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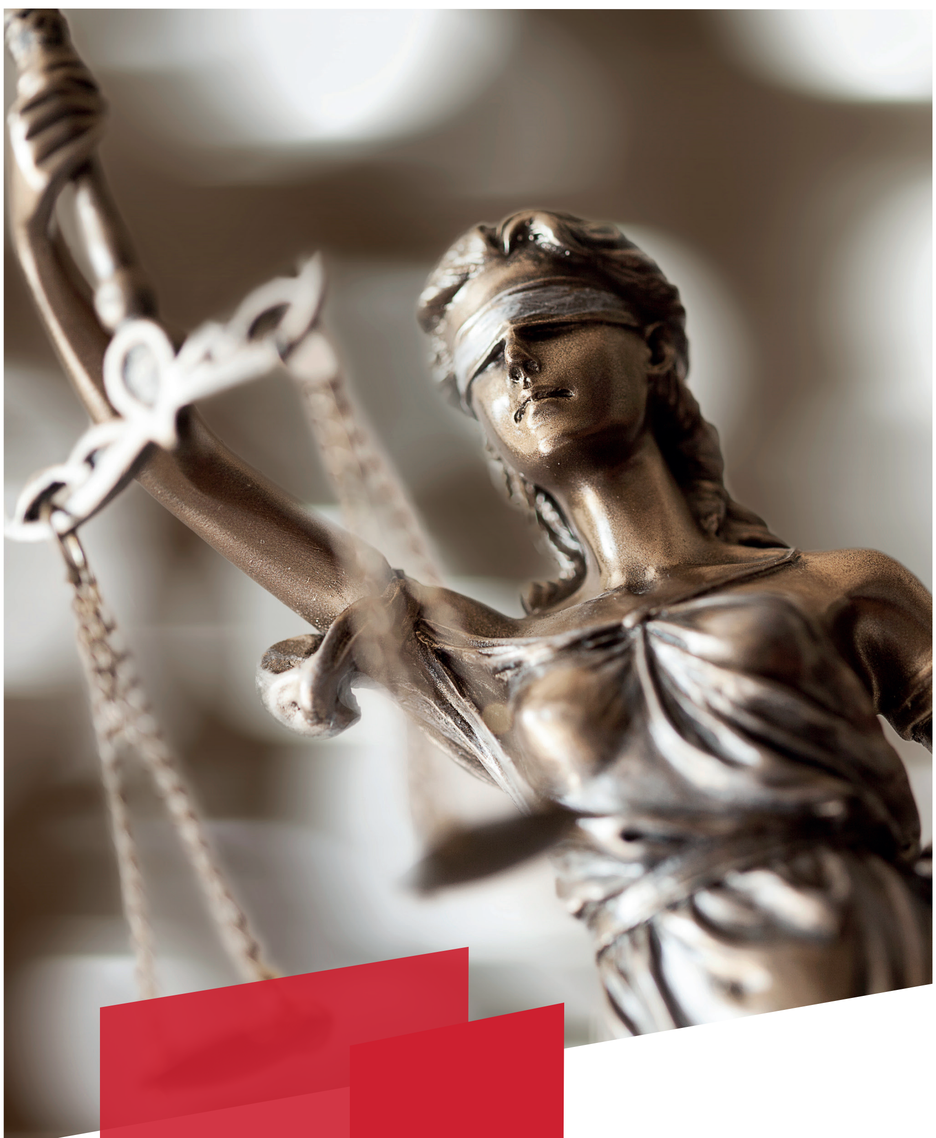
Newsletter

Reed Smith International
RCOM Update

Issue 2 – July 2018



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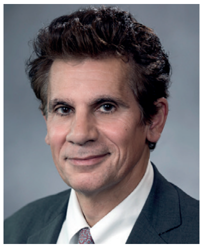
Introduction



Dear colleagues,

Given that the cycle of news and developments within risk management and compliance (RCOM) can be unpredictable, we have decided publish the International RCOM Update (note the new name) on an event-driven basis.

Rather than quarterly issues, the newsletter will be published several times a year, supplemented by client alerts and reports providing our team's insights on breaking news and pertinent hot-button issues affecting those responsible for implementing and assessing their company's risk and compliance processes and policies, irrespective of industry.

In this issue, we address the effects of several new banking regulations in the UK and the United States, insolvency risk and cross-border transactions, and we lay out a case for entertainment companies to look to their counterparts in the financial services industry for guidance on the value of applying risk management and compliance practices to operating companies of all sizes and shapes within the sector.

As always, we appreciate and value your feedback, so please feel free to reach out to me directly at dandrews@reedsmith.com.

