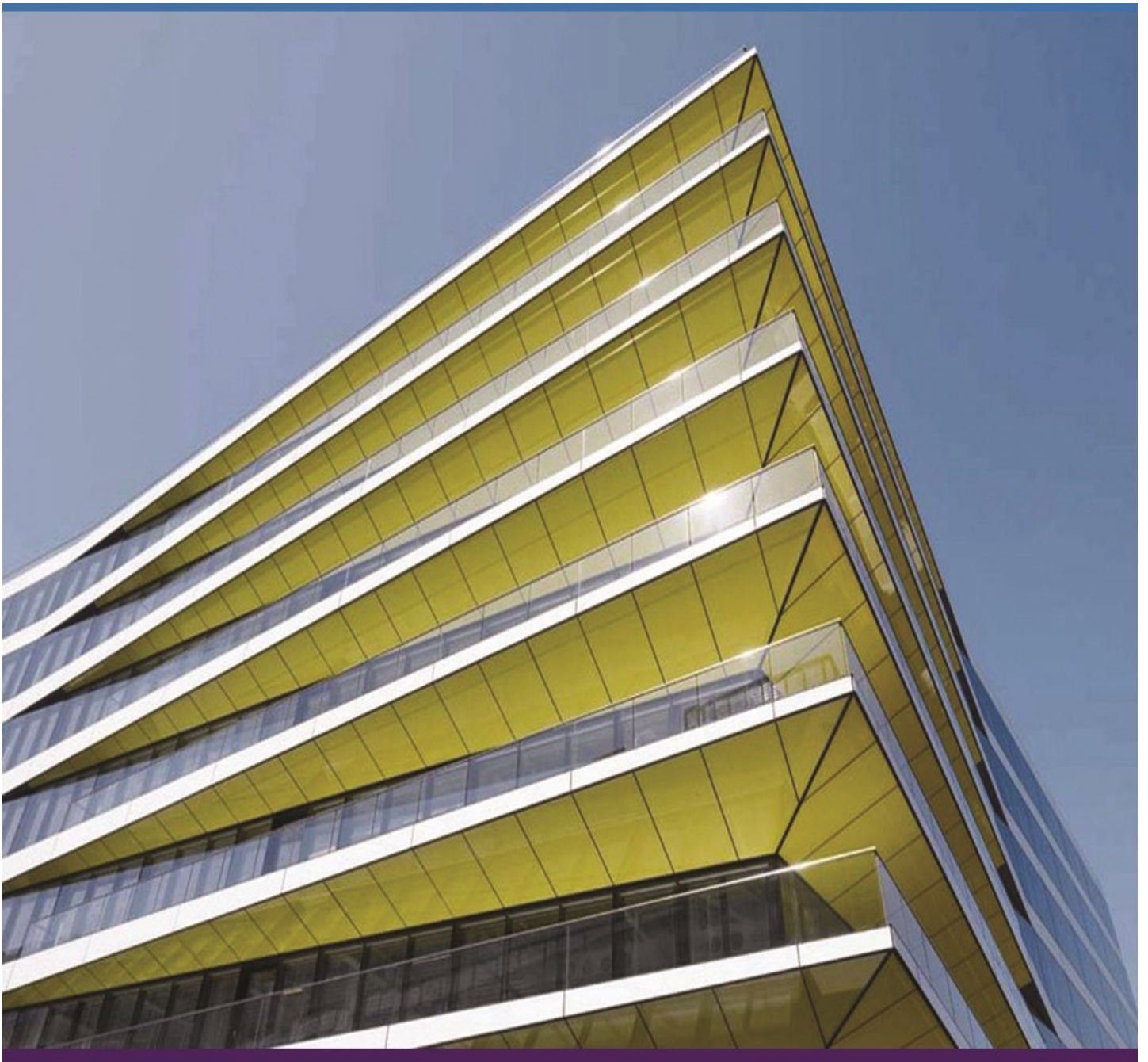


Preparing for PRIIPs

September 2016



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After a lengthy development period, the PRIIPs Regulation is set to come into force on 31 December 2016. Implementing what should be quite a simple idea – producing a consistent way of explaining retail investment products to consumers - is likely to prove more difficult in practice. Implementation does introduce some challenges. With the publication of the FCA's CP 16/18, UK PRIIPs manufacturers can now start to plan their PRIIPs implementation plans in greater detail. However the delay in finalising workable Regulatory Technical Standards is a major hindrance. There is still the potential for a delay in the implementation date.

