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Losing an "I" is Painful

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The European Supervisory Authorities are wading through 90+ responses to their Packaged Retail and Insurance-Based Investment Products consultation, which closed for comment in January. That's a lot of reading in a short time, as the authorities will provide final Regulatory Technical Standards and an impact assessment to the European Commission by 31 March.

KIID Versus KID?

By the start of 2017, the Packaged Retail and Insurance-Based Investment Products Directive will require providers of financial products to create a Key Information Document that is a maximum of three pages. UCITS funds, or investments that may be sold across Europe, must produce a KID starting in 2019 in lieu of the two-page Key Investor Information Documents they have been publishing since 2012.

So far, so good—investment products will be put on a level playing field, allowing investors to compare key information side by side in a standard, short, plain-English format.

If only it were that simple, though. The summary of the required framework for a KID runs to a half page, indicating the challenges of conveying the actual details in three pages.

Exhibit 1 KID Framework

Identifying Information	Descriptions	Sections and Related Content
Name and type of PRIIP Term of the PRIIP	Product's objective and the means for achieving it	**What are the risks and what could I get in return?** ► A brief description of the risk-reward profile ► A summary risk indicator and narrative explanation ► The possible maximum loss of invested capital ► Appropriate performance scenarios ► Details of any performance caps ► A statement referencing tax implications
Date of the document	The type of consumer it is intended to be marketed to	**What are the costs?** ► A clear indication that advisers and distributors will provide details of their own costs
Identity of the manufacturer	Details of any insurance benefits and the circumstances that would trigger them	**What happens if the manufacturer is unable to pay out?**
Applicable competent authority		**How long should I hold it and can I take money out early?** ► Any cooling-off period ► Recommended or required holding period ► Potential consequences of early encashment
		How can I complain?
		Other relevant information

The Dangers of Oversimplification

Consider the nature of the investment products that will require KIDs, each with different structures and features, such as structured products, structured deposits, insurance-linked investments, closed-end funds, non-UCITS open-end investment funds and so on. It is easy to imagine the challenges of comparing their fees, performance and risks. Take fees for example, where more helpful detail will be provided than in the current KIIDs. The fee structures associated with a closed-end fund, however, differ markedly from a unit-linked insurance fund and from a UCITS. The danger is that either the measures are oversimplified or different measures are used for different products, reducing comparability. Worst of all, these variations may not be evident to investors—the people these documents are intended to help.

An Operational Catch-22

It's particularly prevalent in the insurance industry for policies to offer a range of investment options by wrapping UCITS funds. This poses a challenge for providers of both products. For insurance companies to accurately create their KIDs, they are dependent on more fee information than is available in a UCITS KIID. Yet UCITS funds aren't required to start publishing the KID until the end of 2019 (and this is still subject to review)—leading to a Catch-22 situation. This change will also introduce an inconsistency for investors (for example, when comparing a direct investment in a fund versus investing in the same fund via an insurance wrapper) and an operational issue in sharing necessary information between institutions. This is yet another operational challenge on top of what product providers will need to do to manage the processes required to source data for, review, approve, publish, distribute, monitor and update similar but distinctly different regulatory documents.

Controversial Views of Risk

Another particularly interesting section of the KID addresses risk while also encompassing investment performance. The KIID gave birth to the SRRI, or Synthetic Risk and Reward Indicator, which buckets funds by risk level into a highlighted box on a 1–7 scale with 1 representing the lowest risk. It was preceded by many debates about its virtues, which have resurfaced. The PRIIPs proposals retain some of the SRRI concept for certain product types while introducing alterations and additions for other products. Even more controversial is the replacement of past performance information with performance scenarios reflecting unfavourable, moderate and favourable situations.

For U.K. investors, this is a throwback to days gone by when the common way of presenting possible investment outcomes was the use of assumed growth rates. The way the KID addresses performance, investors will have to analyse other sources of performance data to gauge the variance of actual returns achieved by similar products promising similar outcomes.

Where PRIIPs and MiFID II Could Meet

Last, but by no means least, the PRIIPs Directive is related to aspects of the Markets in Financial Instruments Directive II, the EU legislation designed to create a single European market for investment services and activities. The similarities include the disclosure of costs and how they both address complexity. Currently, the industry is anxiously awaiting guidance on whether PRIIPs disclosures will be sufficient to meet MiFID II obligations. Under MiFID II, complexity is a key factor of whether a product can be purchased without advice. PRIIPs present an ideal opportunity to put the onus on the product provider to label products as complex in mandatory disclosure on the KID, rather than leaving that judgement to every distributor and adviser.

Wouldn't it be nice if the regulators followed the precedent of the recently announced one-year delay to MiFID II implementation? We think it's possible to find ways to make the disclosure landscape friendlier for investors without adding to the administrative burden and cost placed upon the industry. Simplification would encourage earlier adoption of the PRIIPs/KID standard, which we think would make losing that "I" a lot less painful for everyone.