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FRANCAISE  
DES MARCHÉS  
FINANCIERS



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*Brussels, 29 August 2023*

## **Subject: Letter from industry associations concerning barriers to sell vanilla products**

Dear Sirs,

As banking federations and associations representing financial market participants, we are sensitive to the Commission's objectives of facilitating access to capital markets for retail investors. The purpose of this letter is not to comment specifically on the current European proposals on the Retail Investment Strategy but to highlight our common concern about the legislative barriers in Europe that currently prevent retail investors from accessing vanilla<sup>1</sup> products in the EU.

After detailing these obstacles, we would like to suggest several approaches to eliminating them.

### **1) The issue**

**Vanilla products such as bonds and shares** are essential instruments for companies to finance themselves efficiently and can be very useful for retail investors to build well-diversified low-cost investment portfolios. A well-functioning secondary market is a pre-requisite for many investors to invest in the securities in the primary market.

However, three key European regulatory barriers prevent Retail investors from accessing vanilla products both on the primary and secondary markets. The first is linked to the application of **MiFID product governance** to vanilla products, the second to the inclusion of certain vanilla bonds in the scope of **PRIIPS Regulation** and the third to the fact that certain local competent authorities consider certain terms and conditions as being "unfair" towards consumers.<sup>2</sup>

**These barriers to the sale of such products are at odds with the Commission's objective to facilitate the financing of the European economy through capital markets and to ease access of retail investors to these markets.**

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<sup>1</sup> When we use the term "vanilla", we refer to "single financial instruments aimed at raising capital".

<sup>2</sup> European directive 93/13.

**Barrier 1: Advisers to issuers of bonds and shares are viewed under MiFID II as manufacturers of such products on the secondary market, which is ill-suited.**

Under MiFID II, a Manufacturer is an investment service provider (ISP) that manufactures financial instruments, which encompasses the “creation, development, issuance and/or design of financial instruments”.<sup>3</sup>

A commonly accepted interpretation of recital 15 of the MiFID 2 DD<sup>4</sup> considers that the ISP acting as adviser for an issuer in connection with an issuance of vanilla products is the “Manufacturer” of such products for Product Governance purposes.

However, such financial instruments are different from investment products that are manufactured to meet certain investors’ expectations and to which product governance rules should rightly apply. The issuance of bonds and shares serves a different purpose, which is to raise funds for an issuer at a moment in time. Therefore, the advice provided by the ISP in this context does only concern the characteristics of the issuance (terms and conditions, timetable, etc.) to source liquidity and it is not directed towards meeting the needs of a target market. For that reason, rules on product governance are ill-suited for vanilla products and raise difficulties.

In particular, the fact that such ISPs are Manufacturers of vanilla products raises significant concerns with respect to their secondary market:

- The requirement to have in place regular reviews and feedback loops between Manufacturers and distributors does not make sense for vanilla products, since the “Manufacturers” are not generally bound with the financial institutions selling them and are not in a capacity to modify the products’ distribution strategy in order to adapt it to the target market or to the economic situation at a later stage. Also, issuers are not required to be contractually bound, until maturity (or without any end date for shares and perpetual bonds), to Manufacturers that have been part of the issuing syndicate.
- The requirement that a “Manufacturer” should keep track of subsequent distribution of a bond or a share on the secondary market (e.g. on trading venues) is impossible to achieve in practice:
  - o First, a share or bond of a leading corporate company issued by a syndicate of several Manufacturers might be distributed by several hundreds of financial institutions in the secondary market without the Manufacturer having any link with them.
  - o Second, because of the fungible nature of shares and bonds, it is not always possible to link a particular security in the secondary market to a Manufacturer involved in the syndicate in the primary market (for example, a tap bond or the issuance of new shares equivalent to the existing shares of an already listed company).

A consequence is that, due to the uncertainty of the approach they should take for product governance requirements, Manufacturers as well as distributors face inappropriate liability issues with respect to matters beyond their control. Considering such legal and regulatory risks,

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<sup>3</sup> In the case of issues of vanilla products, if the issuer is not subject to MiFID 2 (for example, a corporate issuer), it does not itself meet the prerequisites of the definition of Manufacturer.

<sup>4</sup> “... For the purpose of product governance requirements, investment firms that create, develop, issue and/or design financial instruments, including when advising corporate issuers on the launch of new financial instruments, should be considered as manufacturers while investment firms that offer or sell financial instrument and services to clients should be considered distributors.”

distributors may be tempted to eliminate vanilla products on the secondary market from their product offer.

### **Barrier 2: Applying PRIIPs to vanilla bonds prevents their sale to retail clients**

Regarding vanilla bonds, one of the main barriers is the fact that issuers exclude retail investors from the offer, excluding them explicitly in the prospectus via a selling or/and transfer restriction. They usually do that to limit the risks to fall under PRIIPs<sup>5</sup>. When defining their target markets, the Manufacturers (i.e. the ISPs members of the bond syndicate) shall have to take into account the restrictions in the prospectus, while in many cases there is no particular feature related to the product justifying the exclusion of retail investors from the relevant target market.

