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Finance for Europe

20th March 2018

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Dear John

We would like to follow up on our letter dated 21 December 2017 to Vice-President Dombrovskis (attached), which was copied to DG FSMA, highlighting the negative unintended impact that the ambiguity in the scope of the PRIIPs Regulation has been having on retail investors and corporate bond issuers since 1 January.

Since 1 January we have received feedback from our members and gathered evidence from other industry participants, which supports our prediction of a substantial reduction in the availability of non-structured bonds to retail investors in the EEA. You will find attached an overview of the feedback we have received in January and February. This feedback sheds light on the negative impact of the ambiguity regarding the scope and has prompted us to send you a letter in which we have provided further context and suggested a way forward.

In essence, industry uncertainty as to scope and some bilateral discussions with colleagues of yours in the Asset Management Unit have led to risk-minimising advice that any bond that does not have completely fixed returns may be a PRIIP, resulting in issuers designating the vast majority of new issues as not intended for retail, rather than consider whether the product is a PRIIP and, if so, prepare a KID. Given this position and the lack of KIDs for corporate bonds issued pre-2018, retail investors are unable to invest in most new issues of corporate bonds and, causing even greater detriment, are unable to sell their existing holdings of pre-2018 bonds to anyone other than a professional investor.

In light of the evidence received, our concern is that, absent Commission action, there will continue to be the significant negative impacts on the CMU objectives of increasing market-based financing by issuers and increasing direct investment in European corporates by retail investors, as set out in more detail in the second paragraph of our letter dated 21 December.

In addition, as shown in the feedback we have received, we are also concerned by the significant negative impact on retail holders of pre-2018 bonds that are perceived as potential PRIIPs. As these products do not have KIDs, banks with retail customers and who are concerned at the risk that these products would be regarded as PRIIPs cannot facilitate the onward sale or purchase to other retail investors, meaning that existing investors have to hold the investments to maturity or sell to (the few) professional investors who are prepared to stock up on these investments through a number of purchases from retail and then on-sell to other professional investors.

The consequences we have highlighted stem from undue weight being attached to secondary sources such as press releases and footnotes (e.g. press release/statement 14-122 dated 15 April 2014) rather than focussing on the Level 1 text of the PRIIPs Regulation. Such a reading means that plain vanilla corporate bonds that contain one or more investor-protective features (e.g. inflation-linked principal and interest, make-whole call options and some change of control put options), and that are neither structured nor packaged (two key features of PRIIPS), are being treated as PRIIPs.

If an instrument is (or is considered capable of being) a PRIIP, then a KID is required for sale to retail investors. Creditworthy borrowers, who have a responsibility to their shareholders to minimise the level of risk taken when raising capital, are currently able to finance themselves without making issues available to retail. Once advised of the potential liability and ongoing costs linked to producing a KID and keeping it up to date, as well as liabilities that may accrue in jurisdictions outside the EU due to the interplay of PRIIPs and global securities laws[1], issuers are deciding not to produce KIDs and, to minimise risk further, designate the issue as for professional investors and ECPs only. The same reaction is evident in some markets outside the EEA also, sometime irrespective of whether EEA investors are targeted.

As a consequence, plain vanilla corporate bonds of this type are not only unavailable to retail clients (within and outside the EEA), but they are also unavailable to those professional clients or ECPs that are acting on behalf of retail clients or who could on-sell to them. In practice, only retail clients who entrust their assets to a discretionary asset manager can access plain vanilla bonds. All other retail clients are being limited to indirect investments via collective investment schemes, structured products or the occasional bond that has either: (1) been stripped of the investor protective features listed above; or (2) has been issued with a PRIIPs KID.

A similarly cautious approach has been taken in some countries by some issuers in relation to subscription rights. While erring on the side of caution is a rational approach for those who carry the litigation and regulatory risk arising from conflicting global securities laws or from potentially incorrect advice and do not have a need to accept any degree of risk, the overall impact on the market is negative, and goes against the Commission's aims of promoting growth in Europe, fostering retail investment into European companies and reducing the dependence of the European industry on bank funding.

We think that the current state of affairs could be corrected by bringing issuers' and advisers' attention back to the text of PRIIPs regulation, its policy objectives and the intention of the Level 1 legislature, as evidenced by, for example, the Communication from the Commission to the European Parliament and the Council on Packaged Retail Products dated 30 April 2009 and the Commission Proposal for the Regulation. As is clear in those texts, the focus of the EU's initiative was packaged products, where the exposure is not direct, the investor does not buy the specific assets himself, but instead accesses the market through the intercession of "wrappers". Examples of PRIIPs which have been given consistently are investment (or mutual) funds, investments packaged as life insurance

[1] Please see the enclosed paper on the legal and regulatory liability risk associated with the production of a KID for further details.

policies, structured products and structured deposits. In our view, there was no policy intent to capture direct investments such as plain vanilla shares or corporate bonds. The consultations, responses to consultations, impact assessments and legislation were all adopted on this basis.

We are aware of calls for the scope of the PRIIPs Regulation to be broadened. Such a decision is an important one that needs to be debated and evaluated in the proper institutional fora by legislators and policymakers who have consulted with stakeholders and have assessed all the evidence as to the benefits and costs of such a decision. The PRIIPs review, planned for later this year, is the proper forum for such a discussion, which would then need to be implemented by changing Level 1. It would be imperative to give the market sufficient time to prepare for an extension of scope and specific consideration would have to be given to existing retail holders of the products brought in scope so that they are not, as is happening currently, disadvantaged. Such disadvantage runs contrary to the objectives of the Regulation.

In the meantime, the private risk-limitation decisions of individual players should not be allowed to limit retail investors' options and prejudge the legislature's decision. **We would therefore urge the Commission to correct this market failure by bringing issuers' and advisers' attention back to the text of PRIIPs regulation and the intention of the Level 1 legislature.**

We would be grateful for the opportunity to discuss this with you at your earliest convenience.

Yours sincerely,

Simon

Simon Lewis OBE
Chief Executive

cc Verena Ross, ESMA Executive Director
Fausto Parente, EIOPA Executive Director