

FREQUENTLY ASKED QUESTIONS ABOUT THE PRIIPS REGULATION

What is PRIIPs?

The “PRIIPs Regulation” refers to the EU Regulation on Key Information Documents for Packaged Retail and Insurance-based Investment Products. Its aim is to achieve greater consistency and a more level playing field in pre-contract disclosure in the European Union (the “EU”) across different packaged retail investment products and certain insurance-based investment products.

From what date are firms required to comply with the PRIIPs Regulation?

Although the PRIIPs Regulation came into force in December 2014, its provisions do not come into effect until 1 January 2018.

Which products come within the scope of the PRIIPs Regulation?

The definition of a PRIIP is split into two broad categories of product. The first limb of the definition comprises packaged retail investment products which are defined as investments where “regardless of the legal form of the investment, the amount repayable to the investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the investor”. This limb of the definition will include

many structured products and derivatives. The second part of the definition covers insurance-based products which are defined as insurance products which offer “a maturity or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations”.

Does the Regulation give any specific examples of products that come within the scope of the definition of a PRIIP?

No, specific examples of products are not given in the PRIIPs Regulation. The recitals to the Regulation state that, among other investments, PRIIPs should include investment funds, life insurance policies with an investment element, structured investment products, structured deposits and financial instruments issued by special purpose vehicles meeting the PRIIPs definition. Certain categories of product are also expressly excluded from the definition, including (i) deposits other than structured deposits, (ii) certain “vanilla” securities that are exempted from the scope of the EU Prospectus Directive, (iii) life insurance contracts where the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity, (iv) non-life insurance products listed in Annex I to the Solvency II Directive and (v) many occupational pension schemes and pension

products which, under the relevant national law, have the primary purpose of providing the investor with an income in retirement.

What obligations are imposed by the PRIIPs Regulation?

The primary requirement of the PRIIPs Regulation is that before a PRIIP is made available to retail investors, the PRIIP manufacturer shall draw up for that product a “key information document” (or “KID”) in accordance with the requirements set out in the Regulation and must publish the document on its website. In addition, a person advising on, or selling, a PRIIP must provide retail investors with the KID free of charge and in good time before those retail investors are bound by any contract or offer relating to that PRIIP.

Which entities come within the definition of a “PRIIP manufacturer”?

A PRIIP manufacturer is defined as (i) any entity that manufactures PRIIPs and (ii) any entity that makes changes to an existing PRIIP including, but not limited to, altering its risk and reward profile or the costs associated with an investment in a PRIIP. “Manufacturer” is not specifically defined but is generally expected to be the issuer/provider of the product.

Who is a retail investor for the purpose of the PRIIPs Regulation?

A retail investor is a “retail client” as defined in the recast Markets in Financial Instruments Directive (“MiFID II”). Under MiFID II, a retail client is any client that is not a professional client (a client who possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks

that it incurs in accordance with criteria set out in MiFID II – the precise definition is set out in an Annex to MiFID II). A “retail client” also includes any customer of an insurance undertaking or re-insurance undertaking within the meaning of the EU Insurance Mediation Directive who would not qualify as a professional client under MiFID II.

Does a hard copy of the KID have to be produced?

The PRIIPs Regulation states that the person advising on or selling a PRIIP must provide the KID to a retail investor either (i) in paper form, which should be the default option where the PRIIP is offered on a face-to-face basis, unless the investor has requested otherwise, (ii) using a durable medium other than paper, where certain conditions are satisfied (including that the retail investor has been given the choice between information on paper and in the other durable medium) or (iii) by means of a website, subject to certain requirements. A retail investor can always require a hard copy of the KID in paper form to be delivered to it.

Does the KID have to be provided to the retail investor directly or can it be provided to another person on the investor’s behalf?

Instead of being provided to the retail investor directly, the KID can be provided to a person with written authority to make relevant investment decisions on behalf of the investor.

In relation to the requirement to deliver the KID to retail investors, what does the “in good time” requirement mean?

Regulatory Technical Standards (“RTS”) set out in EU Commission Delegated Regulation give some guidance as to the requirement for the investor to be

provided with the KID “in good time” prior to conclusion of the contract. They provide that the person advising on or selling the PRIIP should take into account the investor’s knowledge and experience with the PRIIP or PRIIPs of a similar nature or with similar risks, the PRIIP’s complexity and, if the advice or sale is at the investor’s initiative, the urgency explicitly expressed by the investor of concluding the transaction. Therefore, where the product is simple or the investor is familiar with it, it is possible that the period could be very short, potentially even the same day. The expectation, however, is likely to be that in most cases the delivery of the KID to the investor should be at least a day or two before the contract is concluded.