Said approach penalizes distributors wishing to sell such products to retail clients. Indeed, they would face extra risks and extra administrative burdens because in such a case they will be distributing such bonds outside of the positive target market or in the negative target market as defined by the issuer in the prospectus. In addition, considering the uncertainty of the PRIIPs perimeter and that, consequently, certain products are qualified as PRIIPs even if they are vanilla products, a further obstacle to the distribution to retail clients may be the absence of a KID. Therefore, distributors do not generally make these bonds available to retail investors, thereby restricting investors' access to these simple products.

This leads to inconsistent end target markets across products when distributing them to end investors.

- Example 1: Retail could be included in the positive target market of the shares of the issuer but excluded for the bond.
- Example 2: The positive target market of two similar bonds issued by different issuers could be different – with Retail included in the TM for the riskier issuer but excluded for the less risky issuer.

### **Barrier 3: Terms and conditions considered as being “unfair” by certain local competent authorities prevent the sale of bonds to retail clients**

Certain competent authorities published recommendations and interpretations for the application of the provisions, stemming from European directive 93/13 on unfair terms in contractual relationships, to the issuance of bonds targeting retail investors.

In practice, these authorities forbid the use of the following clauses for retail bonds or request the issuers (and also the distributors) to amend these clauses by offering additional compensation to the investors at the detriment of the issuers. Such clauses could be: (i) call options, (ii) early termination clauses in case of taxation event, (iii) make-whole clauses, and (iv) clauses enabling the substitution of the issuer.

We support the general principle stating that a clause shall not create a significant/obvious imbalance between the rights and obligations of the parties to the detriment of the consumer. However, the view from certain competent authorities is too restrictive, which affects the market of vanilla bonds (both on the primary and on the secondary markets), having negative side effects for retail investors:

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<sup>5</sup> Also to limit the risk of having terms and conditions considered “unfair” according to the view of certain local competent authorities.

(i) Some issuers remove certain of the concerned clauses from the terms and conditions of their issuance even where such removal is detrimental to clients for which such clauses were a protection.

Example 1: a tax call is associated to a gross-up provision: by preventing the issuers to use a standard tax call, the result is that these issuers remove both the tax call and the obligation to gross-up the interests in the terms and conditions of their retail bonds.

Example 2: a make whole clause enables an issuer to early redeem all the bonds in circulation. By preventing the use of that clause for retail investors, (as used in the wholesale market) for retail bonds, such investors face the risk, in case of early redemption by the issuer, to end up with bonds that have no or limited liquidity.

ii) Some issuers, not willing to face such difficulties, prefer to add a selling or/and transfer restriction in their prospectus to prevent the sale to retail investors. In such cases, retail investors will miss investment opportunities both on the primary and the secondary markets. Any transfer restriction in the prospectus will have to be taken into account by distributors when defining their target market, with no room for possible justified deviation.

## 2) Possible regulatory solution(s)

Removing the above barriers would greatly facilitate the access of retail clients to bonds and shares, bringing the policy makers closer to their objective to facilitate Retail investments in capital market products (Capital Market Union initiative).

### Proposals regarding product governance

Proportionality is key in the determination of the product governance requirements and target market assessments. Shares and vanilla bonds are generally considered to be simple products. These are also the reasons why retail investors are entitled, on their own initiative, to execute orders, without the necessity for financial intermediaries to make an appropriateness assessment (in accordance with article 25§4 MIFID). In that context, knowledge and experience of Retail investors should not be verified.

We therefore request that ESMA reconsiders its approach on product governance requirements and focuses only on those products for which product governance requirements would bring an added value (for more complex, opaque and risky products). Vanilla bonds and shares should be distributed without these inappropriate restrictions, under the safeguards provided by MiFID II distribution regimes, in the EEA.

More specifically, we suggest the following three alternative approaches by order of preference.

#### **Proposal 1.1: Exempt vanilla products from MiFIDII Product governance requirements**

Such option would have our preference since it would have the merit of solving all other issues to be dealt with when applying the product governance regime to vanilla products.

In particular, the following requirements appear to be inapplicable or ineffective:

a) **Costs:** by nature, plain vanilla products do not incur product “manufacturing” costs. Therefore, the obligations to verify the compatibility of these costs and charges seems to present no added value.

b) **Scenarios:** similarly, the obligation to undertake analyses of various scenarios seems to be apposite for structured products, but not pertinent for shares and bonds.

c) **Regular review of the product** given the nature of these products, we consider that it is disproportionate, unnecessary and perhaps impossible (particularly on the primary market) to conduct regular reviews.

d) **Target market:** there is little added value in requiring the determination of a detailed target market for such products which are in majority distributed passively through execution services such as RTO or execution of orders. In such cases, there will be little to no matching of the predetermined target market with clients' characteristics because at best it is the appropriateness regime that applies (when the products are not sold under execution only). In such a context, the exercise of determining a target market looks rather artificial :because the sole criterion that will be checked under the appropriateness regime for retail clients will be their knowledge and experience whereas none will be checked under the execution only regime. Moreover, with regard to plain vanilla financial instruments that should be available for a wide array of clients, such criterion will not be very discriminative.

