

The Trialogue on Key Information Documents for Investment Products

Extending the KID's scope to corporate bonds would over-burden issuers, limit investment opportunities for retail investors and reduce the attractiveness of capital markets for financing and investment purposes

Introduction

Deutsches Aktieninstitut¹ follows the legislative process on “Key information documents for investment products” with close interest. We expressed our concern against the extension of the regulation’s scope to financial instruments which are not “packaged” – e.g. corporate bonds and shares. Such an extension will seriously harm corporates’ capability to access capital markets for financing purposes. Furthermore, the KID does not provide any added value for the investor in terms of relevant information. On the contrary, if issuers refrain from addressing retail investors their investment universe will be limited. This would restrict the possibilities of retail investors to diversify their investments in a manner which is adequate from a risk / return perspective.

According to the proposal of the European Commission and the European Council shares and corporate bonds are not part of the regulation. However, the European Parliament discussed the extension of the scope and voted finally in favour of the inclusion of corporate bonds. **Therefore, we strongly recommend pursuing the approach of the European Commission and the European Council in the forthcoming Trialogue negotiations. The proposed regulation should only close the regulatory gap for packaged retail investment products and should not cover areas of capital markets that are already regulated by other European Initiatives (no double-regulation).**

¹ Deutsches Aktieninstitut represents the entire German economy interested in the capital markets. Its about 200 members are listed corporations, banks, stock exchanges, investors and other important market participants. Deutsches Aktieninstitut keeps offices in Frankfurt am Main and Brussels.

1 Inclusion of Corporate Bonds: Damaging Effects

The inclusion of corporate bonds does not have any benefit for retail investors and will limit their investment opportunities. It will also harm the capabilities of corporates to access capital markets.

Having to provide a key information documents (KID) for corporate bonds which are traded on regulated markets is superfluous and redundant. Existing prospectus and transparency requirements are already very detailed. According to the Prospectus Directive (PD) the prospectus for securities offered to retail investors needs to contain a summary with key information “about essential elements of the securities concerned in order to aid investors when considering whether to invest in such securities” (Art. 5 (2) PD). The requirements for such key information have been set by the delegated regulations changing the Regulation 809/2004 in 2012. Hence, it is the main function of the summary to provide the investor the key aspects of the financial instrument in a brief manner. In addition, existing transparency requirements applicable for listed securities according to the Transparency Directive provide retail investors with the necessary information on material developments e.g. ad-hoc disclosure and financial reporting.

Providing key information on corporate bonds offered to retail investors should remain only subject to the already existing relevant requirements. The KID requirements should remain limited to packaged investment products. Therefore, there is no need for additional information to be made available to retail investors and such additional information may even have a negative effect as outlined in Recital 11 (retail investors may not use the information, “unless the information is short and concise”).

We also believe that a KID for corporate bonds provides only little benefits for retail investors as corporate bonds are easy to understand regarding their returns, risks and cost structures. Much more important than the features of the instrument is a basic understanding of the issuer’s credit risk. This is another reason why there is no necessity to apply requirements intended for packaged investments, which are in most cases much more difficult to understand, to corporate bonds. Hence, the limitation of the scope of the Regulation – as proposed by the European Commission and the European Council – to packaged retail investment products and the exclusion of corporate bonds is absolutely justified.

Furthermore, to require corporate bond issuers (the “investment product manufacturer”) to provide a KID for retail investors will undermine political efforts to improve access to the capital markets for corporates. At present there are strict and

detailed requirements regarding primary markets information secondary market transparency requirements. The additional effort and expenditure to comply with KID will discourage issuers to target retail investors. This will further limit the opportunities of retail investors to invest in corporate bonds of large investment grade issuers who can place their corporate bonds solely with institutional investors. Finally, the inclusion of corporate bonds would thwart efforts of the European Commission to establish the capital market as alternative to bank loans as expressed recently in the Green Paper on long term financing of the European economy.



2 Examples for detrimental rules



The KID requirement will put an unnecessary burden on issuers but will not provide benefits to retail investors.

Although the proposal of the European Commission regarding the responsibilities of the issuer is already very complex, the draft of the EP is even much stricter. The following examples refer to the EP's wording and show that the obligation to provide a KID...

