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London E14 5HS

(Submitted e-mail to: [cp16-29@fca.org.uk](mailto:cp16-29@fca.org.uk))

4 January 2017

Dear Sirs,

**FCA Markets in Financial Instruments Directive II Implementation – Consultation Paper III  
(CP16/29)**

The International Capital Market Association (ICMA)<sup>1</sup> is responding to the above.

Representing a broad range of capital market interests including banks, asset managers, exchanges, central banks, law firms and other professional advisers, ICMA's market conventions and standards have been the pillars of the international debt market for almost 50 years. See: [www.icmagroup.org](http://www.icmagroup.org).

ICMA is responding in relation to its primary market constituency that lead-manages syndicated debt securities issues throughout Europe. This constituency deliberates principally through ICMA's Primary Market Practices Committee<sup>2</sup>, which gathers the heads and senior members of the syndicate desks of 51 ICMA member banks, and ICMA's Legal and Documentation Committee<sup>3</sup>, which gathers the heads and senior members of the legal transaction management teams of 21 ICMA member banks, in each case active in lead-managing syndicated debt securities issues in Europe.

We set out our response in the Annex to this letter and would be pleased to discuss it with you at your convenience.

Yours faithfully,



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<sup>1</sup> European Transparency Register #0223480577-59

<sup>2</sup> <http://www.icmagroup.org/About-ICMA/icma-councils-and-committees/Primary-Market-Practices-Sub-committee/>.

<sup>3</sup> <http://www.icmagroup.org/About-ICMA/icma-councils-and-committees/Legal-and-Documentation-Sub-committee/>.

## Annex 1

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### Response to CP16/29

1. **ESMA consultation response** – ICMA is responding in parallel to the current ESMA consultation ESMA/2016/1436 on MiFID II product governance (see further Annex 2).
2. **Limited focus** – Given the many other industry bodies working on this consultation, this response focuses only on the narrow point of stress testing in the product governance context (3.2.15 of the draft PROD Source book).

***Q51: Do you agree with our proposal to apply the MiFID II product governance provisions as rules for firms engaged in MiFID business? If not, please give reasons why.***

3. **Vanilla bonds** – Stress testing may be clearly understood in a structured product context (to test the likelihood of potential outcomes resulting from changes that underlie financial variables and how those changes are modified or taken into account by the structure of a product in terms of its output – e.g. in terms of leverage). It is not clear how one would stress test vanilla bonds – default may involve no loss, loss of the entire investment or anything in between. Vanilla bonds are in any case perceived on a ‘probability of default basis’ (credit risk analysis) and not a ‘loss given default’ basis. If the FCA’s thinking that the myriad of permanently changing microeconomic, macroeconomic and political factors specific to each economic actor (ranging from the United Kingdom’s sovereign debt, via BMW to an SME) are permanently analysed to compute potential losses in default, then this would seem to be disproportionate to the relatively simple nature of vanilla bonds (and the approach outlined #17/18 of the ESMA consultation).
4. **Gold-plating** – Furthermore, the adopted MiFID Level 2 Directive<sup>4</sup> refers to scenario analysis only and not to stress testing.
5. **Generally** – The MiFID II product governance regime attempts to extend what are fundamentally retail/structured market concepts into the institutional/vanilla context. This is an extremely challenging task – with the economic importance of proportionality being crucial and accordingly acknowledged at MiFID II Level 2 (see #1 in Annex 2). One should be careful that delineating additional regulatory detail in national transposition does not undermine this.

## Annex 2

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### Main body of response to ESMA/2016/1436

1. We welcome the frequent acknowledgement that the product governance regime should be applied proportionately. This will be particularly important in relation to the wholesale debt markets, which provide significant funding to the real economies of Member States and an approach based on proportionality is consistent with the objectives of Capital Markets Union,

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<sup>4</sup> C(2016)2031 final, Art.9.10.

which is in part to facilitate such funding, rather than to add unnecessary regulatory burdens to it.

2. In the context of debt capital market issuance, we believe that this can be achieved by designing arrangements to limit distribution to professional investors, who are appropriate target investors for all types of debt capital market securities. Those arrangements would need detailed consideration, but would include primary market selling restrictions, legends warning of the investor base limitations and other reasonable procedures aimed at preventing distribution to retail investors in the secondary market. Such arrangements would also represent a consistent approach across the MiFID II, PRIIPs and Prospectus regimes.
3. Given the nature and effect of these arrangements, they should, without more, satisfy both the initial and the on-going requirements of the product governance regime and enable the wholesale debt markets to continue to operate, for the benefit of issuers and professional investors alike, without excessive additional burden or cost. Incidentally in this respect, new debt issues are already often targeted, in practice, to professional investors only as 'end clients' on a 'buy & hold' expectation (though this would not be inconsistent per se with a subsequent secondary market resale by an investor, for example to rebalance its portfolio over time).
4. Turning to the retail markets, if the nature of the securities being issued makes them suitable for all investors, that fact alone might justify a simple product governance regime, involving merely identification of the product as satisfying appropriate criteria. So, for example, a proportional application of the regime might allow distributors to identify the entire market as target investors of certain "plain vanilla" bonds.