

Less Tradable Corporate Bonds for Retail Investors in 2024

Latest figures from Boerse Stuttgart confirm that eight out of ten corporate bonds are not tradable for retail investors. We welcome The EU Commission's current proposal to facilitate access to corporate bonds in the PRIIPs-part of the "Retail Investment Strategy" and urge the co-legislators to finalize it within the current legislative term.

Corporate bonds are an important instrument for portfolio diversification and wealth creation. They are becoming increasingly popular among retail investors when interest rates have risen. However, our latest analysis revealed that in January 2024, 86% of corporate bonds listed on Boerse Stuttgart are still not tradable for retail investors. The limited access is entirely due to EU Regulations: the "PRIIP" Regulation¹ defines many corporate bonds with an investor protection clause as "packaged retail investment product," for which a key information document (KID) is required but which issuers often do not prepare. The Prospectus Regulation² further incentivises issuers to offer bonds with minimum denominations that are not feasible for retail investors, both Regulations ultimately lead to the de facto exclusion of retail investors. We therefore expressly welcome the EU Commission's amendment to the PRIIPs Regulation as part of its "Retail Investment Strategy" proposal and urge the legislators to reach a swift and consistent agreement within the current legislative term.

Conventional corporate bonds are interest-bearing securities issued as debt capital. They usually serve as long-term financing, for example, for new manufacturing capacities or other investments of companies. A bond gives creditors the right to be repaid the capital they provided at the end of the maturity period along with the interest.³ Their advantage compared to other financial instruments is that bonds are relatively easy to understand.

Moreover, corporate bonds issued by the same issuer as equities are deemed a less risky investment. Bonds are publicly offered to investors on the primary market. They can be traded on the secondary market once they are listed on a trading venue. Especially in the current environment of higher interest rates, bonds are increasingly becoming attractive for retail investors. On Boerse Stuttgart, the overall volume of trading in corporate bonds increased by 82% in 2023 compared to the previous year – which is a clear proof of the popularity of this asset class.

More than eight in ten corporate bonds are not tradable for retail investors

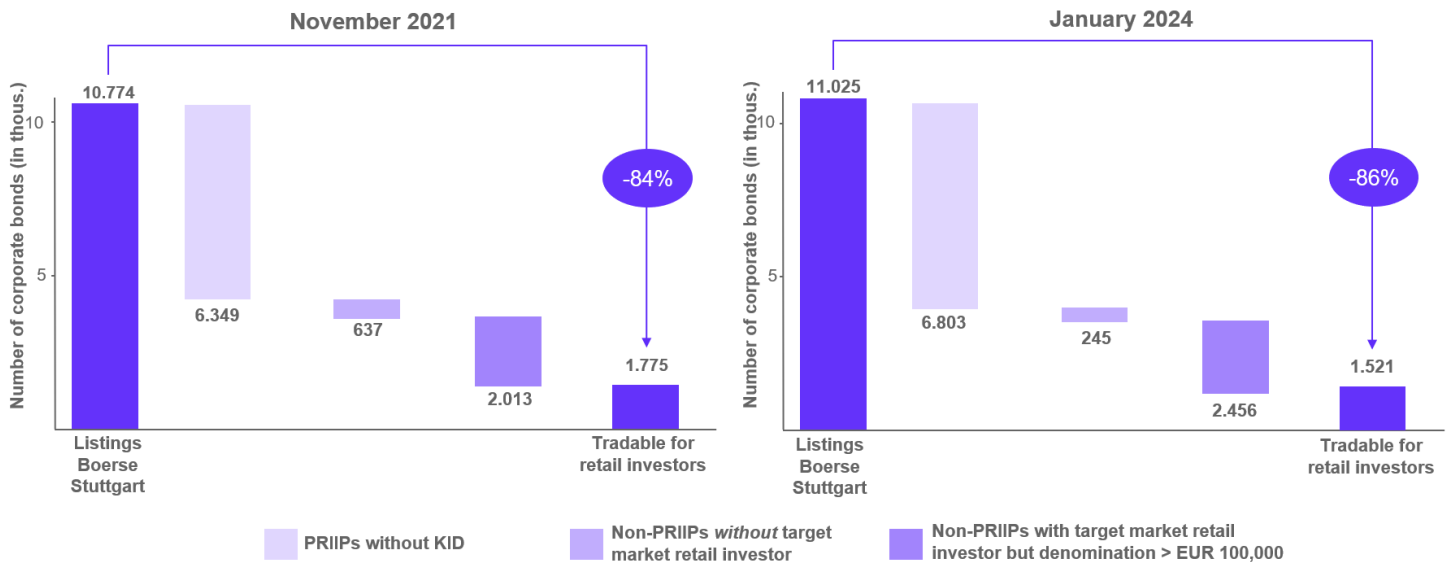
However, the increased demand from investors only hits a limited supply. New figures confirm the trend of recent years. The chart below shows that of 11,025 corporate bonds offered for trading on Boerse Stuttgart in January 2024, only 1,521 could be traded by retail investors. This means that more than eight out of ten corporate bonds (86%) are not tradable. Compared to our previous analysis from November 2021 (84%), this even represents a slight deterioration in tradability.

The reason for the limited supply is mainly regulatory and due to two obstacles stemming from the PRIIPs and Prospectus Regulations, which have a significant impact on the tradability of corporate bonds. To be tradable for retail investors, corporate bonds under the PRIIPs Regulation must have (i) a Key Information Document (KID) if they are categorised as a packaged retail investment product and (ii) a denomination below EUR 100,000 which is related to the Prospectus Regulation.

