Settembre 2017

Product intervention under MiFID II/MiFIR

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This article provides a brief overview of one of the main novelties introduced by MiFID II[1]/MiFIR[2], that is the attribution of new product intervention powers to National Competent Authorities ("**NCAs**") and, in exceptional cases, to ESMA or EBA ("**ESAs**") (NCAs and ESAs, hereinafter jointly referred to as the "**Authorities**" and, each, the "**Authority**"), and identifies some potential issues relating to the above powers.

It is worth preliminarily pointing out that such intervention *powers*, which complement the Authorities' existing ones, are to be read in conjunction with the new product governance *requirements* imposed upon "MiFID firms"[3].

1. Product governance

1.1 *Product governance requirements*

The purpose of the introduction of product governance requirements is to increase the level of investors' protection by requiring MiFID firms to take responsibility, from the beginning of and during the whole life-cycle of their financial instruments or structured deposits (hereinafter jointly referred to as "**Products**" and, individually, as "**Product**"), that the latter are designed in the best interest of target clients.

In particular, product governance aims at anticipating the investors' protection to the very first stage of the product life-cycle (i.e. the manufacture phase). Indeed, manufacturers are called to conceive, from the outset, the financial instruments they intend to offer on the market taking into due account the needs of target clients.

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[1] Directive no. 2014/65/EU on markets in financial instruments (OJ L173, 12.06.2014; "**MiFID II**"), due to enter into application on 3rd January 2018.

[2] Regulation no. 600/2014/EU on markets in financial instruments (OJ L173, 12.06.2014; "**MiFIR**"), due to enter into application on 3rd January 2018.

[3] Credit institutions, investment firms, regulated markets, data reporting services providers and third country firms providing investment services or activities in the European Union (See Recitals 7, 38 and 45 of MiFID II).

Therefore, product governance requirements[4] must be satisfied by firms, which:

(i) manufacture financial products ("**Manufacturers**"[5]); and

(ii) offer or recommend the above products to the end-clients ("**Distributors**"[6]).

In particular:

- prior to marketing or distributing a Product, Manufacturers must adopt an approval process, which identifies a target market of end-clients for such Product, and ensures an adequate assessment of the above market, as well as a consistent distribution strategy for that Product;

- Manufacturers must ensure that the Products they intend to offer meet the needs of an identified target market of end-clients, with a distribution strategy compatible with the latter, and that the Distributors take reasonable steps to ensure that the Products are distributed to such identified target market;

- Manufacturers must make available to Distributors all appropriate information on the Products offered and their approval process, including the identified target market, whilst Distributors must make arrangements to obtain the above information from the Manufacturers and understand the characteristics, as well as the target market, of each Product they are going to distribute;

- Distributors must periodically assess the consistency of the Products with the needs of the identified target market, as well as with the related distribution strategy, taking into account any event that could materially affects the potential risks to such market;

- Distributors must fully understand the Products to be placed, assess their compatibility with the needs of the target clients, whilst taking into account the latter's identified target market, and ensure that each Product is offered or recommended only when it is in the interest of the clients.

The underlying rationale of such a detailed list of obligations being the introduction of effective policies and arrangements aimed at identifying *ex ante* a category of clients to

[4] See Articles 16, paragraph 3 and 24, paragraph 2, of MiFID II.

[5] Pursuant to Recital 15 and Article 9 (1) of the Commission Delegated Directive (EU) 2017/593 of 7 th April 2016 supplementing MiFID II (OJ L87, 31.03.2017; hereinafter, the "**Delegated Directive**"), "Manufacturer" means a firm that manufactures an investment product, including the creation, development, issuance or design of that product, also when advising corporate issuers on the launch of a new product. In some cases, Manufacturers can also offer or recommend to the public the products manufactured.

[6] Pursuant to Recital 15 and Article 10 (1) of the Delegated Directive, "Distributor" means a firm that offers, recommends or sells an investment product to a client.

whom Products are to be offered and ensure that such clients' best interest is met not only in the manufacturing phase, but also in the distribution one.

1.2 *ESMA's guidelines on product governance requirements*

In order to ensure a consistent and harmonised implementation and application of the new product governance requirements laid down in MiFID II and in the Delegated Directive[7], ESMA[8] has recently published some guidelines[9], which:

(i) provide a list of five categories to be cumulatively referred to by Manufacturers when identifying a potential target market, as well as by Distributors when defining such market on a more concrete level, as follows:

a) the type of clients to whom Products are targeted (i.e., retail clients, professional clients or elegible counterparties);

b) client's knowledge and experience;

c) client's financial situation, with a focus on their ability to bear losses;

d) client's risk tolerance and compatibility of the risk/reward profile of the Products with the target market; and

e) clients' objectives and needs.

