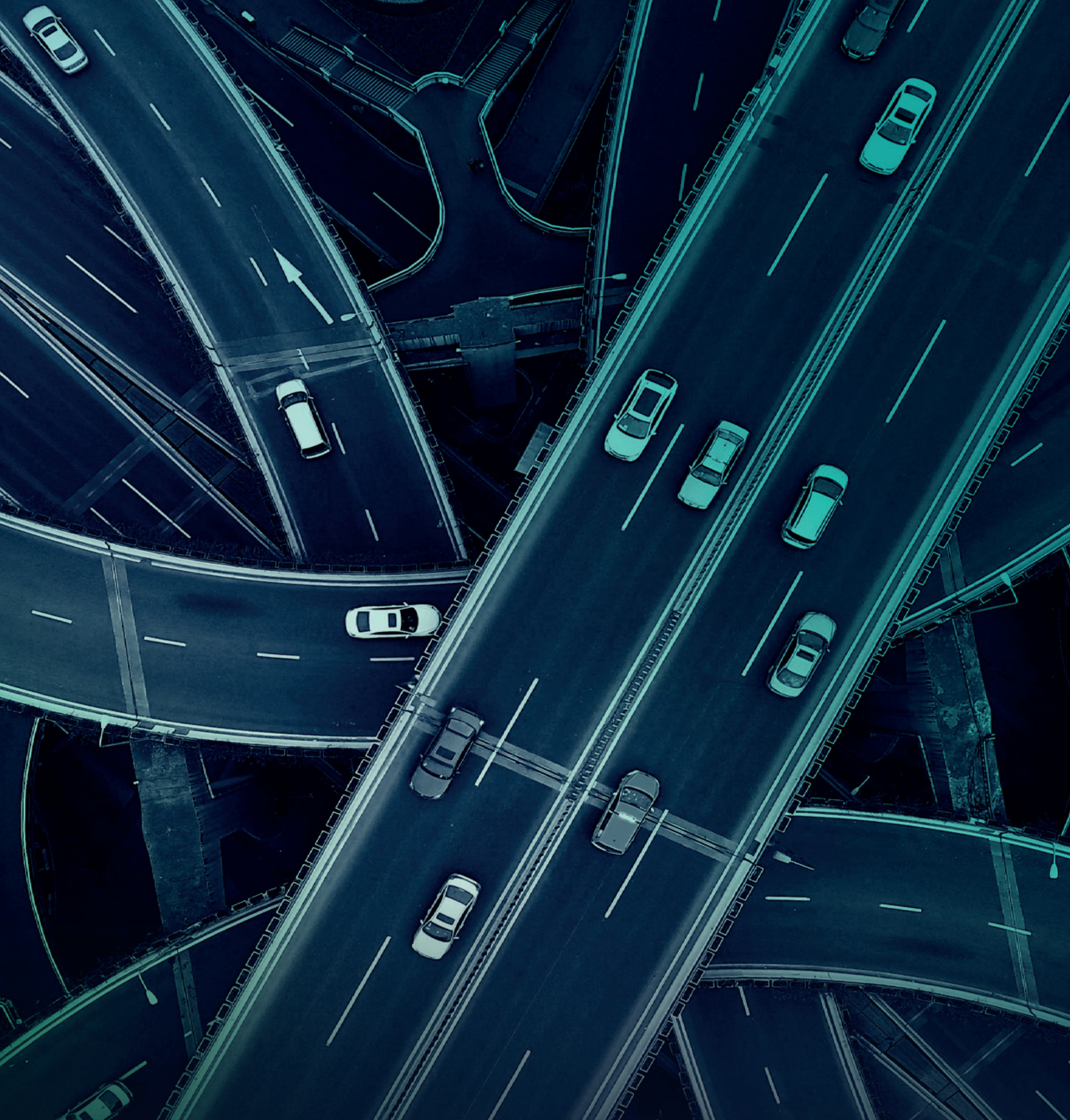

PACKAGED RETAIL AND INSURANCE-BASED INVESTMENT PRODUCTS (PRIIPs) REGULATION

A closer look

FE fundinfo

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In the aftermath of the 2008 financial crisis, the global financial services industry came under increasing scrutiny. A major concern of financial regulators was the disparity that existed between the complexity of financial products and services being offered by institutions such as banks, insurers and fund groups and the understanding of them among the retail investors who would ultimately use them.

As a result, regulators across the EU increasingly began to consider measures which would improve transparency within these packaged retail financial products and protect investors by helping them to be able to compare different products, which may aim to deliver similar outcomes using different product structures, and understand their features.