Don Andrews

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Reed Smith LLP

European regulator intervenes to restrict marketing of CFDs

By David Calligan

For several years, the European Securities and Markets Authority (ESMA) has been frowning at the burgeoning market that provides contracts for differences (CFDs) to retail investors. ESMA's mounting concerns have ultimately led to its exercise of new powers under which it will impose temporary measures to restrict the sale of CFDs.

CFDs have caused concern to regulators because of excessive leverage, structural expected negative return, embedded conflict of interest between providers and their clients, disparity between the expected return and the risk of loss along with the issues related to their marketing and distribution. In short, ESMA was concerned that retail customers were trading in CFD products they did not adequately understand, a view also shared by the UK's Financial Conduct Authority (FCA).

ESMA's product intervention measures are:

- Negative balance protection on a per account basis
- Margin close out rule of 50 percent on a per account basis
- Imposition of leverage limits
- Standardized risk warning
- Restriction on incentivization of trading

ESMA plans to assess the impact of these measures after three months, although it is a widespread view that CFD firms will have to comply with them for the foreseeable future.

Industry impact

CFD providers will need to offer negative balance protection for all retail clients so that their losses cannot exceed the money invested. Providers will also have to communicate leverage restrictions to clients and build them into systems, bringing more clarity to the risk undertaken by clients.

Risk warnings concerning the percentage of investors that have lost money will also need to be placed prominently on the provider's website, as well as on any of its potential advertisements. Furthermore, any bonuses or incentives to trade should be reviewed and removed if considered inappropriate under ESMA's regulations – cutting down on providers' freedom to advertise.

Retail firms will need to review their capital adequacy status. The relationship between matched principal firms and hedging counterparties may have to be adapted to reflect the new loss limits on the client side of the trade. This may result in firms having their license amended, which would lead to a higher capital requirement. Full scope firms may also need to revisit their internal capital adequacy assessment processes to consider the financial impact of these changes on their business model and capital resources.

Avoiding the restrictions

Some clients may wish to sidestep the new restrictions by becoming an "elective professional." For this purpose, a firm would need to demonstrate confidence that the client has the requisite trading experience and knowledge. The client would also need to meet objective qualifications to be classified as an elective professional to disapply the ESMA restrictions.

Another possibility may be to open a CFD account with a broker in a less restrictive jurisdiction outside the EU. However, this would mean that the retail investor will not be afforded the protections of the FCA and other relevant regulators in the EU.

Implementation timetable

The CFD restrictions will come into force on August 1, 2018, and will be in force for three months. Before the end of the three months, ESMA will review these product intervention measures and consider the need to extend them for a further three months.

David Calligan is a London-based partner in Reed Smith's Financial Industry Group. He acts principally for banks, broker dealers and investment management firms on a wide range of regulation and compliance matters including the regulatory aspects of mergers and acquisitions in the financial services sector. He acts for broker dealers, hedge fund managers, corporate finance firms and several electronic trading platforms. He has particular know-how in assisting CFD and FX trading firms. David can be reached at dcalligan@reedsmith.com.

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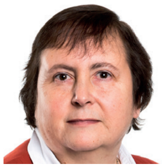
New rules for marketing funds in the EU



By Tamasin Little

Alternative investment fund managers who have raised, or want to raise, money in the EEA need to watch out.

Planned changes to the Alternative Investment Fund Managers Directive (AIFMD) and other directives regulating funds and their marketing, which are billed as intending to make cross-border fund raising easier, are in fact likely to make it more difficult. Consultation on these proposals closed on May 10, 2018, and the next step will be "trialogue" discussions between the EU Commission, Parliament and Council of Ministers to finalize the text of the changes.

As originally proposed, the changes will make it clear that EU managers of EU alternative investment funds don't have to get regulatory approval in order to have discussions with professional investors testing their appetite for planned investment strategies and ideas but are allowed to conduct this kind of "pre-marketing." The trouble is that:

- Expressly permitting something immediately carries the risk that everything else – whether done by EU managers or non-EU managers – is implicitly forbidden.
- The proposed definition of pre-marketing is very narrow. It specifically excludes any situation where the fund is already established or a reference is made to an existing fund, and it won't allow any circulation of draft documents. It therefore doesn't permit many of the communications that currently take place prior to formal notifications and getting approval for cross-border marketing.
- If a fund is subsequently launched, any investment will automatically be treated as the result of marketing by the fund manager, not of an initiative approach by the investor. So full-scale marketing approval is required before any investment is made. This is unsurprising and shouldn't be a problem for EU managers of EU funds. But if, as will almost inevitably be the case, the new provisions are read across to limit the activities of those marketing non-EU funds or funds managed by non-EU managers, the already highly dangerous practice of arguing that "reverse solicitation" by the investor means there has been no breach of local marketing restrictions will become even more hazardous.