Background

The Regulation on Key Information Documents for Packaged Retail and Insurance-based Investment Products ("[PRIIPs Regulation](#)") was made on 26 November 2014. It directly applies in EU Member States from 31 December 2016. Now, with publication of the related [Regulatory Technical Standards](#) ("[RTS](#)") and, in respect of the UK perspective, with the FCA publishing their proposals for changes to disclosure rules in the FCA Handbook in July (in [CP 16/18](#)), UK based firms can make their detailed plans.

Of course, this initiative does not exist in isolation. Many of the concerns, which have not really been moved on very far, arise from differences of approach to disclosures in different areas. In particular, there is a need to work through issues for products which have multiple layers, especially where a product manufacturer requires information from one or more third party firms in order to produce their PRIIPs. For example, information may be required from fund managers by insurers so that they may produce their PRIIPs for insurance products for which they offer external linked funds.

What is a PRIIP?

As finalised in the Regulation, a "*packaged retail and insurance-based investment product*", or *PRIIP*, means a product that is one or both of the following:

- **a PRIP:**

A "**packaged retail investment product**", or "**PRIP**", means "an investment including instruments issued by special purpose vehicles as defined in point 26 of Article 13 of Directive 2009/138/EC or securitisation special purpose entities as defined in point [an] of Article 4(1) of Directive 2011/61/EU where, regardless of the legal form of the investment, the amount repayable to the retail 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 retail investor."

- **an insurance-based investment product:**

An "insurance-based investment product" means an insurance product which offers maturity or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations.

Recital 7 of the PRIIPs Regulation records:

"In order to ensure the Regulation applies solely to PRIIPs as defined, insurance products that do not offer investment opportunities and deposits solely exposed to interest rates should be excluded from the scope of the Regulation. For life insurance products, the term "capital" means capital invested on the request of the retail investor. In addition, any deposit or certificates which represent traditional deposits other than structured deposits should be excluded. Assets that are held directly such as corporate shares or sovereign bonds are not PRIIPs and therefore should be excluded from the scope of the Regulation. Investment funds dedicated to institutional investors are excluded from the scope of the Regulation since they are not for sale to retail investors. Individual and occupational pension products recognised under national law as having the primary purpose of providing an income in retirement should be excluded from the scope of the Regulation in consideration of their peculiarities and objectives, whereas other individual insurance accumulation or savings products offer investment opportunities should be covered by this Regulation."

There is some scope for Recital 7 to be differently construed in various Member States and dependent on their local products. Consider for example the recently introduced freedoms for cashing in pension pots such that the primary purpose will not be purchase of annuities and so income in retirement in a traditional sense.

The European Commission is mandated by the Regulation to assess by December 2018 whether or not to include pension products within PRIIPs but, for the present, they are excluded.

The FCA are taking the view that the PRIIP definition encompasses:

- regulated collective investment schemes other than UCITS and so:
 - NURS;
 - Qualified Investor Schemes (QIS);
 - individually recognised overseas schemes, Section 272 recognised schemes;
- unregulated collective investment schemes that are alternative investment funds (which might be VCTs, private equity schemes, some unauthorised unit trusts) or that are not alternative investment funds;

- alternative investment funds that are not collective investment schemes (including shares/securities in investment trusts that are directly held by the investor);
- investment trust savings schemes that allow shares of securities investment trusts to be held in a managed account;
- EuSEFs and EuVECAs;
- insurance-based investment products – unit linked policies with profits policies and holiday/sickness policies;
- fluctuating return annuities that are not pension products that can result in fluctuating amounts being paid because of exposure to reference values (such as indices) or to the performance of one or more assets which are not directly purchased by the annuitant (e.g. purchased life annuities with variable returns);
- derivatives;
- structured investment products whatever their form (whether unregulated collective investment schemes, convertible securities, insurance policies or instruments issued by SPVs);
- structured deposits as defined in MiFID II Article 4(1)(43);
- securities issued by certain SPVs such as convertible bonds that convert from equity to debt securities.

