No time for KIDding around
PRIIPs is on the way

Rosalind Fergusson
Deloitte EMEA Centre
for Regulatory Strategy

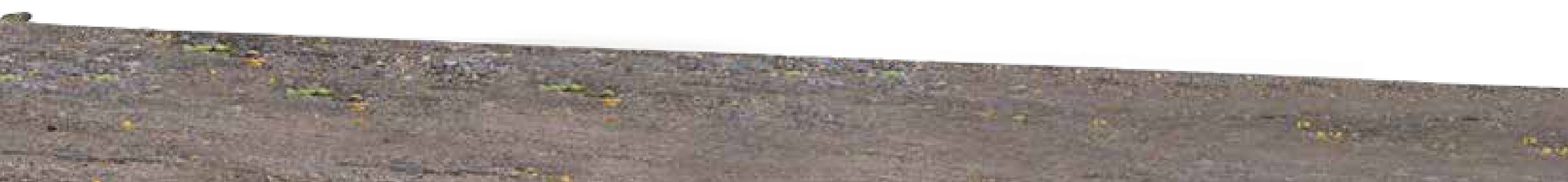
Helmut Bauer
Deloitte EMEA Centre
for Regulatory Strategy

At the start of this year, the EU regulation that will introduce Key Information Documents (KIDs) for Packaged Retail and Insurance-based Investment Products (PRIIPs) entered into force, marking a significant milestone in a process that has already been seven years in the making.

From the end of 2016, all persons in the EU advising on or selling PRIIPs will be required to provide the KID to retail investors. KIDs will be highly standardised documents, no longer than three sides of A4-sized paper. They will be drawn up by the PRIIP 'manufacturer' and include information such as the PRIIP's risk-reward profile and the total aggregate costs.

The KID regulation is a key pillar of the EU's consumer protection agenda, intended to improve the ability of retail investors to understand and compare investment products across sectors. Hence the term 'PRIIP' covers a range of products including investment funds, life insurance policies with an investment element, structured products and structured deposits. Importantly, as UCITS already have their own Key Investor Information Document (KIID), they will be exempt from the regulation for at least five years, after which the transitional period could be extended, the UCITS KIID could be replaced with the PRIIPs KID, or the two documents could be deemed to be equivalent. The same transitional rules will also apply where Member States have already extended UCITS KIID rules to non-UCITS funds sold to retail investors.

The investment management sector will already be well aware of the operational challenges that were involved in implementing the UCITS KIID. Firms that manufacture UCITS will be able to draw on these experiences to some extent, while firms that focus on non-UCITS PRIIPs (e.g. retail Alternative Investment Funds (AIFs)) will have a higher mountain to climb. When set alongside other regulatory initiatives addressing investor protection, such as MiFID II, PRIIPs may also have wider strategic implications for firms by enhancing competition across products, sectors, and ultimately, countries.



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Manufacturing on an industrial scale

A key challenge for PRIIP manufacturers will be the sheer volume of KIDs that will need to be produced. As of 2009, the total PRIIP market in the EU was estimated at €9 trillion, although UCITS accounted for 58% of this figure[1]. Manufacturers will need to establish an inventory of all their PRIIPs, identifying all non-UCITS that meet the PRIIP definition and are sold to retail investors. They will need to source and collect accurate and up-to-date information and data about each PRIIP, from the right department in the firm, to populate the KID. This may prove particularly challenging with respect to the calculations of risk and costs, where the information may differ from that required for the UCITS KIID or may not be readily produced by existing systems. The KID will need to be written in clear and understandable language that avoids financial jargon, while remaining accurate and not misleading. Experience from the implementation of the UCITS KIID suggests that this could prove particularly challenging in a document intended to be concise. Manufacturers will need to ensure that KIDs are kept up to date and made easily available on their website, and that distributors, who are responsible for providing the KIDs to retail investors, receive sufficient training with respect to the KID.

The manufacturer will not be able view the KID in isolation, as it will need to be consistent with any binding contractual documents, with the relevant parts of the offer documents, and with the terms and conditions of the PRIIP. Moreover, the manufacturer will need to consider any overlaps with other EU disclosure documents. As outlined above, the future of the UCITS KIID is currently unclear, but for the next five years at least, UCITS will be exempt from PRIIPs. There could also be some relief in relation to MiFID II disclosure. According to a discussion paper issued by the Joint Committee of the three European Supervisory Authorities (ESAs)[2] in November 2014, the ESAs are seeking coordination between MiFID II and PRIIPs, *"so that information in the KID on costs might be considered complete and sufficient for the purposes of disclosures required by MiFID II"*[3].

