ASSOCIATION FRANÇAISE DES MARCHÉS FINANCIERS

LES PROFESSIONNELS DE LA BOURSE & DE LA FINANCE

AMAFI / 20-10
6 February 2020

IOSCO CONSULTATION
CONFLICTS OF INTEREST AND ASSOCIATED CONDUCT RISKS DURING THE DEBT CAPITAL RAISING PROCESS

AMAFI comments

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It mainly acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI has more than 150 members operating for their own account or for clients in equities, fixed-income products and derivatives. Nearly one-third of its members are subsidiaries or branches of non-French institutions.

AMAFI welcomes the opportunity to comment on IOSCO proposed Guidance to address conflicts of interest in the debt capital raising process and wishes to provide some general remarks on the content of this report before answering the question on whether AMAFI agrees that the Guidance as set out is appropriate, measure by measure.

GENERAL REMARKS

Generally speaking, AMAFI agrees with the Guidance set out in the Report and believes that most of the proposed measures are indeed appropriate to address the potential conflicts of interest and associated conduct risks arising in the Debt capital raising process. As a matter of fact, most of the measures proposed in the report (measures 1, 2 5 to 8) are required by MiFID 2[1] framework and as such are already applied by French financial firms involved in Debt capital raising process and providing Debt Capital Market (DCM) activities to issuer clients.

Before commenting the proposed Guidance, AMAFI wishes to make several comments on the report:

<u>Chapter 3 – Description of the debt capital raising process</u>

- **An example of the bond issuance process**

AMAFI agrees with the statement that bond issuances are primarily targeted at institutional investors. In France, there is almost never participation of retail investors. If several reasons might explain that, AMAFI wishes to outline one in particular: legal and regulatory risks arising from EU regulation that have been strengthened the past few years investors' protection (PRIIPs and MiFID 2 most notably).

[1] Market in Financial Instruments (MiFID II) – Directive 2014/65/EU and its supplementary acts, notably Commission delegated regulation (EU) 2017/565 as regards organisational requirements and operating conditions for investment firms.

AMAFI ■ 13, rue Auber ■ 75009 Paris ■ France
Phone : +33 1 53 83 00 70 ■ Fax : +33 1 53 83 00 83 ■ http://www.amafi.fr ■ E-mail : info@amafi.fr

AMAFI / 20-10
6 February 2020

- **Pre-offering phase**

Regarding the presentation of Pre-offering phase, AMAFI believes that the reference made to “Market soundings” is not accurate, at least for French and to a lesser extent for EU markets. Whereas such practice existed a few years back, it is nowadays fairly rare, if not almost inexistent. Also, footnote 11 seems to focus on “early look meetings” with analysts which are more relevant for Equity capital raising process rather than bonds issuance.

- **Offering phase**

When presenting the Offering phase, the report mentions that “*a prospectus – may be made available alongside the announcement, though this would not necessary be a final version (approved by the competent authority), nor would it be publicly available*”. AMAFI considers that this sentence is unclear and the meaning of “publicly available” here should be further clarified.

Regarding the management roadshow, where the report says that it lasts two weeks, it is more likely one week in our experience. We would therefore suggest saying instead “*one to* two weeks”.

AMAFI agrees with the statement that syndicate banks rarely produce research specifically on the bond issuance process. Going further, in France, there is no such “connected research” in relation to bond issuance.

- **Frequent issuers**

AMAFI agrees as well with the distinction the report makes between infrequent/frequent issuers although some facts relating to the latter are not totally accurate in our experience of the French/UE markets:

- Frequent issuers do not tend particularly to “*work with the same firm*” but run through similar calls for tender that keep investment firms in competition.
- Markets soundings are not really “*less common* […] *(e.g. France)*” but rather very rare, regardless of the nature (frequent or not) of the issuer.
- Transactions for frequent issuers do not “*often involve a small number of institutional investors*”. On the contrary, in our view, the trend tends to be reversed: transactions for frequent issuers do “*often involve a ~~small~~ **large** number of institutional investors*”.

Finally, AMAFI would suggest some adjustments to the diagrams showing bond issuance process. Indeed, like detailed in the diagram below, we consider that the pricing call occurs after the allocation discussion and decisions. Likewise, trading starts usually before the publication of final approved prospectus and final price.

