowed** as long as portfolio as a whole is suitable

Recommendations to clients outside of the TM ⊕ need to be justified and documented

It is **not necessary to notify the manufacturer** in case of distribution outside of the TM ⊕

It is necessary to notify the manufacturer in case of distribution outside of the TM ⊕

It is **not necessary to track distribution** outside of the TM ⊕ (although it may be opportune)

It is necessary to track distribution outside of the TM ⊕

It **may not be necessary to disclose** to the client investments outside of the TM ⊕ within the recommendation report

Integration within the recommendation report of an indication that the investment is sold outside the TM ⊕

A REMAINING CHALLENGE: MAPPING OF TARGET MARKET

MANUFACTURER

potential target market definition

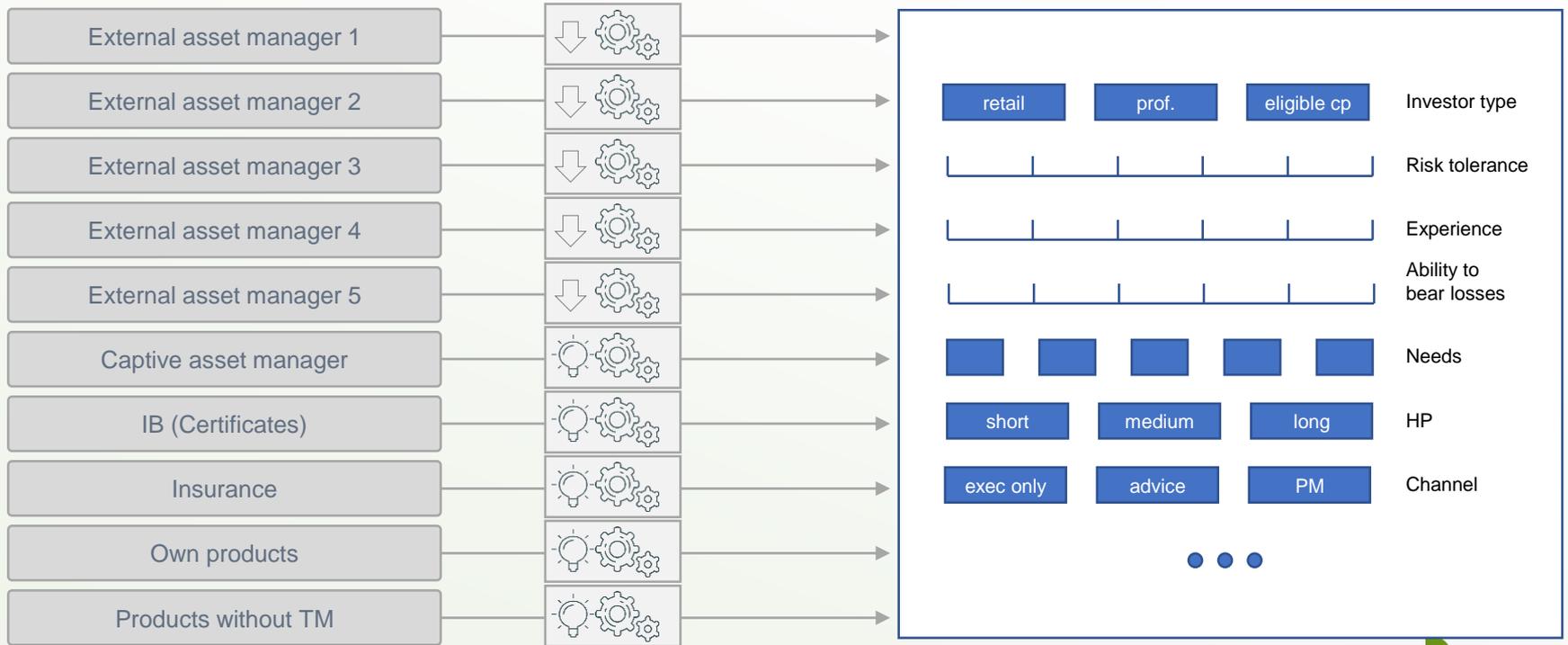
- ① *first draft taxonomies from the industry (European MiFID Template)*
- ① *number of different taxonomies to manage*
- ① *no data yet: strategy/rigor of definitions not yet clear*

