

October 6, 2016

THE NEW REGIME ON PRIIPS

A. General framework

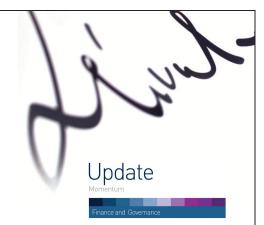
Regulation no 1286/2014, of the EU Parliament and Council, of 26 November 2014 ("PRIIPS Regulation") on key information documents for packaged retail and insurance-based investment products obliges PRIIP manufacturers to provide retail investors with a concise, crystal clear document ("KID") pertaining to the main features and risks of the product. The Regulation applies to financial entities (including banks, asset managers and insurance companies) advising or selling PRIIPs. It was supposed to enter into force on 31 December 2016, but Regulation no. 2016/2340, of the EU Parliament and Council, of 14 December 2016, has amended the PRIIPS Regulation and determined the extension of the date of application of the latter to 1st January 2018.

B. Objective

Regulation no 1286/2014 is part of a *legislative tsunami* seeking to create a level playfield for private market participants in complex financial products.

It tries to cathalyse investment players to better understand the nuances and intricacies of their products. The ultimate goal is to facilitate rational decisions on behalf of retail investors by narrowing information asymmetry. Simultaneously, length limitations envisage preventing information overload.

The Regulation rests on three pillars:



- 1. Pre-contractual disclosure;
- 2. Sales process and role of advisors/sellers in influencing investors' decisions;
- 3. Potential prohibition of certain products deemed too complex.

C. The scope of the concept

The acronym stands for packaged retail and insurance-based investment products. Products are considered packaged where, regardless of form, the surrender values (i.e. the amount payable to the investor) fluctuate as a result of:

- a) Dependence on reference values or
- b) Performance of a combination of assets which the investor does not possess a direct holding.

An insurance-based investment product refers to an insurance product whose maturity or amount payable to the investor is exposed, to some degree, to market risk.

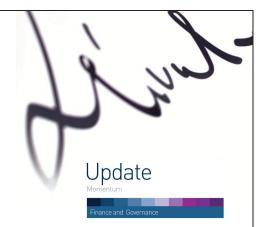
The Commission and ESA have stated that they will not put forward a list of what products amount to a PRIIP, having deferred it to national authorities. In any case, PRIIPS may be:

- 1. Investment products (investment funds, life insurance policies without an investment element, structured products and structured deposits);
- 2. All derivatives (options, futures, contracts for difference, hedging derivatives, FX Forwards in deliverable currencies and other derivatives with no fluctuation)
- 3. Financial instruments issued by an SPV that conform to the definition of PRIIPs;
- 4. Unit-linked policies;
- 5. Investment in transferable securities (UCITS) from 2021 onwards.

Products being marketed as of 31 December 2016 are subject to the Regulation, irrespective of whether they be a new or already existing product.

Additionally, the obligation is in place both for PRIIPS sold on the primary and secondary markets.

The concept does not encompass equities and bonds (directly held assets). Insurance products without investment opportunities (i.e. non-life insurances), non-structured deposits (simple deposits with fixed



or floating rates), investment funds exclusive to institutional investors, individual and occupational pension funds and simple securities are also not in the scope.

D. Subjects

Said Regulation is addressed at PRIIP and units of non-UCITS funds' manufacturers (issuers), advisers and sellers, notably, fund managers, insurance undertakings, credit institutions, investment firms and firms operating retail distribution platforms. Thus, it provides an umbrella for both direct and indirect sales – distributors and intermediaries.

With concern to UCITS, the Regulation is only applicable from 2019 onwards but still subject to evaluation before that date.

E. Territorial scope

The Regulation comes into play where a PRIIP be sold to an EU retail investor. What is relevant for the assessment is whether or not the investor is in the EU, not his/her domicile. Whether it will be applicable in Norway, Lichtenstein and Iceland is currently under discussion and may be included in the EEA agreement.

F. Obligations

PRIIP manufacturers are bound to draw the Key Information Document (from hereunder the "KID") which is meant to operate as an "instructions handbook", summarising the main risks and opportunities of a given investment product. In three pages of clear, precise, understandable text, PRIIP manufacturers ought to describe its nature, features and performance indicators, while answering standard questions such as:

- 1. What is this product?
- 2. What are the risks and what could I get in return?
- 3. What happens if the manufacturer is unable to pay out?
- 4. What costs will be incurred?
- 5. How long should I hold the investment and can I take my money out early?