This poor added value is not consistent with the significant burden stemming from the sheer number of financial instruments concerned (as an example: on one trading day on Euronext there are at least 150 000 different ISIN codes traded). Distributors should determine as many target markets without any help from the issuers with whom they have no links whatsoever.

**Therefore, we advocate for or a full exemption of product governance rules for vanilla products or, at a minimum, for an exemption applying to passive distribution of such products when acquired at the exclusive initiative of clients (in the sense of recital 111 of MiFIDII and question 1 of section 13<sup>6</sup> of the ESMA's Questions and Answers on MiFID II and MiFIR investor protection and intermediaries).**

**Proposal 1.2: Clarify that the role of the manufacturer stops after the primary issuance of plain vanilla bonds or shares.**

That would avoid overly complex situations whereby manufacturers that have been part of the issuing syndicate would have to keep track of and interact with all distributors of the securities in the secondary market.

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<sup>6</sup> "As provided in recital 111, in order to qualify for Article 42 of MiFID II, "where a third-country firm solicits clients or potential clients in the Union or promotes or advertises investment services or activities together with ancillary services in the Union, it should not be deemed as a service provided at the own exclusive initiative of the client". ESMA is of the view that such a solicitation, promotion or advertising should be considered regardless of the person through whom it is issued: the third country firm itself, an entity acting on its behalf or having close links with such third country firm or any other person acting on behalf of such entity. As for the means of such solicitations, ESMA is of the view that every communication means used such as press releases, advertising on internet, brochures, phone calls or face-to-face meetings should be considered to determine if the client or potential client has been subject to any solicitation, promotion or advertising in the Union on the firm's investment services or activities or on financial instruments. Firms are reminded that such clarification is without prejudice to any provisions attached to the marketing of such products. The client's own exclusive initiative shall be assessed in concreto on a case by case basis for each investment service or activity provided, regardless of any contractual clause or disclaimer purporting to state, for example, that the third country firm will be deemed to respond to the exclusive initiative of the client." ([ESMA's Questions and Answers on MiFID II and MiFIR investor protection and intermediaries](#), Section 13, Q&A 1).

Also manufacturers would be more inclined to include Retail clients in their target markets (when justified) if they knew that their responsibility ended after the issuance.

Finally, distributors would be more open to include vanilla products on the secondary market in their offering, as they would face less legal and regulatory uncertainty.

**Proposal 1.3: Allow distributors more flexibility when determining the target market of plain vanilla products in the secondary market.**

With regard to the assessment of the client categorization in the target market, there is no certainty that the manufacturers have made an objective assessment of the possible target market of the product in the best interest of all possible end investors, as they may rather be focused on finding easy access to liquidity in the primary market. Manufacturers may not be willing to consider onward distribution to possible end investors whose needs or objectives may be compatible with the features of the product.

Additionally, a distributor should not be bound by the target market constraints on client categorization defined by the manufacturer at the time of the issuance and initial distribution.

**Proposal regarding PRIIPS**

**Proposal 2: Exempt vanilla bonds from PRIIPS Regulation and clarify the scope of PRIIPS Regulation**

Due to the fact that such vanilla bonds are simple products, they should be exempted from PRIIPS Regulation, which would facilitate access of retail clients to these financial instruments. A clarification of the exact scope of the PRIIPS Regulation would be crucial given that issuers often label their products (even vanilla products) as “professional only” to avoid the burden of drafting a KID.

Such proposal is to be considered as complementary to and having the same importance as the aforementioned proposals about product governance requirements.

**Proposal regarding “unfair” terms**

The following two propositions are alternative and would contribute to creating a level playing field across the EEA.

**Proposal 3.1: Amend the [directive 93/13](#) on unfair terms in consumer contracts to exclude bonds and other financial products.**

**Proposal 3.2: Publish guidelines clarifying the clauses in bonds that could be considered as “imbalanced” for consumers.**

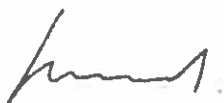
In conclusion, we believe that the Commission's objective of facilitating retail investment in capital market products (the Capital Markets Union initiative) could be achieved in particular by removing the above-mentioned legal barriers through the proposals described in this letter.

We remain at your disposal to discuss the content of our letter if necessary, or to share with you in greater detail the experience of the sector.

Yours sincerely,

**The undersigned associations:**

**For FEBELFIN,**



Karel BAERT  
Chief Executive Officer

**For AMAFI,**



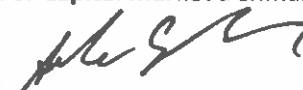
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