The narrow definition of "pre-marketing" is the biggest potential problem with the new proposals, but there are a number of other aspects of the proposals that could give rise to difficulties.

There will be new high-level rules, similar to those in the Markets in Financial Instruments Directive (MiFID II), governing the content and presentation of all marketing communications relating to funds and requiring equal prominence to be given to risks and rewards, with power given to ESMA to impose more detailed obligations in guidelines.

If an EU manager gives notice to market a fund in another EU country, it will not be able to simply withdraw that notice if it decides to cease marketing. It will only be able to do so if it has no investors in the relevant country or has no more than 10 investors who together hold less than 1 percent of the fund; **and** it makes a blanket offer both publicly and to the individual investors to repurchase free of any charges or deductions all interests held by investors in that country; and it publicizes its intention to stop marketing in the country; and it continues to provide investors in that country with investor reports under the AIFMD. While no one can reasonably object to continuing investor reporting, the obligation to comply with all the other conditions seems to create pointless and potentially damaging obligations to publicize the cessation of marketing, which was never conducted publicly in the first place, and to make public repurchase offers even when there are no investors in the jurisdiction. Moreover, many closed-ended alternative investment funds, and those investing in illiquid assets, will have neither the legal power nor the practical ability to repurchase interests.

Individual jurisdictions will be allowed to charge fees to those marketing cross-border into their territory under an AIFMD passport (though only at a level that reflects the supervisory work involved). A number of states have been charging these fees, but it was previously hotly contested whether they had any right to impose extra charges on the exercise of passporting rights. To confirm this power seems a poor way to encourage cross-border fundraising. A proposed new interactive tool to help firms identify and calculate these costs before incurring them should be helpful, but not nearly as helpful to fund managers as a ban on additional charges would have been.

An opportunity has also been missed to extend the AIFMD marketing passport to cover marketing to certain types of high net worth individuals or other sophisticated investors who do not qualify as "professional clients" under the tests in MiFID II. It continues to be left to individual EU Member States to decide how far, if at all, marketing to even the highest end of the "retail" market is permitted.

Instead, new minimum (not maximum) obligations will apply to both EU and non-EU managers whenever they are allowed to do any retail marketing in an EU Member State. Whenever a fund manager plans to market outside the purely professional client market, it will need to have facilities (run by the manager or another regulated entity it employs for the purpose) in the relevant country to process investors' subscription, payment and redemption orders; provide information on how orders can be given and proceeds will be paid; handle information on the exercise of investor rights; make fund documentation and annual reports available; and provide relevant information in a durable medium regarding all these tasks.

The positive side of this change is that the investor servicing facilities will not need to be physically located in each relevant Member State. The negative side is that all these tasks must, for each country, be performed in "the official language or languages of the Member State where the AIF is marketed." If these provisions survive the trialogue discussions, it will not be possible for fund managers to engage in even the most limited and tightly targeted marketing to selected retail investors in any Member State unless they are ready to provide fully translated documents and a functioning website or other facility operating in all the official languages of that country.

If these changes to regulation are made in the form originally proposed by the EU Commission, they are likely to prove a major burden for those fundraising in Europe.

What is not clear is how far the EU Commission's drafts will be amended. The EU Council of Ministers has produced its trialogue negotiation position, which looks significantly more reasonable. In particular, it proposes to:

- Extend the definition of pre-marketing so that it is possible to pre-market an existing fund and to circulate appropriately marked and clearly preliminary draft documents, provided that these do not include even draft subscription documentation, and the AIFM does not allow anyone to acquire interests in the fund through pre-marketing.
- Set an 18-month time limit from the date of pre-marketing for an investment to be automatically treated as having arisen as a result of marketing.
- Lighten the proposed conditions for cessation of marketing so that (a) investors in the relevant Member State may hold up to 5 percent of the assets under management of the relevant fund (without restriction on their number) and the local regulator is given flexibility on this condition; (b) a repurchase offer will not need to be made in relation

- to a closed-ended fund; (c) publicizing the intention to cease marketing in the country just has to be done in a publicly available medium customary for AIF marketing and suitable for a typical AIF investor, which would presumably allow the use of the manager's website.
- Allow the investor servicing facilities for retail investors to be provided in any of the official languages of the relevant Member State or in any other language approved by the local regulator.