(ii) set forth that the identification of the "potential" target market by Manufacturers, as well as of the "actual" target market by Distributors, should be carried out in an appropriate and proportionate manner, considering the nature of the Products to be offered[10];

(iii) provide that the Distributors' obligation to identify the actual target market and ensure that a Product is distributed in accordance with such market is not substituted by the assessment of suitability or appropriateness, and must be carried out in addition to, and prior to such assessment;

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[7] See Recital 18 of the Delegated Directive, according to which "*product governance rules should apply to all products sold on primary or secondary markets, irrespective of the type of product or service provided and of the requirements applicable at point of sale*".

[8] The European Securities and Markets Authority.

[9] ESMA Final Report, "*Guidelines on MiFID II product governance requirements*", published on 2nd June 2017, pp. 31 *et seq.* Such Guidelines will be translated into the EU official languages and the translations published on ESMA's website. A two-month period, during which NCAs must notify to ESMA whether they intend to comply or not with the Guidelines, shall begin to run on the day following the publication of the related translations. The Guidelines will enter into application on 3rd January 2018.

[10] This means that the target market's identification should consider the characteristics of the Product in question, including its complexity, risk-reward profile, liquidity, or innovative character. Consequently, for more complex Products, the target market should be identified in more details.

(iv) require, in line with the Delegated Directive, Manufacturers and Distributors to review Products on a regular basis, so as to assess whether the latter remain consistent with the needs, characteristics and objectives of the identified target market, as well as whether the intended distribution strategy remains appropriate;

(v) require Manufactures and Distributors to consider whether Products are incompatible with certain target clients (the so-called "negative" target market test)[11]; and

(vi) envisage justified deviations from the identified target market (i.e., sale of Products outside the positive[12] or within the negative target market[13]).

In light of the above, ESMA expects that the nature of the Products be duly taken into account when identifying the target market, with particular attention to those characterised by complexity/risk or other features (e.g., illiquidity and innovation)[14].

2. Product intervention

As a response to the financial markets' crisis initiated in August 2007, the introduction by MiFID II and MiFIR[15] of formal intervention powers in favour of the Authorities aims to complete the new product governance regime by ensuring the effectiveness of the latter[16]. Indeed, by means of Articles 39 to 43 of MiFIR[17], an innovative mechanism is introduced, whereby the Authorities are granted the authority to prohibit or restrict, in or from the relevant EU Member State:

[11] In line with the approach followed for the identification of the "positive" target market, Manufacturers, which do not have a direct relationship with end-clients, will be able to identify the negative target market on a theoretical basis, whereas Distributors will be in the position to identify more concretely the group of end-clients to whom they should not distribute a specific Product.

[12] This instance should be justified by the individual facts of the case, whereby the reasons for the deviation should be clearly documented, and included in the suitability report.

[13] According to ESMA, the sale to investors within this group should be a "*rare occurrence*". The justification for the deviation should hence be significant and more substantiated than a justification for a sale outside the positive target market.

[14] It is worth noting that ESMA Guidelines do not make reference to specific Products, such as NPLs, that have lately created new wholesale markets opened to professional clients and eligible counterparties only. It will be thus interesting to see what will be the effects of the new product governance rules on such markets.

[15] In addition to the product intervention powers introduced by MiFIR, Article 69, paragraph 2, of MiFID II grants the Authorities the power, among the others, to require the temporary prohibition of professional activity and the removal of a natural person from the management board of an investment firm or market operator.

[16] In order to cover all the investment products sold to retail clients, Articles 15 *et seq* of Regulation no. 1286/2014 of 26th November 2014 on key information documents for packaged retail and insurance-based investment products ("**PRIIPs**") provides for the same intervention powers as those under MiFIR, granted to NCAs (and EIOPA) with reference to insurance-based investment products.

[17] In addition, MiFIR establishes product intervention power on the positions and exposure assumed on derivate instruments (Articles 44-45 thereof).

(i) the marketing, distribution or sale of certain financial instruments or structured deposits, or financial instruments or structured deposits with certain specified features; or

(ii) a type of financial activity or practice.

Moreover, it is worth preliminarily pointing out that such powers are addressed to MiFID firms and do not apply to UCITS[18] management companies and AIFMs[19], even when marketing units or shares of UCITS and AIFs they manage and/or when carrying out certain MiFID services/activities (*i.e.* individual portfolio management, investment advice and, for AIFMs only, reception and transmission of orders)[20].

As a result, product intervention powers may affect the entire Products' life-cycle; in particular:

(i) the concept and manufacture phase;

(ii) the distribution phase;

(iii) the post-distribution phase.

In brief, pursuant to MiFIR, product intervention powers are allocated among the Authorities according to the following key-rule: the relevant NCA(s)' are the first in line to act, whereas the relevant ESA(s)' intervention is triggered only in "exceptional cases".