Figure 1: Diagrams showing bond issuance process

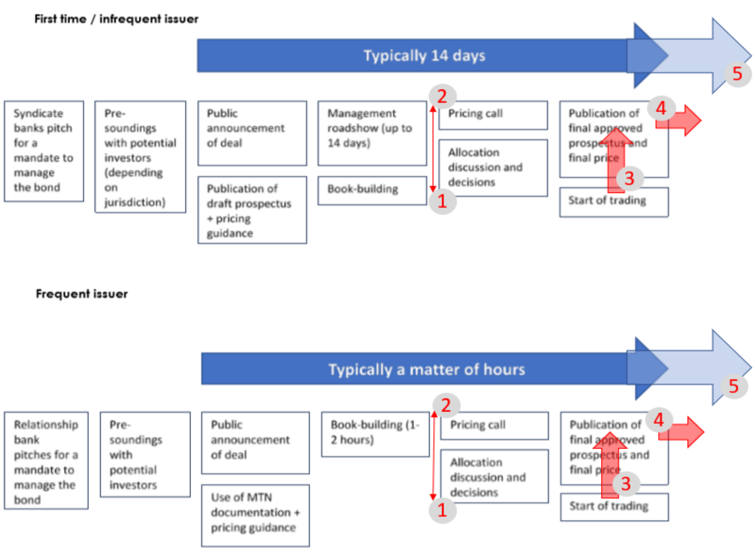
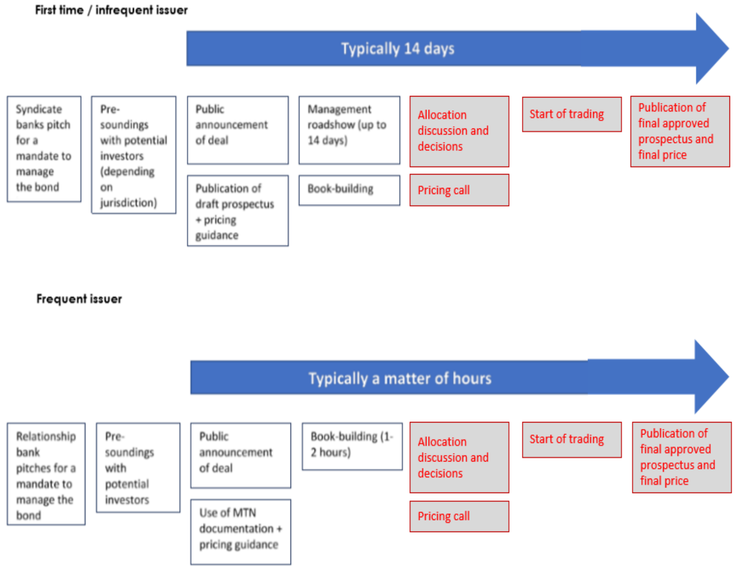


Figure 1: Diagrams showing bond issuance process



- **Pricing and risk management transactions ("RMTs")**

In the first sentence of this paragraph, AMAFI would suggest changing the wording "*The firm managing the securities offering*" by "The firm managing ***the billing and delivery*** of the offering". Indeed, several firms manage an offering, through a syndicate, but only one is responsible for the pricing – the one responsible for the billing and delivery of the offering.

Also, we would remove the words "*in many cases*" since in our view the final issue price is ***always*** agreed between the firm and the issuer.

Finally, the last sentence on RMTs may create confusion in our opinion. It may imply that such RMTs are performed only during the execution period of the transaction. To our experience, hedging through RMTs begins beforehand, potentially before or as soon as the firm is appointed. In that case, potential impact of such RMTs is more unlikely.

- **The allocations process**

Although AMAFI considers that it is relevant to outline the difference between "*private placements*" and "*public of listed offerings*", we have concerns that the notion of "*private placements*" may be confusing and meaning quite different things. For instance, in France, "*private placements*" can mean public offering but exempted from the requirement to publish a prospectus in accordance with the exceptions granted by Prospectus Regulation[2]. It may also mean Euro Private Placements (Euro PP) defined as "*a medium or long-term financing transaction between a company and a limited number of institutional investors, based on ad hoc documentation negotiated between the borrower and the investors, generally with the participation of an arranger*."[3] To avoid possible confusion, AMAFI would suggest the report to be more specific as what it refers to by private placements.

