

White paper: Distributor Oversight Reporting

Ensuring MiFID II Target Market compliance

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1. MiFID II, Target Market and Distributor Oversight Reporting (“DOR”)

With the introduction of MiFID II in January 2018, Fund Providers must now oversee distributors and sub-distributors to ensure compliance with their distribution strategies and ensure that they are selling their funds to the appropriate clients. This is a break from the past when distributors could be tasked to sell the right funds to appropriate investors. This is accomplished by selling funds to investors in compliance with six “Target Market” categories defined by the European Securities and Markets Authority ([ESMA](#)):

- 1) To which investor type is the fund suited? (e.g. Retail or Professional)
- 2) What is the knowledge level of the investor? (e.g. Basic, Informed, Advanced, Expert)
- 3) What is the investor’s ability to bear loss?
- 4) How compatible is the risk and reward aspects of the fund with the Target Market?
- 5) Is the fund in-line with the investor’s financial objectives?
- 6) Does the fund serve the investor’s needs? (e.g. is it sustainable? Currency protected?, etc.)

ESMA has defined these reporting categories to ensure that investors are protected from making non-suitable investments (referred to as “Negative Target Market”), a situation that is only allowed to occur under exceptional circumstances. ESMA’s goal is to ensure that firms which manufacture as well as distribute investment products act in investors’ best interests during all the stages of the life-cycle of their products.

As a key part of MiFID II, Target Market and Distributor Oversight Reporting (“DOR”) are obligatory for any MiFID regulated Fund Distributor which sells financial products into any one of the 31 member states of the European Economic Area; the 28 EU member states plus Iceland, Norway and Liechtenstein.

2. Deploying DOR

Although ESMA mandates distributor oversight reporting, only high-level guidelines are specified. It is thus up to Fund Distributors, Fund Houses and the DOR reporting protocol to adapt to the capabilities of each party to send, receive and process DORs. No doubt there will be many different variations of reporting coverage depending on the capabilities and/or agreement between parties.

What is clear: DOR must support all levels of implementation, from simple reporting of Negative Target Market events to comprehensive reporting of compliance with all six Target Market categories for each investment transaction. A common vocabulary and set of information descriptors must be adopted for DOR at an early stage to facilitate a common understanding of reporting requirements, and avoid misinterpretation of Negative Target Market events.

3. DOR: Reporting formats

There are four different reporting formats within the DOR:

1. **NIL Report:** Distributors use this reporting format when no sales into the negative target market or outside the recommended distribution channels were made.
2. **Exception Reporting – aggregated:** Distributors use this format when reporting only sales into the negative target market or excluded distribution channels in aggregated form.
3. **Exception reporting – transaction level:** Distributors use this format when reporting each transaction into the negative target market or excluded distribution channels.
4. **Full Target Market:** Distributors use this format when reporting all transactions no matter if they were inside or outside the negative or positive target market.

4. DOR: The responsibilities of Fund Distributors

Fund distributors must be able to create DORs on products coming from multiple manufacturers sold into multiple domiciles. IT system architecture and the information template for the reporting system is

a key factor for DORs as it will require access to information about clients, plus their transactions and products purchased. This information may reside on different systems. There are a number of different ways in which a sale outside the target market or into a negative target market could arise:

- 1) The distributor disagrees with a fund provider's target market decision and effectively overrides it with their own, broader target market definition. If a distributor believes the fund provider's assessment is incorrect, a communications channel should exist to transmit the reasons for this back to the fund provider.
- 2) A distributor sells the product to a client to provide portfolio diversification or hedging.
- 3) There is a mistake in a distributor's sales process.
- 4) A client specifically requests a product outside his/her target market.

There also might be other reasons for sales outside the positive target market or into a negative target market. However, all cases should be included in a DOR whether the distributor believes it is justifiable or not. Complete and comprehensive DOR should be carried out by all Fund Distributors to allow their manufacturing partners to fully comply with MiFID directives.

5. DOR: The Responsibilities of Fund Providers

Whatever information Fund Providers receive via DOR, they must be able to understand, aggregate, analyse and act on it, as well as store evidence that they have done so to satisfy regulators. Information may be received from a large number of distributors across multiple countries, across different timeframes and reporting periods.

A DOR information template should enable a fund provider to precisely identify where they may have concerns which warrant:

- Further discussions with a specific distributor, or
- Investigation to assess whether the target market classification for a product is appropriate

Ultimately, it is the responsibility of Fund Providers to ensure that their distribution partners are selling their products into the correct Target Market. For this reason, there is a clear requirement for a common language between all parties to ensure that no omission or misinterpretation of DOR information occurs.

