JOINT COMMITTEE OF THE EUROPEAN SUPERVISORY AUTHORITIES

19 July 2018

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**Mr Olivier Guersent**
**Director General**
**DG FISMA**
**European Commission**
**1049 Brussels Belgium**

**Subject: Implications of the uncertainty as to the scope of the PRIIPs Regulation (1286/2014) and request for Commission guidance**

Dear Mr Guersent,

We are writing to you regarding the application of the PRIIPs Regulation 1286/2014, and in particular uncertainty as to the scope of the Regulation. Our evidence is that this uncertainty has led to negative consequences for the functioning of financial markets and access to these markets by retail investors. It also risks divergent applications by national competent authorities (NCAs) with negative consequences for achieving uniform levels of retail investor protection and a level playing field amongst product manufacturers and distributors within the EU.

The ESAs are currently working with NCAs to monitor the implementation of the PRIIPs Regulation. Concerns have been raised by both market participants and NCAs that in the absence of guidance on the application of the scope of the Regulation, product manufacturers are no longer making certain products available to retail investors in case they are deemed to fall within the scope of the Regulation.

This is particularly the case for bond markets, where there is evidence of a significant reduction in the availability of corporate bonds to retail investors. During discussions with NCAs and stakeholders, the ESAs have been made aware of analysis in some Member States indicating that there has been more than a 60% reduction in the number and overall volume of low denomination issuances by non-financial corporates in the first quarter of 2018 compared to the first quarter of 2017. It has also led to difficulties for retail investors to trade their bonds where these were issued before the introduction of PRIIPs regime on 1 January this year, with evidence of up to a 25% reduction in some secondary markets.

We are concerned about the implications for investor protection. Reduced disinvestment opportunities for retail investors can mean that, contrary to their expectations, such investors are not able to exit their investments when they need to, and may weaken rather than strengthen trust in financial services. Where these products are PRIIPs, retail investors will also not be benefiting from the increased transparency and comparability that should result from the introduction of the PRIIPs Key Information Document (KID). These consequences are in turn affecting the liquidity of these markets, and given the very considerable amount of direct retail investment in bonds, has the potential to undermine the intentions of the Capital Markets Union (CMU). It can be recalled that the

CMU aims, amongst other things, at increasing direct retail investment within the capital markets. The legal uncertainty regarding the scope of the PRIIPs Regulation is leading to unintended consequences that may achieve the opposite.

As this is a matter concerning the legal interpretation of the Level 1 text that goes beyond its consistent and effective application, the ESAs are of the view that it is not appropriate to address this issue through an ESA measure.

The ESAs would therefore urge the Commission to provide detailed public guidance as a matter of urgency on which types of products, and in particular bonds, fall within the scope of the Regulation. This would allow market participants to take an informed decision as to whether or not there is a need to draw up a PRIIPs KID. To support this, the ESAs have prepared an analysis of the application of the scope to some of the main types or features of bonds (see Annex), and would ask the Commission to confirm if they agree with this analysis. Moreover, should the Commission be able to provide additional interpretative criteria this should promote a more consistent application of the scope to the full range of investment products.

In preparing this analysis, the ESAs have borne in mind their understanding of the intention of the Regulation, as clearly expressed in Recitals 6 and 7 of the Regulation, to address packaged or wrapped products rather than assets which are held directly, such as shares and non-structured bonds, and the ESAs' draft regulatory technical standards were prepared on this basis.

Yours sincerely,

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| SIGNED | SIGNED | SIGNED |
| Steven Maijoor<br>Chair, ESMA | Andrea Enria<br>Chairperson, EBA | Gabriel Bernardino<br>Chair, EIOPA |

Cc:

Ugo Bassi, DG FISMA, European Commission

Sven Gentner, DG FISMA, European Commission

## Annex

This table considers whether different types of common bond features fall within the scope of the PRIIPs Regulation based on the relevant provisions of that Regulation, in particular recitals 6 and 7 and Article 4(1). The analysis is without prejudice to the exemption in point (d) of Article 2(2) of the Regulation. Each different type of bond or bond feature is considered individually. Where a bond combines different features, each feature needs to be considered separately.

| Type of feature | Considerations | Conclusion |
|---|---|---|
| Perpetual | There are not considered to be any fluctuations in the amount repayable due to the fact that a bond is perpetual. | Out of scope |
| Subordinated | There are not considered to be any fluctuations in the amount repayable due to the fact that a bond is subordinated. | Out of scope |
| Fixed rate | There are not considered to be any fluctuations in the amount repayable. This would include:<br>- bonds with coupon payments fixed at a defined interest rate until maturity, including at zero;<br>- bonds with pre-defined changes in the coupon rate at fixed times prior to maturity. | Out of scope |
| Variable rate | The amount repayable is considered to be subject to fluctuations based on changes in the coupon rate. It is relevant to consider the basis for those fluctuations and whether there is any structuring.<br><br>Pre-defined increases in the coupon rate (i.e. coupon step-ups) which are not linked to a reference value or to the performance of one or more assets which are not directly purchased are not considered to result in a bond being a PRIIP. This is considered to include changes due to a ratings downgrade of the issuer, change of control event, or tax or regulatory event.<br><br>Where there is a direct link (with or without a spread that reflects the credit risk of the issuer) to an interest rate index, it is still considered to be an asset that is directly held | Not all variable rate bonds are considered to be in scope, but is dependent on the specific feature |

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|---|---|---|
| | unless there is additional structuring, such as a cap or floor (other than at zero); c.f. definition of a structured deposit. | |
| Puttable | Provisions that allow the investor to sell the bond back to the issuer are considered to be a contractual right to exit the investment and not to result in a bond being a PRIIP. | Out of scope |
| Callable | It is considered that provisions that allow the issuer of the bond to redeem the bond before maturity constitute a contractual termination of the investment and therefore do not inherently result in a fluctuation based on an exposure to a reference value.<br><br>However, such features may result in that bond being a PRIIP, where the amount repayable at redemption is not fixed and fluctuation is caused by exposure to a reference value.<br><br>The inclusion of a clause that allows the issuer to pay off the remaining debt early using a reference rate to determine the net present value of future coupon payments that will not be paid (i.e. make whole) is expected to mean that the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values. However, where the mechanism to calculate the discount rate is known in advance to the retail investor, this could be considered as a separate case, which does not satisfy the criteria in Article 4(1). | Not all callable bonds are considered to be in scope, but some are expected to be on the basis of the specific feature |
| Convertible | Where the investor or issuer may convert the bond into shares of the bond issuer (or shares of another company) the amount repayable is considered to fluctuate based on the performance of an asset that is not directly purchased. | In scope |