



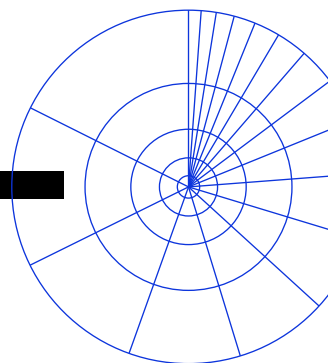
Defy. Deploy. Run.

European PRIIP Regulation

Set for Major Overhaul: A Glimpse into the Proposed Changes

Nov. 2023

Exploring the Key Draft Amendments to PRIIPs Level 1 as of November 2023



Contents

– State of Play as of October 2023	3
– Digital KID	4
– Layered Format.....	4
– Accessibility Features	4
– Additional Requirements	5
– Maintaining Comparability vs. Enhancing Comprehensibility	6
– New Section “How environmentally sustainable is this product?” ...	7
– MOPs with Numerous Underlying Investment Options	8
– When should the KID be handed to the client?	10
– KID Review and Update	11
– Comprehension Alert	12
– Exclusions from PRIIPs scope	13
– Extension to 4-Page Limit	14
– Summary	15

Exploring the Key Amendments to PRIIPs Level 1 Draft

— State of Play as of November 2023

Significant changes are currently under discussion by the National Competent Authorities (NCAs) with regards to PRIIPs. These amendments are a part of the Retail Investment Strategy (RIS), which is designed to enhance the long-term savings of European Union citizens and their engagement in capital markets. The RIS is characterized as an "omnibus directive", which means it is not a standalone directive but instead amends several other directives, including MiFID II, IDD, UCITS, AIFMD, Solvency II, and PRIIPs.

The discussions are primarily centered on Level 1, while the nomination of the European Supervisory Authorities (ESAs) is in progress for the drafting of Level 2 Regulatory Technical Specifications (RTS) once the Level 1 amendments have been agreed upon and approved. As a result, the implementation of these amendments is expected to be at least two years away, with the exception of a few Level 1 changes highlighted below. These do not require Level 2 text and are expected to enter into force immediately after the entry of Level 1 into the Official Journal.

In this article, we will delve into the main draft amendments. While the ones outlined below are not an exhaustive list, we believe they represent the most significant changes. Minor wording corrections have been omitted from our discussion.

— Digital KID

To bring the PRIIP KID up to date with contemporary needs, the adoption of an electronic format is recommended. This format is defined as any durable medium other than paper. The digital KID is proposed to be the default version provided to investors, while the distributor should inform the retail investor of the option to request a paper KID free of charge. In other words, manufacturers will retain the obligation to produce KIDs in the traditional paper document format, in addition to generating the electronic format.

— Layered Format

The digital KID is suggested to adopt a "layered" format. This entails presenting high-level information as the initial step and allowing investors to gradually explore further information based on their interests.

The concept of a layered format has previously been introduced by EIOPA in the Pan European Pension Product (PEPP). For additional details on this concept, please visit EIOPA's website: [EIOPA PEPP](#). To provide a more concrete understanding, you can also examine an illustrative PEPP KID mockup created by BETTER FINANCE, which includes elements such as (1) a dashboard, (2) high-level topics that can be expanded, (3) brief term definitions, and (4) featured warnings and disclaimers: [PEPP KID Mockup](#).

— Accessibility Features

In alignment with the European Accessibility Act, it is anticipated that the digital KID will need to incorporate accessibility features to facilitate reading for individuals with disabilities. For more information about the European Accessibility Act, please refer to: [European Accessibility Act](#).

— Additional Requirements

The draft amendments also set two additional requirements for the digital KID:

1. Allow change of holding periods
2. Allow comparison between PRIIPs

While there is limited detailed information available on these requirements, it is explained that allowing the change of holding periods could prove valuable in simulating costs for different time horizons.

It is crucial to emphasize that, under the current PRIIPs cost calculation methodology, there are significant challenges associated with implementing this requirement. Costs for holding periods longer than one year are currently based on the Moderate Scenario. However, like most scenarios, the Moderate Scenario can vary depending on the holding period. As a result, the following issues are identified:

1. **Misleading cost change:**
The primary aim of illustrating costs for different holding periods is to assess the actual costs that would be incurred due to their nature, whether they are charged as one-off fees, upon entry or exit, or on an ongoing basis. However, part of the cost change resulting from selecting a different holding period may stem from a different Moderate Scenario rather than changes in the cost logic or timing. Explaining this to retail investors could prove challenging.
2. **Technical challenge:**
To accommodate an ad-hoc change of the holding period for cost calculations exceeding one year, manufacturers would need to either (1) calculate the Moderate Scenario for all possible holding periods in advance, which could lead to longer processing times than the already lengthy process in place today, or (2) allow for ad-hoc calculation and the generation of KIDs, which presents a technical challenge.

– Maintaining Comparability vs. Enhancing Comprehensibility

One of the fundamental principles of the existing PRIIP KID framework is **comparability**. This principle aims to enable investors to make comparisons of risk, performance scenarios, and costs among different PRIIPs. Consequently, content that is specific to particular assets, i.e. applicable only to a subset of PRIIPs, has been excluded from the PRIIP KID.

