JOINT COMMITTEE OF THE EUROPEAN SUPERVISORY AUTHORITIES

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Joint ESA Supervisory Statement – application of scope of the PRIIPs Regulation to bonds

Statement

This Supervisory Statement of the European Supervisory Authorities (ESAs) seeks to mitigate the risk of divergent application by National Competent Authorities (NCAs) of Regulation (EU) No 1286/2014[1] (PRIIPs Regulation) as regards determining the type of bonds for which it is necessary to draw up a Key Information Document (KID).

The overall objective of this statement is to achieve a high, effective and consistent level of regulation and national supervision promoting a level playing field and the protection of retail investors.

In the view of the ESAs, uncertainty over the application of the PRIIPs Regulation to bonds, has led to negative consequences for the functioning of bond markets, and access to these markets by retail investors.[2] It also risks divergent applications by 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' assessment is based on the observations collected and analysis conducted by the ESAs and by NCAs in the European Economic Area (EEA) since the implementation of the PRIIPs KID at the start of 2018.

In order to promote a consistent application of the scope of the PRIIPs Regulation to bond markets, the ESAs recommend that NCAs apply the guidance set out in the Annex to this Statement when supervising compliance with the requirements in Chapter I of the PRIIPs Regulation. As part of their risk-based supervision, NCAs should monitor whether PRIIP manufacturers draw up and publish KIDs on their website for bonds that fall within the scope of the PRIIPs Regulation, and whether persons selling such bonds comply with the requirements in Article 13 of that Regulation. Where NCAs identify non-compliance with these requirements, they should take appropriate measures, including administrative steps in accordance with Chapter V of the PRIIPs Regulation.

Ultimately, in order to fully address the risk of divergent applications by NCAs, the ESAs recommend that during the upcoming review of the PRIIPs Regulation, the co-legislators introduce amendments to the Regulation in order to specify more precisely which financial instruments fall within the scope of the Regulation. We would also recommend to reflect more expressly the stated intention of the PRIIPs Regulation[3] to address packaged or wrapped products rather than assets which are held directly, to avoid any legal uncertainty on this point.

[1] REGULATION (EU) No 1286/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) OJ L 352, 9.12.2014, p. 1.

[2] The ESA set out their concerns on this issue and evidence of negative consequences in a letter to the European Commission on 19 July 2018 (JC 2018 21)

[3] This is stated in recitals 6 and 7.

Annex

The below table provides guidance on the practical application of the provisions determining the scope of the PRIIPs Regulation, in particular recitals 6 and 7 and Article 4(1), to different types of common bond features. Each different type of bond or bond feature is considered individually. Where a bond combines different features, each feature needs to be considered separately. It should also be noted that the Regulation does not apply to securities that fall within point (d) of Article 2(2) of the Regulation.

Type of feature	Main considerations on the extent to which the instrument would fall in the scope of the PRIIPs Regulation
Perpetual	There are not considered to be any fluctuations in the amount repayable due to the fact that a bond is perpetual. Without prejudice to other features of a specific bond that could lead to review this assessment, this should lead to the conclusion that the "perpetual" feature of a bond *per se* does not imply that this bond falls in the scope of the PRIIPs Regulation.
Subordinated	There are not considered to be any fluctuations in the amount repayable due to the fact that a bond is subordinated. Without prejudice to other features of a specific bond that could lead to review this assessment, this should lead to the conclusion that the "subordinated" feature of a bond *per se* does not imply that this bond falls in the scope of the PRIIPs Regulation.
Fixed rate	There are not considered to be any fluctuations in the amount repayable. This would include: - bonds with coupon payments fixed at a defined interest rate until maturity, including at zero; - bonds with pre-defined changes in the coupon rate at fixed times prior to maturity. Without prejudice to other features of a specific bond that could lead to review this assessment, this should lead to the conclusion that the "fixed rate" feature of a bond *per se* does not imply that this bond falls in the scope of the PRIIPs Regulation.
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. 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. 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 unless there is additional structuring, such as a cap or floor (other

	than at zero); c.f. definition of a structured deposit. This direct link to an interest rate index would therefore not imply that the instrument is a PRIIP. Therefore, not all variable rate bonds are considered to be in scope, but it is dependent on the specific “variable” rate feature, as well as the other contractual features of the bond.
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. Without prejudice to other features of a specific bond that could lead to review this assessment, this should lead to the conclusion that the “puttable” feature of a bond *per se* does not imply that this bond falls in the scope of the PRIIPs Regulation.
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. 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. 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). Therefore, not all callable bonds are considered to be in scope, but some are expected to be on the basis of the specific “callable” feature, as well as depending on the other contractual features of the bond.
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. Convertible bonds would therefore be considered to fall in the scope of the PRIIPs Regulation.