Building upon the 2009 Undertakings for the Collective Investment in Transferable Securities (UCITS) Directive, which introduced the key investor information regime, the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation was developed and came into effect across the European Economic Area (EEA) from 1 January 2018.

While the aim of the PRIIPs Regulation has always been to help retail investors better understand and compare the key features, risk, rewards and costs of different investment products (which were largely subject to different regulatory regimes), its implementation has faced difficulty at almost every juncture and has faced criticism from national regulators, supervisors, industry trade bodies and even consumer associations.

As such, a number of proposed amendments and updates have been submitted since PRIIPs came into effect. With several of these regulatory updates appearing on the horizon, along with the Brexit transition period coming to an end from January 2021 (affecting UK-domiciled funds), this paper sets out some of the key questions that fund groups may have as the current deadline for when the UCITS exemption is due to come to an end.

WHAT IS THE REGULATION SO FAR?

Before looking at what the regulation introduced, we need to look at the two types of products that fall into the definition of a PRIIP – packaged retail investment products (PRIPs) and insurance-based investment products (IBIPs).

In the latter group are products that combine an insurance structure with some investment element, so general insurance and pure life assurance are excluded. However, it is the definition of PRIPs that has caused most confusion. In fact, the regulation started by listing what is NOT in scope, including pension products, deposits and securities. After initial confusion, it became clear that investment trusts, while being listed securities, are also packaged investment products available to retail investors.

If they are available to retail investors, PRIPs include investment funds, structured products and derivatives, but confusion has continued around real estate investment trusts (REITs) and some corporate bonds. UCITS funds – at least share classes available to retail investors – are in scope, but were given a specific exemption to continue with their own key investor information document (KIID), initially until the end of 2019 and later extended until the end of 2021.

The PRIIPs Regulation states that any organisation which 'manufactures' a PRIIP must prepare a 'Key Information Document' (KID) for each PRIIP that they produce and publish them all on their website. Additionally, the regulation sets out that anyone who advises on or sells a PRIIP to a retail investor must provide them with a KID 'in good time' before completing the contract to buy the product, which has implications on intermediaries and distributors of funds.

There are some exceptions to this in that KIDs may be provided after a transaction has taken place when the retail investor has purchased the PRIIP through 'distance' communications (with their permission) and it has not been possible for it to have been provided beforehand.

WHAT ARE PRIIPs KIDs?

The PRIIPs KID is a pre-contractual generic disclosure document created by those who manufacture PRIIPs. The document (which must be created for each separate PRIIP that is produced) is intended to inform retail investors of the main features of that product, as well as its risks, costs and the potential gains and losses associated with investment in it. This information must be set out in 'a clear and accessible manner' in advance of any potential investment and be available on the manufacturer's and/or seller's website(s). They must be written in a concise manner, no longer than a maximum of three sides of A4 paper 'when printed' and promote comparability, focusing on its key features.

Specifically, a KID must contain the following information:

- Its name and identification details, its manufacturer and associated regulatory authority;
- A section setting out what the product is, including its nature, main features, its type, target investor market and investment objectives;
- A section focusing on risk and return, including the inclusion of future performance scenarios, which set out expected returns over different time periods and in different economic conditions;
- Details on what happens if the manufacturer is unable to meet its obligations to pay out;
- A section on the associated costs borne by the investor;
- Details on the expected timeframe the product should be held and any associate penalties for withdrawing assets early;
- Details on grievance procedures and how investors can complain if necessary;
- Other information which may be of relevance to the investor.



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The information included within a PRIIPs KID must also be accurate and up to date and the manufacturer needs to ensure that they are reviewed regularly and revised if necessary. The regulation states that a review should take place at least once every 12 months and when changes are made which are likely to impact the accuracy of the information included.

At the time of writing (Autumn 2020), it should be noted that the specific content of a KID continues to be debated at policy level in the EU. Three European Supervisory Authorities (EBA, EIOPA and ESMA, together the ESAs) are in disagreement over targeted changes to the regulatory technical standards (RTS), which include showing a product's past performance on its PRIIPs KID, as they are with UCITS KIIDs.

WHY WERE UCITS FUNDS EXEMPT FROM PRIIPs REGULATION?

The Undertakings for the Collective Investment in Transferable Securities (UCITS) regulatory framework, which allows for the sale of mutual funds across Europe, has been in place since the 1980s. It has been broadly popular within the industry, acknowledged both for its longevity and the strength of its investor protection requirements and has been adopted as the gold standard in a number of other countries as well. As part of the UCITS framework, fund groups already have to provide investors with a two-page KIID, which differs somewhat from the PRIIPs KID (more on this later on).

