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Application of the PRIIPs Regulation: what happens to US packaged products subscribed before the regulation came into force?

The European PRIIPs Regulation entered into force on 1 January 2018 with the aim of standardising pre-contractual information on "packaged" financial products (ETFs, derivatives, life insurance products, etc.) offered to retail investors through a key information document. This key information document is now required for the marketing of products that come under PRIIPs.

In this mediation case, an account keeper refused a sell order on a packaged product developed by a US management company. The product had been purchased by a retail investor before the PRIIPs regulation came into force and no key information document had been provided at the time.

This dispute allowed me to clarify the purpose of this requirement, which in my view should not have applied in such a situation - as the account keeper did eventually acknowledge.

The facts

Ms H informed us that she had purchased units in a US exchange traded fund (ETF) in 2017, which she acquired in her ordinary securities account in the books of institution X.

On 20 August 2018, Ms H contacted institution X to sell all her shares.

The institution replied that her sell order could not be executed, but did not give any further explanation.

Since she was unable to obtain any information on the reasons for the blockage and faced with the persistent silence of her account keeper, Ms H became discouraged and explained that she had given up trying to sell her shares.

In August 2022, wishing to transfer her ordinary securities account to another institution and on noting that institution X had assigned a zero price (equal to zero) to the shares of the ETF units that she held, Ms H again approached the customer service to express her dissatisfaction at the fact that she could not arbitrate on her ETF units, while pointing out that, even if the price had fallen, it was not zero.

In September 2022, institution X finally contacted Ms H to tell her that her ETF units could not be sold because the product's originator, a US management company, had not provided a key information document (KID) either before or after the PRIIPs regulation came into force.

Institution X therefore told Ms H that it was up to her to contact the American management company to obtain the KID, and that without this document, the ETF units could not be sold.

Unhappy with the answer given by X, considering that she should have been able to sell all of her shares on 20 August 2018, Ms H referred the matter to me to obtain reparation.

Investigation

I questioned the account keeper X who confirmed that he had valued the ETF units at zero since 2018, following the entry into force of the PRIIPs regulation. He informed me that he had refused to sell any units in this ETF, since, according to institution X, it was no longer in compliance with the regulation.

Institution X also explained to me that Ms H's ordinary securities account had been transferred to a new investment service provider.



Recommendation

I started by looking at the PRIIPs Regulation, which has been applicable since 1 January 2018 ^[1], i.e. after Ms H acquired the ETF units.

This regulation applies to all "packaged retail investment products" (PRIIPs), the definition of which effectively includes ETFs, which are financial instruments designed to replicate the movements of an underlying asset, whether upwards or downwards.

Since 1 January 2018, it has therefore been the responsibility of the originator of such a product to draw up a KID, in accordance with Article 5 of the PRIIPs Regulation, and it is the responsibility of the account keeper, under Article 13 of the Regulation, to provide retail investors with the same document.

However, I had the opportunity to explain to Institution X that the PRIIPs Regulation, while imposing certain marketing obligations, is an EU regulation, and is therefore not binding on US investment management companies.

This European jurisdictional limitation explains why the US investment management company was not required to provide a KID to investors.

Thus, while it has no longer been possible since 2018 for the originator of this ETF to market it in the European Economic Area, for lack of a KID, I felt that the absence of such a document should obviously not have prevented an investor who acquired the ETF units before 2018 from reselling it. In fact, while institution X was right to prohibit subscription, it seemed to me to be completely abnormal that the sale of the shares of this ETF was refused to Ms H, who in this case already had an open position in this security in her portfolio.

This is because the obligation to draw up and communicate a standardised information document to investors before any subscription is intended to inform their consent by enabling them to compare the main characteristics of a product and the related risks.

In this case, I considered that the fact that an account keeper conditioned the sale of units subscribed before the PRIIPs Regulation came into force on obtaining the key information document was clearly unfounded.

In the light of these elements, I proposed to institution X that it compensate Ms H for the proceeds of the sale of all her units, which she could have sold on 20 August 2018, as she had requested.



Regarding the line of ETF shares valued at zero that remained in Ms H's ordinary securities account with her new financial intermediary, in view of the difficulties involved in selling foreign securities and the absence of a key information document, I told the client that one solution was to withdraw the securities together with the compensation.. This operation would allow the line to be removed permanently from the portfolio, and was accepted by the institution.

Lesson to be learned

The key information document introduced by the European PRIIPs regulation is a pre-contractual document that helps to inform investors' consent at the time of subscription. It is a summary document in which the following information is presented in a uniform manner for all financial products: the legal nature of the product, the management objective, the investment strategy, the level of risk, the costs and charges and the performance scenarios.

It is also clear that, since the entry into force of PRIIPs, packaged US products falling within the scope of this regulation that are not accompanied by the Key Information Document can no longer be marketed.

Nevertheless, the regulation must be applied with common sense and, in a situation such as this, the question of the application of the law over time must necessarily be raised.

In this case, even without a key information document, institution X should have allowed Ms H to sell her units in August 2018, since they had been acquired before PRIIPs came into force and were, in fact, already held in the portfolio. The unfounded refusal of institution X was therefore detrimental to Ms H, who found herself with ETF units in her ordinary securities account without being able to sell them, even though their value was falling.

Furthermore, this case is a reminder that investing in foreign securities can sometimes lead to disappointments, as the applicable regulations may differ from those applied in the European Economic Area, thereby generating conflicts in the application of legal standards.

Keywords

PRIIPS

ETF

[1] The entry into force of the Regulation was deferred to 1 January 2023 for investment funds.

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Head of publications: The Executive Director of AMF Communication Directorate. Contact: Communication Directorate – Autorité des marchés financiers 17 place de la Bourse – 75082 Paris cedex 02