Are there any circumstances in which the KID can be delivered to retail investors after the transaction is concluded?

In limited circumstances, it may be possible for the KID to be provided to the retail investor after conclusion of the transaction if the investor chooses, on its own initiative, to contact the person selling the PRIIP and concludes the transaction using a means of distance communication (so not face-to-face). This is only permitted where it is not possible for the manufacturer, adviser or seller to provide the KID to the investor prior to conclusion of the contract. In these circumstances, the person advising on or selling the PRIIP must have informed the investor that it is not possible to provide the KID pre-contract and must clearly state that the investor may delay the transaction in order to receive and read the KID. The investor must consent to the delay and the KID must be provided to such investor without undue delay after conclusion of the transaction.

What must the KID contain?

The requirements as to form and content of the KID are detailed and prescriptive. The PRIIPs Regulation states that the KID must constitute pre-contractual information and there is an overriding requirement that it is accurate, fair, clear and not misleading. The KID must provide “key information” and shall be consistent with any binding contractual documents, relevant parts of the offer documents and with the terms and conditions of the PRIIP. It must be set out in specific sections as set out in the PRIIPs Regulation and in the required sequence. The document must be clearly titled “Key Information Document” at the top of the front page. The PRIIPs Regulation also states that, where applicable, a comprehension alert must be included in the KID which shall read: “You are about to purchase a product that is not simple and may be difficult to understand”. The RTS state that the comprehension alert should be provided in respect of any “complex” product as defined in MiFID II.

Is the KID subject to length restrictions?

Yes, the KID must be a maximum of three sides of A4-sized paper when printed. It must be written in a concise manner which promotes comparability with other products. It is also required to be presented and laid out in a way that is easy to read, using characters of readable size.

Can the KID cross refer to other documents or incorporate information by reference?

The KID is required to be a stand-alone document, clearly separate from marketing materials (and must not contain any cross-references to such materials). It may, however, contain cross-references to other documents including a prospectus where applicable, but only

where the cross-reference is related to the information required to be included in the KID under the PRIIPs Regulation.

What language must the KID be drawn-up in?

The KID is required to be written in the official language of the Member State where the PRIIP is distributed, or in another language accepted by the competent authorities of that Member State (or one of the official languages where there is more than one official language). If the KID has been written in a different language, it must be translated into an official language.

Does the PRIIPs Regulation apply to secondary sales?

Yes, there is no distinction between primary and secondary sales in the PRIIPs Regulation. Therefore, from 1 January 2018, any PRIIP offered to retail investors in the secondary market will require a KID to be produced. No guidance has yet been given as to when PRIIPs traded in the secondary market will be regarded as available to retail investors. In view of the fact that the obligation to produce a KID falls on the manufacturer, a manufacturer of a product that is not intended to be sold to retail investors in the EU and for which no KID is produced will need to ensure that intermediaries selling the KID have agreed not to offer or sell the product to EU retail investors.

Are there any “grandfathering” provisions in relation to products issued prior to 1 January 2018?

Somewhat surprisingly, the PRIIPs Regulation does not contain “grandfathering” or transitional provisions and the EU Commission has confirmed that any existing products that continue to be offered to retail investors on or after 1 January 2018 will require a KID. This

approach has given rise to significant concern among many market participants, particularly in relation to compliance costs for existing products where the costs of preparing and maintaining the KID will not have been built into pricing of relevant products. To seek to give some comfort on this issue, Guidelines published by the EU Commission (the “EU Commission Guidelines”) state that where a PRIIP is no longer made available to retail investors as of 1 January 2018, and changes to the existing commitments are only subject to the contractual terms and conditions agreed before that date, a KID is not required for that product.

Does the PRIIPs Regulation apply to non-EU issuers? What about EU PRIIPs that are sold to non-EU investors?

The territorial scope of the PRIIPs Regulation is not clear on its face. The EU Commission has, however, confirmed that it considers that the requirement to produce a KID for a PRIIP applies where it is sold by any entity (whether or not in the EU) to an EU retail investor. It has also confirmed that it does not believe a KID is required for sales of PRIIPs to retail investors situated outside the EU.

What are the required sections of the KID?

The required sections of the KID include (i) “What is this Product?”, (ii) “What are the risks and what could I get in return?”, (iii) “What happens if [the PRIIP manufacturer] is unable to pay out?”, (iv) “What are the costs?”, (v) “How long should I hold it and can I take my money out early?” and (vi) “How can I complain?”. The RTS contain further detail on the content requirements and a draft template for the form of the KID.

What information has to be included in the “What are the risks and what could I get in return?” section of the KID?

