FINANCIAL REGULATORY QUICK START GUIDE

EU PRIIPS REGULATION: US CAPITAL MARKETS IMPACT

OVERVIEW

The EU Packaged Retail and Insurance-based Investment Products (**PRIIPs**) Regulation took effect on 1 January 2018. It was introduced to strengthen retail investor protection by requiring the introduction of a three-page key information document (**KID**) containing prescribed disclosures, which is meant to assist investors in understanding and comparing the key features, risks, rewards and costs of different PRIIPs.

WHAT IS A PRIIP?

The table below sets out certain capital markets instruments impacted by the Regulation.

GREY AREAS

Although corporate bonds may not intend to provide exposure to reference values, certain typical features that facilitate the calculation of the bond value by reference to an underlying asset cause them to be at risk of being defined as PRIIPs. For example:

- Issuer calls (make-wholes)
- Caps and floors
- Change of control put

WHO IS THE MANUFACTURER?

The PRIIPs Regulation refers to manufacturers as entities “such as fund managers, insurance undertakings, credit institutions or investment firms”. However, this could extend to a non-financial firm that issues a product that qualifies as a PRIIP (including corporate bond issuers). Where a corporate issuer does not wish to produce the KID, certain options are available:

- It can delegate the production of the KID to a third party – in which case it retains the responsibilities of the “manufacturer” under the Regulation.
- A third party, who wants to facilitate the distribution of the relevant product to EEA retail, can choose to produce the KID without the delegation of the issuer. In which case, that third party would take on the responsibilities of the “manufacturer” under the Regulation.

OBLIGATIONS ON MANUFACTURERS

The PRIIPs Regulation requires that a PRIIP manufacturer:

- Prepares a KID in relation to any PRIIP made available to retail investors in the EEA.
- Publishes the KID on its website.
- Reviews and updates the KID in response to certain market and issuer related events. Note: certain information in the KID is subject to fluctuation and so the KID is a ‘live’ document.
- Translates the KID into one of the official languages in each EEA Member State in which the PRIIP is distributed.

Instruments in scope		
PRIIP Definition	An Investment where, regardless of its legal form, 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 that are not directly purchased by the retail investor **PRIIP = repayment amount subject to fluctuations + exposure to a reference value / assets) (not directly held by the investor)**	
Out of Scope	*Regulatory guidance:* • Corporate shares • Sovereign bonds • Local authority bonds • Fixed rate notes • Floating rate notes linked to interest rates in a linear way	*Examples*: Zero coupon bonds; Call rights at a fixed amount
In Scope	*Regulatory guidance:* • Floating rate note linked to an underlying reference value / asset • Convertible bonds that embed a derivative	*Examples*: ABS; convertibles; sukuks; cocos; CLOs; REITs structured as alternative investment funds

SELLING TO EEA RETAIL

Relevant considerations include:

- Is there a PRIIP?
- If so, who is the manufacturer?
- Is there capacity / capability to produce and monitor / update a KID?

RISK FOR US ISSUERS*

**Or any entity taking on the responsibility to "manufacture" the KID*

Where an issuer chooses to produce a KID, it will be exposed in the following ways:

- *EEA retail investors* – legal liability where the KID (including any translation) is misleading, inaccurate or inconsistent with the relevant parts of the offering documents or with the prescriptive content requirements laid down in the Regulation.
- *EEA regulators* – potential enforcement action against the manufacturer for breach of its obligations under the Regulation.
- *Non-EEA investors / EEA professional investors* –
  - Potential US anti-fraud liability in cases of divergence from US offering documents.
  - Potential claims for material omission by investors not receiving the KID where US offering documents do not cover the full spectrum of disclosures mandated by the KID (e.g. SRI and performance scenarios).
- *Updating requirements* – alignment of the KID review and update requirements with other ongoing disclosure obligations under US 8-K rules and the EU Market Abuse Regulation.

Note: It is not possible to limit EEA legal liability by cross-referring to more fulsome offering documents, or by incorporating those offering documents by reference

RESTRICTING SALES TO EEA RETAIL

Options include:

- Limiting distribution to EEA professional investors only
- Excluding EEA private banks from the book, unless purchasing on behalf of discretionary managed clients only
- Including relevant selling restrictions in offering documents

The question of REITs & MLPs

REITs structured as investment funds fall within scope of the PRIIPs Regulation.

An alternative investment fund (AIF) is defined broadly as:

- A collective investment undertaking – having at least the following characteristics:
  - No general commercial or industrial purpose
  - Pools investor capital with a view to generating a 'pooled return' – a return generated by the pooled risk arising from acquiring, holding or selling the investment assets, including activities to optimise the value of those assets
  - Unitholders / shareholders have no day-to-day 'discretion or control' – defined as a form of direct and ongoing power of decision-making
- Which raises capital from a number of investors
- With a view to investing with a defined investment policy for the benefit of those investors – to invest in certain categories of assets; to pursue certain strategies; to conform to restrictions on leverage; etc.

Joint ventures generally are considered to be exempt, although there is no express definition of what constitutes a joint venture for these purposes. National guidance can offer some assistance in this respect.

Holding companies are expressly exempt. Broadly, a holding company is defined as a company carrying out business strategies through subsidiaries and associated companies in order to generate long-term value. The company must also either be (i) listed in the EU; or (ii) not established for the main purpose of generating returns for its investors by means of divestment of its subsidiaries or associated companies.

Impact on REITs

Each structure should be considered against the above criteria on a case-by-case basis, based on the substance of the arrangements.

If the analysis as to whether or not a REIT is an AIF is inconclusive, specific exemptions in relation to joint ventures and holding companies may need to be considered.

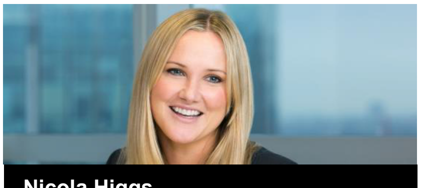
Impact on MLPs

While an MLP need not fall within the definition of an AIF, without careful attention to the structuring there is a risk of it doing so.

Factors such as ensuring an MLP is structured as a general commercial company, not a collective investment undertaking, and ensuring that it does not have a defined investment policy, can help avoid classification as an AIF.

If the structure still appears to be at risk, specific exemptions in relation to joint ventures and holding companies may need to be considered

CONTACTS



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