In addition, with regard to the NCAs, they may take action only on the ground that[21]:

a) there is a significant investor protection concern, or a threat to the orderly functioning and integrity of financial markets or commodity markets, or to the stability of whole or part of the financial system within at least one Member State, or where a derivative has a detrimental effect on the price formation mechanism in the underlying market;

[18] Undertakings for Collective Investment in Transferable Securities, under Directive 2009/65/EC.
[19] Alternative Investment Fund Managers, under Directive 2011/61/EU.
[20] According to ESMA (see Opinion dated 12th January 2017), the exclusion of UCITS management companies and AIFMs from the scope of intervention powers could jeopardise the effectiveness of the measures taken in execution of such powers, whilst entailing a risk of arbitrage between MiFID firms and fund management companies. The latter could be, in fact, entitled to distribute types of UCITS or AIFs, and/or offer MiFID services/activities, whereas the same activities could be banned/prohibited to MiFID firms by virtue of an action taken by the competent Authority in execution of intervention powers. In ESMA's view, the way to avoid the risks mentioned above would be to enlarge the scope of intervention powers to fund management companies, as well as MiFID firms.
[21] See Article 42, paragraph 2, of MiFIR.

b) the existing regulatory requirements do not sufficiently address the mentioned risks, and the issue would not be better addressed by improved supervision or enforcement of existing requirements; and

c) the action is proportionate given the risk, level of sophistication of investors or market participants concerned, and the effects of such action on investors and market participants.

Please also note that product intervention powers must be exercised provided that the principles of proportionality and non-discrimination are complied with. In this respect, pursuant to Article 42, paragraph 2, sub-paragraph c), of MiFIR, *"the action is proportionate taking into account the nature of the risks identified, the level of sophistication of investors or market participants concerned and the likely of the action on investors and market participants who may hold, use or benefit from the financial instrument, structured deposit or activity or practice".*

In addition, Article 42, paragraph 2, sub-paragraph e), of MiFIR provides that the action should not have *"a discriminatory effect on services or activities provided from another Member State".* In this respect, before exercising intervention powers, NCA(s) of a given Member State shall consult with the competent NCA(s) of (an)other Member State(s), when the latter is/are (or could be) significantly affected by the intended action.

In light of the above, intervention powers are to be seen as an "*extrema ratio*", to be triggered only if there is no other available action to be taken in order to tackle the risk at issue. In other words, the authority to prohibit marketing, distribution or sale of Products or ban certain financial practices is to be construed as a safeguard measure, which could be triggered only in consequence of a failure in the application of product governance rules by MiFID firms. However, MiFIR grants to the Authorities the power, as a precautionary measure, to impose the same restrictions mentioned above even before the marketing, distribution or sale of a Product to end-clients[22].

Moreover, although MiFIR expressly admits[23] that, for obvious proximity reasons, NCAs "*are better placed to monitor market developments*", it nevertheless assigns intervention powers even to ESAs (in particular, to ESMA with regard to financial instruments, and EBA with regard to structured deposits).

[22] Recital 29 of MiFIR establishes that product intervention powers "*do not imply any requirement to introduce or apply a product approval or licensing by the competent Authority (...) and do not relieve investment firms of their responsibility to comply with all the relevant requirements laid down*". As a result, investment firms hold full responsibility with regard to product governance powers, whilst the Authorities could still decide to make the marketing, distribution or sale of Products subject to prior authorisation.

[23] See Recital 48 of MiFIR.

In fact, Products' market will be simultaneously monitored by both NCAs and ESAs[24].

In order to avoid conflicts, MiFIR provides for specific rules to be observed by the Authorities so as to govern their relationships. In particular:

a) before imposing a ban/restriction (more specifically, at least one month before the measure is intended to take effect), the relevant NCA(s) must inform the competent ESA(s), as well as any other interested NCA(s)[25];

b) the competent ESA(s) must then issue an opinion on whether the proposed action is justified and proportionate. However, such opinion is not binding. In fact, should the relevant NCA(s) decide to take an action that is contrary to the ESA(s)' opinion, it will be necessary to justify such a decision by publishing the grounds thereof on its/their website (according to the so-called "comply or explain" principle).

Furthermore, direct intervention powers of the competent ESA(s) are also envisaged under MiFIR[26], when:

a) there is a significant investors' protection concern or a threat to the orderly functioning and integrity of the market or to the stability of the whole or part of the financial system;

b) existing regulatory requirements are deemed insufficient to address the situation at issue; and

c) the competent NCA remains inactive, and/or has not taken adequate actions to sort out the problem.

However, the action[27] taken by the competent ESA(s) is effective for three months only, following which the action may be renewed, but if it is not, it will expire. Yet, even if only temporary, the relevant ESA(s)' action prevails over any action previously taken by the competent NCA(s).

