ICMA
International Capital Market Association

M

PRIIPs and MiFID II/R product governance

ICMA continues to work on anticipated approaches, in the Eurobond markets (ie syndicated cross-border bond issuance), to the product governance (PG) and PRIIPs regimes coming into effect from 2018. These approaches would not purport to be exhaustive or exclusive, but are anticipated to be useful to the extent transaction parties wish to minimise deal/syndicate-level deliberations, to maximise execution efficiency and speed (bearing in mind that many seasoned borrowers today are able to mandate a syndicate of underwriters to then price a benchmark-sized new issue within hours intra-day).

Background

It may be helpful to recap briefly on the PG/PRIIPs regimes by way of background. For PRIIPs, simplifying substantially: (i) any person manufacturing a "packaged" product, before it is "made available" to retail investors in the EEA, must publish a key information document (KID) and then regularly review it, and if needed, publish a revised KID; and (ii) any person advising on, or selling, such a product must provide retail investors in the EEA with the KID in good time before those retail investors are bound by any contract or offer. For PG, simplifying substantially: (i) MiFID II persons that "create, develop, issue and/or design financial instruments, including when advising corporate issuers on the launch of new financial instruments" are "manufacturers" for PG purposes (with co-manufacturing documented in an agreement); (ii) MiFID II persons that "offer or sell financial instrument[s]" are "distributors" for PG purposes (with no connection to the manufacturer being explicitly required); (iii) manufacturers must identify, and communicate to distributors, a compatible target market of investors and periodically review that target market; and (iv) distributors must identify their own target markets (by either adopting manufacturer's target market or refining it) – all on a "proportionate" basis.

Neither regime "grandfathers" pre-existing bonds and there has been limited consensus on what does *not* constitute a "packaged" product. This is partly due to various public statements by the European Commission and ESMA that seemingly purport to widen the range of what might otherwise have been perceived as "packaged". Practically in the context of syndicated bond issuance, borrowers are understood to be manufacturers for both PRIIPs and (if a MiFID II person) PG purposes (together with, as co-manufacturers for PG purposes only, any MiFID II person underwriters that satisfy the related "advising" characteristic). Though post-2018 "distribution" of pre-2018 bonds is subject to the PRIIPs (if "packaged") and PG regimes, the "manufacturing" of such bonds, however, occurred prior to the PRIIPs and PG regimes coming into effect.

Challenges

Significant practical/logistical challenges are perceived regarding: (i) borrower liability risk in producing a KID in the context of high value / flow transaction bonds (let alone keeping it up to date); and (ii) underwriters' scope to execute extensive target market review procedures, particularly on a co-manufacturer basis that is effectively syndicate/ISIN-specific and given traditional market practice whereby borrowers engage (and remunerate) underwriters for the initial issuance procedure only.

Some of these concerns may abate with practical experience of the new regimes and any future helpful official guidance, but the approaches ICMA is working on seek to account for them in the interim – by focusing on manufacturers: (i) being clear that they are not facilitating availability to retail investors in the EEA of any products that are not outside the scope of PRIIPs' "packaged" concept; and (ii) defining "robust" target markets for PG purposes – ie that are highly likely to endure for the life of a bond and so substantially moderate the ongoing (review process) resourcing burden, this seemingly being simplest in first instance to outline in a proportionate wholesale context of professional investors.

PG professional investors intended target market

On the basis that professional investors (as defined in MiFID II, including elective professionals and discretionary managers) possess the experience, knowledge and expertise to define their needs and objectives, make their own investment decisions and properly assess and manage the risks and returns that they incur, they should be able to buy and hold any bond investment, regardless of specific product type, and therefore the manufacturer of a bond should have then substantively complied with the PG regime if it ensures that measures are put in place on issue that are reasonably expected to result in sales only being made to such investors (and see further below).

Because professional investors are appropriate target investors for all bond types, this will continue regardless of any changes individual bonds over time. In this respect, manufacturer target market reviews of the bond markets would most likely (if not inevitably) conclude that no target market changes are warranted – at least whilst the MiFID definition of professional investors endures. In this respect, feedback from third party "distributors" (in the specific PG sense) would be expected to be without impact on the target market assessment.

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

A written agreement between co-manufacturers seems likely (beyond generally acknowledging the PG regime and the professional investors target market approach) to address any desired ongoing logistical role attributions. Some co-manufacturer groups may consider in this respect that no specific role attributions are necessary: ie that all tasks be effectively equally shared. Other co-manufacturer groups may wish perhaps to attribute the task of initially receiving any distributor feedback (no matter how unlikely to materialise) and consequentially notifying the other co-manufacturers, as well as defining a technical means of conferring/deciding on any co-manufacturer proposal to amend the target market (again no matter how unlikely to materialise).

Options for measures reasonably expected to result in sales only to professional investors

Various options are 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 sales only being made to professional investors. 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. The more salient options could include line items in any origination staff formalities e-mail in response to mandate, in any term sheet and/or in any sales staff memorandum, legends in any prospectus and any final terms or pricing supplement and on new issue screens, selling restrictions in any prospectus and any final terms or pricing supplement, counterparty procedures (including in terms of any secondary trading involvement), the absence of a retail prospectus or of a KID, admission to a "qualified investor" segment on an EEA regulated market, MiFID trader PG obligations, markers on market/trading screens and high denominations. ICMA is working on model forms of wording relating to some of the above. However, these are not anticipated to involve debt issuance programmes to be updated on an emergency basis prior to 2018.

Retail investors intended target market

ICMA is also continuing to consider potential target market approaches for retail investors (and to engage with EU and national authorities in this respect). However, public offers conducted on behalf of EEA governments at least have presumably a mass retail target market (on an initial and ongoing basis) as a matter of public policy (EEA government bonds are also exempted from the PRIIPs regime).

Conclusion

ICMA will continue to focus on the PRIIPs and PG regimes with its committees and keep members updated.

Contact: Ruari Ewing
ruari.ewing@icmagroup.org