

# Early adoption?

Joaquim Pedro Lampreia, Orlando Vogler Guiné and Rita Rendeiro of Vieira de Almeida & Associados discuss the possible early arrival of a Prips framework in Portugal

**M**uch driven by the turmoil in the financial markets which began in 2007, and the corresponding perception that many unregulated or poorly regulated areas of the financial sector urgently required clear boundaries, the Portuguese government jumped into action in late 2008 and enacted Decree-Law 211-A/2008. Its main purpose was to increase transparency and information duties across the financial sector, in a clear attempt to enlarge the obligations of market players towards both supervisory authorities and investors.

Among the innovative measures enacted by the Decree-Law, the introduction of the concept of complex financial product (CFP) stands out for its profound impact in a segment of the retail financial business which had been reasonably performing without significant turbulence within the consensual framework of both the Prospectus Directive and the Markets in Financial Instruments Directive (Mifid).

CFPs are financial instruments (as defined in Mifid) which, while assuming the legal form of an existing financial instrument (such as a bond), present other characteristics which do not directly derive from such base financial instrument, for reason of having associated other financial instruments (including, without limitation, indices, funds, derivatives or shares) upon which the outcome of the investment depends. Considering the complexity of CFPs, specific information obligations towards investors and advertising rules are required to be observed in the context of

their marketing and distribution.

While innovative, the introduction of this CFP concept was in itself insufficient to generate immediate and significant changes in existing market practice. Decree-Law 211-A/2008 itself determined that special legislation would have to be enacted to regulate in detail the issue and distribution of CFPs. However, it further established that until such time the competent supervisory authorities would be responsible for ensuring compliance with the newly-adopted information and transparency duties, including the delivery of informative documents and the disclosure of advertising messages to investors.

The above developments led to the issuance of a joint statement by the CMVM (the Portuguese Securities Market Commission) and the Bank of Portugal that in essence distinguishes between CFPs which are classified as deposits only (subject to the supervision of the Bank of Portugal) and those not qualified as such (falling under the supervision of the CMVM) – thus clearly delimiting the competence of both regulators as far as CFPs are concerned.

## Local language delivery

It was shortly after the Communication from the Commission to the European Parliament and the Council on Packaged Retail Investment Products (Prips) that, giving effect to the provisions of Decree-Law 211-A/2008, the CMVM approved Regulation 1/2009, which sets forth the requirements to be complied with in the

distribution in Portugal to retail investors of CFPs subject to its supervision. Regulation 1/2009 introduces the obligation of prior delivery to investors of an informative document in Portuguese, detailing the characteristics of the product and further establishes the rules applicable to the advertising of CFPs.

Although the Prips Communication and Regulation 1/2009 are not directly connected, since the latter's main purpose was to give effect to general principles approved by a domestic decree-law on the stability of the financial system, most of the concerns expressed in the Prips Communication, in terms of lack of availability of clear and objective information to retail investors in the context of investments in products which offer exposure to a diversity of underlying assets, is clearly also at the epicentre of Regulation 1/2009.

Both documents have their fundamentals in the perception on the part of regulators that the sequence of events which occurred since 2007 had significantly damaged investors' confidence in the financial markets in general and, particularly, that there was not enough transparency and disclosure of information to retail investors when subscribing to financial products which involved a considerable level of complexity.

Key aspects of investments were found to be insufficiently dealt with in the required documentation, even when considering together the requirements already made by the provisions of the Prospectus Directive and Mifid. Such aspects include, among other things, the main risks and potential losses involved, the type and nature of the financial instruments underlying the product or even the existence of a conflict-of-interests situation in respect of the distributor or dealer.

The idea was not to limit the possibility of certain complex financial products being offered to retail investors (not yet, at least), but to ensure that the average retail investor is informed in detail of the features of the product he is investing in. Many of these complex financial products have payments (remuneration or the invested capital itself) which are linked to indexes, shares, commodities or similar underlying (or baskets of underlyings) and also frequently depend on the performance of underlying derivative transactions contracted by the issuer.

Thus, they expose investors to the risks inherent to the aforementioned financial instruments in ways which may not be immediately perceptible to the average retail

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investor. For this reason it was considered necessary to create specific rules to ensure that the relevant information – in a simple and understandable format – was actually passed on to the final investor in these products.

While at European level this issue is still under discussion for the time being, the public consultation period on this matter having lapsed at the end of January 2011, in Portugal Regulation 1/2009 has been in force since mid-2009, with a strong impact in retail offers carried out in Portugal by both domestic and foreign issuers.

As an example, before the enactment of Regulation 1/2009 an offer of an index linked or credit linked note under an ordinary EMTN Programme involved simple and straightforward steps in accordance with the Prospectus Directive requirements on the part of the issuer and in accordance with the applicable financial intermediation requirements established in Mifid on the part of the distributor; in the current framework, besides such requirements, the distributor or the issuer must additionally submit to the CMVM and subsequently deliver to investors an informative document containing extensive information on the instruments at stake.

Regulation 1/2009 does not specify upon whom the legal obligation of producing and submitting to the CMVM the informative document exactly lies. In any case, it does determine that no retail investor should invest in a product which qualifies as a CFP (subject to the supervision of the CMVM) without receiving a copy of the informative document. In practice, this means that no distributor can accept a subscription order from a retail investor without having previously delivered this document.

For these purposes, retail investor means a non-qualified/professional investor as defined in the Portuguese securities law, which concept is in line with European Directives on this matter, and therefore these requirements are applicable also in situations in which non-qualified investors subscribe for securities in the context of private placements. In addition, many retail offers carried out in Portugal are made pursuant to a passport under the terms of the Prospectus Directive and therefore involve foreign issuers who are in general less prepared to produce a technical document in Portuguese than a local distributor.