The PRIIPs Regulation states that this section must contain a brief description of the risk-reward profile of the product. This must comprise (i) a summary risk indicator (“SRI”) giving the product a risk-based score from 1 (least risky) to 7 (most risky), (ii) the possible maximum loss of invested capital, (iii) appropriate performance scenarios and the assumptions made to produce them, (iv) information on conditions for returns to investors or built-in performance caps, (v) a statement that the tax legislation of the retail investor's home member state may have an impact on the actual payout and (vi) other specified information.

How is the SRI determined?

The SRI requirements are set out in the RTS and the format must follow the template contained in the RTS. The SRI should be assigned using a combination of a market risk measure (“MRM”) and a credit risk measure (“CRM”). The MRM varies by reference to 4 specified categories. CRM is based on credit assessment of relevant obligor by external credit assessment institutions. An additional narrative is required for PRIIPs with particular liquidity concerns or currency risks.

What rules apply to performance scenarios?

Detailed requirements are set out in the RTS. Performance scenarios are subject to requirements on calculations and presentation corresponding to favourable, moderate and unfavourable outcomes and a “stress performance scenario” at recommended holding and intermediate periods.

What information on costs has to be included in the “What are the costs?” section?

The PRIIPs Regulation states that this section must include costs associated with an investment in the PRIIP, comprising both direct and indirect costs to be borne by the retail investor, including one-off and recurring costs. Further requirements are set out in the RTS. Costs associated with investment in the product must detail both direct and indirect costs and one-off and recurring costs. Costs should be presented using two tables: (i) costs over time (using a reduction in yield (“RIY”) indicator) and (ii) composition of costs. Costs must be indicated in both monetary and percentage terms. The costs over time table should indicate potential exit periods for different holding periods, including the recommended holding period. The costs section should also state that advisers, distributors and any other person advising on or selling the product will provide information to enable the investor to understand the cumulative effect that aggregate costs have on the return under the product.

Costs tables should assume an investment of €10,000 (€1,000 for insurance-based PRIIPs) and the composition of costs table should include one-off costs including entry and exit costs (e.g., distribution fees, constitution costs, marketing costs and subscription fees) and recurring costs, including portfolio transactions costs per year. For investment funds, transaction costs should be calculated on an annualised basis, based on an average of the transaction costs incurred by the PRIIP over the previous three years (or if the period is less than three years, based on estimates of portfolio turnover).

Are there requirements for updating the KID?

Although the KID is primarily envisaged as a pre-contractual document, the PRIIPs Regulation requires the manufacturer to review the information contained in the KID regularly and to revise the document promptly if the review indicates that changes need to be made. The RTS provide that such review shall be made every time there is a change that significantly affects or is likely to affect significantly the information contained in the KID but that, in any event, a review should be made at least every 12 months following the initial publication of the KID. The review should verify whether information contained in the KID remains accurate, fair, clear and not misleading and, in particular, whether the KID continues to meet the form and content requirements of the PRIIPs Regulation, whether the MRM and CRM have changed and whether the mean return for the PRIIPs moderate performance scenario, expressed as an annualised percentage return, has changed by more than five percentage points. The EU Commission Guidelines state that neither the PRIIPs Regulation nor the RTS require manufacturers to provide “on-demand” or “real-time” KIDs and the frequency with which the manufacturer must review and revise the KID depends upon the nature of the PRIIP and the extent to which information in the KID remains accurate and not misleading.

Does the PRIIPs Regulation contain provisions as to liability for inaccuracies in the KID?

The Regulation provides that a PRIIPs manufacturer will not incur civil liability based solely on the KID, unless it is misleading, inaccurate or inconsistent with the legally binding contractual and pre-contractual documents or with the detailed KID content

requirements. The Regulation provides that where a retail investor can demonstrate a loss resulting from its reliance on information in the KID that is misleading, inaccurate or inconsistent, the investor can claim damages against the manufacturer for loss in accordance with applicable national law. The manufacturer’s potential liability under the KID cannot be waived or limited. The EU Commission Guidelines clarify that the PRIIPs Regulation does not exclude civil liability that may be incurred by PRIIPs manufacturers in respect of specific information on the different investment options where that information would prove to be misleading, inaccurate or inconsistent with relevant parts of legally binding pre-contractual and contractual documents or with the requirements of the RTS.

How can the three page KID requirements be met for products giving investors different options?

