20 May 2022

IOSCO Retail Market Conduct Task Force Consultation Report (CR03/2022)

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ICMA response

Key points

(1) Cross-border bond markets are overwhelming institutional-only, inter alia due to onerous retail regulations.

(2) There seem to be significant limitations to disclosure as a retail investor protection tool: full/long-form disclosure is necessary to satisfy the substantive requirement that all material information be disclosed but will not be read by typical retail investors; short-form disclosure may not necessarily be read either and is often misunderstood.

(3) Consequently, long disclosure is necessary as a public transparency preliminary (and perhaps of use for a minority of retail investors) – to be complemented (for the majority of retail investors) by suitably regulated and supervised intermediation.

(4) Product governance is conceptually flawed regarding commoditised funding products and so is not a suitable alternative regulatory tool to disclosure in the bond markets. Attempting to 'customise' commoditised products such as bonds can undermine the liquidity that is one of the fundamental characteristics sought after by bond market investors.

1. ICMA is responding this IOSCO consultation from the perspective of the cross-border primary markets for bonds / debt securities ($6 trillion of turnover in 2021[1]).

Q7: Are the main fraud types covered correctly (e.g., crypto-asset scams, boiler room scams, clone investment firms, and ***misleading information*** *and promotional material)? What are the fraud patterns that cause/have potential to cause most retail investor harm? Are there other types of frauds or scams that regulators should consider?*

2. In relation to misleading information, IOSCO's focus with this question is likely to be on information that is intentionally (or recklessly) misleading. It is worth remembering however that **the concept of misleading information also encompasses information that is neither intentionally nor recklessly misleading**.

[1] See https://www.icmagroup.org/assets/documents/Market-Info/Dealogic/International-DCM-Volume-Q42021.pdf.

3. In the context public offerings of bonds, and distinctly from any regulatory requirements, the issuance parties face civil liability for material misstatements and omissions made in the context of the offering disclosure. This has been the subject of decades' worth of statute and case-law and consequent long-standing practices relating to due diligence defences. See further in this respect concerns about short-form disclosure in #5(D) below.

*Q9: Does the Consultation Report capture well the **existing cross-border challenges**? Are there any missing concerns or issues that are not highlighted? Are there any other novel ways of addressing cross-border challenges affecting retail investors? As an international body, what could be IOSCO's role in addressing the cross-border challenges highlighted in this consultation report?*

4. Onerous regulation in the context of retail bond offerings, as well as logistical considerations and fiscal and cultural specificities, has generally meant that **cross-border bond markets are overwhelming institutional-only**.[2] Any mass retail bond offerings tend to occur on a domestic basis only. They tend to be rare even domestically, with the exception of domestic government bonds and a few domestic corporate bond markets. Any retail participation in cross-border bond markets tends to involve high net worth investor accounts, generally professionally managed on a discretionary basis.

*Q10: What may be the concerns or issues that regulators should ask for **disclosure** of (at both firm and product level), keeping in mind the balance between quantity of disclosure and the ability of retail investors to absorb such disclosure? Should markets continue to seek to put in place special arrangements that could encourage companies during stressed market events to provide disclosures and updates that help retail investors better evaluate current and expected impacts of such events? If so, what may be the practical options to achieve this, including who should provide this information? Are there specific technological measures or non-technological measures (e.g., changing the timing, presentation of the information) you would suggest to enhance the ability of retail investors to process the disclosure?*

5. Bearing in mind behavioural science findings and as noted in the ASIC/AFM 2019 report *Disclosure: Why it shouldn't be the default*, there indeed seem to be **significant limitations to disclosure as a retail investor protection tool** (at least in the bond context).
   (A) Full/long-form disclosure is necessary to satisfy the substantive requirement that all material information be disclosed.
   (B) However long-form disclosure will not be read by typical retail investors.
   (C) Short-form disclosure may not necessarily be read either, and is often misunderstood by typical retail investors (c.f. various studies regarding the EU PRIIPs KID, including indeed the AFM 2019 research on short form disclosure).
   (D) Intrinsically short-form disclosure cannot contain all material information / simplify substantive complexity (e.g. the likelihood of a bond issuer being unable to honour its payment obligations arising under the bond) and so is likely to be misleading (and a liability disincentive to retail bond supply) if it purports to act at a sufficient basis for an informed investment decision (which has been officially suggested as the purpose of the PRIIPs KID) – rather than e.g. as the basis for a preliminary filtering out of less attractive investment options.

