

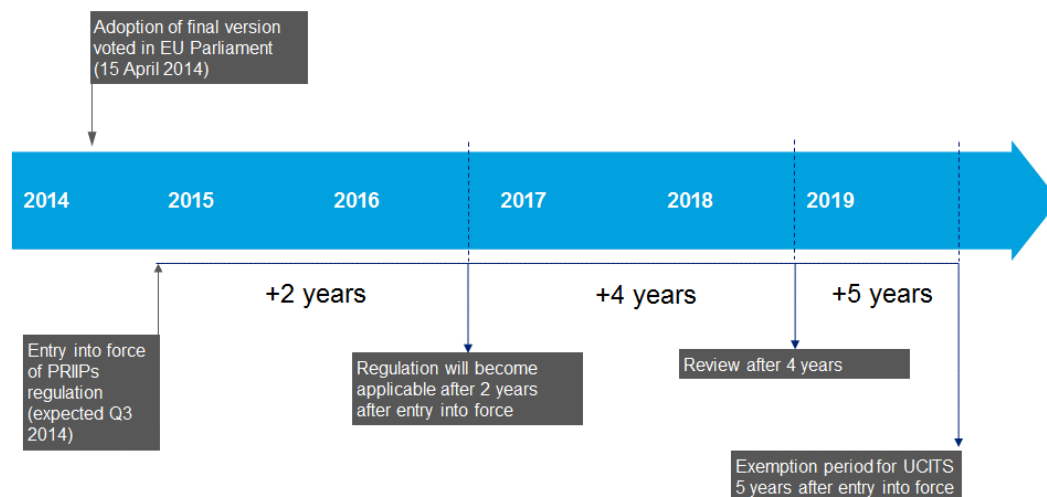
Packaged Retail and Insurance-based Investment Products (PRIIPs)

Regulation adopted



In its plenary session on 15 April 2014, the European Parliament adopted the text for a Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs).

The Regulation will enter into force after publication in the EU Official Journal, which is expected for Q3 2014. It will then become applicable 2 years after the entry into force, meaning that the PRIIPs Regulation is likely to be applicable in the second half of 2016.



Background

Information available to retail investors was sometimes considered confusing or opaque, using technical jargon, which makes it difficult for investors to compare across products. Conflicts of interest between the sales and advice process may also lead to investments that are not in the best interest of the investor. The product may not suit the investors' needs and investors may not understand all product features such as the risks associated with the investment.

To address these concerns faced by retail investors and rebuild consumers' trust in financial products, the PRIIPs Regulation aims at increasing the transparency and comparability of certain financial products subscribed by retail investors through the issue of a standardised short form disclosure document, the Key Investor Document (KID).

To further improve investor protection, on 15 April 2014, the European Parliament also adopted MiFID II package, introducing a range of measures which seek to modernise MiFID I and issues raised by the financial crisis, such as making financial markets more efficient, resilient and transparent. Both Regulation complement each other: whereas PRIIPs Regulation deals with disclosure requirements at product level, MiFID II rather focuses investment advice. Only a few MiFID II provisions apply to insurance-based investment products and amend the Insurance Mediation Directive (IMD), currently under review.

Preparing for PRIIPs: consequences and challenges

The impact of PRIIPs will be significant for the distribution processes. One of the major challenges will be the production of a KID for each PRIIP in a timely manner so that the document can be provided to investors prior to the investment. Volume management, content creation and life cycle management require dedicated in-house resources or the outsourcing to specialized service providers.

Lessons can be learned from the experience with the KIID for UCITS funds, a document comparable to the KID in terms of size, objectives and contents, which became obligatory in July 2012. When it was introduced, the impact of the KIID regarding the complexities of its production and the related costs were vastly underestimated.

Furthermore, PRIIP manufacturers may need to produce the KID in addition to existing documents such as the “encadré” or “nota informativa” for insurance products distributed to foreign residents.

As the KID has to be provided to investors prior to the investment, manufacturers and distributors need to identify the most suitable way to disseminate the KID, e.g. via a dedicated website or webpage which has to be set up.

