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**REGULATORY CHALLENGES
IMMEDIATELY AHEAD – THE PRIIPS
KID REGIME**

INTRODUCTION

After a rough start, the Commission Delegated Regulation (EU) 2017/653 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents (the "**PRIIPs RTS**") was adopted on 8 March 2017 by the European Parliament. The approval of the PRIIPS RTS by the European Parliament is an important milestone in relation to the European regulations on key information documents for packaged retail and insurance-based investment products (the PRIIPs KID regime). The PRIIPS RTS, together with the Regulation on key information documents for packaged retail and insurance-based investment products¹ - the PRIIPs Regulation - are set to apply from 1 January 2018.

Having been already postponed for an entire year (the PRIIPs KID regime was meant to enter in force in 2017), this pan-European set of rules and regulations is aimed at improving the transparency of PRIIPs offered to retail investors by promoting a levelled playing field between different products and distribution channels across the European Union by increasing transparency and confidence of retail investors in the financial markets. It is hoped that this would be achieved by regulating a template KID that would make it easier for retail investors to understand and compare the economic and legal features of various products falling in the scope of the PRIIPs Regulation.

From a structural perspective the framework for the PRIIPs KID regime is contained in the PRIIPs Regulation, while the PRIIPs RTS makes the application of the legal framework functional by providing detailed rules on the content of, the review and revision obligation of, and the delivery obligations related to a KID.

¹ Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014

WHAT YOU NEED TO KNOW

The object of the PRIIPs KID regime is not the products (PRIIPs) themselves, but the rules regarding the drawing up, format, provision and review of the key information document (KID) that should accompany a PRIIP when it is made available to retail investors. The key players of the PRIIPs KID regime are – the retail investors, the manufacturers of the product, and the persons advising on, or selling, a PRIIP.

Therefore in order to establish if you are subject to the PRIIPs KID regime you need to answer the following questions: (i) Who is a *retail investor*?; (ii) What are the products in scope?; (iii) Am I a manufacturer? If yes, what are my obligations? (iv) If I am a PRIIPs dealer, what are my obligations?

Who is a *retail investor*?

The definition of a retail investor is closely linked to the definition of client under MiFID II². Thus, a retail investor means (a) a retail client as defined in under MiFID II; (b) a customer within the meaning of Directive 2002/92/EC³, where that customer would not qualify as a professional client as defined in MiFID II.

As a result of this link with the two directives, the interpretations given to the definition of *retail client* and *professional client* under MiFID II and, respectively, to *customer* under Directive 2002/92/EC will have a major impact on the application of the PRIIPs Regulation.

What are the products in scope?

A PRIIP is a product that falls within the following definitions:

- an investment, where, regardless of the legal form of the investment, the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor. This definition includes instruments issued by special purpose vehicles as defined in Solvency II⁴ or securitisation special purpose entities as defined in AIFMD⁵; or

² Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast)

³ Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation

⁴ Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast)

⁵ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

- an insurance product which offers a maturity or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations.

Although the scope and purpose of the PRIIPs KID regime appears straight forward, the application in practice may prove to be more difficult than anticipated.

The PRIIPs Regulation does not define the products in scope (*i.e.* PRIIPs) by providing a list of products. This makes it difficult to assess whether a product is a PRIIP or not.

Limited guidance on this matter may, however, be found in the recitals of the PRIIPs Regulation and mainly consists in examples of what should be considered a PRIIP (*i.e. investment funds, life insurance policies with an investment element, structured products and structured deposits*); and examples of what should not be considered a PRIIP (*i.e. insurance products that do not offer investment opportunities and deposits solely exposed to interest rates; any deposit or certificates which represent traditional deposits, other than structured deposits as defined in point (43) of Article 4(1) of MiFID II; assets that are held directly, such as corporate shares or sovereign bonds; investment funds dedicated to institutional investors are excluded from the scope of the PRIIPs Regulation since they are not for sale to retail investors; individual and occupational pension products, recognised under national law as having the primary purpose of providing the investor with an income in retirement*).

The Commission Guidelines⁶ – meant to provide additional information in relation to the PRIIPs Regulation - *only provide that a product whose acquisition does not require payment by the retail investor, meaning that there is neither an initial payment nor any risk of future financial commitments by the retail investor may not be considered an investment and therefore does not require a KID pursuant to the PRIIPs Regulation.*

Uncertainty is further increased by the very broad description of the process further to which a PRIIP is created (*i.e.* packaging and wrapping) included in the recitals of the PRIIPs Regulation.

