

ESAs Consult on Amendments to the PRIIPs KID

Consultation Paper looks at ways in which issues with the KID requirements could be improved.

Key Points:

- The ESAs are seeking to make adjustments to the PRIIPs KID requirements to address ongoing issues relating to both calculation methodologies and presentation formats.
- This consultation only considers the KID and does not address the wider issues with the PRIIPs regime, which are due to be considered as part of the upcoming European Commission review.

The European Supervisory Authorities (ESAs) published a [consultation paper](#) on potential amendments to the PRIIPs KID Regulatory Technical Standards (RTS) in October 2019.

The aim of the proposals is to address some of the regulatory issues that have been identified with the PRIIPs Key Information Document (KID) since its introduction, and to deal with the potential end of the temporary exemption for UCITS, currently expected to take place at the end of 2021.

Background to the consultation

The PRIIPs Regulation came into force on 1 January 2018, and introduced prescriptive requirements for the KID. From its inception, problems were identified not only with various elements of the KID, but also with the scope of the Regulation itself, in particular its application to corporate bonds.

In relation to the KID, particular problems surfaced concerning future performance scenarios, the disclosure of costs, and the presentation of multi-option products. Firms raised specific concerns that the performance scenarios presented too optimistic an outlook. The performance scenario issues led the FCA to publish a [statement](#) shortly after the Regulation came into force, permitting firms to provide additional explanations alongside a KID if they felt that the performance scenarios in their KIDs were at risk of misleading investors.

To date, the FCA has considered taking further unilateral action to address the concerns relating to the PRIIPs regime. However, it has not yet done so, preferring to keep protocol and defer to the EU authorities. This has not prevented the FCA from being openly critical of the regime in speeches and other published materials.

The ESAs have been willing to listen to concerns about the Regulation (more so than the European Commission), and published a [consultation paper](#) in November 2018 with a view to initiating some “quick fix” amendments to the PRIIPs Regulation, prior to the European Commission’s planned review of the regime. Part of the reason for this rush was the impending expiration of the temporary exemption for UCITS, which was originally due to expire on 31 December 2019. However, respondents felt that making only targeted amendments on an accelerated timetable would not be helpful. Many were concerned that the lack of time for analysis and consumer testing could mean that the changes might have unintended consequences, and thought it better to wait for a proper review. This feedback, coupled with the fact that the Commission decided to extend the exemption for UCITS to the end of 2021, meant that the ESAs did not pursue any amendments at that time. They decided instead to wait and conduct a more comprehensive review in 2019, which has led to the current consultation paper.

What does the consultation address?

The consultation discusses a range of issues with the PRIIPs KID, and suggests potential improvements concerning both methodology and presentation. In addition to the the proposals outlined below, the ESAs also pose some questions regarding digital innovation, including whether the way in which the PRIIPs regime operates hinders the use of digital solutions for preparing KIDs.

Future performance scenarios

The ESAs acknowledge that the current methodology is pro-cyclical in nature, resulting in investors being provided with inappropriate expectations. They also note that, in some cases, performance scenarios even show an expectation of having a positive return in the unfavourable scenario, or show potential returns that are greater than any returns ever seen for that product.

The ESAs are considering removing intermediate scenarios and the stress scenario from the future performance scenarios, in order to simplify the information provided to consumers. The ESAs are also looking at a revised methodology using dividend yields to estimate future growth rates. Further, the ESAs consider that, even if the methodology for future performance scenarios corrects the issues identified, issues may still arise. As such, the ESAs ask whether compensatory mechanisms might be needed for unforeseen methodological faults.

In relation to structured products, the ESAs question whether it could make sense to include illustrative scenarios in addition to, or instead of, future performance scenarios. This is because it is difficult to conceive a methodology for structured products that does not risk creating inappropriate results.

Transaction costs

This is a priority area for the ESAs, in light of the feedback received to their 2018 consultation paper. The ESAs are considering what changes could be made to the methodologies for calculating costs, and the methods for presenting them, to ensure that they cover all relevant costs and facilitate the comparison of products by investors.

The ESAs note that they intend to make substantive amendments to the cost tables in the KID. Another key aim of the changes is to improve compatibility with MiFID costs and charges disclosures. Although the ESAs have identified a preferred approach, they are consulting on a number of different options. The ESAs continue to consider that reduction in yield is the best cost indicator for all PRIIPs for showing overall costs in percentage terms. Therefore, the amendments focus on trying to ensure that investors understand these figures.

For transaction costs, the ESAs note that a key concern is the use of slippage methodology. Consequently, the ESAs are proposing adjustments to this methodology that it considers will resolve the issues identified. The ESAs also believe that it is better to amend the arrival price methodology rather than replacing it with a more principles-based approach.

Multi-option products

This is another priority area identified by the ESAs, given the difficulties in applying the KID requirements to PRIIPs offering a range of options for investment. The ESAs consider that a proportionate solution might be to require manufacturers to provide more detailed information about at least four of the most relevant options, and generic information for the other options. The ESAs are also proposing some further adjustments to the generic KID, including adding some narrative explanation to indicate whether or not all costs are shown.

Past Performance

The ESAs are considering whether past performance information should be included in PRIIPs for AIFs, UCITS, and certain types of insurance-based investment products. They are carrying out consumer testing exercises to determine whether disclosure of this information is effective in relation to these products. The ESAs are also seeking views as to how past performance information could be presented.