These proposed amendments are still not ideal. The introduction of national discretion over the conditions for cessation of marketing and the languages for investor servicing facilities and retention of national powers to charge fees for cross-border marketing means that even for EU managers and funds the marketing rules will still not be consistent across the EU. Much more importantly, the ability of non-EU managers and funds to carry out any "pre-marketing" in the EU remains uncertain and entirely a matter for national discretion.

But they are a significant improvement on the Commission's drafts. The position of the EU Parliament is now awaited. Based on past experience of whether or not the EU Parliament is willing to agree with the Council's proposed amendments, it is unlikely to make marketing and pre-marketing easier for non-EU managers and funds.

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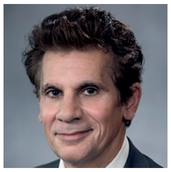
Regulating RegTech: Technology should complement – not replace – diligent compliance



By Don Andrews

It is July 2002. After years of being relegated to lower tier status on Wall Street's pecking order, compliance officers are suddenly in hot demand. A steady stream of headline-grabbing investigations of financial institutions, threats of terrorist money infiltrating banks, and irate investors are fueling the need to hire more compliance officers in leading institutions and quickly. A generation of would-be more generalist-minded attorneys and other professionals are rushing to populate the new world of "compliance."

After the economic collapse of 2008, members of senior management set aside a place in their budget for risk and compliance professionals, or they could run the risk of potentially fatal adverse effects on their reputation and bottom lines should something unforeseen happen. And because there is a shortage of individuals who have trained eyes to spot potential issues or wrongdoing, compliance and risk professionals are in huge demand.

Fast forward 15 years. Even with the global economic collapse in the not-too-distant past, there are some signs that the industry may be getting a little too comfortable. Never mind that we still live with many of the same (if not graver) systemic and geopolitical risks of the early 2000s. Companies are cutting back on human compliance teams, entrusting vital risk management processes to emerging technology platforms that, while extremely capable and sophisticated, are still new and relatively untested in various market conditions.

Technological tools are not a replacement for a firm grasp of securities regulations or experience in the arena of human interaction. It is important to have senior people on the compliance team who understand that markets do not move in just one direction. As such, here are some things for financial firms and operating companies to think about:

- **Institutional knowledge is essential**
  Effective compliance and risk management technology is not a good replacement for people who thoroughly understand the inter-workings of the institution and what the ongoing risks are in a live context. Every institution is unique and has its own set of problems and issues. Bringing in new people who do not know where to look is a considerable risk in itself.

- **Technology is not an end in itself**
  The same way that the quality of data is central to any risk assessment or stress test analysis, software is only as effective as the data that drives it and the individuals who interpret the results. Critical data cannot be retrieved by individuals who do not know where to look and which data is important.

- **There is no substitute for experience**
  People who are faced with critical situations turn to veterans for a reason. They have done it before. No one is thrilled over the prospect of going into open heart surgery with a first-year surgeon who is relying on "technology." So it is curious why firms would be comfortable with less experienced team members who have not been battle tested. Experienced compliance professionals do not need a software system to detect fraud. Risk managers who have been through more than one market cycle are usually more valuable than individuals who have not.

- **Something doesn't smell right**
  When the market adds $5 trillion in assets in less than a year, a seasoned compliance professional instinctively asks about the kind of representations that are being made to investors during the market run-up. The aftermath and recriminations of the housing collapse have only just abated, but the balance of capital formation vs. preventative risk and compliance already seems lopsided.
- **Globalization increases the need for experience and local knowledge**
  Increasing globalization means that we could be facing a worst case scenario of poor communication between regulators and conflicting regulations, combined with the kind of problems that are endemic to large, siloed entities. Firms must seek to retain and reward individuals who understand how market cycles work and how sales goals affect compliance behavior.

As attorneys, we have come across situations where individuals or entities fail to take relatively minor proactive steps, which result in a major expense and, at worst, catastrophe for themselves or their organization. Unfortunately, many compliance professionals are concerned that this may be happening on an industry-wide, or even global basis. Compliance professionals are not appropriately valued until someone needs them. Given the current preconditions for what could be a difficult correction, we need them now more than ever.

Don Andrews is a New York-based partner in Reed Smith's Financial Industry Group and is Global Practice Leader of Risk Management and Compliance. Don has a rare combination of experience and understanding of all manner of financial institutions and operational companies, small and large, combined with over 28 years of federal and private sector experience in litigation, compliance and risk management. Don can be reached at dandrews@reedsmith.com.