It is recognised in the PRIIPs Regulation that it may be impracticable in some cases, for a KID to meet all the requirements of the PRIIPs Regulation, including the three page length limit, particularly when a PRIIP offers retail investors a wide range of options. In such a case it may not be practicably possible to provide the prescribed information for each option within a three page KID. In these circumstances, the PRIIPs Regulation states that the KID shall provide at least a generic description of the underlying investment options and state where and how more detailed pre-contractual information documentation relating to the investment products backing the underlying investment options can be found. The issue is also dealt with in the RTS which provide that for PRIIPs with multiple options, one of two approaches may be selected by the manufacturer. The first is that a separate

KID is produced for each option with generic information about the KID and specific information about the option. The other option is that a single generic KID is produced with specific information on each of the options provided in supplemental documents.

What considerations apply with respect to KIDs prepared in relation to derivative transactions?

The EU Commission has confirmed that its view is that the PRIIPs Regulation will apply to most derivatives sold to or entered into with retail investors. This presents various challenges. Most derivatives are not investment products in the conventional meaning of the term as payments under derivatives are generally made throughout the life of the transaction and frequently envisage both sides to the transaction could make payments. They are also most typically entered into for hedging rather than investment purposes by a range of different entities and many aspects of the required content requirements of the KID, including elements of the SRI, performance scenarios and costs, do not fit in well with the typical derivatives transaction. Also, from a practical perspective, the relevant pricing for most derivatives will not be known until the product is traded. Such pricing cannot therefore be disclosed in the pre-contract KID whilst the product is being made available to retail investors in accordance with the PRIIPs Regulation. To address these concerns, many market participants have lobbied to be able to produce generic or standardised KIDs for certain OTC derivatives. During a PRIIPs Workshop in July 2016, the EU Commission indicated that, in principle, standardised KIDs should be permissible in these circumstances. This issue is dealt with in Q&As published by the European Supervisory Authorities

where it is stated that where specific information is not available in relation to an OTC derivative whilst the KID is made available to retail investors, the content of the KID (including performance scenarios and cost information) should be based on market data that are representative for the market conditions applicable. It is also acknowledged in the Q&As that it may be acceptable to draw up a single KID for a class or group of derivatives that share the same relevant product characteristics.

What are the consequences if a manufacturer or person advising on or selling a PRIIP does not comply with the PRIIPs Regulation?

The manufacturer and persons advising on or selling the PRIIP must establish appropriate procedures and arrangements that ensure that retail investors have an effective way of submitting a complaint against the manufacturer and that any such complaining investor receives a substantive reply in a timely and proper manner. The manufacturer, adviser or seller must also ensure that effective redress procedures are available to retail investors in the event of cross-border disputes, particularly where the manufacturer is located in another member state or outside of the EU. The Regulation provides that, without prejudice to the supervisory powers of competent authorities and the right of member states to impose criminal sanctions, member states must enact rules establishing appropriate administrative sanctions in respect of breaches of the PRIIPs Regulation and that relevant competent authorities must have the power to impose certain specified sanctions including orders prohibiting or suspending the marketing of a PRIIP, public warnings and fines up to specified amounts.

In relation to UCITS funds that are also PRIIPs, does the fund have to comply with the KIID requirements under the UCITS IV Directive or with the requirements of the PRIIPs Regulation?

Manufacturers of PRIIPs in the form of UCITS are already subject to the obligation to produce a short form key investor information document (“KIID”) under the UCITS IV Directive. Therefore, management companies and investment companies and persons advising on or selling UCITS are exempt from the PRIIPs Regulation until 31 December 2019. The obligation to produce a KIID under the UCITS IV Directive will remain in the meantime. The EU Commission must assess by the end of 2018 whether these transitional arrangements should be prolonged or whether the KIID provisions in UCITS IV should be brought in line with the PRIIPs Regulation requirements.

What will the impact of Brexit be on the PRIIPs Regulation?

Subject to any transitional arrangements agreed between the United Kingdom and the EU, the PRIIPs Regulation will cease to be directly applicable to the United Kingdom following Brexit. However, under the proposed European Union (Withdrawal) Bill which has now been introduced for debate to the UK Parliament, the terms of the PRIIPs Regulation will still apply in the United Kingdom immediately following Brexit – this means that UK manufacturers/distributors selling products to UK retail investors will need to comply with requirements equivalent to those in the PRIIPs Regulation. In any event, the PRIIPs Regulation would still apply to UK manufacturers/distributors selling products to retail investors in the EU. It is not entirely clear if the European Union (Withdrawal) Bill would

mean that requirements equivalent to the PRIIPs Regulation will apply to EU manufacturers / distributors selling products to retail investors in the United Kingdom and this may need clarification although it is expected that this will be the case. It also seems likely that the United Kingdom will want to maintain a “level playing field” between the United Kingdom and the rest of the EU following Brexit in relation to the requirement for the publication of KIDs in relation to PRIIPs so we do not expect a change from the status quo in this regard in the United Kingdom in the foreseeable future.

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