

The PRIIPs Regulation: Background, Current Reform and Open Questions

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Theses

1. The **PRIIP KID usefully complements** the information available to retail investors. However, its **positive impact** on retail investment decisions is **likely not measurable** alongside other regulatory and social developments.
2. By comprehensively alerting retail investors to the risks of a PRIIP, the KID may increase **moral hazard** through guilt-sharing between intermediaries and investors.
3. The current reform of the PRIIP Reg. will enable **interactive and personalized KID representations** on digital devices while curing some more technical shortcomings of the regulation.

Overview

1. PRIIP Reg. at a glance
2. How a KID did not prevent me from a bad investment
3. Objectives of the PRIIP Regulation
4. Chronology
5. Reform
6. Criticism and open questions
7. Scope for improvement

1. PRIIP Reg. at a glance (1)

- **PRIIP** = Packaged Retail Insurance-based or Investment Product (e.g. UCITS funds, structured debt products, structured term deposits, unit-linked life insurance products etc.)
- **KID** = Key Information Document (= standardized, max. 3 pages description of the nature, risks, performance and complete costs of the product in non-technical, clear, non-misleading language)

1. PRIIP Reg. at a glance (2)

- A PRIIP manufacturer must **draw up a KID** before the PRIIP is **made available** to retail investors
- keep the KID up to date
- The persons **advising on, or selling a PRIIP** shall make the KID available to retail investors prior to the investment

2. How a KID did not prevent me from a bad investment (1)

A safe bet on sustainable growth?

- ETF on the hydrogen economy
- Dropped sharply when central banks raised rates
- Corp. Finance 101: impact of rising interest rates on NPV
- The KID contains just boilerplate language on market risk.

2. How a KID did not prevent me from a bad investment (2)

What does the KID tell?

- ETF on a thematic hydrogen economy index
- Unit category: USD accumulating ETF
- Investment policy (including derivatives and out-of-index stocks)
- Depository bank: State Street
- Not suitable for short term investors who cannot bear more than minimal losses
- Summary risk indicator: risk category 6/7

2. How a KID did not prevent me from a bad investment (3)

- 4x (!): No protection against market risk, partial or total loss is possible
- No coverage by deposit insurance
- Product risks are described, but not distribution costs and personal tax situation
- Three performance scenarios.
- When in doubt, consult your advisor.

2. How a KID did not prevent me from a bad investment (4)

Comparison: ETF on the MSCI World

- KID is very similar to the KID for the hydrogen ETF
- But: Risk category 4/7
- Securities lending is mentioned as source of additional risk
- Risk of total loss is mentioned 4 times.

2. How a KID did not prevent me from a bad investment (5)

Anecdotal evidence

- superfluous warnings (lack of deposit insurance for ETF investors)
- Boilerplate language
- Redundant and somewhat unspecific risk warnings: “You may lose your entire capital.”

3. Objectives of the PRIIP Regulation (1)

Functioning of the EU capital market

- Rebuild investor confidence after its collapse during the GFC
- Help retail investors make effective and responsible investment decisions
- Increase retail investor participation in capital markets
- Facilitate comprehension of PRIIPs
- Protect manufacturers and distributors against costly complaints, lawsuits and reputational damage

3. Objectives of the PRIIP Regulation (2)

Does the alleged reduction of complaints and lawsuits work?

- Optimistic view: Thanks to the KID, retail investors make **rational decisions** and have no reason to complain.
- Pessimistic view: no impact at best
 - “I told you so” defense
 - guilt sharing: “[...] making the customer’s information acquisition less costly leads to less prosocial behavior of the advisor.” [Inderst et al., 2019]

3. Objectives of the PRIIP Regulation (3)

Foster competition

- Transparency enables retail investors to **compare** similar PRIIPs
- **Level playing field** across product categories (= prevent advisors from regulatory arbitrage)
- Could higher transparency (scil. through ESAP) lead to concerted behavior and concentration and thus **weaken competition**?

4. Chronology (1)

- 2007-2010: preparatory work by EP, EC and 3L3 committees
- 2012: EC proposal for a Regulation
- Nov. 2014: PRIIP Regulation 1286/2014 enters into force
- 2015: EC Consumer testing study on KID structure, content and presentation
- 2016: Transition period extended until Jan. 2018
- 2017: Delegated Regulation 2017/653 prescribing in detail the KID's content

4. Chronology (2)

- 2018: EC Study on distribution systems
- 2020: Consumer testing study regarding the KID's section on performance
- 2021: Regulation amending the KID's section on performance, and deferring UCITS transition to the KID
- 2022: Joint Committee of ESAs publish advice on the PRIIP Regulation review
- May 2023: EC publishes draft amendment Regulation

5. Reform (1)

Clarify the PRIIP definition

- Bonds with make-hole clauses if redeemed at fair value
- Pension products, including immediate annuities without a redemption phase providing certain benefits

5. Reform (2)

Optional additional electronic KID format

- **Dashboard** and **Layered** presentation adapted to digital devices
- Flexibility to **personalize** the information given **parameters** such as investment **amount, holding period**, available options and **other PRIIPs for comparison**
- Conditions for **accessibility** to persons with disabilities
- ESAs to draft RTS

5. Reform (3)

New KID Section: How environmentally sustainable is this product?

- Replaces existing reference to external disclosures
- Information leverages existing data required by the Sustainable Finance Disclosure Regulation 2019/2088.
- ESAs to draft RTS

5. Reform (4)

Publication of KIDs on the European Single Access Point (ESAP)

- Make KIDs data-extractable or even machine-readable
- Third-party **tools for comparison** and retrieval
- **Q:** Impact on market structure and competition?

5. Reform (5)

Multi-option products

- KID may be restricted to a **generic description** of the options
- Manufacturer / intermediary must provide **tools**, including simulation tools allowing to access and **compare the total costs** before selection
- Upon request by a potential retail investor, the **manufacturer** must **provide the complete costs** of a specific investment option.

5. Reform (6)

Other amendments

- New section: “Product at a glance”
- Removal of the “Comprehension alert”
- Amended rules on keeping the KID up to date. **NB:** Manufacturer must provide the investor with **previous versions** upon request.

6. Criticism and open questions (1)

Concerns regarding the content of the KID

- Banks: advisors tend not to use the KID
- Overloaded with information
- Some banks build their own comparison tools
- Performance information: Regulation lacks flexibility, e.g. for insurance-based products
- Complexity is not synonymous with high risk.

6. Criticism and open questions (2)

- In general, warnings and disclosure documents tend to be **less effective than policy-makers think**: “Disclosures shouldn’t be the default.” [AFM/ASIC 2019]

6. Criticism and open questions (3)

Liability (Art. 11 PRIIP Reg.)

- Amalgam of EU and national law
- Uncertainty regarding
 - Causality
 - Burden of proof
 - Damages

6. Criticism and open questions (4)

- Disclosure obligations under **EU law and national law** are somewhat **incoherent**.
The KID adds to the existing **patchwork**.

6. Criticism and open questions (5)

Barriers for third-country manufacturers

- Manufacturer must draw up and publish a KID when the PRIIP is available to retail investors.
- Intermediaries are prohibited from selling a PRIIP unless the manufacturer has published a KID.

7. Scope for improvement

Joint Committee Advice of 2022 contains more proposals worth considering:

- Reduce information overload by prioritizing investor protection over transparency (limits of the information model)
- Improve alignment of the PRIIP Reg. with passport regimes
- Tackle the frictions caused by national ex-ante notification requirements (Art. 5 (2))
- Better alignment of the competences of home and host authorities