



Clarity, transparency and comparability

The colors of the PRIIPs Regulation

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The Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation is a pillar of the EU's consumer protection normative framework, directly applicable in all EU Member States as of 31 December 2016. It focuses on products and requires clarity, transparency and comparability across them.

The KID (Key Information Document) is the instrument used to pursue this objective: a pre-contractual stand-alone document that informs investors on the investment in a timely and proper manner. Its three pages, structured in a question-based format, provide investors with answers to key questions.

On 9 December 2014, Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investments products (PRIIPs) (hereafter the Regulation) was published in the Official Journal of the European Union.

4 key questions:



WHAT IS
THE PRODUCT?



WHAT ARE
THE RISKS?

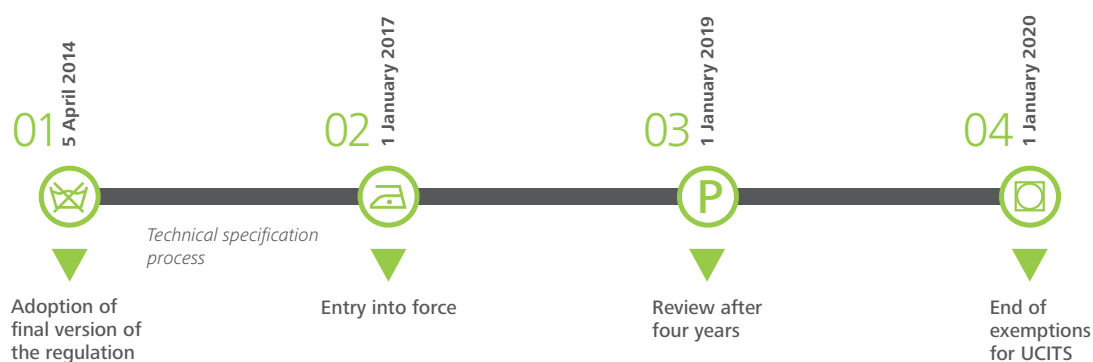


WHAT ARE
THE COSTS?



WHAT COULD
I GET IN RETURN?

The PRIIPs Regulation shall come into force on 31 December 2016



Context

The information provided to retail investors is sometimes misleading or not completely clear, making it difficult for investors to compare different products. Moreover, the conflict of interest between sales and the advice process may also lead to investments that are not in the best interests of the investor. Products may also not fulfil investors' needs, and investors may not always understand all product features and the risk linked to such investments.

To address investors' concerns and restore consumers' trust in financial products, the Regulation is designed to enhance the transparency and comparability of selected financial products through the issue of a standardized stand-alone disclosure document, the Key Information Document (KID).

The European Parliament moreover adopted the MiFID II package on 15 April 2014, to further improve investor protection. This package was designed to modernize MiFID, solve issues resulting from the financial crisis and thus foster a more efficient, resilient and transparent financial market. The PRIIPs Regulation and MiFID II complement each other: while the first focuses on disclosure requirements at product level, the latter targets investment advice. Only a few MiFID II provisions affect insurance-based investment products (within the scope of the PRIIPs Regulation) and amend the Insurance Mediation Directive (IMD), prior to the entry into force of the revised version, the Insurance Distribution Directive (IDD).

In another development for the EU consumer protection normative framework, 16 July 2015 saw the Council of the European Union publish the final agreed version of the text of the Insurance Distribution Directive (IDD), formerly known as the Insurance Mediation Directive 2 (IMD II). This amends and replaces the 2002 Insurance Mediation Directive (IMD I) and is expected to enter into force before the end of 2017, with a review to be carried out after five years.

IDD is designed to significantly raise the minimum standards of the IMD I and ensure a level playing field between all participants involved in selling insurance products, in order to achieve improved consumer protection, integration and competition. Its focus is prominent issues like intermediary qualification, advisory duty, remuneration and commissions, conflicts of interest and product design. The aim of the Directive is minimum harmonization; hence, it does not preclude Member States and national competent authorities from maintaining or introducing more stringent provisions, provided that these are consistent with its guidelines.

PRIIPs, MiFID II and IDD are the instruments required to realize a singular EU normative framework, with the aim of strengthening protection for consumers and investors from all of the different industries involved (e.g., banking, insurance, and fund/investment management) and standardizing each discipline as much as possible, with a particular focus on the clarity and transparency of marketed products.