6. How can I make a complaint?

The goal with this standardization is to enable comparability among products of the same and different categories, for they often work as substitutes. Disclosure on non-market risks (i.e. those independent of market developments, notably, operational, counterparty and liquidity risks, change in value of the underlying assets, currencies and interest rates) encompass added relevance for they are at the core of the distinction between different categories of PRIIPS.

The KID should be provided to clients in advance of their purchases and be published on the company's website in one of the EU or the country of commercialization's official languages. In given cases, it is admissible for it to be delivered immediately after the conclusion of the transaction, notably, if distance communication was used. It ought to be kept up to date and be handed out in hard copy or media format, free of charge. Additionally, it should be consistent with said product's marketing material.

It should be noted the obligation only emerges in the case of PRIIP manufacturers and not regarding all subjects of the Regulation. Additionally, four exemptions are in place:

- 1. For products sold only to professional investors (as defined in MiFID);
- 2. For PRIIPS traded by portfolio managers, including for the account of a retail investors;
- 3. For listed products with a bid only price;
- 4. If it proves to be a highly impractical task, in which case, PRIIP manufacturers may delegate the task.

G. Difficulties

The obligation to make a KID available to retail investors prior to commercialization may prove a conundrum in hedging derivatives. The rationale of a hedging directive is to lower risk, not to offer an investment opportunity. Indeed, they are bought as a risk management tool. Thus, providing a KID for these products might be slightly misleading. Nonetheless, this results from the inexistence of a purpose test in the Regulation which would have filtered products such these from falling under its scope. This raises a problem as to how to draw a KID in an instance where not all the information deemed mandatory is available prior to the hedge's commercialization. This may happen where the manufacturer requires information on the sale of a product (i.e. amount of sales), in order to determine the cost of the hedge.

A way to curb the problem is to produce a generic KID for certain types of derivatives, though it is not yet clear what will be the exact degree of standardization.



The generic KID is also allowed in the case of exchange-traded derivatives, for their features are constantly mutating. It allows manufacturers not to have to revise a new KID every year, since the generic one works as an umbrella framework.

There is also some adaptation in the case of MOPs (multiple option products), for each and every underlying investment option has its own risks, performance and costs. Thus, it would require manufacturers to draw a specific KID for each of the products. Hence, they may opt for a generic KID with a supplemental document detailing the specificities of each product.

H. Potentially conflicting laws

Bearing in mind the current trend towards maximum harmonization, it is highly predictable that the rules regarding PRIIPs provided in DL 211-A/2008, of November 3rd will be revoked.

I. Sanctions

The Regulation provides for civil liability and administrative sanctions, where the KID is misleading, inaccurate or inconsistent *vis a vis* (pre-) contractual documents or the requirements laid down in Article 8. Nonetheless, it should be borne in mind that KID-based liability does not exclude further civil liability disputes admissible pursuant to national law.

They range from shaming, fines up to €5 million or 3% of annual turnover and potential prohibition to commercialise a given product. These sanctions envisage raising the standard of care by issuers.

The subjects of the Regulation ought to have appropriate redress procedures in place in order for investor to be able to submit a complaint and claim compensation.

J. Supplemental legislation

Two relevant Commission Delegated Regulations have been approved in this respect. On the one hand, regulatory technical standards ("RTS") have been set on presentation and content of the KID, notably, methods for calculating and putting forward risks, rewards and costs, as well as on review, revision and publication of the KID. It also details the information to be provided in answering the questions listed in F) regarding the KID. On the other hand, it contains rules regarding supervisory measures on product intervention to be untaken by national authorities and EIOPA. The Regulation attributes powers to



monitor financial products falling under their supervision as well prohibit/temporarily restrict marketing, distribution and sale of PRIIPs or related financial practices. Moreover, it sets limits under which said powers may operate (notably, the main factors and criteria to be taken into account when engaging in actions so as to uphold significant investor protection concerns and threats to the orderly functioning and integrity of financial markets or to the stability of the financial system).

Ana Luísa Melo

alm@servulo.com

Sérvulo & Associados | Sociedade de Advogados, RL

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Rua Garrett, n.º 64 1200-204 Lisboa - Portugal Tel: (+351) 21 093 30 00 Fax: (+351) 21 093 30 01/02 geral@servulo.com www.servulo.com