UCITS funds fall within the PRIIPs definition, but have been given an exemption to allow them to continue to provide a UCITS KIID instead of the PRIIPs KID. This has largely been because of UCITS KIIDs' widespread use and acceptance within the industry, with national regulators, including the FCA, lobbying for their continuation. Nonetheless, it was always envisaged at policy level that PRIIPs KIDs would be the long-term replacement for UCITS KIIDs and this exemption was only ever time-delayed; initially until 31st December 2019, but with a further extension granted until the end of December 2021. Until an agreement is reached, as it stands, from 1 January 2022, UCITS funds will have to provide both a PRIIPs KID and a UCITS KIID, although it is fully expected that the UCITS Directive will be updated before the end of the exemption to remove the need to produce a UCITS KIID as well as a PRIIPs KID.

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WHAT'S CHANGING NOW?

At the time of writing (Autumn 2020), the Joint Committee of the ESAs has proposed changes to the PRIIPs regulation. These changes sought to address some of the key areas that have been most widely criticised since the introduction of PRIIPs KIDs (such as the calculation and presentation of performance scenarios and costs) and to ensure these had been fixed ahead of the regulation applying to UCITS funds.

The Joint Committee was expected to submit proposed changes to the RTS to the European Commission for endorsement by the middle of 2020, but only two of the three ESAs could secure board approval, with the third believing that a more wholesale review of the regulation is needed. As a result, the ESAs have been unable to submit the revised RTS, but published them for everyone to see. Currently, these issues have yet to be resolved and the RTS remain unpublished.

UK

Alongside this, for UK-domiciled funds, the Brexit transition period formally comes to an end at the end of 2020. While HM Treasury has yet to formally announce its plans in respect of which regulatory regime it will follow (or indeed if it will create a wholly new framework), it published a policy statement in July, which hinted at some divergence from the PRIIPs regime. Three amendments to the existing regulation have been flagged:

- enabling the FCA 'to clarify the scope of the PRIIPs Regulation through its rules' to avoid any ongoing confusion;
- replacing 'performance scenario' with 'appropriate information on performance' in the PRIIPs Regulation, which is likely to allow the inclusion of past performance; and
- allow HM Treasury to extend the current UCITS exemption by up to a further five years, i.e. up to the end of 2026, as the UK 'government currently considers that the existing rules for UCITS disclosure are satisfactory'.

All of the above, it should be noted, will only be looked at 'when Parliamentary time allows'. The UK government will most likely ask HM Treasury to undertake a review of the UK framework for investment product disclosure in the coming years.

WHAT ARE THE OUTSTANDING ISSUES BEING DEBATED?

The central issues currently concerning the PRIIPs Regulation relate to the following, as set out by the European Securities and Markets Authority (ESMA), who are one of the three supervisory bodies making up the ESAs, are:

- Illustrations of what the retail investor might receive in return from their investment (performance scenarios);
- Information on the costs of the investment;
- Specific issues for different types of investment funds;
- Specific issues for PRIIPs offering a range of options for investment (so-called "Multi-Option Products", or MOPs).

While two of the three boards of the ESAs approved of the changes that were included in its final report, the third, EIOPA, did not. This meant that the report could not be formally submitted to the European Commission for endorsement. EIOPA's resistance was because its board members believed that 'a partial revision of the PRIIPs regulation [was] not appropriate at this stage' and that 'a number of Board members also indicated that for investment funds, they would prefer the past performance graph from the UCITS key investor information document to be included in the PRIIPs KID itself, rather than in a separate publication'. This latter issue refers to the fact that, because the regulation limits a KID to three pages, there would not be enough space to add a past performance chart, so the draft RTS proposed that it should be on a separate document with sign-posting from the KID. The draft report was published in July 2020 and no further date has yet been announced for a resumption in discussing these issues.

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WHAT ARE THE KEY DIFFERENCES BETWEEN PRIIPs KIDs & UCITS KIIDs?

As one might expect with two overlapping regulatory frameworks, there are many similarities between PRIIPs KIDs and UCITS KIIDs. The intentions are similar in that both aspire for the generic information included to 'be clear and not misleading' and must be reviewed and updated at least once a year. Nonetheless, there are some differences, the most fundamental of which is that a PRIIPs KID attempts to show what an investor should expect in future, whereas a UCITS KIID focuses on actual historical information. Other differences are set out below:

UCITS KIID	PRIIPs KID
Updates and reviews	
An annual review at the start of each calendar year, with a corresponding regulatory deadline by which it must be updated.	Must be reviewed at least every 12 months following the date of its initial publication or 12 months from its last revision and should be updated if necessary.
Applicable to	
Retail and professional investors.	Retail investors only.
Length	
A maximum of two pages of A4 when printed	A maximum of three pages of A4 when printed
Performance	
Up to 10 years of past performance history included. This also must include a disclosure reminding investors that past performance is no guide to future performance.	Performance scenarios are forward-looking. They must include projected performance returns (both value and % returns) based on historical data. Different scenarios based on recommended holding periods under four different economic conditions must be presented (stress, unfavourable, moderate and favourable). Past performance must not be shown, but its inclusion is currently being debated.
Risk	
Risk is presented through a 'Synthetic Risk and Reward Indicator' (SRRI), which assigns each UCITS share class a score of 1-7, with '7' being the most volatile (annualised volatility greater than 25%). The SRRI is a measure of volatility of a fund's prices over the previous five years. It should be calculated and monitored weekly, in the case of daily-priced funds, and if the actual SRRI differs from the published SRRI at every instance for a period of four months (16 weeks), the KIID must be updated and reissued with the new SRRI.	Risk is presented through a 'Summary Risk Indicator' (SRI), which also assigns each PRIIP a score of 1-7, with '7' being the most volatile (VaR-equivalent volatility greater than 80%). The SRI is designed to show the relative risk of a PRIIP, using a combination of Market Risk (based on the historical price volatility) and, where applicable, Credit Risk (i.e. the risk of the issuer defaulting). Because it is possible to lose more than the amount invested on certain PRIIPs, the intervals do not match those on a UCITS KIID SRRI. A PRIIPs KID must be updated and reissued when the published level is no longer the most common when comparing all observations over a four-month period.
Costs and charges	
The information included relating to the costs borne by the investor and the charges they will be expected to pay is broadly similar for both UCITS KIIDs and PRIIPs KIDs but is presented in different ways. PRIIPs KIDs present the information as a 'reduction in yield' (that is how their overall returns are impacted over time by costs and charges, while in the UCITS KIID, costs are presented in table format as 'costs over time'. Additionally, PRIIPS KIDs will include 'portfolio transaction costs', borne by the fund when transacting in the underlying instruments. The presentation of costs on a PRIIPs KID shows the annual impact of each of the elements of costs, including any one-off costs and a UCITS KIID shows the actual costs applicable over the previous year.	

HOW DO THE CHANGES IMPACT FUND MANAGERS AND FUND DISTRIBUTORS?

As PRIIPs KIDs are forward-looking and UCITS KIID are backward-looking, a change of mindset will be needed when the UCITS exemption ends.

The forward-looking SRI and performance scenarios are based on historical data, with added complexity to try to show what investors should expect in future. So, while a UCITS KIID relies only on fund price histories for risk and return, a PRIIPs KID has additional calculations applied to these.

A positive aspect of the move to PRIIPs KIDs would be the removal of the 35-working-day rush at the start of every year to republish every UCITS KIID. Instead, PRIIPs KIDs must be reviewed at least annually and updated only if necessary. It would be possible, therefore, to stagger the review dates throughout the year (subject to any interim events that might trigger a review).

Reduction in Yield (RIY) is a well-established way for insurance-based products to illustrate the effects of costs on returns, but it is not something that fund groups have used up to now, so this would be an added complication. Users of FE Analytics will be familiar with its 'Reduction in Yield' calculator designed to help users understand the impacts of costs on yield over different time periods.

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HOW CAN WE HELP?

At FE fundinfo we have been working alongside Fund Managers to produce their KIDs, and other regulatory and marketing documents for many years.

Our Regulatory Document Production tools are built to scale and enhance operational efficiencies while meeting regulatory obligations for both UCITS (Undertakings for the Collective Investment in Transferable Securities) and PRIIPs (Packaged Retail Investment and Insurance-based Products), and helping fund managers respond to significant market fluctuations affecting disclosed risk calculations.

Our solutions minimise manual handling and the associated risks of disparate sources of data and separate vendors.

ABOUT FE fundinfo

FE fundinfo is a global fund data and technology leader. We facilitate better, more efficient investing by connecting fund managers and fund distributors and enabling them to share and act on trusted, insightful information. We provide the data, tools, infrastructure and the expertise required to research, distribute, market and invest in funds and model portfolios.

We maximise efficiencies for fund managers and fund distributors through our unique fundinfo.cloud market place, one of the world's largest information marketplaces for local and international investment funds and support market participants at every stage of the investment lifecycle.

With roots stretching back to 1996, FE fundinfo was created in 2018 following a merger between investment data, research and software provider FE, fundinfo, a provider of services for asset managers and distributors in Europe and Asia and F2C, the Luxembourg-based data management firm, which operates the publiFund platform.

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