Some open questions still remain with respect to the content of the KID. Most of the missing information will be provided in supplementary delegated acts which still have to be published.

Depending on the industry (banking, insurance or investment management), specific considerations may have to be taken into account when drafting the KID. For the insurance industry for example, the challenge will consist in drafting a meaningful KID in an open architecture model where costs, risks and performances linked to underlying assets are not known in advance.

What do you need to do now?

Depending on where you sit in the PRIIPs panorama, e.g. if you are involved as a manufacturer or distributor of the products, the gaps can be multidimensional and a PRIIPs compliance strategy is necessary.

You should begin considering:

- The impact of the PRIIPs Regulation on your distribution processes;
- Updating the SLAs between manufacturer and distributors to include the respective responsibilities under the Regulation;
- The classification of your products;
- How to produce the content of the KIDs;
- How to manage the assembly, life cycle and dissemination of the KID;
- Your competence and required resources to implement the Regulation.,

Actors and products in scope

The Regulation applies to all PRIIP manufacturers such as fund managers, insurance undertakings, credit institutions or investment firms.

UCITS management companies and investment companies are exempt from the obligations under the Regulation until 5 years after the entry into force of the Regulation. Until then they may continue to use the KIID as specified under Directive 2009/65/EC (“UCITS IV”). Given the considerable investments made by the fund industry for implementing the KIID and the fact that the PRIIPs Regulation will be reviewed four years after its entry into force (and thus possibly resulting in an extension of the exemption for UCITS), it is very unlikely that UCITS manufacturers will adopt the KID before the review.

The products falling into the scope of the Regulation are those which offer investment opportunities to retail investors where the amount repayable to the investor is subject to fluctuations because of the exposure to reference values, or depends on the performance of one or more assets which are not directly purchased by the investor. These products include investment funds, life insurance policies with an investment element and structured deposits. The following products are excluded from the scope of the Regulation:

- Non-life insurance products as listed in Annex I of Directive 2009/138/EC (“Solvency II”);
- Life insurance contracts where the benefits under the contract are payable only on death or in respect 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 referred to 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 recognised as having the primary purpose of providing the investor with an income in retirement, and which entitle the investor to certain benefits;
- Officially recognised occupational pension schemes falling under the scope of Directive 2003/41/EC (“Occupational Pension Funds Directive”) or Directive 2009/138/EC;
- Individual pension products for which a financial contribution from the employer is required by national law and where the employer or the employee has no choice as to the pension product or provider.

The Key Investor Document (KID)

The KID is a standardised document designed to improve comparability between PRIIPs. Its content is limited to key information on the nature and features of the product, such as whether it is possible to lose capital, the costs and risk profile, information on the performance and other information on the specific features of individual types of products.

The KID shall constitute pre-contractual information. The contents shall be consistent with any binding contractual documents and relevant parts of the offering documents and terms and conditions of the PRIIP. It shall be accurate, fair, clear and not misleading.

The KID has to be a stand-alone document separate from marketing documents and shall not contain cross-references to marketing material. It may have a maximum of 3 DIN A4 pages, shall be easy to read using characters of readable size. It shall be written in a language and a style that facilitates the understanding of the information, similar to the plain language requirement of the UCITS KIID. The language used shall be the official language or one of the official languages of the host Member State or a language accepted by the competent authorities of the Member State. Colours can be used provided that the understanding is not altered when printed in black and white.

The term “Key Information Document” must appear prominently on the top of the first page and a mandatory statement must appear directly underneath the title. Apart from mandatory basic information on the product, the manufacturer and the competent authority, the KID must under certain conditions include a “comprehension alert”.

