

ESAs' advice on the PRIIPs review

Introduction

- 1 On 29 April, the ESAs published their [advice](#) to the European Commission regarding its review of the PRIIPs regime. This follows the ESAs' [October 2021 call for evidence](#) and ICMA's related [December 2021 response](#) covered in the [First Quarter 2022 edition](#) of this Quarterly Report (at pages 26-28). The ESAs generally encouraged a broad review of the PRIIPs framework and advised on a range of specific aspects.

Whilst ICMA has a focus on retail protection and retail bond markets, ICMA's main priority is that whatever official steps are taken in this respect do not disrupt the institutional/wholesale markets which have been reliably providing trillions in financing to Europe's economy over the years. It is thus #2-7 below that seem of most interest in the context of the ESAs' recommendations – namely ensuring clarity as to what bonds are within PRIIPs scope and as to individual responsibilities for any availability of PRIIPs without a KID to EEA retail investors (and in this respect aligning the PRIIPs regime exemptions with the Prospectus Regulation exemptions). These headline interpretational issues have faced a compounding complication in terms of apparently concurrent regulator jurisdiction under the PRIIPs regime, with the ESAs' advice in this respect, as narrated under #20 below, thus being also of particular interest.

Product scope

- 2 *More precise specification regarding bonds:* In terms of the product scope of the PRIIPs regime, the ESAs recommended that the scope not be extended but rather that it specify more precisely which types of bonds fall within scope. The ESAs proposed their [October 2019 Supervisory Statement](#) as an appropriate starting basis in this respect, though emphasising make-whole clauses should not *per se* result in a bond falling into scope (the Statement was somewhat ambivalent on this point, in noting that such clauses merely “could be” considered as “a separate case”) and suggesting the development of a significantly longer non-exhaustive list of products that are in or out of scope.

Such a granular approach to regulatory guidance can give rise to extended complex debate about individual product features and can also be more challenging in terms of future-proofing for new product structures. For example, sustainability-linked coupon step-ups were not included in the Statement with the other event-driven steps that were listed, which should not be seen as intentional since SLBs did not really exist at that time. (The first ever SLB was only issued in the month preceding publication of the Statement and there was no further SLB issuance until around 11 months thereafter.) (In this respect ICMA

had historically proposed an alternative, conceptual, approach to product scope guidance and then, at Q.22 of its [December 2021 response](#), proposed specific wording to amend the definition of a PRIIP in the PRIIPs Regulation itself as the most effective approach.) However, an effective adoption by the Commission of the ESAs' advice would still provide some helpful clarity and be consequently welcomed by industry.

- 3 *Alignment to Prospectus Regulation exemptions:* In terms of specific exemptions, the ESAs recommended that the Prospectus Directive exemption references be updated/aligned to the current Prospectus Regulation (PR). In this respect the ESAs noted that being PR-exempt is an appropriate reference point regarding the relevance of these securities being subject or not to the KID obligations.

This is a welcome endorsement of coherence between PRIIPs and PR exemptions.
- 4 *Clarifying application to non-financial services companies:* The ESAs also recommended the regime clarify the application of PRIIPs regime scope to non-financial services companies. The ESAs noted seeing both rationale to exclude non-financial services companies from scope and arbitrage risks in so doing, but without providing further detail.

In terms of arbitrage risks, the ESAs may have had in mind that non-financial issuers might issue PRIIPs without a KID. One might however note the risk of an unlevel playing field between vanilla securities issued by non-financial services companies and by financial services companies – if the product scope of the regime is not appropriately clarified as noted in #2 above.

Investor scope and “made available”

- 5 *Clarification of “made available”:* In terms of the investor scope of the PRIIPs regime, the ESAs recommended one clarify or further specify the “made available” concept, which ICMA had previously noted stakeholders were broadly comfortable with. The ESAs noted four possible options in this respect: (i) the UK FCA's recent approach (of retail restrictions combined with a £100,000 minimum denomination); (ii) PR alignment; (iii) a focus on securities that are “not actively marketed” (eg when the subscription period has closed) and (iv) replacing the reference to securities being “made available” with a reference to securities “sold”.

ICMA expressed concern regarding the first option, in its [September 2021 consultation response](#) (at #14-18), in terms of both regulatory incoherence and potentially worsening (rather than alleviating) uncertainty as to how wide the regime's scope is. ICMA had previously noted the second option as a helpful measure (for legal certainty and regulatory coherence), notably in terms of minimum denominations and (but distinctly) of offers addressed

solely to qualified investors. Regarding the third option it is unclear whether the ESAs also had new bond issuance transactions in mind – in which case the regime would not apply where the initial issuance offering excluded retail investors (regardless of subsequent secondary trading patterns). The fourth option does not seem to be a particularly meaningful change (investors are hardly likely to be gifted securities in a mainstream context).

