

MiFID II/R and PRIIPs: implementation in primary markets

by Ruari Ewing

Professional investors (PRIIPs/product governance):

Regarding the professional investors' intended target market (all bonds) outlined in some detail in the [Fourth Quarter 2017 edition](#) of this Quarterly Report, ICMA has circulated that rationale and related draft forms of language for consideration by transaction syndicates. This includes some of the more salient options available for consideration in terms of measures that might be put in place on issue that could, in varying combinations according to the circumstances, be reasonably expected to result in a target market encompassing sales being made to professional investors only. (Furthermore in this respect, manufacturers should not then be characterised as "making available" to retail investors in the EEA any "packaged" securities for PRIIPs purposes.) It also includes some examples of a written agreement between co-manufacturers that seems likely to be included in subscription agreements. Such an agreement seems likely to acknowledge the product governance regime and to cover the product approval process (and notably the professional investors target market approach) and distribution channels.

Retail investors (PRIIPs/product governance): Regarding a retail investors' intended target market, ICMA has continued to consider various potential approaches (as briefly noted in the [Fourth Quarter 2017 edition](#) of this Quarterly Report). Though the product governance regime envisages simple products being compatible with mass retail investors, one initial approach focuses on what one might simplistically summarise as bonds that are simple and listed. More specifically it relates to low-denomination bonds admitted to trading ("listed") on an EEA regulated market, and so within the contemplation of the EU's related initial and ongoing transparency regimes (or analogously subject to similar transparency). In relation to this approach, ICMA has circulated a draft rationale (outlined below) and related draft forms of language for consideration by transaction syndicates. The approach does not address the PRIIPs regime, which needs to be separately satisfied in terms of any KID requirement.

MiFID II/R regulates EEA regulated markets. There are no restrictions on the type of issuer or credit that can

be admitted, and suspension is only triggered by non-compliance with periodic and *ad hoc* transparency obligations. Further, bonds other than ESMA complex bonds can be bought by retail investors on an execution-only basis outside the appropriateness regime. So, the regulatory infrastructure contemplates that retail investors can freely buy non-complex bonds provided the transparency obligations are met. It is thus proportionate that a product manufacturer's target market assessment should not be affected by fluctuations in an issuer's credit, provided that the bonds concerned continue to be admitted to the regulated market. In this respect, manufacturer target market reviews of the bond markets would logically conclude that no target market changes are warranted (and any distributor feedback would be expected to be without impact).

Whilst ESMA complex bonds cannot be bought by retail investors on an execution-only basis outside the appropriateness regime, certain ESMA complex bonds do not include terms that would affect the return expected from the product (the contractual right to return of principal consistent with, or more than, the original amount invested and, if applicable, a contractual right to regular payments of interest that are not deferrable). So, whilst technically ESMA complex, there are no additional risks that are difficult to understand. It is thus proportionate that such bond manufacturer's product governance responsibilities should also be based on admission to a regulated market, the disclosure obligations consequent on it and a similarly enduring target market - albeit not outside the appropriateness regime.

The EU has as a matter of public policy exempted from its initial and periodic transparency regimes bonds issued by an EEA Member State or by related official bodies. It has been noted that Member States publish abundant information on their financial situation which is, in general, available in the public domain. Given the connection with Member States of their related official bodies, it follows that such information in their respect should not need to be provided in the prospectus either. It is therefore proportionate that such bond manufacturer's product governance responsibilities (being otherwise the bonds

discussed in the preceding two paragraphs) should again also be based on admission to a regulated market, the disclosure obligations consequent on it and a similarly enduring target market.

A negative target market is unlikely for these bonds given diversification/portfolio considerations and absent the exercise of regulatory intervention powers. However, any such negative target market will be subject to consideration in the specific circumstances.

Other aspects: ICMA members have further discussed various alternative ways of complying with MiFID II's allocation justification recording, inducements (and costs and charges) and trade and transaction reporting regimes. There seems to be sufficient understanding of the dynamics of the various alternatives for decisions to be made ahead of 2018's bond syndications.

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