Finally, regarding the key considerations for allocation decisions, AMAFI has concern about "*The length of the investor-client, including* […] *the prospect of future, client-relationship based business*".

[2] Règlement (UE) 2017/1129.
[3] http://www.euro-privateplacement.com/index_fr.htm

If the prospect of obtaining new future business and additional source of income for the firm that could imply that such client would receive a better allocation, potentially at the expense of other investors clients or the issuer, we would even consider that as a potential conflict of interests and therefore disagrees with the fact that it could be a key consideration (without impairing our duty to act fairly towards all clients).

Chapter 4 – Potential risks and harms, and regulatory framework

- **Pricing**

AMAFI does not understand the assumption that the firm managing a bond offering may be incentivised to price an offering in a way that promotes its own interests. It may be incentivised to promote the interests of their own clients or one/limited number of investor clients rather than other investors clients or rather than the issuer (or vice-versa) but not its very own interests. Indeed, in our experience, firm's managing a bond offering cannot take any personal advantage from the pricing itself. Even for the case of discretionary fees (*i.e.* additional fees provided by and at the discretion of the issuer for rewarding special "performance" of the firm in the offering), those do not depend on the level of pricing but rather – and among other factors - on its relevancy *vis-à-vis* investors and how close it reflects the meeting of the offering and the demand.

Also, we disagree with the last sentence that says: "*conflicts of interest may arise regarding pricing, where an affiliate of the firm, such as its related asset management arm, is also an investor in the bond offering*". Indeed, asset managers affiliate of the firm are, at least in the French markets, most of the time, clients of other firms including the others managing firms. The fact that an investor is also an affiliate of the firms have no impact on the pricing that again is determined as the result of the meeting of the offering and demand as materialised through the book building process.

This issue of affiliate is actually more relevant for potential conflicts of interest in the allocation process (rather than pricing). Indeed, one may argue that a client who is also an affiliate could be treated more favourably than other investors clients. In reality, this risk mitigates naturally since allocations decisions are collegiate decisions made by the whole syndicate of firms involved (so no individual firm could advantage significantly its own clients to the detriment of other clients of other firms) and with the issuer. Furthermore, like explained above, asset managers affiliate of one firm are, at least in the French markets, most of the time, as well clients of other managing firms. Therefore, it is unlikely that one managing firm could advantage one particular investor, even if that investor is an affiliate.

- **Risk Management transactions**

AMAFI would like to comment on the statement that "*in terms of mitigating the potential for misconduct*", most jurisdictions mentioned that a separate department of the firm deals with the RMTs and that so, "*the firm erects an information barrier*" between the relevant departments. It should be outlined that organisation of firms in that matter depends on the scope and missions of the relevant sales staff. Indeed, those sales staff may be exclusively dedicated for performing RMTs in relation to bonds issuance, for the benefit of issuers without performing any other transactions for any other type of clients that could be conflicted in that way. Therefore, in such cases, those staff can be located on the private side of the information barrier and/or affiliated to the same department managing bonds issuance. Such specialisation of the staff involved in RMTs is another appropriate mean to prevent potential misconduct.

More importantly, AMAFI wishes to outline that MiFID 2 covers widely the potential risks in relation to hedging (here RMTs) transactions. Thus, article 39 of Delegated Regulation 2017-565 of 25 April 2016 supplementing MiFID 2 requires firms to "*inform and engage with the issuer client about <u>any hedging</u> or stabilisation strategies it intends to undertake with respect to the offering, including how these strategies may impact the issuer clients' interests*." Consistent with this requirement, firms are expected, in accordance with MiFID 2, to explain to an issuer client whether, and in what circumstances, they will undertake risk management transactions and how those could impact on an issuer client's interests. Therefore, the risk is appropriately addressed by MiFID 2, in Europe.

- **Quality of information available to investors**

AMAFI would agree with the risk identified in the report that investor may not have "*sufficient time to read through disclosures*" but points out that (i) legal and regulatory framework requires firms to provide many information to investors and (ii) institutional investors are able to decide if they had sufficient time to analyse the available information.