- 6 *KID prior to any advice or selling*: The ESAs suggested as a minimum that Article 5 of the PRIIPs Regulation be amended to provide that manufacturers publish a KID “before any person can advise on, or sell” the relevant product to retail investors in the EU.

This does not seem to solve uncertainty around the regime’s apparently wide scope – because it is not wholly clear who is primarily responsible if there are sales or advice in the absence of a KID (and see next paragraph below). Article 5 should rather be amended to state that “No person can advise on, or sell, such a PRIIP to retail investors in the EU unless the manufacturer of that product has drawn up a key information document for that product in accordance with the requirements of this Regulation, and has published the document on its website.”

The key point in this respect (which ICMA has historically emphasised) is that it would be fundamentally unjust to separate action from related responsibility. Illegal secondary market selling of PRIIPs to retail investors by third parties, either unknown to the manufacturing issuer or over which it has no control (the PRIIPs definition of “distributor” is not specific in this respect), should not cause that issuer to be in technical breach of an obligation to produce a KID. It should suffice (as the ESAs’ acknowledged) that where a “distributor” does not have a KID, such “distributor” would be in breach of the PRIIPs Regulation if proceeding with the sale of the PRIIP concerned – ie the mere absence of a KID amounts to a statutory prohibition on retail sales/advice of in-scope products by anyone (excepting retail investors themselves as noted in #21 below).

- 7 *Non-retail design*: The ESAs noted it could be made clear that no KID is required where the PRIIP manufacturer designs a PRIIP in such a way that its target market excludes retail investors or that its legal documentation (prospectus, rules or instruments of incorporation) makes it clear that the PRIIP is solely addressed to professional investors.

In this respect, it is worth recalling that the “target market” concept arises in the context of the MiFID product governance regime¹ that is separate and distinct from the PRIIPs regime.

KID presentation

- 8 *“Super-key” information*: The ESAs ironically noted the KID is too long and detailed for many types of retail investors and consequently suggested the KID include a summary of the “most essential” information at the top of the KID, such as in the form of a dashboard. The ESAs further noted the “vital” information be included in the first layer to avoid “crucial” information being given less prominence.

It has always been unclear how “key” information differed conceptually from the long-established (and clearly understood) concept of information “material” to an informed investment decision – with consequent uncertainty as what information is deemed key information, beyond the legislators’ subjective selection of specific information line items. Adding a further concept of seemingly “super-key” information would seem likely to add even more uncertainty – albeit again to the extent not limited to the legislators’ subjective selection of specific information line items.

- 9 *Personalisation/tailoring*: The ESAs suggested manufacturers be required to take into account the characteristics of the type of retail investor to whom the PRIIP is intended to be marketed and that it should be possible for them to provide a more personalised or tailored KID without prior website publication.

It is unclear what context the ESAs had in mind here, but it seems unlikely to relate to a public offering of bonds.

- 10 *Digital compatibility/machine readability*: The ESAs encouraged the Commission to consider the regime’s fit with the European Single Access Point (ESAP) and expressed support for machine readability (distinct from machine-extractability). They also supported smart device compatibility.

In this respect, ICMA’s 29 March [response](#) to the Commission’s ESAP proposals noted that machine readability depends to a great extent on the preliminary existence of structured/standardised data (in addition to the use of a taxonomy), which could be inappropriate in many sectoral cases. Indeed structured/standardised data would suggest application to highly standardised/harmonised products – which is not the case for bonds. It is furthermore unclear how smart device compatibility would be coherent with the relevance of full disclosure (as noted in #12 below) – since it is unclear how such full disclosure could be compatible with smart device interfacing (other than in the historic PDF format).

- 11 *Page limit extension*: Lastly the ESAs’ envisaged that content changes to the KID’s “performance” section (see #17 below) might require a marginal extension of the KID’s three-page limit.

1. On 8 July, ESMA published a [consultation paper](#) on a review of its Guidelines on MiFID II product governance requirements. ICMA will confer with its members to respond by the 7 October deadline.

KID purpose

- 12 *Summary linked to fuller disclosure:* The ESAs' advice noted that one of the objectives of the KID is to be a concise summary document that might sit "above" a longer more detailed pre-contractual disclosure document such as a prospectus.