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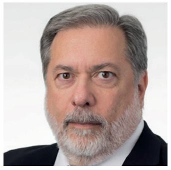
Insolvency risk planning for cross-border transactions



By Michael Venditto

Clients engage transactional lawyers for two reasons. First is to identify risks to the client's transactional objectives. Second, but equally important, is to advise on how to eliminate those risks, or at least reduce them to an acceptable level. For this predictive exercise, counsel relies on knowledge and experience, frequently utilizing time-tested solutions. But knowledge and experience can be disrupted by a variety of forces. Globalization is one such force that has changed the advice given to clients engaged in cross-border transactions. Recent insolvencies in countries such as Brazil, India, Mexico and Korea are a reminder that transactions do not always fulfill their promise, illustrating the importance of insolvency risk assessment and planning on the front-end of transactions.

Globalization and enforcement risk

Globalization is alternately cited as the cure for, or the cause of, many of the world's problems. There is little doubt that the lowering of trade barriers has stimulated global economic activity, encouraging development and investment across national boundaries. But it is also disruptive.

Market participants try to optimize the balance of return and risk; and, commonly used structures for trade and finance require predictability. When a lender or investor is unable to anticipate how its rights will be adjudicated in a particular jurisdiction, it must accommodate the additional risks and associated costs when evaluating, pricing and structuring a transaction. International financings have always required additional analysis and attention to structure, most often to minimize taxation in multiple jurisdictions. But transactions in foreign countries introduce enforcement risks beyond those in a domestic transaction. This enforcement risk escalates as businesses diversify operations and capital is deployed into more jurisdictions, many of which are trying to attract investment by modernizing their legal systems.

Several nations, including Mexico, India and the Dominican Republic, have in recent years revised, or implemented, debt restructuring laws that incorporate some concepts adapted from British schemes of arrangement or U.S. Chapter 11 cases. In some cases, these are welcome reforms that, in the long-run, may help save distressed business and allow lenders and investors to better protect their positions. But enacting legislation and implementing a viable system to deal with insolvencies are distinctly different exercises. An, no one wants to be the test-case for a newly designed legal system.

As businesses diversify operations, the value on which investors and lenders rely in making their transactional decisions can be spread across multiple jurisdictions. The tried-and-true methods developed for domestic transactions are inadequate when a business has operations and assets deployed in different countries. Relying on a well-developed body of commercial law is not enough.

Over the last several years, acquisitions of foreign businesses having little or no presence in the United States have been financed with debt raised in the United States using New York law governed finance documents. What happens if this debt needs to be restructured? Lenders and investors must plan for the possibility of distressed investments and insolvencies in countries with different, and sometimes irreconcilable, legal systems and policies. Moreover, recent U.S. government policy initiatives have complicated the international commercial landscape and undermined some of the cross-border initiatives that were expected to help lenders and investors navigate among these obstacles.

Eliminating risk is relatively simple: if your client doesn't close a transaction, you never have to worry about enforcement risk. But making a return on capital requires accepting some amount of risk. So a balance needs to be found. The key is to reduce risk to an acceptable level through transactional structuring. The most basic elements of structure will involve the ability to realize on collateral and credit support.

Planning across borders

When the business or assets are located outside the United States, a restructuring will have to take place under, or at least comply with, foreign law. Depending on the location of assets and creditors, the restructuring could require taking action in multiple jurisdictions. Generally, to effect a cross-border reorganization, the main proceeding will be commenced in one country with related or ancillary proceedings filed in other nations as needed to make a plan of reorganization or scheme of arrangement binding on creditors in those jurisdictions.

To ensure that a lender or investor receives the hoped-for benefits of its bargain, counsel needs to structure and document a transaction utilizing experience with, and knowledge of, a developed body of commercial law and the expectation that this body of law will be consistently applied by an impartial judiciary through an efficient legal process. Changes, no matter how well intentioned, undermine the requirement for predictability. Even in countries where the insolvency laws remain unchanged, many participants in cross-border financings have discovered that all of the elements needed for predictability may not be present.

The selection of the main forum is important because differences in foreign insolvency law and practice introduce both uncertainty and delay into debt restructuring. Foreign insolvency laws often involve different dynamics in the creditor-debtor relationship, which require different strategies. In the United States, for example, involuntary filings by creditors are relatively uncommon since they can only be filed by a group of unsecured creditors; this gives debtors significant control over the whether, when and where of a filing. By contrast, in many foreign countries, insolvency cases are routinely filed by creditors, particularly in legal systems that do not offer robust mechanics for restructuring debt. If foreign creditors have the ability to force a business into insolvency, they will probably have significant leverage that can be used to their advantage during negotiations.

Ideally, a secured lender should be able to act without resorting to the legal system in the borrower's jurisdiction. Several techniques used by project finance lenders can be effective in confining enforcement to predictable venues, such as England or the United States. Although they do not offer complete protection, they can reduce the risk that realization of claims or collateral will be delayed by foreign insolvency proceedings.