Also, if the timing is even tighter for frequent issuers like the report outlines – hence, less time for investors to go over the documentation – the risk undertook by investors on frequent issuers is actually lower than for debut or infrequent issuers (even if other factors like the nature of the bond is to be taken into consideration).

Regarding the point made on roadshows and the fact that "*it could create discrepancies of information provided to the invited investors and those who are not invited*", we must qualify this statement in light with the fact that only publicly available information is provided during roadshow. As a standard market practice – at least in France – firms remind issuers that they must only share public information during roadshows. Therefore, "*not invited*" investors can always have access to the same information which prevent any discrepancy. Moreover, in practice, firms invite all their clients potentially interested so it is rare to have investors "*not invited*". Firms cannot often fill in all positions, so it is quite uncommon to refuse investors. Anyway, it is as well common standard to set up a "global investors call" as a conclusion of the roadshows, with the issuer attending and where all investors could attend with a Q&A session at the end.

As far as the credit ratings is concerned, AMAFI would suggest the report adds the mention of "*financial*" credit ratings to clarify that the issue here concerns financial credit ratings published by credit rating agencies (and avoid possible confusion with other forms of rating, like ESG ratings). On the point itself, that such ratings may not be available, AMAFI agrees but wishes to outline that there is no relation with the fact that the bonds are or are not offered through private placements. It depends on the issuer. Not all issuers have a financial credit rating. It is a costly service that not all can afford or wishes to pay for. For issuers who do have a rating, it is true that such rating may change in the future. To mitigate that risk, it may be outlined that firms involved in the offering when performing their due diligences beforehand, ask the issuer if, to his knowledge, such rating is about to change in the next future. Finally, we could also mention that if credit rating is surely a relevant information for investors, they do not make their decision to invest exclusively on that basis, so they still can make an informed decision without it.

- **Allocations**

AMAFI mostly agrees with the potential harm and risks identified in the report as regards to Allocations as well as with the observation that the legal and regulatory MiFID 2 framework widely and exhaustively covers those risks.

- **Grey market Trading**

AMAFI would like to comment on the reference made to "*grey market trading*" in the report. First, we think that the definition provided in footnote 17 is confusing since grey market trading is more likely to occur ***after*** **the final pricing** (that itself occurs *after* the end of the allocation process). Therefore, we would suggest the following amendment: "*Grey market trading is trading that occurs during the period between ~~pricing and allocation~~* ***final pricing*** *and its admission to the market*". In that case, since all conditions of the offering are set and final, it could not have material impact on the result of the offering and therefore could not impair our duty to act on the issuer's best interest. On the contrary, grey market trading could help to set up a secondary market for the securities and creates liquidity that is essential to investors and therefore to issuers as well.

However, if "grey market trading" can happen before the final pricing, the risk of conflicting is more likely and should be indeed managed. Thus, where "grey market" trading starts once the transaction is announced and launched but ***before*** **final pricing**, lead managers should not participate in such "grey market" trading.

- **Changes to the Legal and Regulatory Framework**

AMAFI notes that most member's jurisdictions had no plans to modify or enhance their frameworks regarding the identified risks and potential harms.

As regards Europe, AMAFI wishes to insist that many heavy reforms, and most notably MiFID 2, occurred in the past few years and have just been implemented. Therefore, stakeholders now need very much regulatory stability. MiFID 2, like already pointed out and as evidenced in our comments on proposed measures below, widely addresses all issues of conflicts of interest notably in securities offering. For some aspects, it may go even further than the measures proposed in the Guidance. **Therefore, AMAFI considers that no enhancement of the European framework is needed in that respect.**

COMMENTS ON PROPOSED POLICY MEASURES

Measure 1: *Regulators should consider requiring firms to manage conflicts of interest that may arise in relation to the* ***pricing*** *of a debt securities offering, keeping the issuer informed of key decisions or actions which can influence the pricing outcome, and giving the issuer an opportunity to express its preference regarding the pricing of an issue during the pricing process.*

AMAFI does not have any remark on this proposed measure as it is a MiFID 2 requirement (see specifically Articles 38 to 43 of the Delegated regulation (EU) 2017/565).