In light of the above, the functional diversity of NCAs' powers, on the one hand, and ESAs' powers, on the other hand, make them differ from each-other in so far as:

[24] More specifically, the competent Authorities involved might be several ones in case the relevant Products are sold and/or distributed in more than one Member State, for the intervention powers will be thus exercised by the competent NCA(s) of each interested Member State.
[25] In exceptional cases, NCA(s) can take action (on a provisional basis and as an interim measure of three months only) provided that a 24-hour prior written notice is given to the ESA(s) and/or to the other NCA(s) involved.
[26] See Articles 40 and 41 of MiFIR.
[27] When exercising its intervention powers, the competent ESA shall ensure that the action (a) does not have a detrimental effect on the efficiency of financial markets or on investors that is disproportionate to the benefits of the action itself, and (b) does not create a risk of regulatory arbitrage.

(i) the action taken by NCAs (a) is neither subject to periodic review nor to a final term, and (b) must be revoked only if the grounding facts no longer exist;

(ii) the action taken by ESAs (a) must be reviewed every three months, (b) is subject to a final term, and (c) produces only temporary effects.

In order to define the limits of the above powers, MiFIR[28] entrusts EU Commission with the task of adopting delegated acts which lay down factors and criteria to be considered by the Authorities when taking action. Among those: (i) the degree of complexity of the financial instrument in question and the relation with the type of clients to whom it is marketed, distributed and sold, (ii) the degree of innovation of the financial instrument, the activity or the practice at issue, (iii) the leverage of such financial instrument or practice, and (iv) the size or the notional value of an issuance of financial instruments in relation to the orderly functioning and integrity of financial markets or commodity markets[29].

Pursuant to such provision, on 18th May 2016, the European Commission issued a delegated regulation (the "**Delegated Regulation**")[30], which contains a detailed list of the aforesaid criteria and factors that the Authorities' must take into account in order to take action pursuant to MiFIR[31].

[28] See Articles 40, paragraph 8, 41, paragraph 8, and 42, paragraph 7, of MiFIR.

[29] In addition to those, ESMA provided for additional criteria and factors. In its "*Technical Advice to Commission on MiFID II and MiFIR",it* specified that flexibility must be the key-principle of any assessment. In particular, *"the factors and criteria listed in this advice are elements which are relevant when assessing whether there is a significant investor protection concern, a threat to the orderly functioning and integrity of financial markets or to the stability of the whole or part of the financial system which justify (...) product intervention power".* Also, ESMA clarified that, *"depending on the severity of the issue, it may be that an intevention of the relevant Authority is justifiable where only one of these factors or criteria is present".* Moreover, competent NCA(s) and ESA(s) *"should be able to intervene in new instruments or services or activities that may not meet these factors or criteria or, converserly, not necessarily intervene if given criteria are met but overall detriment is not foreseen or detected or the relevant proportionality test is not satisfied".*

[30] Commission Delegated Regulation (EU) 2017/567 of 18th May 2016 supplementing Regulation (EU) 600/2014 of the European Parliament and of the Council with regard to definitions, transparency, portfolio compression and supervisory measures on product intervention and positions (OJ L87, 31.03.2017). It will enter into application on 3th January 2018.

[31] In addition to the criteria laid down by MiFIR, the Delegated Regulation makes reference, *inter alia*, to:
- the size of potential detrimental consequences;
- the type of clients involved;
- the degree of transparency and the particular features or components of the financial instrument;
- the existence and degree of disparity between the expected return or profit for investors and the risk of loss;
- the costs and ease with which investors are able to sell the relevant financial instrument or switch to another financial instrument, or exit a structured deposit;
- the pricing, the costs and the selling practices associated with the financial instrument;
- the financial and business situation of the issuer of a financial instrument;

3. Product intervention powers in the EU Member States

As of today, Belgium, Czech Republic, Denmark, Germany, Ireland, Spain, France, Italy, Cyprus, Luxembourg, Hungary, Austria, Portugal, Slovakia, Sweden and the United Kingdom have already implemented MiFID II into national law[32].

In the meanwhile, the Securities and Markets Stakeholders Group ("SMSG")[33] has recently published a report on product intervention measures which Member States (and Norway) have adopted or meditate to adopt under MiFIR[34].

The product intervention measures adopted or proposed to be adopted can be classified in four categories:

(i) ban on the sale of certain Products to retail clients:

a) Belgium introduced a ban on the sale of life settlements, products derived from virtual currencies and financial products derived from unusual products;

b) the UK introduced a ban on the sale of contingent convertible instruments ("**CoCo's**") and CoCo-funds;

c) Germany introduced a ban on the sale of financial contracts for difference ("**CFD's**").