One of the most common of these techniques is to perfect a pledge of the stock of a holding company that owns the operating business or the entity owning the valuable collateral. Preferably, the pledger is a borrower, although with proper structuring and drafting it might be a guarantor. This pledger, organized in a reduced-risk jurisdiction, should be the sole owner of the foreign entity. This holding company enters into a pledge agreement, which is governed by the law of a jurisdiction with a sophisticated and well-developed body of commercial law such as New York or the UK. Upon a default, the lender can enforce the pledge and sell the foreign entity as a going concern. An insolvency proceeding by the borrower should not prevent the lender from enforcing its pledge. Of course, it is critical to ensure that the borrower's home jurisdiction will recognize the resulting change in ownership. This illustrates the importance of having sophisticated counsel in the foreign jurisdiction that can provide advice on commercial and regulatory issues.

Isolating and protecting revenue generating assets such as receivables is common for asset-based lenders wanting to ensure access to their collateral. This can be especially important when structuring deals in jurisdictions that have bankruptcy systems that are not creditor-friendly. Lenders could require the sale of such assets into a special purpose vehicle, but devising a workable "bankruptcy remote" structure is challenging in jurisdictions where the bankruptcy laws are unsettled. The legal and accounting requirements for bankruptcy isolation are predicated on consistently applied principles that may be difficult to predict, particularly if the legal system is not based on an Anglo-American legal tradition.

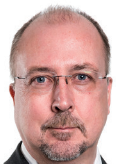
Parent and affiliate guaranties are a common form of credit enhancement that merit particular attention in cross-border transactions. They are most useful when assets or value move, whether intentionally or otherwise, from the original obligor to an affiliated entity, thereby keeping them within the reach of the lender if the obligor defaults. Guarantees provide recourse when the obligor is insolvent or bankrupt but the guarantor is not, since guarantees are independent and distinct from the underlying obligations. However, guarantees are secondary obligations that are contingent on the obligation of the third party. It therefore becomes important to understand how the guarantees will be treated if the underlying obligation is compromised or satisfied in an insolvency. This will depend on the governing law, which should be the law of a sophisticated commercial jurisdiction such as New York or the UK and the court enforcing the guarantees. To enhance the lender's position, guarantees should include indemnification provisions that can protect against the satisfaction or discharge of the guaranteed obligations, since they are primary obligations that are independent of the underlying guaranteed obligations.

Conclusion

Of course, there are no absolute protections against the downside risk in any transaction. This is especially the case in cross-border transactions that span multiple jurisdictions. Nevertheless, some careful planning and drafting can improve the prospects for the outcome.

Michael Venditto is a New York-based partner in Reed Smith's Financial Industry Group. He represents lenders, investors, indenture trustees, debtors and creditors in business reorganizations, out-of-court restructurings, cross-border insolvencies, bankruptcies and commercial disputes in various industries, including energy, shipping, retail, health care, financial services, transportation, construction, telecommunications, hospitality, manufacturing, food processing and entertainment. Michael can be reached at mvenditto@reedsmith.com.

Watch out for PRIIPs

By Tim Dolan, Adrian Brown and James Nicholson

In Europe, the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation will enter into force January 1, 2018, and it will have an impact on many types of firms around the world that offer securities to retail investors in Europe.

The main objectives of the PRIIPs Regulation are to provide European retail investors with clear information about the risks of investment products failing and also to improve the quality and comparability of information provided. PRIIPs should enable investors to make more informed choices between different investment options across product classes. As part of this, firms that "manufacture" PRIIPs must create a key information document (KID), which must be provided by distributors to retail investors in good time before they buy.

What is a PRIIP?

PRIIPs can be either:

- An investment where the amount repayable to the investor is subject to fluctuation because of an exposure to reference values, or to the performance of one or more assets that are not directly purchased by the investor. Examples include investment funds, special purpose vehicles, futures, options, CFDs, structured products and structured deposits. There is, however, a transitional exemption for European UCITS funds, which will not be brought into the regime until December 31, 2019. Or
- An insurance-based investment product that offers a maturity or surrender value, and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations. This will include life insurance policies with an investment element.

The key point is that PRIIPs are products that intercede between the retail investor and the markets through a process of packaging or wrapping together assets or reference values so as to create different exposures, provide different features or achieve different cost structures, as compared with a direct holding.

What is a retail investor?