The biggest hurdle: the classification of many corporate bonds as PRIIPs, which require a KID

The PRIIPs Regulation in particular has proven to be obstructive. The German regulator BaFin also drew attention to this fact in its own analysis of the German corporate bond market. This analysis confirms our results and shows that the volume of corporate bonds traded by retail investors on the German market has declined significantly since the introduction of the PRIIPs Regulation.⁴

Why is that? For products categorised as PRIIP, banks must provide retail investors with a KID. It is intended to help investors better understand the basic characteristics and risks of these products in simple and clear language. The issuer of the financial product is responsible for creating a KID. The PRIIPs Regulation was originally conceptualised for „packaged retail investment products“ – i.e. for those products that relate to an underlying asset around which a kind of "package" is formed. However, it



should not be applied to products that are held directly by the investor, such as corporate bonds, which do not incorporate an underlying asset.

Most corporate bonds have a so-called “make-whole” call that allows the issuer to redeem the bond early. If the call is activated by the issuer, the investor must then be paid a form of compensation for the early redemption. The amount of compensation is usually calculated using a comparative benchmark. This is often a government bond. In principle, such calls are an instrument of investor protection, as investors are compensated in the event of early redemption.

The problem lies in the fact that the PRIIPs Regulation categorises such corporate bonds bearing a “make-whole” call a PRIIP due to the reference to a benchmark (the government bonds). For which, in turn, a KID must be prepared by the issuer. **However, most issuers are reluctant to prepare a KID – due to cost and liability issues.**

On Boerse Stuttgart, around 60% (6,803 of 11,025) of all listed corporate bonds are categorised as PRIIPs, which do not have a KID. As a result, these corporate bonds cannot be traded by retail investors due to the lack of a KID. **This is somewhat paradoxical: ultimately, a compensation clause that protects the investor leads to a de facto product exclusion.**

The second hurdle: High denominations are unattractive to most retail investors

Another obstacle is related to the minimum denomination of corporate bonds. Each company defines the denomination when issuing bonds. The smaller the denomination, the easier it is for retail investors to invest, as smaller sums can also be invested.

However, the Prospectus Regulation incentivizes issuers

to issue bonds with a denomination of greater than EUR 100,000 to circumvent the requirement to draft an onerous prospectus. However, a bond with a denomination of more than EUR 100,000 is unattractive for most retail investors who do not have enough funds to invest, as the entry hurdle is too high.

The number of corporate bonds that are not categorised as PRIIPs and would therefore be tradable in principle but are unattractive to most investors due to a denomination of over EUR 100,000, stood in January at 2,456. Corporate bonds in this category account for around 22% of all listed corporate bonds on Boerse Stuttgart that are not tradable. This is a further increase compared to the figures from our last analysis in 2021, when this share was around 19%.

Less product diversity for retail investors is problematic – our demands on policy makers

- **Current regulations prevent retail investors from using corporate bonds to diversify their retirement plans.** Against the backdrop of increasing life expectancy and demographic change, this is particularly harmful for investors with a long-term investment horizon.
- **Furthermore, the savings of retail investors are not mobilised to finance the economy.** And this is especially true at a time when private capital is urgently needed for the financing of our future – the digital and ecological transformation.
- **Thirdly, secondary market liquidity in the trading of corporate bonds is unnecessarily reduced.** Ultimately, it runs counter to the fundamental objective of the EU Capital Markets Union to increase the participation of retail investors in the capital markets and enable them to access a wide range of products that meet their needs.

We are therefore urging policy makers to improve the tradability of corporate bonds for retail investors. A first step would have been to lower the minimum denomination of EUR 100,000 as part of the revision of the Prospectus Regulation in the so-called “Listing Act”. Unfortunately, this threshold has become established in the market as the line of demarcation between retail and institutional investors, which is why the EU Commission refrained from proposing an amendment.

The PRIIPs part of the Retail Investment Strategy urgently needs to be finalised

In contrast, the EU Commission has taken a major step in the right direction when it comes to amendments to the PRIIPs Regulation. As part of the Retail Investment Strategy⁵, the EU Commission proposes to exempt all corporate bonds with a “make-whole” call from the scope of the PRIIPs Regulation. That would be a true “game changer” for retail investors that we as Boerse Stuttgart Group had long advocated.

However, this extremely welcome and long overdue amendment is now jeopardized by the fact that the Retail Investment Strategy is in risk of not being concluded. This is mainly due to the highly controversial changes that legislators are proposing to MiFID II. Should this happen, the regulatory relief for corporate bonds as part of the changes to the PRIIPs Regulation would also fail – again to the detriment of retail investors and product diversity.

Thus, we are calling on the EU legislators to at least agree on the amendments to the corporate bonds part. Time is running out – the European elections are already in June and the current legislative period is about to end. So, there is not much time left to finalise this amendment, which is so crucial for retail investors. They are an important part of capital markets and should not be excluded from participating.

It is a clear objective of the Capital Markets Union to increase the participation of retail investors

The obstacles in the current legal framework need to be removed. The current situation, where retail investors are unable to trade simple and easy-to-understand corporate bonds, is no longer acceptable.

Notes

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).

² Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.

³ Additional rights can also be set. A plain vanilla bond, for example, grants the creditor a fixed interest rate over the life of the bond. In the case of a floater, on the other hand, the interest rate during the term is based on a reference rate such as EURIBOR.

⁴ BaFin (2021): Fewer corporate bonds for retail investors ([Link](#)).

⁵ The Retail Investment Strategy comprises two parts: a) Proposal for an amendment of the PRIIPs Regulation ([Link](#)), and b) Proposal for an amendment of MiFID II and IDD ([Link](#)).

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