This is a welcome suggestion, as bringing some measure of clarity (albeit indirectly) to the KID's unclear purpose that has been a historic ICMA concern (eg as expressed under Q4.2.1 of ICMA's August 2021 [response](#) to the Commission's consultation on a retail investment strategy for Europe) and also in terms of regulatory consistency with the PR as noted in #3 above.

- 13 *Insufficient content for informed decisions:* The ESAs noted in passing feedback from some regulators that marketing documents generally contain less information and are more concise than the KID and therefore do not include all the information necessary for a retail investor to make an informed decision.

However, ICMA's historic concern referenced in #12 above has been that the KID may also fail to satisfy such a purpose (except for the most basic or standardised products) – hence the importance of a link to longer more detailed pre-contractual disclosure.

- 14 *Retail disclosure challenging:* The ESAs' advice included a further passing acknowledgement as how challenging it is to use disclosures to retail investors as a regulatory tool to protect consumers.

In this respect, it seems standalone disclosure does not work anyway (as short disclosure, even if read, often seems to be misunderstood) and needs to be complemented (for the majority of retail investors) by suitably regulated and supervised intermediation – as recently noted in ICMA's 20 May [response](#) (at Q5-Q6) to an IOSCO retail consultation (separately reported in this edition of the ICMA Quarterly Report).

- 15 *Competing aims (comparability and understanding)/ product differentiation:* The ESAs noted that two of the principal aims of the PRIIPs regime are (i) to help retail investors to compare different products (so involving a highly standardised and prescriptive template) and (ii) to understand their features. But the ESAs also noted that there are challenges to achieve both these aims simultaneously in the context of the broad scope of the regime and that it is important to recognise that there can be some tension or a trade-off between these two aims. The ESAs recommended a statement that comprehensibility should have priority over comparability and an empowerment to allow different approaches where appropriate in order to provide information that is fair, clear and not misleading. This is to account for different product types but still aiming for direct comparability between products that are substitutable

(not all of the products currently within the scope of the regime being considered to be substitutable). The ESAs suggested six product groups in this respect: (i) long-term savings (or retirement) products, (ii) very short-term products, (iii) products with material insurance benefits, (iv) linear (non-structured) products (including investment funds and certificates), (v) structured products and (vi) derivatives.

It remains unclear whether the ESAs' recommendation would, in practice, account sufficiently for bonds (or whether it is even intended to) – particularly given the ESA's six suggested product groups. Pending any resolution of these competing aims, this is indeed a further factor behind the need to clearly exclude bonds from the scope of the regime as noted in #2 above. (The return to a focus on substitutable products is however welcome, bearing in mind the Commission's initial call for evidence behind the regime, in October 2007, was formally about "substitute" retail investment products – with bonds arguably not being substitutable for UCITs.)

KID content

- 16 *Content derogation (at manufacturer, not regulator, discretion):* The ESAs noted challenges to designing a highly standardised template to help retail investors. They suggested the regime provide some discretion to PRIIP manufacturers (only to be used in specified cases) to make adjustments to the strict application of certain requirements, provided this is duly justified and documented. The ESAs had considered an alternative that regulators be able (as per the PR) to authorise a certain part of, or certain information within, the KID to be adjusted – if the inclusion of information according to the prescribed template or methodologies would risk being misleading, or otherwise risk causing material detriment. The ESAs however did not recommend this alternative on the basis that its advantages were outweighed by its drawbacks – the risk of non-convergent approaches at EU level and high regulator resourcing given the potential for a high number of requests. (This last aspect notwithstanding the ESAs also noting it was not clear how many issues would arise and seeing the issues that have arisen to date as part of the implementation phase of the KID and expecting them to arise less frequently over time.)

It is unclear (subject to more specific details) whether bond issuers would feel comfortable exercising a discretion to derogate from KID content, with likely focus continuing to be on out-scoping bonds as noted in #2 above. In terms of regulator discretion, the PR's derogation mechanism benefits from the PR's relative clarity as to the Member State whose regulator has jurisdiction under the PR – which is not the case for the PRIIPs regime (as further noted under #20 below).

17 *Appropriate performance information:* The ESAs also supported appropriate information on performance, allowing for more-product specific measures (including past performance). Some products (such as retail structured products) might stay with performance scenarios and others (such as funds) might perhaps move to other types of information on performance together with past performance (so not solely past performance). Such other information types might include narrative-based performance information indicating the factors upon which performance depends. This could include the most relevant index, benchmark, target, or proxy, as applicable, along with an explanation of how the PRIIP is likely to compare in terms of performance and volatility, sensitivity to changes in interest rates etc. In certain cases, where relevant, these might also include hypothetical (“what if”) information.