Measure 2: *Regulators should consider requiring firms to take reasonable steps to disclose to the issuer how any* ***risk management transactions*** *it intends to carry out for itself, the issuer, or investor clients, will not compromise the issuer's interests in relation to the pricing of the new issuance.*

AMAFI does not have any remark on this proposed measure as it is a MiFID 2 requirement (see specifically Article 39 of the Delegated regulation (EU) 2017/565).

Measure 3*: Regulators should encourage the timely provision of a* ***range of information*** *to investors in a debt securities offering, where distribution of such information is permitted under local law.*

It remains unclear what "*range of information*" would mean precisely here. As regards Europe, Prospectus Regulation and MiFID 2 already require comprehensive and clear information to be provided to investors in relation to the offering. This measure should not create additional requirement nor additional information to be provided to investors. Like the report mentions itself, there is not enough time anyway for investors to go through all that is already provided. Also, it is important not to create additional constraints that could disturb the timing of those operations.
If by "*information*", the measure includes any research (like the mention "*where distribution of such information is permitted under local law could imply*"), like already mentioned, in France/Europe, research on a debt securities offering ("connected research") is highly uncommon, at least in France/UE.

Measure 4*: Regulators should consider requiring firms to have appropriate controls to identify, prevent where possible and manage any conflicts of interest that arise in the* ***preparation of research on a debt securities offering****.*

Like outlined in the Report, research on a debt securities offering ("connected research") is highly uncommon, at least in France/UE. Such conflicts are anyway widely covered by both Market Abuse Regulation ("MAR")[4] and MiFID 2 in Europe.

[4] Regulation (EU) n° 596/2014 on market abuse.

Measure 5: *Regulators should consider requiring firms to maintain an* ***allocation policy*** *that sets out their approach for determining allocations in a debt securities offering, and for the firm to regularly assess its compliance with the policy.*

AMAFI does not have any remark on this proposed measure as it is a MiFID 2 requirement (see specifically Articles 38, 40 to 43 of the Delegated regulation (EU) 2017/565).

However, we would like to outline that such policy could be drafted at a relatively high level when describing usual practices and high principles so it could be applicable to all bond issuances of the firm and then applied for each transaction. In other words, regulators should not expect firms to draft a dedicated policy for each transaction.

Measure 6: *Regulators should encourage firms to consider their issuer client's preferences e.g. investor profile and composition, when making* ***allocations*** *decisions or recommendations.*

AMAFI does not have any remark on this proposed measure as it is a MiFID 2 requirement (see specifically Articles 38, 40 to 43 of the Delegated regulation (EU) 2017/565).

We may add that MiFID 2 goes further since firms are not encouraged but required to not only consider the issuer's preferences but obtain his consent on allocation policy of the firm. Such consent should deem that issuer client's preferences have been considered properly. That is why we wonder why this measure says that regulators "should encourage firms" whereas other measures say "should consider requiring firms".

Measure 7: *Regulators should consider requiring firms to have appropriate controls to identify, avoid where possible and manage any conflicts of interest that arise in the* ***allocation*** *recommendations of a debt securities offering.*

AMAFI does not have any remark on this proposed measure as it is a MiFID 2 requirement (see specifically Articles 38, 40 to 43 of the Delegated regulation (EU) 2017/565) to identify, avoid or manage any conflicts of interest that arise in the allocations of a debt securities offering.

As for "*appropriate controls*", like any other regulatory requirement, appropriate and proportionate monitoring of compliance with this requirement would be assessed by the firm according to its control plan and compliance program.

Measure 8: *Regulators should consider requiring firms to maintain* ***records of allocation*** *decisions to demonstrate that any conflicts of interest are appropriately managed.*

AMAFI does not have any remark on this proposed measure as it is a MiFID 2 requirement (see specifically Article 43 of the Delegated regulation (EU) 2017/565).

However, as it is the case within MiFID 2 framework (see specially ESMA Q&A 6.3 from Q&A on MiFID II investor protection topics, ESMA35-43-349) , and considering proportionality principle, allocation decisions at material stages only in the allocation process must be recorded and not all exchanges that are not necessarily relevant in that context. Focus should be made on recording justification of final allocations that could be considered as the most important and/or untypical.