The FCA stress that this list they have produced is neither definite nor complete – and indeed, as new products develop, further product types might be added to the list.

It might also be instructive to look at the list which the FCA have set out in their Consultation of products which they think are not likely to be caught as PRIIPs:

- non-life insurance/general insurance
 - non-life insurance products in Directive 2009/138/EC (the Solvency II Directive) – classes of non-life insurance are specifically excluded in PRIIPs Regulation Article 2 (2)(a);
 - life insurance that only pays benefits on death or incapacity due to injury, sickness or infirmity, i.e. no surrender value or one which does not depend on fluctuations in the performance of one or more underlying assets or reference values – this again is, in part, a specific exclusion under the PRIIPs Regulation (in relation to the former issue);
- deposits other than structured deposits as defined in MiFID II (again a specific exclusion);
- assets that are held directly by the retail investors such as corporate shares or sovereign bonds. The FCA take the view that, due to Recital 7 of the PRIIPs Regulation, this includes holding such assets in dematerialised form through nominee

accounts.

- pension products – excluded under Article 2(2)(e) of the PRIIPs Regulation;
- fixed annuities that are not pension products where the amount payable does not fluctuate;
- certain securities such as securities issued by Member States, their regional or local authorities, central banks, public international bodies, non-profit making bodies or credit institutions, subject to certain conditions.

What will a PRIIP KID look like?

Although the UK FCA are looking at smarter consumer communications etc, PRIIPs are still stuck in the short concise paper format.

A KID should be no more than three sides of A4 sized paper when printed. It can refer to a document such as a prospectus if the cross-reference is related to the information required to be included, or in certain circumstances referred to where detailed information can be found (see PRIIPs Regulation Article 6(2)(3)). The requirement is as follows:

"The key information document shall be a standalone document, clearly separate from marketing material. It shall not contain cross-references to marketing material. It may contain cross-references to other documents including a prospectus where applicable, and only where the cross-reference is related to the information required to be included in the key information document by this (PRIIPs) Regulation.

By way of derogation [from the above paragraph], where a PRIIPs offers the retail investor a range of options for investments, such that all information required by Article 8(3) with regard to each underlying investment option cannot be provided within a single concise standalone document, the key information document 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."

If colours are used, they must not diminish the comprehensibility of the information when a KID is printed or photocopied in black and white. Where a corporate branding or logo of the PRIIP manufacturer or the group to which it belongs is used, it should not distract the retail investor from information contained in a document or obscure the text.

The FCA refer to the possibility of transactions on mobile devices and subsequently printing documents on black and white printers and so they are considering this provision on the use of colours to be something which should apply to both PRIIPs and non-PRIIPs. FCA Guidance at COBS 4.5.2R(4) is proposed that it is to require firms to include information which does not disguise, diminish or

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obscure important items, statements or warnings to clarify how firms should use colours in their disclosure document. The Guidance is to state that firms should ensure that their disclosure documents use colours that can be printed or photocopied in black and white without diminishing comprehensibility.

Platform issues

The FCA currently allow the production of combined KFDs, simplified prospectuses or EEA simplified prospectuses when schemes are offered through a platform service so long as the combined document clearly describes the differences between the schemes. The FCA, in relation to PRIIPs, take the view that:

- the post contractual provision of a combined document is outside the scope of the PRIIPs Regulation;
- it would like to continue to allow (but not require) firms to provide information separate to the KID that combines information about several products offered at the same time, such as via a platform service, because they think this may help to improve an investor's understanding of the potential outcomes which are relevant to him.

Consequently, while standalone KIDs must be prepared and made available, firms can, post contractually, provide a document combining information about more than one PRIIP.

What will the PRIIP KID contain?

A PRIIPs KID must contain specified information presented in a certain order:

- An introductory explanatory statement under the title shall read:

"This document provides you with key information about this investment product. It is not marketing material. The information is required by law to help you understand the nature, risks, costs, potential gains and losses of this product and to help you compare it with other products."