Sections of the KID

The KID has to contain various sections that shall provide information to the following mandatory questions:

- “What is this product? (type of PRIIP, objectives, consumer type to whom PRIIP is intended to be marketed, information on insurance benefits, the term of the PRIIP);
- “What are the risks and what could I get in return?” (brief description of the risk-reward profile, containing: a summary risk indicator with supplementary explanations; possible maximum loss of invested capital; performance scenarios; conditions for returns or performance caps; impact of tax legislation);
- “What happens if [name of the PRIIP manufacturer] is unable to pay out?” (brief description of whether the related loss is covered by a compensation or guarantee scheme, if so, which risks are covered and which not);
- “What are the costs?” (costs associated with an investment in the PRIIP, comprising direct and indirect costs, one-off and recurring costs with summary cost indicators and aggregate costs; an indication of additional costs charged by advisors, distributors etc. must be included);
- “How long should I hold it and can I take money out early?” (applicable cooling off or cancellation period, minimum holding period, disinvestments before maturity, consequences of cashing in early);

- “How can I complain?” (how and to whom complaints can be made);
- “Other relevant information” (brief indication of any additional information documents, excluding marketing material).

Reviews of the contents of the KID shall be made regularly and revised versions shall be made available promptly.

Provision of the KID

PRIIPS manufacturers are responsible for drawing up the KID before the PRIIP is made available to retail investors (even if the drawing up can be delegated). The KID shall be made available on the website of the PRIIP manufacturer.

The KID shall be provided to retail investors by the person advising on or selling a PRIIP in good time before the investor is bound by any contract or any offer related to the PRIIP. Where a person may take investment decisions on behalf of a retail investors based on an authority, it is sufficient to provide the KID to that person.

The KID must be provided to retail investors free of charge in one of the following media: on paper (especially in face-to-face offerings), a durable medium other than paper or by means of a website under certain conditions.

Under certain conditions the KID may be provided to the retail investor after the conclusion of the transaction.

EU Member States may require an ex-ante notification of the KID to the competent authority in the host Member State where the PRIIP is marketed.

Liabilities

The PRIIP manufacturer shall not incur civil liability solely on the basis of the KID unless it is misleading or inaccurate or inconsistent with the relevant parts of the legally binding pre-contractual and contractual documents or with the contents of the KID as required by the Regulation.

When a retail investor demonstrates a loss resulting from the reliance on a KID produced for the PRIIP in which the investment was made under the conditions listed above, the retail investor may claim damages from the PRIIP manufacturer for that loss in accordance with national law.

The PRIIP manufacturer and the person selling the PRIIP shall establish appropriate procedures and arrangements which ensure that retail investors have an effective way of submitting a complaint, receive a substantive reply in a timely and proper manner after having made a complaint and have access to effective redress procedures in the event of cross-border disputes.

After the entry into force

Following the entry into force of the Regulation, supplementary delegated acts shall specify:

- The details of the procedures used to establish whether a PRIIP targets specific environmental and social objectives;
- The details of the presentation and the content of each element of information referred to in the Regulation on the contents of the KID;
- The methodology for the presentation of risk and reward;
- The methodology for calculation of costs, including the specification of summary indicators.

Furthermore, technical standard shall be developed to specify how KIDs shall be revised and how revised KIDs shall be made available to investors. ESMA shall develop draft regulatory technical standards specifying the conditions for fulfilling the requirement to provide the KID.

The EU commission has 3 years after the entry into force of the Regulation to adopt delegated acts. However, this period may be extended.

Within 4 years of the entry into force of the Regulation the EU Commission shall review the Regulation and, among others, assess whether pension funds currently exempted from the scope of the Regulation should be included and whether UCITS exemption should be extended.