As already mentioned above, the main objective of these measures is to ensure transparency in the distribution of these instruments and, in particular, to ensure that retail investors thoroughly understand the features of the instruments in which

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Joaquim Pedro Lampreia joined Vieira de Almeida & Associados in 2000 and is currently managing associate with the tax and the banking & finance practice groups. In such capacity, his practice focuses mainly on the conception and drafting of derivative and hybrid instruments, and tax related matters. He has also been actively involved in international tax planning, tax disputes and litigation and transfer pricing issues.

Author of several articles, such as *Transfer pricing, cost-sharing agreements and taxation of royalties*, 2003, and *The new invoice*, 2004.



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Orlando Vogler Guiné has been conducting research in business law, having published several articles and obtained a masters degree in this field from the University of Coimbra, Faculty of Law on March 2009 with his dissertation entitled *Anti-takeover conduct by Directors*. Post-graduate degree in securities law, University of Lisbon, Faculty of Law, Securities

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Before joining the firm, he completed an internship with the Portuguese Securities Commission (*Comissão do Mercado de Valores Mobiliários*), having been a part of the working-group for the reform of the Portuguese Commercial Companies Code and for the implementation of the Takeover Directive. He also worked as a consultant at *Fundação Bissaya Barreto*.

Joined Vieira de Almeida & Associados in 2006 and is an associate with the banking & finance and capital markets practice groups. In such capacity he has been involved namely in the areas of debt issuances, securitisation transactions, investment funds and venture capital.



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She joined Vieira de Almeida & Associados in 2006 and is an associate integrated in the Banking and Finance practice group. In such capacity she has been involved in various transactions focused on the issue and placement of debt and equity instruments of financial institutions and other structured debt and derivatives transactions, including credit derivatives, credit linked, equity linked and fund linked securities. She has also

been actively involved in securitization transactions and other asset-backed transactions, namely in the drafting/ reviewing of the derivatives financial instruments used in the context of these same transactions. Active participation in the establishment of covered bonds and EMTN programmes. She has previously worked in the Public Law practice group.

they invest, as well as the magnitude of the risks to which they are exposed, and the possible outcomes of their investment decision.

In a way, the regulation at stake (as is also the case of the Communication from the Commission to the European Parliament

and the Council on Packaged Retail Investment Products) indicates that the provisions of the Prospectus Directive (and implemented in Portugal) on information requirements applicable to prospectuses and related offering documents, and the provisions of Mifid (also transposed in

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Portugal) on the obligations impending on financial intermediaries towards investors are insufficient to ensure an adequate level of information disclosure for CFPs.

With this goal, Regulation 1/2009 is clear in determining that the informative document has to be written in Portuguese. Considering that most prospectuses and similar offering documents (such as final terms and term sheets) are very often written in English (even though a Portuguese translation of the summary may be required), this is very significant from the Portuguese investors' perspective.

In terms of formal structure, the first information to be included in the informative document is a box containing the most prominent risk factors presented by the product (and namely whether or not the product is principal protected, whether there is the risk that the issuer early redeems the securities or if there are costs or commissions that the investor should be aware of).

Other mandatory information includes a clear description in non-technical language of the functioning of the product in terms of payments and reimbursement of the

invested amount, graphics evidencing the evolution of any underlying and also a chapter describing possible evolution scenarios for the product.

This last requirement is of particular importance, since the inclusion in the informative document, in Portuguese, of examples of the possible outcome of the investment (and necessarily including optimistic, pessimistic and mild scenarios) constitutes a very useful piece of information to a potential investor.

In this context, it should be noted that one of the aspects of CFPs that regulators found potentially more dangerous to investors was the fact that calculating formulas and complex definitions in documents made it difficult for an average investor to fully understand and determine the consequences of the investment.

It should also be noted that in many cases riskier products which present a more attractive remuneration also specify conditions for such remuneration to be due which are difficult to fulfil or at least unlikely to take place. In fact, underlying the obligation to include possible payment scenarios in the informative document is not only the idea that an investor must correctly understand the extent of the losses he or she may be exposed to; there is also an underlying idea that in many cases complex products which provide for a potentially very high remuneration subject to certain conditions being met end up being unattractive due to the difficulty of fulfilment of such conditions.

### **A Ucits counterpart?**

As described above, in many aspects the informative document introduced by Regulation 1/2009 presents similarities to

the KID (key investor information) which is being implemented in the context of the new Ucits framework (Ucits IV). It seems obvious that the whole idea surrounding the production and delivery of the informative document to investors before subscription to any complex financial products is to provide investors with one document in their own language which, in a non-technical language and using simple – and even graphical – information, contains all the information considered relevant for their investment decision.

Notwithstanding the above, it should in any case be highlighted that Ucits, as well as unit-linked insurance policies, are not subject to the provisions of Regulation 1/2009, since in both cases it is considered that the existing – and relatively recent – legal and regulatory frameworks are at this stage sufficient to ensure investors' protection.

Given the above, it may be concluded that Regulation 1/2009 to a certain extent already deals with many of the issues which are under discussion for a European packaged retail investment products (Prips) regime. It cannot be ascertained at this stage whether – if and when a European Prips regime is implemented – Regulation 1/2009 will be adjusted in order to accommodate the new provisions, or if a brand new framework will be put in place.

In any case, and until that time comes, public offers and private placements (whenever at least one retail investor is targeted) of CFPs subject to the supervision of the CMVM in Portugal are required to comply with these additional requirements, established for the benefit of retail investors and intending to present them with all the information they need to take an informed investment decision.