DISTRIBUTOR

distribution to effective target market

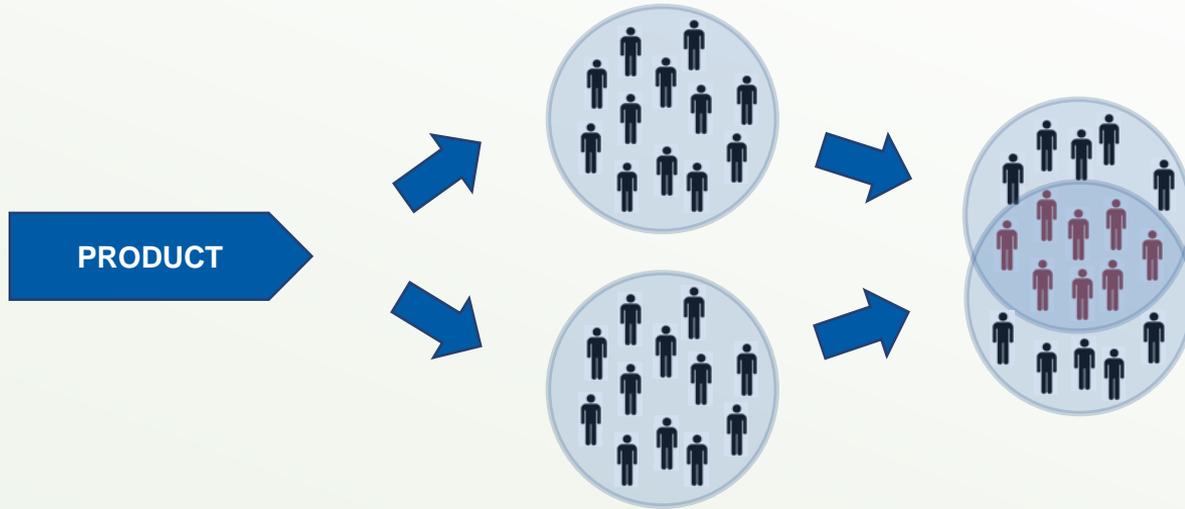
- definition in terms of available client characteristics
 - acquisition and subsequent translation of manufacturer TM to house rules
 - determination of TM for products without manufacturer definition like equities, bonds, etc.
- ① *heterogeneity in client data collected by each distributor and the resulting segmentations and advisory guides*

MAPPING OF TARGET MARKET: LOTS OF WORK TO DO!



THE EX ANTE EFFECTIVE TARGET MARKET

Identify clients for whom the product would pass TM and all **suitability checks**



Identify clients for whom the product would be **coherent with the advisory model**:
asset allocation, client needs, diversification, ...

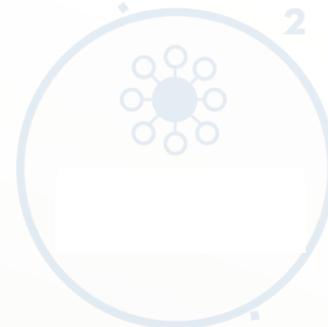
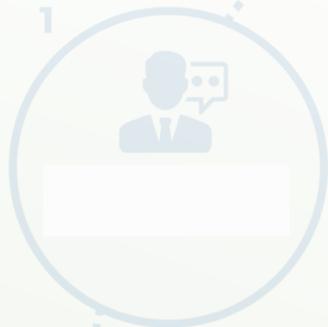
The effective target market is the set of clients for whom the product would pass **all applicable checks** including liquidity constraints



Approach may be qualitative for simple/common products, and simulation for complex ones

CONCLUSIONS

- *One size doesn't fit all, and it will be difficult and time consuming for distributors and manufacturers to design and implement a complete approach to ex-ante and ex-post product governance*
- *Difficult to precisely define the approach to TM without data to guide the process (e.g. definition of negative TM)*
- *It remains to be seen if potential restrictions on the commercialization of products such as TM will prompt a broader adoption of the portfolio model*



THANK YOU FOR YOUR ATTENTION

