

Luxembourg Stock Exchange Professional Segments – the real impact

What changes?

Both the Euro MTF, as well as the Regulated Market of the Luxembourg Stock Exchange are from now on equipped with their respective Professional Segments i.e. trading platforms reserved to qualified, non-retail investors.

- By “qualified investors” reference is made to the MiFID II client classification. Hence, it comprises professional clients (per se and elective), as well as eligible counterparties, unless they have opted-out and have requested to be treated as non-professionals.

The introduction of these segments represents a more efficient alternative for products exclusively targeting professional investors as per the MiFID classification.

Drivers for the introduction of Professional Segments

Increased liquidity in the bond markets is being achieved in 3 main ways:

1. Less onerous prospectus disclosure in one step.

Regulation (EU) 2017/1129 (**Prospectus Regulation**) paved the way for enhanced bond market liquidity, by significantly easing access to wholesale funding. This is achieved through reduced prospectus disclosure and more flexible language requirements (when it comes to public offers solely addressed to qualified investors).

The launch of a product in one of the Professional Segments automatically meets the standards for the alleviated prospectus regime (as set out further below).

2. Minimized regulatory compliance risk for MiFID Firms when they handle products traded on the Professional Segments.

The exclusively dedicated Professional Segments provide for a de facto fixed target market, which serves as a valuable solution to 2 important backstops in funding:

– Primary bond market:

“Co-Manufacturing” by several MiFID Firms (often in different member states) is a common underwriting tool for issuers.

Nonetheless, Co-Manufacturing Agreements are typically heavily negotiated, as practical and logistical issues arise in relation to role attributions, particularly when it comes to target market assessment/review.

As target market related obligations are mitigated for products traded on the Professional Segments, the above agreements will be easier to negotiate and implement and issuance will be facilitated.

– Secondary bond market:

Distributors face difficulties in the identification of the target market, as they are typically not connected to the manufacturer. These difficulties are now tackled by the new Professional Segments, whereby the target market is defined per se (through selection of the professional platforms).

3. Removal of false incentives for debt issuance in high denominations.

The favourable treatment of non-equity securities (initially stemming from Directive 2003/71/EC (the Prospectus Directive)) is now extended under the Prospectus Regulation to wholesale issues addressed to professionals, regardless of their denomination. Previously, only bonds with a denomination per unit of €100,000 or above could benefit from the alleviated treatment.

Offer and trading on the Professional Segments facilitate this in the most effective way.



As a result:

- the incentive is being built to issue bonds in denomination sizes attractive and accessible to a wider investor base;
- and liquidity and depth in corporate bond markets are enhanced.

Combined advantages

The Prospectus Regulation, as well as Directive 2014/65/EU (**MiFID II**) and Regulation (EU) 1286/2014 (**PRiIPs**) brought about burdensome disclosure obligations which could impede funding.

In this interconnected regulatory context, the newly established Professional Segments constitute a ground-breaking move forward, as they allow issuers and intermediaries to profit all at once from all of the available exceptions reserved for products dedicated to non-retail investors across the following 3 different pieces of legislation.

- **Prospectus Regulation:** Minimized disclosure and increased language flexibility.
- **MiFID II:** Less regulatory burden with respect to the identification of the target market and the distribution strategy in accordance with the MiFID II standards and the respective Guidelines on MiFID II product governance requirements of the European Securities and Markets Authority (**ESMA Product Governance Guidelines**).
- **PRiIPs:** Discharge of the obligation to publish a Key Information Document (**KID**) for packaged and insurance based investment products.

What are the concrete benefits?

In a nutshell: Professional Segments tackle a range of regulatory risks

The advantages for issuers and Investment Service Providers are multifaceted, ranging from issuance to distribution and notably consist of the following:

Lighter prospectus disclosure requirements

- The prospectus disclosure should be appropriate and proportionate to the level of knowledge, expertise, experience and risk-tolerance of each type of investor.
- This effectively means that less detail is needed for products exclusively addressed to qualified investors. Previously, prospectus disclosure requirements were not dependent on the nature of the investor but rather on the bonds' denomination.
- In light of the aforementioned extension of the more lenient disclosure regime to all wholesale offers, the Professional Segments allow issuers to avoid compliance costs linked to the full "retail-type" disclosure as much as possible.
- By virtue of the Prospectus Regulation, the prospectus disclosure is less onerous provided that:
 - Trading involves solely non-equity securities.
 - Trading in the relevant securities is exclusively accessible to qualified investors only. This requirement is met when trading takes place on the Professional Segments.
 - **Securities are not subsequently on-sold to retail investors:** This refers to the so called "retail cascade", where securities purchased by intermediaries on a Professional Segment are subsequently resold to retail investors. Distributors must be aware, that in such case an appropriate prospectus and related disclosure must be included.

These reduced standards notably consist of:

- less onerous disclosure and details;
- waiver of the obligation to draw up a summary;
- flexible language requirements: when issuers seek admission to trading in more than one EU member state, they can draft the prospectus in a language customary in the sphere of international finance such as English; and
- the Prospectus Regulation draft Delegated Regulation, which follows ESMA’s final report clearly sets out the content requirements for the non-equity registration documents and securities notes, respectively.

Simplified MiFID II product governance compliance

The admission to a Professional Segment is an initial and ongoing signpost of the target market, the assessment and periodical review of which is a MiFID II product governance requirement.

In a wholesale market context, MiFID II allows certain assumptions to be made about the end-clients’ knowledge and experience, as well as its risk bearing capacity and understanding.

The dedicated Professional Segments are “water-proof” platforms, whereby access to non-professionals is restricted. They result in the following ex ante and ex post benefits, when it comes to the definition and continuous review of the target market (taking into account the five categories defined in the ESMA Product Governance Guidelines):

- **Proportional initial target market identification:** The ESMA Product Governance Guidelines specify that the target market may be identified in less detail when it comes to products belonging to stock-exchange segments with certain requirements. MiFID firms may apply a common approach to identify the target market for all products traded in such segments and can describe the end-client categories in more generic terms.
- **Simplified compliance with ongoing obligations:** By using the professional segment, which is not accessible to retail

investors, issuers can show that they do not target retail investors, which, therefore, de facto simplifies the obligations to periodically review/update:

- the product target market; and
- the product distribution strategy.
- It must be noted however, that the Stock Exchange does not verify whether investors are indeed qualified or not and it is for the members to deny to place orders of retail investors.

No need for a KID under PRIIPs for packaged (including structured) and insurance-based products traded on Professional Segments.

By using the Professional Segments which are not accessible to retail investors, issuers can evidence that a given product does not target retail investors and can therefore avoid the KID for the relative products, including structured and insurance-based products.

Outlook

The Luxembourg Stock Exchange has already launched updated application forms which reflect the option of admission to trading on the Professional Segments.

The launch of these new Professional Segments will not only assist in facilitating issuances to qualified investors but will also indirectly boost the protection of retail investors.



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