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Briefing note

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PRIPS KID Regulation agreed – another milestone in Europe's regulatory reform agenda

Another milestone in Europe's post crisis regulatory reform agenda has been reached, as the European Parliament and the Council of the EU forge agreement on the proposed Regulation on key information documents (KID) for packaged retail investment and insurance based investment products (PRIIPs).

Key Facts

- Political Agreement reached on the PRIIPS KID Regulation
- Clear, comparable and complete information to be provided in a mandatory, three-page KID
- Applies to all investment products intended for small investors
- Non-life insurance products, some life insurance contracts and deposits other than structured deposits and securities not covered
- Product manufacturers could be liable for losses caused by inaccuracies in the KID
- Likely to take effect mid 2016

The Regulation will introduce a pan-European, pre-contractual disclosure document for packaged retail products and insurance based investment products (PRIIPs), which is one component of a wider package of reforms on the regulation of PRIIPs, complementing those in MiFID2 and IMD2. The term 'PRIIPs' will replace 'PRIPs' within the agreed Regulation and therefore it has been used throughout this briefing.

In order to become law, the Regulation needs to be adopted jointly by the European Parliament and by the EU Member States in the Council. It is expected that the European Parliament will vote on the proposed Regulation at its plenary later in April, after which it must be formally adopted by the Council. The requirements of the Regulation will apply two years after it enters into force, so from mid 2016 or thereabouts.

This briefing serves as a reminder of the principal aims of the proposed Regulation and discusses some of the key issues for asset managers and distributors of PRIIPs, based on early indications of what the politically agreed Level 1 text will include or drop. However, as has typically been the case with recent regulatory reforms, the 'devil will be in the detail' and we shall have to wait until the agreed Level 1 text is published and for the European Supervisory Authorities to develop detailed technical requirements to know the full implications of the proposed Regulation.

The purpose of PRIIPS KID Regulation

The purpose of the KID is to help retail investors understand, compare and use information that is made available to them about different investment products. The Regulation will therefore require the provision of basic information about investment products, the risk and return that can be expected, as well as the overall aggregate cost that will arise in making the investment. This information must be provided in a consistent manner and the Regulation will lay down uniform rules on the format and content of the KID and its provision to retail investors. Whilst, the Regulation will also set out the overall principles, it will be supported by detailed delegated and implementing acts in due course. In order to ensure that the new rules are uniform and harmonised across the EU, they are to be implemented by way of a regulation, reducing the possibility of divergence at national level.

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Key Issues on the KID Regulation

Responsibility to produce the KID

The product manufacturer is responsible for preparing the KID and publishing it on its website. The product manufacturer would typically include asset managers, insurance companies and banks. Member States are likely to be entitled to require an ex-ante notification of the KID to the regulator in that State.

However, identifying the product manufacturer is not a 'one-off' determination as there may be more than one manufacturer in some circumstances: manufacturers will include those who manufactured the original investment product but also those who make a change to the risk or cost structure of an existing investment product, the intention being to deal with the situation where the original manufacturer no longer has control over the investment product. However, not every change to the original product triggers such a shift of responsibility. It would apply only to those changes which alter the features of the investment product, such as its risk-reward profile or its costs.

On delegation, it is expected that the Regulation will indicate that delegation of the preparation of a part or the whole of the KID, such as may occur under collaboration with distributors, but is to have no impact on the overall responsibility of the product manufacturer.

Form and content of the KID

The KID should be a short document of a maximum size of three sides of A4 paper. It should be presented in a form that can be read easily, focused on the key information that retailers require and be written in such a manner that it facilitates the understanding of the information by the investor.

All KIDs should include wording specified by the Regulation explaining what the KID does and does not do. The KID must also include particular information about the manufacturer, the regulator of the manufacturer and the nature and main features of the product. In this area, the Regulation is likely to contain a detailed prescription of the information which must be included. The objective of these standardised requirements is to enable retail investors to easily compare between different investment products.

Marketing communications should not contradict the information contained in the KID. Furthermore, the manufacturer should regularly review the KID and revise the document when changes need to be made.

Obligation to provide the KID

The KID is to be provided to retail investors (rather than simply offered). Whoever is advising or selling the product to retail investors (whether a distributor or the product manufacturer in the case of direct sales) generally must provide a KID to the potential investor in good time before a sale is transacted.

There are limited circumstances in which the person selling a product may provide the KID to the retail investors after the transaction. To achieve consistent outcomes, details of the method, timing and conditions for the provision of the disclosure to a retail investor will be clarified by delegated acts.

A watching brief

As mentioned above, the final agreed text of the PRIIPS KID Regulation is yet to be published and much of the detailed rules will be issued at some point by way of technical standards. To that extent, the full implications of the Regulation are yet to emerge. However, there are some key areas that are likely to prove troublesome.

Complete standardisation

One of the fundamental aims of the Regulation is to standardise the presentation of information about an investment product. However, it has been queried whether such a 'cookie cutter' approach can be taken in practice, given the unique elements of each investment product.

When is a KID necessary?

The requirement to provide a KID covers 're-manufacturers' i.e. those other than the original manufacturer who make changes that alter the features of the investment product, such as its risk-reward profile or its costs. Determining the boundary between changes that have such a sufficient effect and those that do not may prove problematic.

Liability Issues

Whether or not a product manufacturer will bear the burden of proof (as to whether it has complied with the Regulation) if a retail investor makes a claim, as was suggested in the Commission proposal, will be a question many will hope is answered in the negative; early indications suggest manufacturers may be relieved by the compromise position. Nonetheless, a number of issues in connection with liability from the perspectives of distributors and manufacturers remain e.g. should a product manufacturer be liable for alterations of a product beyond its control? Is a distributor likely to be held liable for errors and omissions in the KID that it should have been aware of? Even if the distributor is not liable, will it face adverse reputational issues, especially in the retail context?

No doubt these and other issues will be discussed in coming weeks as the requirements become clear.

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A further briefing will be produced by Clifford Chance once the final text of the Level 1 legislation is published. In the meantime, should you have any queries on the PRIIPS KID Regulation, please contact us using the details above.