Actors and products involved

All PRIIPs manufacturers are affected by the Regulation (e.g., fund managers, Insurers, credit institutions and investment firms).

For UCITS and investment management companies, the application of the PRIIPs provisions will not be mandatory until 31 December 2019, meaning that they can continue to provide KIIDs in accordance with Directive 2009/65/EC (UCITS IV). In light of both the significant investments made to implement KIIDs and the fact that the PRIIPs Regulation will pass through a review process four years after its entry into force, it is unlikely that UCITS will adopt the KID before the review.

With regard to products, the PRIIPs Regulation affects those offering investment opportunities to retail investors, where the amount repayable 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 investor.

Such products include (non-exhaustive list):

- Guaranteed interest rate insurance contracts with profit-sharing schemes
- Unit linked products
- Investment funds
- Structured products (i.e., market-linked investments)

The following products are not in scope:

- Non-life insurance products as described in Annex I of Directive 2009/138/EC (Solvency II)
- Life insurance contracts where the benefits are payable only on death or in the event of incapacity due to injury, sickness or infirmity
- Deposits other than structured deposits as defined in Article 4 of Directive 2004/39/EC (MiFID)
- Securities as described in points (b) to (g), (i) and (j) of Article 1 (2) of Directive 2003/71/EC (Prospectus Directive)
- Pension products which, under national law, are recognized as having the primary purpose of providing the investor with an income in retirement and which entitle the investor to certain benefits

- Officially recognized occupational pension schemes within the scope of Directive 2003/41/EC (Occupational Pension Funds Directive) or Directive 2009/138/EC

Sanctions

Member States and competent authorities are responsible for establishing appropriate administrative penalties and measures applicable in the event of an infringement of the PRIIPs Regulation. They must also ensure they are properly implemented. Sanctions shall be effective, proportionate and dissuasive.

The conflict of interest between sales and the advice process may also lead to investments that are not in the best interests of the investor

The following list provides some examples of infringements (non-exhaustive list):

- The PRIIPs manufacturer not drafting a KID before the PRIIP is made available to investors
- The form and/or content of the KID not complying with the provisions
- The language of the KID not complying with the PRIIPs provisions on official languages and translation requirements
- The KID not being presented in the sequence/layout defined by the Regulation or not containing all necessary information (e.g., name and type of PRIIP, objective(s) pursued and means to achieve them, specification of markets in which the product invests, summary risk indicator and possible maximum loss, performance scenarios, benefits and circumstances that trigger them, etc.)
- The marketing communications related to the PRIIP diminishing the significance of KID information or even contradicting it

With regard to sanctions, Member States may provide for additional sanctions or higher fine levels. However, competent authorities may impose the following as a minimum (non-exhaustive list):

- An order prohibiting/suspending the marketing of a PRIIP
- Administrative fines (minimum applicable) for legal entities:
 - Up to €5,000,000 or up to 3 percent of the legal entity's total annual turnover (based on 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
- Administrative fines (minimum applicable) for natural persons:
 - Up to €700,000, or
 - Up to twice the amount of the profits gained or losses avoided because of the infringement, where those can be determined

KID: a standardized document with seven sections

The KID is a stand-alone disclosure document. It does not replace any other contractual documents, nor is it replaced by any of them.

The KID is divided into clearly defined sections: apart from the first two sections, which introduce the product through an overview of the investment and a brief description of the objective pursued, there are seven specific sections that each focus on a particular issue.





SECTION 1: "WHAT IS THE PRODUCT?"

In this section PRIIPs manufacturers must indicate the nature and main features of the product. The following information shall be necessarily present:

- *Type of PRIIP*
- *Purpose of PRIIP*, also indicating the means to achieve it, whether there is direct or indirect exposure to underlying investment asset, a description of the underlying instruments or reference values, the market(s) where the product invests in, as well as how the return is determined;
- *Intended market*, meaning the type of targeted retail investor, with specification of their investment horizon and ability to suffer from investment loss



SECTION 2: "WHAT ARE THE RISKS AND WHAT COULD I GET IN RETURN?"

In this section, PRIIPs manufacturers must describe the risk-reward profile of the product, including the following elements as a minimum:

- *Summary Risk Indicator* (i.e., the position of the product on a scale ranging from low risk to high risk), accompanied by a brief narrative explanation of the indicator and its main limitations, as well as a description of the risks that are substantially relevant to the PRIIP and those that are not sufficiently represented by the risk indicator
- *Performance scenarios*: manufacturers must also include, where applicable, the conditions for returns and/or performance caps, as well as a clear statement informing investors about the impact of the investor's home Member State tax legislation on pay-out



SECTION 3: "WHAT HAPPENS IF [NAME OF PRIIP MANUFACTURER] IS UNABLE TO PAY OUT?"