(ii) ban on certain Products' features:

a) Belgium and France introduced a limit on the level of complexity;

b) Malta, Poland and the UK introduced leverage limits;

- whether there is sufficient, or unreliable, information about a financial instrument, to enable market participants at whom it is targeted to make an informed decision;
- whether a financial instrument would leave the national economy vulnerable to risks;
- whether the characteristics of a financial instrument or structured deposit make it particularly susceptible to being used for the purposes of financial crime or would threaten investors' confidence in the financial system.

[32] For a detailed list thereof, please see http://eur-lex.europa.eu/legal-content/EN/NIM/?uri=celex:32014L0065.

[33] The SMSG is currently composed of 29 individuals representing ESMA's key stakeholder constituencies. More specifically, financial market participants (10), employee representatives (2), consumer representatives (6), users of financial services (2), small and medium sized enterprises (2) and academics (7). The SMSG helps to facilitate consultation between ESMA, its Board of Supervisors, and stakeholders on ESMA's areas of responsibility, and provides technical advice on its policy development.

[34] See SMSG Advice to ESMA, *"Own initiative report on product intervention under MiFIR"*, dated 16th June 2017. Please note that, so far, only nine Member States (and Norway) have already taken or intended to take certain measures concerning product intervention. Some of them are "voluntary" in nature (e.g., Belgian moratorium, German measure, Italian warning), in the sense that market participants can voluntarily commit to abstain from certain Products' offerings or practices, but they have also the choice not to commit, whilst some others are binding for market participants.

c) Germany introduced a minimum denomination of credit-linked notes.

(iii) ban on marketing of certain Products to certain investors:

a) the Netherlands, the UK and Germany introduced a ban on all types of marketing to retail investors;

b) Belgium and France introduced a ban on the on-line marketing.

(iv) extra information or warnings in respect of certain Products introduced by France, Malta, the UK and Norway.

With regard to the scope of protection, almost all product intervention measures in question aim at defending retail investors. Only Malta has taken a measure with respect to the maximum leverage of complex products, which affects both retail and professional investors. The Netherlands, on the other hand, are considering to target only a subgroup of retail investors (namely, "consumers").

Moreover, in respect of product intervention measures adopted or proposed to be adopted, two different approaches can be distinguished:

(i) certain Member States have taken product-specific measures against:

a) CFD's (Belgium, Germany, Malta and the UK);

b) binary options (Belgium);

c) life settlements, financial products derived from virtual currencies and financial products derived from unusual products (Belgium);

d) credit-linked notes (Germany);

e) Forex (Malta);

f) CoCo's and CoCo-funds (the UK).

(ii) other Member States (namely, Belgium, France, the Netherlands, Malta, the UK, Norway and Italy) have adopted measures targeting a range of "complex" products, often including therein one or more of those mentioned above.

4. Product intervention powers in Italy

4.1 *"Pre-MiFID II/MiFIR" measures: CONSOB Communication on the distribution of complex financial products to retail investors*

A list of highly complex financial products that may be offered to the public only if some requirements are satisfied was provided by CONSOB (*Commissione Nazionale per le Società e la Borsa*; the Italian Companies and Stock Exchange Commission) in

2014[35]. In addition, CONSOB clarified that, within the types of highly complex financial products included in the above list[36], some are "*not normally suitable for retail clients*"[37].

By doing so, CONSOB anticipated in Italy, yet by means of a non-binding measure[38], some of the principles enshrined in MiFID II/MiFIR. This initiative was taken by considering that the transparency requirements imposed by the then current regulation was insufficient to ensure a full investors' protection, as well as to prevent distortion in the placement of highly complex financial products.

Moreover, the Communication recommended intermediaries to:

- verify the coherence between the products offered and the clients' profile;
- prevent conflicts of interest that may occur in the distribution of complex financial products to retail clients; and
- recur to the same assessment and simulation methods used (for internal purposes) to manage risks when preparing the information to be provided to retail clients in the distribution phase.

Furthermore, should intermediaries decide not to comply with the above recommendations, for they deem that the distribution of a specific complex product is in

[35] CONSOB's Communication no. 0097996/2014 of 22nd December 2014 (the "**Communication**"), issued on the basis of two ESMA opinions (namely, "*MiFID practices for firms selling complex products*" of 7th February 2014, and "*Good practices for product governance arrangements*" of 27th March 2014), which listed certain complex products, recommending intermediaries to adopt good practices when offering such products to the public. In the Communication, CONSOB fully embraces ESMA's position outlined in the opinions.

[36] Such list includes:
- over-the-counter derivatives traded on trading venues, with hedging purpose;
- financial products whose pay-off is linked to indices not compliant with ESMA's Guidelines;
- perpetual bonds;
- alternative collective investment undertakings;
- structured financial products, traded on trading venues, without full capital protection at maturity;
- leveraged financial products with a leverage ratio higher than 1 (including financial products taking short positions);
- structured UCITS funds and unit linked, index linked or capitalization insurance policies.

