

C L I F F O R D  
C H A N C E



A PRIIPS PRIMER

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# A PRIIPS PRIMER

When is the PRIIPs Regulation effective?	1 January 2018. Note no "grandfathering" for bonds issued prior to January 2018.
What is a PRIIP?	<p>The first limb of the definition in the <a href="#">PRIIPs Regulation</a> is relevant for DCM transactions, it defines a "PRIIP" as "an investment where, regardless of the legal form, <i>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.</i>"</p> <p>However, the scope of products to which the Regulation applies is unclear and there has (to date) been limited regulatory guidance. Current market consensus is that:</p> <p><u>Products/features likely to be a PRIIP</u>: repackagings, securitisations; convertible bonds; products with variable repayment based on exposure to underlying; subordinated debt; make-whole provisions;</p> <p><u>Product/features not likely to be a PRIIP</u>: bonds issued by <a href="#">EEA</a> sovereigns or local authorities (or guaranteed by any of them), by public international bodies of which one or more Member States are members, or the central banks of the Member States; fixed/floating rate bond with bullet redemption; bonds redeemed at par; zero coupon/fixed amortisation;</p> <p><u>Products/features where unclear if a PRIIP</u>: bonds issued by non-EEA sovereigns; some types of put and call options.</p>
What is the consequence of a product being a PRIIP?	<p>A "KID" will be required before the PRIIP is "made available" to a "retail investor" in the EEA.</p> <p>Penalties for non-compliance are harsh, for example in the case of a legal entity, the fine can be up to EUR 5,000,000 (or equivalent) or up to 3% of the total annual turnover of that legal entity according to the last available financial statements OR up to twice the amount of the profits gained or losses avoided because of the infringement where those can be determined.</p>
What is a "KID"?	A short (3 page) "key information document" – a factsheet outlining features, risks and rewards of certain investment products. Creating a KID is highly technical and includes the requirement to calculate a summary risk indicator (SRI). The content of a KID is strictly regulated and it must be kept up-to-date throughout the life of the product.
What does "make available" mean?	Unfortunately there is currently no definition or guidance. The FCA noted in its May 2017 <a href="#">Policy Statement PS 17/ 06</a> that it is unclear.
What is a "retail investor" for the purpose of PRIIPs?	Any investor that does not fall within the scope of Annex II of MiFID2 will be a "retail investor" (this is because the definition under the PRIIPs Regulation cross refers to MiFID2). This means that most small corporates, public sector bodies, local public authorities and municipalities might be classed as "retail" investors for PRIIPs purposes, in addition to individuals and the general public, typically considered to be retail investors
Who are PRIIPs "manufacturers" and "distributors" and what are their obligations?	<p>A PRIIPs <u>manufacturer</u> has responsibility for preparing and publishing the KID. For typical DCM transactions which could constitute a PRIIP this will be the issuer.</p> <p>A PRIIPs <u>distributor</u> has responsibility for delivering the KID to a retail investor before the transaction is concluded. On typical DCM transactions this will include the issuer and the managers.</p>

## A PRIIPS PRIMER (CONTINUED)

<p>Does the Regulation set out any exemptions?</p>	<p>Certain securities are exempted from the Regulation, including debt securities issued by EEA Member States or one of their regional or local authorities, public international bodies of which one or more EEA Member States are members, the ECB or central banks of the Member States and securities guaranteed by a Member State or their regional or local authorities (see Article 2(d)).</p> <p>Recital 7 also indicates that corporate shares and sovereign bonds are not caught, although the Recital does not limit this to EEA sovereigns the operative provision (Article 2(d)) only references EEA.</p>
<p>Is there any impact on tap issues and fungibility post 1 January 2018?</p>	<p>Potentially, yes. For example, a KID would be required in order to issue a post 1 January 2018 fungible tap of an original issue by a corporate issuer with low denominations and a make whole provision. To avoid producing a KID, the make-whole (which would make it a PRIIP) would need to be removed but this would mean the bonds were not fungible.</p>
<p>Is there grandfathering of debt securities already in issue? What does that mean in practice for secondary sales?</p>	<p>There is no grandfathering. Caution should be exercised in respect of secondary sales to EEA retail investors of bonds that may constitute a PRIIP. If the PRIIP manufacturer (the issuer) has not already drawn up/published a KID, bonds cannot be lawfully sold to EEA retail investors. If a person on-sells the bonds without a KID, they may be in breach of the PRIIPs Regulation (Article 13(1) of the PRIIPs regulation which requires a person advising on or selling a PRIIP (the distributor) to provide retail investors with the KID in good time before they purchase the PRIIP).</p>
<p>What is the impact on documentation?</p>	<p>The prospectus, base prospectus and final terms (as applicable) should include appropriate legends and selling restrictions to ensure that any notes which could constitute a PRIIP are not made available to EEA investors. ICMA standard language is available. Legends should also be included on announcements.</p> <p>Note that high denominations of EUR 100,000 will not, on their own, be sufficient to keep bonds away from retail investors, the measures noted above should also be considered.</p>
<p>Are non-EEA persons who produce/distribute PRIIPs caught?</p>	<p>Yes – in that they are not permitted to make a PRIIP available to <u>EEA retail investors</u> without a KID (the Regulation focuses on who the product is sold to). Although not addressed in the PRIIPs Regulation itself it was confirmed in the European Commission July 2017 <a href="#">Guidelines</a>.</p>
<p>Is a KID needed if a PRIIP is produced/ distributed to non-EEA retail investors only?</p>	<p>No. Whilst not addressed in the text of the PRIIPs Regulation, this was confirmed in the European Commission July 2017 <a href="#">Guidelines</a>.</p>

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