In this section, PRIIPs manufacturers must indicate whether the possible loss is covered by an investor compensation or guarantee scheme; if this is the case, they must also include the name of the guarantor, the type of guarantee scheme and the scope of covered risks (i.e., which risks are/are not covered).



SECTION 4: "WHAT ARE THE COSTS?"

In this section, PRIIPs manufacturers must indicate the costs over time and their composition: a breakdown of direct and indirect costs for the retail investor must be included, as well as a description of one-off and recurring costs. All of this information must be presented in the form of summary indicators.

Moreover, to ensure comparability across products, improve transparency and highlight the compound effect, total aggregate costs (i.e., performance fees, trailer fees, advisory fees, management and operating fees), must be expressed both in monetary and percentage terms.



SECTION 5: "HOW LONG SHOULD I HOLD IT AND CAN I TAKE MONEY OUT EARLY?"

The objective of this section is to clearly document the "Recommended minimum holding period" (expressed in years). In addition, PRIIPs manufacturers must also indicate, where applicable:

- The cooling off or cancellation period
- The opportunity for disinvestments before maturity, stipulating the conditions under which they are possible, as well as all fees and/or penalties applied
- The potential consequences of cashing in before the established term or the recommended holding period (i.e., loss of capital protection or extra fees borne by the investor)



SECTION 6: "HOW CAN I COMPLAIN?"

In this section, PRIIPs manufacturers must indicate how and with whom a retail investor can lodge a complaint about the product itself or the conduct of the PRIIP manufacturer or the person advising and/or selling it.



SECTION 7: "OTHER RELEVANT INFORMATION"

In this section, PRIIPs manufacturers must outline any other relevant information to be provided to the retail investor at a pre-contractual stage. Marketing materials, whatever their content, must be excluded.

Major challenges for PRIIPs

The PRIIPs Regulation will have a significant impact on distribution processes, as manufacturers must produce a KID for each of their PRIIPs and ensure that it is promptly provided to the investor prior to the investment. In this regard, dissemination is a key issue: investors must receive the KID in a timely manner prior to the investment, thus both manufacturers and distributors must identify the most suitable dissemination method (e.g., a dedicated website to be implemented and managed) and be able to prove that it was actually delivered (e.g., when required to do so by the authorities).

Management of volume, content and life-cycle will certainly require the allocation of dedicated resources or outsourcing to external specialized providers. Furthermore, in some cases the KID must be produced in addition to existing documents, such as an “encadré” or “nota informativa” for products offered to foreign residents.

Moreover, it will be necessary to define a compliance strategy for each type of PRIIP manager (manufacturer or distributor), which could include:

- An assessment of the effects on distribution processes (e.g., the review of SLAs between manufacturer and the distributor, which must be compliant with mutual responsibilities pursuant to the Regulation)
- The classification (KID positioning map) of all marketed products, primarily outlining the three key pillars of risk, cost and performance, with a view to ensuring investors always have a full picture of the range on offer

The compliance strategy will naturally entail a parallel evaluation of the skills and resources required to implement it, whether they are in-house resources and/or outsourced resources.

The KID will reflect industry-specific factors (for the banking, insurance and investment management industries). For instance, Insurers will face the challenge of drafting a reliable and exhaustive KID within an open architecture model where costs, risks and the performance of the associated underlying asset are not known in advance.

Nevertheless, for all stakeholders, the PRIIPs Regulation constitutes an important means of raising distributors’ level of awareness, knowledge and expertise (e.g., sellers will be required to respond promptly and properly to customers/investors’ questions on KID content, without delegating the responsibility to manufacturers).

In the main, the entire new EU framework constitutes a major opportunity to rethink and renovate processes, instruments and structures, in accordance with the emergence of new technologies, the evolution of customer preferences and the advent of new competitors.

The new provisions and the actions needed to implement them may also represent a boost for business digitalization, particularly in the case of outsourcing the production of KIDs. Deloitte Luxembourg, indeed, leveraging on its consolidated UCITS KIID production service offers an outsource solution for the production and life cycle management of the KID, covering content creation, document production, dissemination and web publishing.”

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