[37] Such list includes:
- financial products deriving from securitisation transactions of receivables or other assets;
- convertible securities and other financial products that entail a reduction of the nominal value upon the occurrence of certain conditions or at the issuer's initiative;
- credit-linked securities;
- over-the-counter derivatives not traded on trading venues, with no hedging purposes;
- structured financial products, not traded on trading venues, without full capital protection at maturity.

[38] Indeed, the Communication does not establish a ban on distribution of highly complex financial products to retail clients, but provides only for some recommendations to intermediaries.

the interest of the retail clients and that the latter have been provided with adequate information concerning such product (and the related risks), they may be invited by CONSOB to adopt certain precautions during the placement phase[39].

For the purpose of this article, it is just the case to note that the Communication may be read as an anticipation, in substance, of the rules on product governance[40]/product intervention[41] under MiFID II/MIFIR, in so far as CONSOB's recommendations provided therein have been normally followed by intermediaries, also taking into account that "*the decisions taken by the latter will contribute to guide the supervisory actions of CONSOB"*[42].

4.2 *The implementation of product intervention powers into national law*

Italy has recently transposed MiFID II into national law and adapted the latter to MiFIR provisions by means of Legislative Decree no. 129 of 3rd August 2017, published on the Official Gazette no. 198 of 25th August 2017 and entered into force on the following day, 26th August (the "**Decree**").

The Decree introduced several changes to the Consolidated Financial Act ("*Testo Unico della Finanza*"; namely, Legislative Decree no. 58/1998, as amended), among which those relating to product governance[43] and product intervention[44].

It is important to note that the new provisions are in line with the supervisory model currently in place, which is based on the allocation of competences "for purposes" ("*per finalità*")[45] between CONSOB and the Bank of Italy, according to which[46]:

> (i) CONSOB shall be competent for investors' protection, orderly functioning and integrity of financial or commodity markets, as well as in case of prohibitive or restrictive actions whether it is reasonable that a

[39] The decision to distribute the products should be accompanied by an "*ex ante*" identification of investment limits for both actual and potential clients, taking into account:
- clients' socio-economic characteristics;
- relevant quantitative thresholds;
- modalities of the offer.
In addition, the intermediaries must provide their clients with a disclosure on the "unsuitability" for retail clients of the distributed products.

[40] See, on this point, M. Tofanelli in "*La Comunicazione CONSOB sulla distribuzione di prodotti complessi",* Financial Community Hub, 10th April 2015.

[41] See, on this point, M.E. Salerno in *"La disciplina in materia di protezione degli investitori nella MiFID II: dalla disclosure alla cura del cliente?*", in Regole e Mercato, Tomo I, p. 459, 2016.

[42] See paragraph 5 of the Communication.

[43] See Article 21, paragraphs 2-*bis* and 2-*ter*, of the Consolidated Financial Act, which reproduce the above mentioned provisions set out in Article 24, paragraph 2, of MiFID II.

[44] See Articles 7 to 7-*novies* of the Consolidated Financial Act.

[45] See Government's explanatory report to draft Decree, page 14.

[46] See Article 7-*bis,* paragraphs 2 and 3, of the Consolidated Financial Act.

derivative has a detrimental effect on the price formation mechanism in the underlying market; and

(ii) the Bank of Italy shall be competent for the stability of the whole or part of the financial system.

Among the main novelties introduced by the Decree, it is worth mentioning the changes made to the existing Article 7, as well as the new Article 7-*bis* of the Consolidated Financial Act.

In particular, Article 7[47] confers new intervention powers upon the above mentioned NCAs, as follows:

(i) the Bank of Italy and CONSOB, within their respective competences, are allowed to issue public notices[48];

(ii) CONSOB must intimate to authorised subjects not to make use, in their own business and for a period not exceeding three years, of the professional activity of a natural person which could cause detriment to the transparency and the correctness of behaviours[49];

(iii) CONSOB must remove, within its competences and after consulting with the Bank of Italy, one or more natural person from the management board of an investment firm or market operator[50], whenever their tenure of office could be detrimental to the transparency and the correctness of behaviours of the authorised subjects; and

(iv) CONSOB must order, for a period not exceeding 60 days for each time, the suspension of the marketing or sale of financial instruments in case of violation of the obligations concerning the product governance, and whenever there could be a detriment to the investors' protection[51].