It will be important to get the KID right, as manufacturers will be liable where damage is suffered by the retail investor as a result of reliance on a KID that is misleading and/or inaccurate, or inconsistent with pre-contractual or contractual documentation. Firms will struggle to do this on a manual or ad hoc basis. Instead, they will need a streamlined process, with robust governance arrangements. Firms will

1 *Impact assessment of the proposal for a regulation on key information documents for investment products, European Commission, July 2012*

2 *The European System of Financial Supervision (ESFS) consists of the three ESAs, the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA), and the European Systemic Risk Board (ESRB)*

3 *Discussion paper: Key information documents for Packaged Retail And Insurance-based Investment Products (PRIIPs), Joint Committee of the ESAs, November 2014*

need to ensure a team is responsible for overseeing and documenting the lifecycle of the KID, to compile, verify and maintain the KID. Firms that manufacture UCITS may to some extend be able to leverage existing experience, processes and systems used for the UCITS KIID. One option for firms could be to outsource their KID production, as many firms have done with respect to the UCITS KIID. However, they would still retain liability under the PRIIPs Regulation.

Staying ahead of the competition

While there is no doubt that PRIIPs will bring significant operational challenges, particularly for firms that focus on non-UCITS PRIIPs, firms should regard PRIIPs implementation as more than a compliance exercise. The ESAs are seeking to ensure that the KID does not become yet another disclosure document that investors skim read or ignore. Drawing on behavioural economics, the content and design of the KID will be informed by consumer testing organised by the European Commission and completed by a contractor which will assess the relative effectiveness of different KID 'mock-ups'. The testing will be completed in August 2015 and will include assessing how well visual summary indicators of risks and costs associated with the product (e.g. 'traffic light' symbols or charts) are understood by customers.

If the KID works as the ESAs intend, retail investors, as well as independent advisers, should be able to easily and quickly compare the relative value of products between different manufacturers, and across sectors and countries, enhancing competition. Behavioural economics suggests that people are less likely to choose products that have extreme results in the summary risk and cost indicators. The KIDs products that may be difficult for retail investors to understand will also contain a 'comprehension alert' flagged by the manufacturer, which could prompt investors and advisers to consider whether a less complex product could be more appropriate.

And PRIIPs is not the only initiative seeking to strengthen investor protection. Among a number of other requirements, MiFID II will introduce extensive product governance rules and a definition of independent investment advice. There will also be stronger inducements rules and enhanced disclosure on products and services. Against this backdrop, now might be a good time for firms to consider their product offerings to ensure that their products meet the needs of a defined target market, are not unnecessarily complex, and offer good value for money.

Next steps

While the text of the KID Regulation has been finalised, in some ways this is only the beginning of the story. Work is now under way by the ESAs to develop the level two measures that will underpin the regulation. They have a lot to get through if they are to leave firms with sufficient time to implement the regulation before the rules 'bite' on 31 December 2016.

The discussion paper issued by the ESAs in November 2014 outlined preliminary options and possible approaches for the KID Regulation. A further discussion paper is expected in the spring on more complex aspects of the Regulatory Technical Standards (RTS). The ESAs will publish further consultation papers prior to the summer covering specific parts of the KID Regulation, and a consultation on the draft RTS in autumn 2015. The RTS will be submitted to the European Commission between December 2015 and February 2016, where they will need to go through a further EU approval process before entering into force. These rules will apply directly in member states, without the need for transposition.

It may therefore be some time before we know the final content and format of the KID. Given the narrow implementation window for firms, implementation plans should consider how much can be done in advance of the finalised requirements. Firms should follow the level two discussion closely and be aware of the implications for their business. This should leave them in a relatively strong position to make any necessary investments in systems and resources to meet the implementation deadline.

To the **point**:

- The PRIIPs regulation will bring significant operational challenges for manufacturers to compile, verify and maintain a large volume of KIDs, particularly for firms that focus on non-UCITS PRIIPs
- If the KID works as the ESAs intend, retail investors, as well as independent advisers, should be able to easily and quickly compare the relative value of products between different manufacturers, and also across sectors and countries, thus enhancing competition. Other initiatives, such as MiFID II, will seek to further strengthen investor protection. Against this backdrop, now might be a good time for firms to consider their product offerings
- The Regulation will apply on 31 December 2016. The ESAs are to consult on the draft RTS in autumn 2015. Given the narrow implementation window for firms, implementation plans should consider how much can be done in advance of the finalised requirements
- Manufactuers will need to consider overlaps with other EU disclosure documents, although it is unclear if the UCITS KIID could be replaced by the PRIIPs KID, or the two documents could be deemed equivalent. UCITS will be exempt from the Regulation for at least five years. There could be some relief in relation to MiFID II disclosure, since the ESAs are seeking coordination beteween MiFID II and PRIIPs