In relation to the definition of *PRIIPs manufacturer* - the Commission Guidelines provide that the listing of an existing PRIIP on a secondary market may not automatically imply a change which alters its risk and reward profile or the costs associated with that PRIIP.

Another practical problem – that would be apparent very early along the line – is the lack of a transitional legal regime for products that are currently made available to retail investors and that will continue to be made available to retail

⁶ Communication from the Commission Guidelines on the application of Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs)

investors after 1 January 2018, but further to this date they will be qualified as PRIIPs. This may result in a spike in KID production for a lot of products that may or may not really be PRIIPs under the PRIIPs Regulation or in the disappearance of a significant portion of investment products made available to retail investors – until further clarity is provided.

In relation to offers closed by 31 December 2017, the Commission Guidelines provide that a KID would not be required where (i) a PRIIP is no longer made available to retail investors as of 1 January 2018 and changes to the existing commitments are only subject to the contractual terms and conditions agreed before that date; and (ii) where those contractual terms and conditions allow exiting the PRIIP, but that PRIIP is no longer made available to other retail investors after 1 January 2018.

Am I a manufacturer? If yes, what are my obligations?

A PRIIP manufacturer is defined as means: (i) any entity that manufactures PRIIPs; or (b) any entity that makes changes to an existing PRIIP including, but not limited to, altering its risk and reward profile or the costs associated with an investment in a PRIIP.

As mentioned above, the process of creating a PRIIP is unclear. Further guidance is, however, once again, provided by the recitals of the PRIIPs Regulation where examples of PRIIPs manufacturers are provided.

The main obligations of a PRIIP manufacturer include: (i) the drawing up of a KID, (ii) the publishing of the KID on its website before a PRIIP is made available to retail investors and (iii) review and periodical update of the information contained in the KID. The PRIIPs RTS further expands on the review and periodical update of the KID by providing that the PRIIPs manufacturers must review the information contained in the KID every time there is a change that significantly affects or is likely to significantly affect the information contained in the KID and, at least, every 12 months following the date of the initial publication of the KID. In addition to establishing what must be verified upon each review, the PRIIPs RTS further provides that PRIIP manufacturers shall establish and maintain adequate processes throughout the life of the PRIIP where it remains available to retail investors to identify without undue delay any circumstances which might result in a change that affects or is likely to affect the accuracy, fairness or clarity of the information contained in the KID.

If I am a PRIIPs dealer, what are my obligations?

A person advising on, or selling, a PRIIP shall provide retail investors with the KID in good time before those retail investors are bound by any contract or offer relating to that PRIIP. Further details regarding this obligation are included in the PRIIPs RTS, the most important being the obligation to assess the time needed by each retail investor to consider the KID that will fall with the person advising on or selling a PRIIP.

According to the PRIIPs KID regime, management companies, investment companies and persons advising on, or selling, units of UCITS (as such terms are defined with the UCITS Directive⁷) will be exempt from the obligations under the PRIIPs Regulation until 31 December 2019.

It is further provided that, a person advising on, or selling, a PRIIP may satisfy the requirements regarding the provision of the KID to *retail investors* by providing the KID to a person with written authority to make investment decisions on behalf of the retail investor in respect of transactions concluded under that written authority. Interestingly, the PRIIPs Regulation does not itself provide additional colour on what may be understood by *written authority*. However, the Commission Guidelines emphasize the fact that it was not intended for the PRIIPs Regulation to *distinguish between PRIIPs sold with or without advice provided to the retail investor, or acquired by the retail investor on its own initiative or otherwise*.

PRIIPs IN ROMANIA

The Romanian regulator has amended the Romanian Capital Markets Law (*i.e.* Law no.297/2004) in order to sanction the violation of certain articles of the PRIIPS Regulation (including the failure to draw up a KID before a PRIIP is made available to retail investors and the failure of a person advising on, or selling, a PRIIP to provide a KID to retail investors in good time before those retail investors are bound by any contract or offer relating to that PRIIP). The sanctions include fines (for legal entities: from RON 10,000 and up to RON 22,450,000 or up to 3% of the total annual turnover of that legal entity according to the last available financial statements approved by the management body or up to twice the amount of the profits gained or losses avoided because of the infringement; and for individuals: from RON 1,000 and up to RON 3,150,000 or up to twice the amount of the profits gained or losses avoided because of the infringement) and the interdiction to trade or the suspension of trading of a PRIIP.

In a very recent proposal to amend the FSA Regulation no 9/2014, the Romanian regulator included a provision paving the way for the application of the PRIIPs Regulation to UCITS.

⁷ Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast)

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