[47] Article 7 transposed into national law the provisions laid down in Article 69, paragraph 2, sub-paragraphs f), q), s), t) and u), of MiFID II.
[48] See Article 7, paragraph 1-*ter*, of the Consolidated Financial Act.
[49] See Article 7, paragraph 1-*quater*, of the Consolidated Financial Act. It is worth noting that, unlike Article 69, paragraph 2, sub-paragraph f), of MiFID II that does not expressly provide for a maximum period in respect of the temporary prohibition of the professional activity, Article 7, paragraph 1-*quater* establishes a period of up to three years.
[50] Article 7, paragraph 2-*ter*, refers to CONSOB's power of removal of one or more directors and/or managers of Italian investment companies (*società di intermediazione mobiliare*; "**SIM**"), Italian banks, asset management companies (*società di gestione del risparmio*; "**SGR**"), variable capital investment companies (*società di investimento a capitale variabile*; "**SICAV**") and fixed capital investment companies (*società di investimento a capitale fisso*; "**SICAF**").
[51] See Article 7, paragraph 3-*bis*, of the Consolidated Financial Act.

In addition, Article 7-*bis*[52] grants to CONSOB and the Bank of Italy, only under certain conditions[53] and after consulting with each-other[54], the authority to prohibit or restrict:

(i) marketing, distribution or sale of certain financial instruments or structured deposits, or financial instruments or structured deposits with certain specified features; or

(ii) a specific type of financial activity or practice[55].

Without prejudice to such intervention powers, the afore-said NCAs may finally order, after consulting with each-other and within their respective competences, the suspension, for a period not exceeding 60 days each time, of the marketing and sale of financial instruments and structured deposits where the conditions pursuant to Articles 40, 41 or 42 of MiFIR are met[56].

It will be interesting to see how the industry will react to the new set of rules summarised above, and to the new intervention powers. As far as the competent Italian NCAs are concerned, the comments officially made so far[57] did not go beyond generic statements about the importance of such new intervention powers, yet without going into details on how, for instance, the latter would necessarily imply the strengthening of the internal organisation of the NCAs in question.

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[52] Article 7-*bis* adapts the national legislation to the provisions laid down in Article 39, paragraph 3, Article 42 and 43, paragraph 3, of MiFIR.

[53] It should be reminded that, according to Article 42, paragraph 2, of MiFIR II, NCAs may take action only on the reasonable ground that, *inter alia*:
- there is a significant investor protection concern, or a threat to the orderly functioning and integrity of financial markets or commodity markets, or to the stability of whole or part of the financial system within at least one Member State, or a derivative has a detrimental effect on the price formation mechanism in the underlying market;
- the existing regulatory requirements do not sufficiently address the mentioned risks, and the issue would not be better addressed by improved supervision or enforcement of existing requirements; and
- the action is proportionate given the risk, the level of sophistication of investors or market participants concerned, and the effect of such action on investors and market participants.

[54] See Article 7-*bis*, paragraph 5, of the Consolidated Financial Act.

[55] See Article 7-*bis*, paragraph 1, of the Consolidated Financial Act.

[56] See Article 7-*bis*, paragraph 5, implementing Articles 40 ("*ESMA temporary intervention powers*"), 41 ("*EBA temporary intervention power*") and 42 ("*Product intervention by competent Authorities"*) of MiFIR.

[57] In this respect, even CONSOB's Strategic Plan for 2016-2018 did not make any reference to the new intervention powers and how the supervisory authority intends to carry out them, in practice. In his conclusive remarks at the Annual meeting with the financial market on 8th May 2017, President Vegas pointed out that the assignment of such powers will constitute a real leap in quality with regard to CONSOB's supervisory action, whilst Commissioner Di Noia, in the same direction, during his informal hearing at the Finance Committee of the Italian Chamber of Deputies on 15th June, underlined how necessary is to protect investors during the whole life-cycle of financial products by means of intervention powers.

5. Final remarks

In the last decades or so, financial products sold have generally neither been conceived nor marketed in the real interests of end-clients. As a result, the global financial crisis has revealed gaps in the level of protection granted by MiFID I, as well as shortcomings in the functioning and transparency of financial markets. Strenuous efforts have been thus made to carry out a detailed review of MiFID I regime by introducing, among others, *ex ante* product governance and *ex post* product intervention rules, both necessary to prevent harmful financial instruments from reaching the market.

However, the new intervention powers could lead, for instance, to an excessive interference of the Authorities in the banks and investment firms' policies, as well as in the parties' contractual autonomy.

Below please find a summary of preliminary criticisms that could be moved to the new set of rules:

5.1 *The NCA(s) will operate as a filter before the creation and distribution of financial products?*

MiFIR expressly states that intervention powers "*do not imply any requirement to introduce or apply a product approval or licensing by the competent Authority, ESMA or EBA, and do not relieve investment firms of their responsibility to comply with the all relevant requirements laid down in this Regulation and in MiFID II*"[58] .

Therefore, MiFIR expressly excludes the introduction of a product pre-approval procedure before the competent NCA(s), maintaining upon the investment firms the obligation to satisfy the relevant product governance requirements.