[2] Care needs to be taken that any attempts to minimise retail supply disincentives do not disrupt the institutional/wholesale markets which have been reliably providing trillions in financing to the global economy over the years.

See further #12-#15 September 2018 ICMA response to FCA call for input on the PRIIPs Regulation.

6. It would consequently seem that **long disclosure is necessary as a public transparency preliminary** (and perhaps of use for a minority of retail investors[3]), **to be complemented** (for the majority of retail investors) **by suitably regulated and supervised intermediation** (whether direct holdings on an advised/discretionary basis or indirect access typically via funds). See further in this respect #99-#100 of ICMAs' April 2015 response to ICMA to the European Commission's green paper on building a Capital Markets Union.

7. Incidentally, the above **AFM 2019 research on short form disclosure seems to include several substantive inaccuracies**.
   (A) It purports to evaluate a *"summary prospectus"* seemingly as a standalone disclosure document – when in fact relevant EU regulation (currently Regulation EU/2017/1129) provides for a "prospectus summary" (under Art.7) *"that is to be read together with the other parts of the prospectus"*.
   (B) It concludes the *"summary prospectus"* as even more likely to be misunderstood than the PRIIPs KID, but without being clear whether its *"summary prospectus"* sample was under the current or prior EU regulation (the related gradual change-over only started from July 2019) – bearing in mind that the prior regulation's prescriptive summary regime was widely criticised as being incomprehensible (including at p.26 of an ICMA February 2015 response to the European Commission) and was materially improved under the current regime.
   (C) It interestingly judges the sample investors' decision-making on the basis that the appropriate outcome for retail investors is to concentrate their entire €10,000 investment in the 'best' product alone – seemingly ignoring diversification as a fundamental basis of sound investing (presumably diversification, even to riskier exposure, can be less risky than concentration to a single, albeit nominally less risky, exposure).

*Q13: Are the above **regulatory tools appropriate, proportionate, and effective**? Are there other regulatory tools regulators might consider? What new technologies may help regulators as they continue to address misconduct and fraud (including online/via social media)?*

8. **Product governance** is noted in the above ASIC/AFM 2019 report as a **possible alternative regulatory tool to disclosure** and is also covered in Chapter 5.5. of this IOSCO consultation (citing notably the EU MiFID regime): *"The requirements of product governance aim to ensure that during all stages of the product life cycle, products are designed to meet the needs of, and distributed to an appropriate target market."*

9. However, **product governance** (as applied under the EU MIFID regime that requires the designation of "target markets" of specific "compatible" investors for each product) is **conceptually flawed regarding commoditised funding products** such as bonds that are not "designed" as a "service" for investor "clients". Rather, bonds have been in existence for decades as a "product" for corporate and other borrowers to seek funding from the markets. See further July 2020 ICMA Quarterly Report article on May 2020 ICMA response to European Commission MiFID II/R review consultation.

[3] ICMA suggested investor knowledge/experience, as a differentiating factor from ordinary retail investor treatment / product access under the EU's MiFID regime, could also be based on recognised third party certification. See further Q7.1 in August 2021 ICMA response to the European Commission consultation on a retail investment strategy for Europe.

10. Furthermore, **attempting to 'customise' commoditised products such as bonds can undermine** one of the fundamental characteristics that are sought after by bond market investors: **liquidity** (IOSCO itself having recently published a discussion paper on liquidity concerns in corporate bond markets).

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