An illustrative example of such content is the past performance data for funds. While this information is included in UCITS KIIDs and has proven highly beneficial to investors, it did not become an integral part of the PRIIP KID due to the emphasis on comparability. Instead, manufacturers are mandated to create a separate webpage or document for presenting past performance information and include a link within the "Other Relevant Information" section of the PRIIP KID.

One of the draft amendments suggests shifting the balance towards **comprehensibility** over strict comparability. In other words, it is proposed to allow the inclusion of asset-specific content if it contributes to investors' understanding. This change would permit the inclusion of past performance data for funds within the PRIIP KID, along with other asset-specific content.

– New Section “How environmentally sustainable is this product?”

Another proposed amendment suggests a shift in the presentation of the product’s environmental sustainability in the PRIIP KID. Rather than including it in the “What is this product?” section, there should be a dedicated segment specifically outlining the environmental sustainability aspects of the PRIIP. While the precise location is not explicitly specified, from the location of this amendment within the directive, it appears that this section could follow the RHP section (“How long should I hold it, and can I take my money out early?”) and precede the “How can I complain?” section within the KID.

Currently, it seems this sustainability section will be required for products aligned with SFDR Article 8 and Article 9. It should include the product’s minimum proportion of environmentally sustainable investments, its expected GHG emission intensity and a link to the product’s pre-contractual SFDR disclosure. The content of this section is expected to be further developed by the European Supervisory Authorities (ESAs) as part of Level 2 Regulatory Technical Standards (RTS).

It’s worth mentioning a noteworthy suggestion put forward by Germany’s Sustainable Finance-“Beirat”, proposing the inclusion of an ESG scale ranging from A (indicating the strongest consideration of sustainability preferences) to F (signifying no explicit consideration of sustainability preferences). This suggestion has been tested among both investment advisors and retail investors and has received positive feedback for its simplicity and comparability.

Incidentally, a previously proposed section called “Product at a Glance” was introduced in an earlier version of the draft amendments. This section was designed to provide a snapshot of the PRIIP, including its type, SRI (Sustainable and Responsible Investment) aspects, total costs, RHP, and insurance benefits (if applicable). However, during discussions, National Competent Authorities (NCAs) argued that this new section included redundant information. Furthermore, it was emphasized that the entire KID serves as a summary document presenting only “key information,” leading to the removal of this particular draft amendment.

– MOPs with Numerous Underlying Investment Options

This particular draft amendment holds relevance primarily for insurance-based investment products (IBIPs). If you are not dealing with IBIPs, you may proceed to the next draft amendment.

Most often, these IBIPs are Unit Linked products that offer investors the flexibility to select from a range of underlying investment options, encompassing funds, structured products, and various other investment choices. The existing PRIIPs Regulatory Technical Standards (RTS) present two distinct approaches for Multi-Option Products (MOPs) associated with IBIPs:

Article 10(a): Preparing a Key Information Document (KID) for each combination of the insurance wrapper and underlying investment option.

Article 10(b): Generating a Generic KID featuring risk and cost ranges at the insurance wrapper level, accompanied by a Specific Information Document (SID) for each underlying investment option, detailing its risk, performance scenarios, and costs. The cost ranges presented in the Generic KID should amalgamate the expenses associated with the insurance wrapper and the underlying investment option.

In certain cases, MOPs permit investments in a multitude of underlying options, where investors may acquire numerous equity shares, corporate bonds, and government bonds within the insurance wrapper. However, implementing Article 10(a) or Article 10(b) for such PRIIPs presents significant challenges:

1. **Article 10(a):** Drafting a KID for each combination of the insurance wrapper and underlying investment option necessitates the manufacturer to calculate Summary Risk Indicator (SRI) and performance scenarios for tens of thousands of underlying investment options. Calculating performance scenarios involves utilizing a 10-year price history, and for any share or bond lacking this requisite price history, the manufacturer must undertake the laborious task of history completion.
2. **Article 10(b):** Determining cost impacts, named Reduction in Yield (RIY) in PRIIPs RTS version 1, necessitates to calculation of the Moderate Scenario for holding periods exceeding one year. Similar to Article 10(a), calculating

the Moderate Scenario for each underlying investment option entails disproportionate efforts, including compiling a 10-year price history and calculating the Moderate Scenario for tens of thousands of underlying investment options.

Apart from the technical complexities, the inclusion of numerous underlying investment options results in extensive risk and cost ranges within Generic KIDs, casting doubts on their practicality for investors.

To address these formidable challenges, a proposed draft amendment suggests allowing Generic KIDs to encompass solely the costs associated with the insurance wrapper, provided that:

- The manufacturer provides the investors with an interactive tool allowing them to research and compare underlying investment options, including their costs and, where available and comparable, risks and performance;
- The investors have easy access to the pre-contractual information relating to the underlying investment options;
- The manufacturer provides investors with comprehensive cost information related to an investment option if requested by an investor.

Nevertheless, several questions and concerns have been raised by National Competent Authorities (NCAs) regarding the interactive tool, and further deliberation on this draft amendment is anticipated.