All individuals will be retail investors unless it is possible to "opt them up" to professional investor status. In order to do this, both of the following tests (which derive from Europe's MiFID legislation and do not apply perfectly to this context) need to be satisfied:

- A "qualitative test," where a distributor may treat a person as an elective professional if the distributor assesses the expertise, experience and knowledge of the person, which gives reasonable assurances, and the distributor considers that the investor is capable of making their own investment decisions and understands the risks involved.
- A more onerous "quantitative test," where at least two of the following criteria must be satisfied:
    a) The investor has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters.
    b) The size of the investor's financial instrument portfolio exceeds EUR 500,000.
    c) The investor works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

Therefore, if the investor satisfies both tests above, it will not be treated as a retail investor for PRIIPs purposes and will not be subject to the PRIIPs Regulation.

It is also possible in certain circumstances that a corporate or partnership can be considered to be a retail investor, and so care must be taken.

What does a KID need to contain?

The KID must be accurate, fair, clear and not misleading, provide key information and be consistent with any binding contractual documents, with the relevant parts of the offer documents and with the PRIIP's terms and conditions. It must be a stand-alone document and clearly separate from marketing materials, and not contain cross-references to marketing material.

Additionally, the KID must be written in a concise manner and should be no longer than three sides of A4 paper. It should be presented in a way that is easy to read and must focus on the key information that retail investors need. It shall be written in the official or any other accepted language of the Member State where the PRIIP is to be offered or sold.

The following is a prescribed structure that the KID must take:

- The title "Key Information Document" must appear prominently at the top of the first page of the KID.
- The KID must then contain a prescribed explanatory statement directly under the title of the KID.
- Information on the identity of the manufacturer and its competent authority.
- A prescribed comprehension alert.
- Specification of the PRIIPs type, its objective and the intended market.
- Details of the risks associated with the PRIIP, and a summary risk indicator (SRI).
- Performance scenarios.
- The consequences of a potential default of the manufacturer.
- The costs of the PRIIP.
- Details as to how long they should hold the PRIIP and whether they can take out their money early.
- How complaints can be made.
- Other relevant information.

The SRI is a figure that provides information on the risk profile of the PRIIP that is obtained by combining a market risk measure (MRM) and a credit risk measure (CRM) with respect to the PRIIP.

The MRM is a measure of the PRIIP's market risk on a scale of one (being the lowest risk) to seven (being the highest risk). This figure is calculated on the basis of the market price of the PRIIP and its annual volatility in relation to the value-at-risk.

The CRM measures the PRIIP's credit risk on a scale of one to six. CRM takes into account the credit risk associated with the manufacturer or the party bound to make payments to the investor. Depending on whether there is an entity that directly engages to pay the return to the investor, and whether the PRIIP invests or is exposed to underlying investments or techniques that entail credit risk, the credit risk assessment will take into account the underlying investments or exposures on either a "look-through" or "cascade" basis.

If the recommended holding period of the KID is three years or more, the KID must contain performance values based over three moments in time: at one year, at half the recommended holding period, and at the recommended holding period. If between one and three years, performance values need to be shown at two moments in time: at one year and at the end of the recommended holding period. If the recommended holding period is shorter than one year, only the values at the end of the recommended holding period need to be shown. These must be calculated net of costs and presented both in monetary and percentage terms. At each of these intervals, the performance scenarios will show a range of possible returns in a stressed, unfavorable, moderate and favorable scenario of the underlying investment. If the PRIIP is an insurance-based investment product, an additional scenario, based on the moderate scenario, shall be included, where the performance is relevant in respect of the return on the investment.

In terms of costs, all direct and indirect costs borne by the retail investor, including one-off, recurring and incidental costs, must be disclosed in the KID.

Under the section titled "How long should I hold it and can I take money out early?" the KID should state whether there is a cooling off or cancellation period for the PRIIP, an indication of the recommended and, where applicable, required minimum holding period, and the ability to make, and the conditions of, any disinvestments before maturity (including applicable fees and penalties).

Under the complaints section, detail is needed about how and to whom a retail investor can make a complaint against the manufacturer or a person advising on or selling the product.

The final section, "Other relevant information," should have a brief indication of any additional information documents to be provided to the retail investor at the pre-contractual and/or post-contractual stage. This excludes marketing material.

Next steps

A manufacturer (which will be the firm that creates the PRIIP) must create the KID and make it available on its website. Manufacturers should also ensure that they have an enforceable distribution agreement with distributors, making it clear that distributors will need to distribute the KID in accordance with PRIIPs.

A distributor must communicate the KID and make it available to European retail investors in good time before they invest.

All firms involved in the creation and distribution of PRIIPs to retail investors in Europe should be assessing whether they are subject to the new PRIIPs regime.

The authors would like to recognize James Nicholson, trainee solicitor at Reed Smith, for his contributions to this article.