6. openfunds: providing a bottom-up approach to DOR

DOR, as defined by ESMA, is a top-down description of reporting requirements and the responsibilities of Fund Distributors and Fund Providers to meet those requirements. To fulfil practical implementation of DOR and allow for meaningful interpretation of reporting data, a precise, bottom-up description of all possible information fields associated with DOR needs to be defined and adopted across the fund industry.

openfunds The openfunds association is addressing this issue for DOR standardisation by extending the openfunds standard for the characterisation of investment funds to include information fields covering DOR. These fields are aligned with the MiFID feedback template proposed by TISA and PIMFA in collaboration with the European Working Group (not yet finalised).

Established in 2016 as a non-profit consortium of leading financial institutions active in the funds industry, the goal of the openfunds association is to improve the quality and efficiency of the dissemination and exchange of fund information between fund providers, fund distributors, as well as all participants in the fund market ecosystem, particularly investors.

The openfunds association is closely monitoring the development of DOR and is currently defining a comprehensive fields list. As this is the first requirement for fund data travelling in the upstream direction (Fund Distributor to Fund Provider), the field identifiers begin with "OFUP", which stand for "openfunds upstream" data followed by a unique identifier for each field. The preliminary fields listed below are currently planned for DOR.

Please note this fields list is only for pre-informative purposes and not yet final. Please monitor the progress of the openfunds DOR fields list at: <https://www.openfunds.org/fieldmenu/fields/distributor-oversight-reporting/>.

Distributor Oversight Reporting Fields as defined by openfunds (NTM = Negative Target Market):

- OFUP000005 DOR Period Start
- OFUP000010 DOR Period End
- OFUP000500 DOR Report Status
- OFUP000505 DOR Report Format
- OFUP000600 DOR Reference Currency
- OFUP000610 DOR Aggregated Value Share Class
- OFUP000620 DOR Transaction Reference Code
- OFUP000623 Transaction Status
- OFUP000625 Transaction End Investor Type
- OFUP000627 Transaction Distribution Channel
- OFUP000629 Neither NTM Nor NDC Value
- OFUP000630 Investor Type NTM Value
- OFUP000631 Investor Type NTM Transactions
- OFUP000635 Knowledge And Experience NTM Value
- OFUP000636 Knowledge And Experience NTM Transactions
- OFUP000640 Ability To Bear Losses NTM Value
- OFUP000641 Ability To Bear Losses NTM Transactions
- OFUP000645 Risk Tolerance NTM Value
- OFUP000646 Risk Tolerance NTM Transactions
- OFUP000650 Client Objectives NTM Value
- OFUP000651 Client Objectives NTM Transactions
- OFUP000660 Execution Only NDC Value
- OFUP000661 Execution Only NDC Transactions
- OFUP000665 XO Appropriateness Test Failed NDC Value
- OFUP000666 XO Appropriateness Test Failed NDC Transactions
- OFUP000670 Execution With Appropriateness NDC Value
- OFUP000671 Execution With Appropriateness NDC Transactions
- OFUP000675 Investment Advice NDC Value
- OFUP000676 Investment Advice NDC Transactions
- OFUP000680 Portfolio Management NDC Value
- OFUP000681 Portfolio Management NDC Transactions
- OFUP001000 Distributor Name
- OFUP001001 LEI Of Distributor
- OFUP001003 Distributor Reference Number
- OFUP001005 Distribution Country
- OFUP001010 Next Upstream Reporting Entity Name
- OFUP001012 Next Upstream Reporting Entity Type
- OFUP001013 Next Upstream Reporting Entity Type Email

These DOR fields complement openfunds' 400+ existing "downstream" [fields](#) that describe all possible aspects of an investment fund. Through the establishment of an industry-wide standard, openfunds has become the de-facto method for exchanging information and comparing funds sold in Europe and Asia. To date, over 65 companies active in the funds market have adopted the standard. For more information about openfunds, please visit www.openfunds.org

The openfunds association encourages all participants in the fund industry to adopt the license-free, cost-free openfunds standard to achieve transparency and increased efficiency when exchanging fund information. For a complete overview to Distributor Oversight Reporting, refer to TISA's and PIMFA's [MiFID II Product Governance – Approach to Implementation for Distributor Reporting](#).

7. Revision History

Version	Date	Author	Description
1.0.0	31.10.2018	carl.fenger@fundinfo.com	Initial version