End of the UCITS exemption

Given the potential end of the UCITS exemption at the end of 2021, the ESAs are considering what adjustments would need to be made to the PRIIPs KID to accommodate UCITS. The ESAs set out which requirements for the UCITS KIID should be incorporated into the PRIIPs KID once it applies to UCITS.

What does the consultation not address?

The consultation only looks at potential amendments to the PRIIPs KID RTS; not to the Level 1 text. Therefore, it does not address more fundamental issues with the PRIIPs regime overall, such as the scope of application. Notably, it does not address the issues relating to the impact of the regime on the corporate bond market. However, the ESAs subsequently published a Supervisory Statement on the application of the PRIIPs Regulation to bonds (see [PRIIPs and Corporate Bonds — Clarity at Last?](#)). The Statement sets out the ESAs' view as to whether certain features within bonds should lead to a conclusion that the bond in question must be treated as a PRIIP. Pending any potential future clarifications to the Level 1 text, this guidance is extremely helpful for issuers grappling with the scope of the Regulation.

The ESAs do not propose any amendments to the PRIIPs Regulation itself, but note that the Commission has raised concerns that the proposals in the consultation in relation to performance scenarios may not be fully compliant with the Regulation. Therefore, these could require changes to the Level 1 text. The ESAs also highlight that, depending on the feedback received, they may yet recommend changes to the Regulation, if responses to the consultation indicate that changes to the RTS alone are not likely to address the issues identified concerning the KID.

What are the next steps?

Responses to the consultation are requested by 13 January 2020. The ESAs state that they intend to conclude their review by the end of Q1 2020, with a view to submitting their proposals to the Commission shortly afterwards. Subject to the time it takes for the proposals to be endorsed by the EU legislative bodies, the ESAs suggest that the amendments could come into force during 2021. However, the ESAs also acknowledge that it may be preferable to delay the application of some of the changes, such as the

inclusion of past performance in the KID, to coincide with the expiration of the temporary exemption for UCITS at the end of 2021.

As discussed above, the consultation does not address broader issues regarding the scope of application of the PRIIPs Regulation, as these would need to be dealt with under the review of the Regulation itself, not a review of the RTS. The ESAs do not have the power to review the Level 1 text. Article 33 of the PRIIPs Regulation requires the European Commission to carry out a review of the Regulation by 31 December 2019. However, in the consultation paper the ESAs note that, while they understand that the Commission is preparing to initiate this review, it is not expected that all of the required elements of the review will be completed by the end of the year. Consequently, the timing of the overall review of the PRIIPs Regulation remains uncertain and it may yet be some time before all of the issues arising from the regime stand to be addressed.

In addition to monitoring these EU developments, PRIIP manufacturers are also having to assess how they might reconcile EU PRIIP requirements with equivalent documentation in non-EU jurisdictions, such as Switzerland, which now requires its own version of the KID when distributing PRIIPs to retail.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

David Berman

david.berman@lw.com
+44.20.7710.3080
London

Stuart Davis

stuart.davis@lw.com
+44.20.7710.1821
London

Frida Montenius

frida.montenius@lw.com
+44.20.7710.1161
London

Kishore Bhindi

kishore.bhindi@lw.com
+44.20.7710.4785
London

Carl Fernandes

carl.fernandes@lw.com
+44.20.7710.4777
London

Rob Moulton

rob.moulton@lw.com
+44.20.7710.4523
London

Sherryn Buehlmann

sherryn.buehlmann@lw.com
+44.20.7710.3043
London

Nicola Higgs

nicola.higgs@lw.com
+44.20.7710.1154
London

Denisa Odendaal

denisa.odendaal@lw.com
+44.20.7710.1845
London

Brett Carr

brett.carr@lw.com
+44.020.7710.4695
London

Gabriel Lakeman

gabriel.lakeman@lw.com
+44.020.7710.4645
London

Jonathan Ritson-Candler

jonathan.ritson-candler@lw.com
+44.20.7710.1815
London

Charlotte Collins

charlotte.collins@lw.com
+44.20.7710.1804
London

Anne Mainwaring

anne.mainwaring@lw.com
+44.20.7710.1018
London

Katy Sanders

katy.sanders@lw.com
+44.20.7710.4548
London

Becky Critchley

becky.critchley@lw.com
+44.20.7710.4519
London

Sam Maxson

sam.maxson@lw.com
+44.20.7710.1823
London

Sean Wells

sean.wells@lw.com
+44.20.7710.4662
London

You Might Also Be Interested In

[PRIIPs and Corporate Bonds — Clarity at Last?](#)

[Review of the EU Benchmarks Regulation](#)

[ESMA's Consultation Paper on the MAR Review](#)

[Research Unbundling — FCA Finds Rules Working Well](#)

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the lawyer with whom you normally consult. The invitation to contact is not a solicitation for legal work under the laws of any jurisdiction in which Latham lawyers are not authorized to practice. A complete list of Latham's *Client Alerts* can be found at www.lw.com. If you wish to update your contact details or customize the information you receive from Latham & Watkins, visit <https://www.sites.lwcommunicate.com/5/178/forms-english/subscribe.asp> to subscribe to the firm's global client mailings program.