18 *New section on sustainable investment objectives:* The ESAs proposed, instead of the existing objectives provision, a new section (in line with the [Sustainable Finance Disclosure Regulation \(SFDR\)](#)) where a product has sustainable investment as its objective or it promotes having environmental or social characteristics. They also noted the approach and terminology used in PRIIPs should be aligned with those in the SFDR and that it would be appropriate to limit the type of PRIIPs, which can show that they have such an objective or that they promote having such characteristics, just to financial products included within SFDR Articles 8 and 9. However, the ESAs noted it can be relevant to take into account further developments in this area, such as regarding the European green bond standard (EUGBS).

As SFDR’s definition of financial products (under its Article 2.12) does not include bonds, it is unclear how this proposed new section in the KID is intended to operate regarding sustainable bonds (bearing in mind also the ESAs’ stated focus on the EUGBS). The reference to SFDR reflects the current European ESG regulatory approach to apply and insert concepts defined in one piece of sustainable finance legislation to other pieces of sustainable finance legislation, notably in the European Parliament’s [EUGBS 20 May report](#) (where there is a similar lack of clarity as to how those concepts originating from SFDR will apply in a different context). Although sustainable bonds (aside SLBs as noted in #2 above) typically tend not to be packaged, it would nonetheless be useful to get greater certainty in this respect consistent with the ESA’s recommendation noted in #2 above.

19 *Costs & charges:* In terms of costs & charges differences between the PRIIPs and MiFID regimes, the ESAs agreed it is vital to try to ensure that the information that retail investors receive under different investor protection frameworks are consistent (with this being related to the more general issue of differentiation – as noted in #15 above).

Other aspects

20 *Regulator jurisdiction:* The ESAs suggested it might be relevant to clarify the respective responsibilities of host and home authorities, noting “home” as where the PRIIPs manufacturer is established (albeit accounting for existing passporting arrangements). The ESAs supported broader use of *ex-ante* KID notification (albeit in the context of encouraging the Commission to consider the fit of the PRIIPs regime with the ESAP as noted in #10 above). But they were clear that this should not amount to a review/approval requirement. (The ESAs’ advice seemed to list just Finland and Portugal as currently having elected *ex-ante* KID notification.)

The PRIIPs regime has not so far seemed to provide for clear, single-regulator jurisdiction over individual PRIIPs. Article 4.8 of the PRIIPs Level 1 Regulation defines “competent authorities” only as the national authorities designated within each Member State to supervise the requirements that the regime places on PRIIP manufacturers and the persons advising on, or selling, PRIIPs. It does not explicitly define a single Member State whose regulator would have jurisdiction as the “home” regulator distinct from “host” regulators. Article 8.3(a) of the Regulation requires the KID to state information about the competent authority of the PRIIP manufacturer – this might seem to hint at some form of MiFID-like general supervisory authority. But the legislators’ intention is unclear, and it is also uncertain whether this would be compatible with issuing manufacturers that are not necessarily regulated financial institutions or even EEA-based (given the regime’s potentially wide product scope as noted in #2 above). Issuing manufacturers have been consequently likely to assume that any or all of the 27 EU Member State regulators given PRIIPs responsibility at the national level may have concurrent jurisdiction – a compounding complication to the various interpretational ambiguities arising in the context of the regime (including as to product scope as noted in #2 above).

Aside from being clear, jurisdiction should ideally be exclusive – at least to the extent a KID has been published. (Any illegal selling/advising in individual Members States in the absence of a KID would be open to the national regulators to enforce, albeit ideally on a coordinated basis.) Since manufacturing issuers are not necessarily regulated financial institutions or even EEA-based, an approach might for manufacturers publishing a KID to have some element of flexibility for their KID to nominate the “home” regulator (with jurisdiction over the KID’s adequacy) – similar to that under the PR’s Article 2(m) definition. This would leave the “host” regulator with jurisdiction over any translation and *ex-ante* notification requirements.

- 21 *Retail sellers:* The ESAs suggested it should also be clearer that the obligation to provide a KID should only apply to professional advisers or sellers (i.e. retail sellers are not required to provide a KID).
- 22 *PRIPs regime data/statistics:* The ESAs advice included data received from various national regulators.

Conclusion and next steps

- 23 Whilst a broad review of the PRIIPs framework conceivably opens the possibility of an alleviation of the incompatibility of the regime with the flow bond markets, the many detailed challenges involved make such a full alleviation seem unlikely. So industry focus seems likely (for now) to continue to be on ensuring bonds are sufficiently clearly excluded from the scope of the PRIIPs regime. ICMA will continue to engage with the EU authorities in this respect.



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