However, in light of the characteristics of the new intervention powers, it would be advisable to promote, at least during the financial product's conception phase, a dialogue between investment firms and competent NCA(s), aimed at understanding whether such product complies or not with the new product governance rules. This would considerably reduce the risk of ban and/or restriction actions to be taken by the relevant Authorities once the product in question is already being distributed to the public.

5.2 *Limitation of the parties' contractual autonomy and effects on the investment contracts already entered into force*

As anticipated above, the Authorities' intervention could affect the whole product life-cycle, and so entail two sets of potential issues depending on the production/distribution's phase involved.

[58] See Recital no. 29, paragraph 2, of MiFIR.

With reference to the conception phase, intervention powers aimed at banning the creation of financial instruments seem to introduce a new kind of limitation on the private parties' contractual autonomy enshrined in the Italian Civil Code (the "**Code**")[59], as well as a restriction of the freedom of private economic initiative[60].

In respect of the distribution and post-distribution phases, one could easily identify a potential harmful impact of the triggering of the intervention powers under examination on contracts already entered into force between intermediaries and end-clients.

In fact, according to Article 1418, paragraph 2, of the Code, contracts are to be considered void should, *inter alia*, the object thereof become unlawful. Therefore, the contracts entered into force and then banned as a result of the intervention of a competent Authority could become void due to the fact that they would no longer be lawful, with a subsequent effect on the contractual relationship between investment firms and end-clients[61]. As a result, the investment firm in question should immediately return to the client the amount of the investment made.

Also, in case an action for damages is brought before a competent Court, the latter could declare the termination of the contract at issue for breach of the general rule of good faith and fair dealing, set forth by Articles 1175 and 1375 of the Code, and award compensation for the potential damages caused.

5.3 *Limitation of the parties' participation in the NCA(s)' decision-making process*

Once it has decided to prohibit/ban a Product, the competent NCA is obliged to publish such decision on its website. The notice shall contain: the details of the measure, the period from which the measure will take effect, and the evidence upon which the action is taken[62]. There is no obligation to inform the interested parties of the NCA's intention to take such an action.

The above circumstances seem to violate some of the pillars of Italian administrative law[63]: the principle of the parties' participation in sanctionary proceedings and the right of defence.

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[59] See Article 1322 of the Code.
[60] See Article 41, paragraph 1, of the Italian Constitution.
[61] See on this point, V. Troiano and R. Motroni in "*La MiFID II – Rapporti con la clientela – regole di governance – mercati*", p. 232, 2016.
[62] See Article 42, paragraph 5, of MiFIR.
[63] See Articles 7 and 10 of Law no. 241/1990, according to which the decision to start a relevant administrative proceeding shall be communicated to the interested parties, in order for the latter to file reports and documents with the competent Authority, which the latter shall take into account when taking the final decision. See also Article 195 of the Consolidated Financial Act, and Articles 4 and 5 of CONSOB Regulation on Sanctioning Proceedings (namely, Regulation no. 18750 dated 19th December 2013, lastly modified on 24th February 2016).

For this reason, the promotion of a dialogue between competent NCA(s) and investment firms prior to the adoption of the ban/prohibition of a Product pursuant to the intervention power under MiFIR is deemed advisable so as to allow the participation and, where appropriate, the objection to such action and to avoid that the latter could be wrongful due to missed information regarding the Product in question.

5.4 *NCA(s)' liability for lack of intervention?*

Another foreesable issue that deserves to be pointed out concerns NCA(s)' potential liability in the event of omitted exercise of its/their new intervention powers.

As of today, Italian Courts[64] have, in several occasions, ruled upon CONSOB's liability for the damages suffered by the investors on the ground of falsehood in prospectus[65] when:

- the prospectus was ascertained to be false;

- such a falsity was *ictu oculi* ascertainable solely through a formal exam;

- the action (or omitted action) was taken (or not taken) with wilful misconduct or gross negligence by CONSOB's employees or officers;

- if promptly and correctly exercised, CONSOB's powers of control and ban would have discouraged the damaged parties from investing in such fraudulent transactions.

It is thus possible to foresee that the omission in the recourse to the new intervention powers under MiFIR may imply the occurrence of potential liabilities where damages to end-clients will be judicially ascertained as a direct consequence of the afore-said omission[66].

[64] See Supreme Court decisions no. 23418/2016 of 17th November 2016, no. 6681/2011 of 23h March 2011, no. 4587/2009 of 25th February 2009, no. 3132/2001 of 3rd March 2001. See also decision no. 4201 of 24th December 2012 of the Court of Appeal of Milan.
[65] See Article 94-*bis* of the Consolidated Financial Act providing for CONSOB's duty to verify that the information indicated in the prospectus are complete, coherent and comprehensible.
[66] See, on this point, Supreme Court decision no. 3132/2001 of 3rd March 2001.