

Corporate Bonds with customary clauses should not be within the scope of PRIIPs

Legislators should provide legal certainty

Introduction

Deutsches Aktieninstitut (identification number: 38064081304-25) represents the entire German economy interested in the capital markets. The about 200 members of Deutsches Aktieninstitut are listed corporations, banks, stock exchanges, investors and other important market participants. Deutsches Aktieninstitut keeps offices in Frankfurt, Brussels and in Berlin. We followed the legislation process regarding PRIIPs Regulation, expressing the view of companies using bond markets for financing purposes.

Answer to question 24

Do you agree with the ESA Supervisory Statement relating to bonds and what are your experiences regarding the application of the Statement?

The uncertainties regarding the scope of the PRIIPs Regulation, which are reflected by the ESA Supervisory Statement, turned out to be an obstacle for retail investors to invest into corporate bonds, although these instruments are assets that can be held directly by retail investors (not only through funds) and rightfully should not fall into the scope of PRIIPs. The legislator should clarify that common contractual features listed below require not the preparation of a Key Investor Document (KID) by the issuer.

According to [Börse Stuttgart](#), a German stock exchange focusing on retail investors, almost 50 per cent of corporate bonds are currently classified as PRIIPs.

Most likely due to the obligation to produce a KID and the prohibition of sales without a KID to retail investors the German national competent supervisor [BaFin](#) identified a significant decline of retail investor participation in the market for corporate bonds. The study conducted by BaFin in 2021 is based on transaction data reported for regulatory purposes (Art. 26 MiFID). As a main result of the study, BaFin notes an overall decline of the total value of corporate bond purchases by retail investors per year from 4.5 billion Euros in 2016 (before the entry into force of PRIIPs) to around 2.5 billion Euros in 2019 (after the entry into force of PRIIPs). The same results for sales of corporate bonds by retail investors: The total value declined from 3.5 billion Euros (2016) to 1.5 billion Euros (2019). Comparable declines in other asset classes, such as government bonds or DAX stocks which are excluded from the application of the PRIIPs Regulation, could not be discovered.

The shortcomings of the scope of the PRIIPs Regulation limits the opportunities of retail investors to invest directly and in a transparent, cost efficient way in investment grade corporate bonds. In addition, this deprives corporate bond issuers of a simple access to an important, diversified investor base for their funding needs that is considered “buy and hold”, i.e. adds to market stability.

To avoid these unintended side effects, the legislator has already reacted with Directive (EU) 2021/338 and the insertion of Art. 16a MiFID (“Exemptions from product governance requirements”). Bonds including make-whole clauses, which are so far classified as packaged instruments and therefore requiring the preparation of a KID by the issuer according to PRIIPs, are exempted from the product governance regime. In recital 4 of Directive (EU) 2021/338 the legislator justifies the exemption because bonds including a make-whole clause “are generally considered safe and simple products that are eligible for retail clients” and protecting retail investors against losses in the redemption event.

We urge the legislator to follow this MiFID approach and clarify the scope of the PRIIP Regulation in the context of corporate bonds. In particular, the legislator should confirm that certain well-established standard terms and conditions – like make-whole clauses – do not turn corporate bonds into PRIIPs.

Given that the definition of PRIIPs in Art. 4 relates to investments where the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor, the following contractual features of a corporate bond, already mentioned in the ESA supervisory statement, should be exempted from the PRIIPs-regulation:

- Every callable bond feature which allows the issuer a redemption before maturity and which safeguards the bond investor from losses in the redemption event e.g. by providing for a redemption at least at 100 per cent of the nominal amount (redemption at par). This should include any redemption rights of the corporate bond issuer (e.g. customarily used “make whole clauses”, “par call clauses 3 months ahead of final maturity”, “clean up calls” or “M&A clauses”);
- Puttable corporate bonds, which provide the investor with an option to sell back the bond to the issuer before maturity (e.g. in a case of a change of control of the issuer);
- Caps and floors on the interest rate;
- Floating rate corporate bonds;
- Fixed rate corporate bonds;

- Perpetual and subordinated corporate bonds;
- Hybrid instruments issued by corporates, if interest or redemption is linked to an internal reference rate (e.g. financial performance figures) of the issuer.

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