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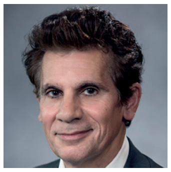
For entertainment companies, risk management is a competitive advantage



By Don Andrews

What do these scenarios have in common? A film with a budget of eight figures, which relies upon significant special effects is in production, however, budget has not been set aside for special effects. An on-location project in a foreign country experiences significant delays and cost overruns because the appropriate permissions to shoot in that jurisdiction have not been obtained. An entertainment company employs hundreds of third-party vendors for core processes without centralized oversight, resulting in operational breakdowns and potential information breaches. An entire studio is threatened because of alleged discrimination practices by a handful of senior executives. What these scenarios have in common is that these types of practices are still tolerated in corners of the entertainment industry as if they were inscrutable laws of nature.

To understand risk management, one needs to understand the difference between consciously taking knowing risks and blind irresponsible risks. Risk is not bad. Risk is what has driven humanity toward greater and greater heights. It is necessary for human progress and the progress of our economy. The thousands of entrepreneurs that disrupt their quiet existence to realize their dreams are to be admired and supported. They make our world a better place.

But while risk takers certainly do not lack courage, they will not be successful through courage alone. There is a difference between thoughtfully charting your course for the New World and negligently setting sail for the North Atlantic with little thought to encountering an iceberg. A CEO is like any ship captain. They are responsible for the lives and the careers of the people on board, whether they are employees, investors or board members – it is a serious mandate. They have a responsibility to take risks in an informed, thoughtful and strategic manner to improve the chances for the success of the enterprise.

Risk assessment and risk management are nothing new, and the fact that anyone would need to impose this discipline on a business rather than the business taking action says more about the nature of the business enterprise than the regulations requiring it. In other words, good businesses already do this. What has changed in recent years is the science and understanding behind enterprise risk management. The tools are more precise, the categories more greatly defined and the process far less amorphous than in previous decades. Science is being utilized to support and confirm "gut instinct." Despite the rollback in regulations, financial institutions, their boards and their shareholders do not want to see a return to the days where no one bothered to apply science as a tool to improve the decision-making process.

Financial institutions are subject to specific regulations, but they are not the only types of companies that should be employing risk assessment and management strategies. Decision making in all fields benefit from an understanding of data points, regulations, previous practice, and a thorough inventory of the types of risks that a business confronts. Senior management and boards have a right to require and demand that operational managers understand the risks in their respective areas and that they are taking steps to deal with them. Senior management needs this information to make smart everyday decisions, information that should be in usable form and right at their fingertips. Smart people know they need information to make good decisions, and they become frustrated when that information is not available or presented to them in with accuracy and consistency.

As we have seen in recent years, the entertainment industry is a field where the failure rate and the stakes are high. The industry can and does tremendous benefit from a scientific understanding of the risk landscape. Television and movie production risk management requires location scouting and an understanding of local culture, regulations and related insurance issues. Everything from OSHA standards to kidnap insurance could be a consideration. Electrical safety, fire safety, location security and aerial operations need to be considered from the outset of a proposed project.

But back at the office there are other concerns. Cybersecurity and privacy considerations figure more prominently in the wake of well-publicized breakdowns. Employment discrimination scandals and securities regulatory issues that are connected to fund raising and project financing efforts need to be considered on anything but a "reactive basis." Studios and entertainment companies work with hundreds of third-party vendors, who collectively represent a significant risk management challenge that requires greater centralization and consistency. Related to these types of issues are the consideration incentives offered in various locations, from Croatia to Georgia, when making decisions about the best place to shoot a movie or television show.

Clearly, these are decisions that require a strong degree of operational and regulatory science and know-how, and cannot be predicated on anything other than strong analytics and careful evaluation. Shareholder and investor interests are an overriding concern and without a largely organized and centralized manner of decision making, an entertainment company or studio risks not only the failure of a single project, but imperils their reputation for future projects. Major studio bankruptcies, the dismissal of high-level executives, litigation that plays out in the public sphere and other near calamities in recent years demonstrate that the competitive landscape requires a commitment to more disciplined and informed risk management.

However, the important takeaway from all of this is not to foster sensitivity to risk to the extent that strategic initiatives are shelved. The reason to do all of this is to find a way to launch projects that wouldn't otherwise be thought possible, to find opportunity where others do not. Risk management for entertainment companies is ultimately about sharpening and focusing efforts and becoming more formidable and competitive, not less. The effort should be about replacing science with myth and objectivity with politically based subjectivity. It is about applying twenty-first century thinking to twenty-first century problems. The entertainment industry is another industry that will benefit from such innovation.

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