– When should the KID be handed to the client?

One area of concern relates to the timing of KID distribution to clients. During their mystery shopping exercises, the European Supervisory Authorities (ESAs) identified instances where the PRIIP KID was handed over to investors at the conclusion of the sales process, mere minutes before investors subscribed to a new product.

A proposed draft amendment seeks to provide clarity by stipulating that the PRIIP KID should be furnished by distributors to retail investors concurrently with other marketing materials, such as product brochures, factsheets, and the like.

In light of this requirement, manufacturers should also consider situations where the indicative terms of a product at the outset of a subscription period may differ from the final terms of the product.

– KID Review and Update

The existing Regulatory Technical Standards (RTS) employ wording like "where it remains available to retail investors" (RTS Article 15). This phrasing has led to ambiguity in cases where it is unclear whether a KID should be monitored and revised (in the event of a "significant change" or every 12 months). Such cases include:

1. **Closed-end funds:** Following the initial launch and capital raising phase, closed-end funds enter a second stage where investments are deployed, and investors await returns. During this phase, if an existing investor wishes to exit and new investors need to be located to purchase the investment, it's uncertain whether a PRIIP KID is required and whether it qualifies as being "available to retail investors."
2. **Run-off regular premium products:** In the context of regular premium products, if a product is closed to new investors, and new investments are solely made through premium payments from existing investors, it's unclear whether the product is still considered "available to retail investors."

The draft amendments are expected to clarify these scenarios and determine whether KIDs should be monitored and updated in these cases.

– Comprehension Alert

The draft amendments propose the elimination of the comprehension alert for complex products, citing two key reasons:

- It has not demonstrated effectiveness in alerting retail investors to the potential risks associated with particularly complex products.
- It inadvertently dissuades retail investors from considering less complex investment products.

In the event of approval, this amendment will come into effect immediately upon the publication of Level 1 in the Official Journal, as it does not necessitate a Level 2 specification.

The National Competent Authorities (NCAs) are currently engaged in discussions regarding this suggestion, with several potential outcomes under consideration. These range from complete removal, partial removal, adjustments to the alert's narrative, replacement with alternative narratives, to retaining the alert in its current form.

– Exclusions from PRIIPs scope

Several amendments propose the exclusion of certain products and features from the purview of PRIIPs:

1. **Immediate annuities:** An immediate annuity is a financial product that involves a single lump-sum investment, providing ongoing income either for a specified duration or for the investor's lifetime in return. A draft amendment seeks to clarify that immediate annuities do not fall within the scope of PRIIPs.
2. **Make-whole clause:** Many corporate bonds incorporate a "make-whole clause" that allows the bond issuer to prepay the remaining debt early, based on a predefined formula. In a prior supervisory statement issued in October 2019 (available at [ESMA - Supervisory Statement](#)), it was clarified that if "the mechanism to calculate the discount rate is known in advance to the retail investor," this clause would not render the product a PRIIP. Given the debatable legal binding status of a supervisory statement and the inherent ambiguity in the described scenario, the draft amendments suggest that "make-whole clauses are outside the scope of the PRIIPs Regulation, provided they are redeemed at a fair value."

These amendments will come into effect immediately upon the publication of Level 1 in the Official Journal, as they do not require Level 2 specifications.

– Extension to 4-Page Limit

At present, Level 1 regulations impose a constraint on the length of the PRIIP KID, limiting it to **three** A4 pages. However, with the incorporation of additional content, including the new sustainability section and asset-specific information (e.g., past performance), it becomes apparent that allowing for a longer document is necessary. Therefore, the draft amendments recommend extending the paper version of the PRIIP KID to **four** A4 pages.

– Summary

With the new PRIIP Level 1 regulation on the horizon, the winds of change are becoming palpable, and they are undeniably significant. In a move not entirely unexpected, environmental considerations are making their way into PRIIPs, aligning with the growing emphasis on responsible investing.

Furthermore, the introduction of more digital content and interactive presentations heralds a promising shift, although it necessitates a substantial IT effort to ensure broad accessibility to the digital Key Information Document (KID).

While we continue to rely on PDFs as a reference point, the state of the update process reveals an interesting dynamic. Some National Competent Authorities (NCAs) have reached consensus on certain updates, while others remain under discussion, leaving room for potential major shifts in the coming years.

In essence, this journey represents an opportunity to transform the KID into a more modern, useful, and interactive tool, a change that promises to be for the better. However, it's a challenge that cannot be underestimated, especially given the usually tight deadlines. Rest assured, we are committed to steering through this challenge and diligently monitoring the evolving landscape.

As we move forward, our commitment to keeping you informed about these transformative developments remains unwavering, and we stand ready to navigate this evolving landscape together.

— Get in touch with us!



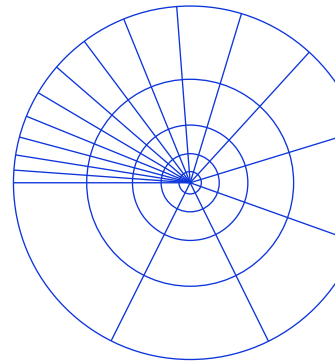
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