Deloitte contacts

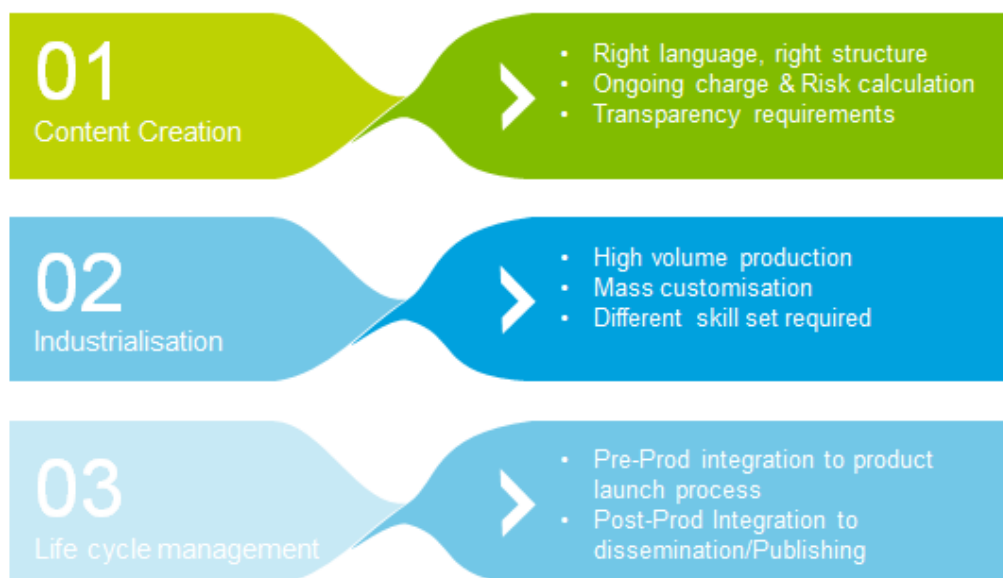
Deloitte experts in regulatory matters offer assistance on specific areas such as regulatory awareness, impact assessment for your organisation, the efficient implementation of the Regulation as well as offering tailored solutions for the outsourcing of the production and dissemination of the KID.

Deloitte also serves UCITS managers by managing the KIID production process which provided us with many insights and valuable experience.

Deloitte KID factory service

Key success factors for the production of the KID

Based on the production of the KIID for UCITS, we have identified three main challenges for the production of a document like the KID:



Content creation

Each section (i.e. question) of the KID is a challenge on its own and requires specific solutions. Examples:

- “What is this product? “: the required information covers the type of PRIIP, the investment objectives, the consumer type to whom PRIIP is intended to be marketed, information on insurance benefits and the term of the PRIIP
- “What are the risks and what could I get in return?”: this section requires a brief description of the risk-reward profile, containing: a summary risk indicator with supplementary explanations, possible maximum loss of invested capital, performance scenarios, conditions for returns or performance caps and the impact of tax legislation
- “What are the costs?”: the manufacturer must provide the costs associated with an investment in the PRIIP, comprising direct and indirect costs, one-off and recurring costs with summary cost indicators and aggregate costs as well as an indication of additional costs charged by advisors, distributors etc. must be included)

Industrialisation

We would like to draw your attention to three aspects:

- Operations - The operational aspect of the UCITS KIID production has proved to be a much greater challenge for the fund market than initially assumed. Avoid such error for the PRIIP KID;
- Costs - The cost dynamics of the KID must be clearly understood. Impressions can be misleading and the true costs may be much higher than assumed;
- Industrialisation – The coordination of processes between various stakeholders and the required technology have proved to be one of the greatest challenges going forward.

Life cycle management

The integration of pre- and post- production processes is the key to efficient KID production solutions.

- KID life cycle – Reviews of the content of the KID shall be made regularly and revised versions shall be made available promptly;
- Product life cycle – The KID will become a crucial part of the product launch process. Integration into the launch process is paramount to ensure speed to market;
- Post production: dissemination and publishing – The KID production is just the first challenge. Once produced, the KID shall be provided to retail investors by the person advising on or selling a PRIIP in good time before the investor is bound by any contract or any offer related to the PRIIP. The integration of the dissemination and publishing processes are as important as the production itself.

Our KID Factory service

Leveraging on our UCITS KIID production service (producing 100,000+ distinct KIIDs per year) we offer an outsourcing solution for the production and life cycle management of the KID covering content creation, document production, dissemination and web publishing.

Contact



Vincent Gouverneur

Partner – EMEA Investment Management Leader
vgouverneur@deloitte.lu



Lou Kiesch

Partner – Regulatory Consulting
lkiesch@deloitte.lu

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