- ...would be redundant, as the requirements to provide key information already exist in the prospectus regime. Furthermore, we see the danger that these rules contradict each other.
- ...would mean additional costs for issuers without a corresponding benefit to investors due to the implementation of the respective processes. Such additional funding costs may be at the expense of retail investors, reduce their investment results and investment opportunities.
- ...applies in particular to the issuer of the bond, while it is unclear how the issuer, who is not directly involved in the distribution process, shall comply with the rules. As a rule it is the task of the bank to act as intermediary between the corporate issuer and the retail investor. Banks buy the newly issued bonds from the corporate and then resell the bonds to their clients (e.g. retail customer). Therefore, it is for instance difficult for the issuer to prevent the distribution to retail investors if he refrains from providing a KID in particular for cost reasons. The issuer may increase the denomination per bond to an amount which is not affordable for retail investor. However, Art. 2 does not provide for an exemption for securities with a denomination of € 100,000 and more, and the sole denomination is no guarantee that retail investors are effectively excluded. Even worse, this would significantly decrease the flexibility of the bond issuance and the capacity to address a broad range of investors. Rising transaction costs would be the result. These difficulties show clearly that the regulation – as originally proposed by the European Commission – was not intended to address corporate bond issuers.

Examples for proposed rules which already exist in the prospectus regime:

As mentioned above many information sources are already available for the retail investor to take an informed investment decision (in particular the summary of the prospectus). There are further issues which the KID addresses and which are already regulated in the PD. Take for instance Art. 11 which requires the issuer to accept an unlimited liability under civil law if a retail investor incurs losses from relying on a KID which failed the requirements of the regulation. In addition, it shall be up to the issuer to prove that he prepared the KID in accordance with the regulation.

The legislator should be aware that there is already a comprehensive liability regime in place according to the PD. Therefore, a further liability regime which is very likely to deal with overlapping issues (regarding the prospectus and the KID) is not necessary and would bear the danger to contradict the existing one.

Examples for proposed rules which are very burdensome and would decrease the attractiveness to raise capital via bond issuance:

According to Art. 5a the issuer has to implement a product approval process. The benefits of such a process are not obvious as common “plain vanilla corporate bonds” are easy to understand and are a well established financial instrument among investors. This requirement also shows that the regulation was originally not intended to include corporate bonds, but to address packaged instruments, which are frequently more complex. Nevertheless, to implement the respective processes including stress tests and an annual review of the processes would increase the administrative costs significantly.

Furthermore, compliance with the liability regime would be very costly. The obligation for the issuer to prove that the KID was prepared in accordance with the regulation is likely to result in a “flood” of – possibly abusive – litigation against the issuer. As the burden of proof rests with the issuer it is much easier for the investor to claim compensation for losses, irrespective of whether these are well founded and in the context of the KID.

In this regard it is also not reasonable to impose administrative fines of up to 10 per cent of the total annual turnover (see Art. 19 para. 2da).

In addition, the “alternative dispute resolution” regime according to Art. 15 is problematic. The procedure on how to resolve disputes is already part of the prospectus regime. A further dispute resolution regime might not be compatible and add significant extra costs for the respective administration processes.

Another example of a cost-intensive obligation is the proposed requirements for the issuer’s risk management (Art. 13e). Among others it is not clear why the bond

issuer should calculate a value at risk. Also quite burdensome is the obligation to implement a process to manage complaints of retail investors (Art. 14).

Examples for proposed rules which address the distributor of the bond and which the issuer cannot comply with:

Art. 7 obliges the issuer to translate the KID into the official language of the country where the bond is distributed. Issuers are only able to influence the distribution of their bonds in the primary market during the issuance process. They can determine the countries in which the bond may be publicly offered. Nevertheless, when the corporate bond is listed and traded on secondary markets (*not* part of the public offer) the issuer is not able to control in which countries the freely tradable bond is distributed by third parties to retail investors.

The proposal of the EP distinguishes between the KID, which should be provided by the issuer, and the annex, which should be provided by the “person selling investment products”. This distinction is intended to better reflect the ability of the issuer and the selling person to provide certain information. Nevertheless, it is not clear which costs the issuer is required to publish. See for instance Art. 7 para. 2f which states that the KID should include total costs. If this requirement refers to the costs of the issuance the information would be redundant as it is already provided in the final terms for the base prospectus. If these costs refer to the distribution of the bond on secondary markets the issuer is not able to provide it as he does not know the details of the various distribution channels.

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