The identity of the product and its manufacturer – with contact details and regulator, plus the date of the document should be stated.

- "What is this product?"
- What are the risks and what could I get in return?
- What happens if [the name of the product manufacturer] is unable to pay out?
- What are the costs?
- How long should I hold it and can I take my money out early?

- How can I complain?
- Other relevant information.

Chapter 1 of the proposed RTS document sets out further detail on the content and presentation of the key information document over and above that which is set out in the Regulation itself. These provisions inevitably start to differentiate between different types of products in order to deal with each product's particular features.

Obviously the RTS are designed to accompany the PRIIPs Regulation but it now seems that one possibility is that the Regulation will come into force at the end of December without the Technical Standards being in place. At the time of writing, a full plenary vote of the Parliament is awaited within September, for which see further comment below.

Who must produce a PRIIP KID?

The Regulation applies to persons who advise on or sell PRIIPs. The obligation to produce a PRIIP KID applies to a "packaged retail and insurance-based investment product manufacturer", or PRIIP manufacturer, which means:

- (a) any entity that manufactures PRIIPs,
- (b) 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.

A person selling a PRIIP means "a person offering or concluding a PRIIP contract with a retail investor".

UK UCITS schemes and EEA UCITS schemes are exempt until 31 December 2019 and should continue to prepare a UCITS KIID.

UK authorised firms with the obligation to produce a KID will therefore include:

- retail investment product providers;
- life companies;
- discretionary investment management firms;
- firms providing services in relation to insurance-based investments;
- fund managers;
- stockbrokers and other firms that provide advice to retail clients on funds, structured products and derivatives;
- financial advisers; and
- firms operating retail distribution platforms.

It can also apply to non-FCA authorised firms, for example offshore (non-UK) manufacturers of PRIIPs.

The PRIIPs Regulation is unclear as to its applicability! The FCA are taking the view that the PRIIPs Regulation does have application to those outside the EEA dealing with EEA retail clients. Conversely, where a manufacturer or distributor is in the EEA and targets only non-EEA retail clients, the FCA take the view that the PRIIPs Regulation does not apply and no KID needs to be prepared.

When should a PRIIP KID be provided?

The PRIIPs Regulation requires a PRIIP manufacturer to provide a KID for each PRIIP advised on, or sold to, retail investors. It should be provided in good time before a retail investor is bound by any contract or offer relating to the PRIIP so that the investor can make an informed investment decision based on the information in the KID. The FCA observe this [may] include sufficient time to compare KIDs for different PRIIPs as well as the time to read and understand each KID.

Under the draft RTS, the person advising on or selling a PRIIP must assess the time needed by each retail investor to consider the Key Information Document taking into account:

- the knowledge and experience of the retail investor with the PRIIP or with PRIIPs of a similar nature, or with risks similar to those arising from the PRIIP;
-
- the complexity of the PRIIP;
-
- where the advice or sale is at the initiative of the retail investor, the urgency explicitly expressed by the retail investor of concluding the proposed contract or offer.

What will be the review procedures for PRIIPs?

Under the draft RTS, PRIIPs manufacturers will be obliged to review the information in the Key Information Document every time there is a change that significantly affects, or is likely to significantly affect, the information contained in it, and at least every twelve months following the date of initial publication of the Key Information Document. The purpose of the review as one would expect is to verify whether the information in it is accurate, fair, clear and not misleading.

For this purpose, PRIIPs manufacturers must establish and maintain adequate processes, throughout the life of the PRIIP where it remains available to retail investors, to identify without undue delay any circumstances which might result in a change that affects, or is likely to affect, the accuracy, fairness or clarity of the information contained in the Key Information Document.

Should a review conclude that changes need to be made, the PRIIPs manufacturer must revise the Key Information Document "without undue delay" and publish a revised document on its

website.

Specific issues

Of course the UK has a long history of requiring disclosure documents and many existing COBS, COLL and FUND Rules might be affected. The FCA acknowledges that the PRIIPs KID will not be the only disclosure document that firms might need to consider and additional ones might be required. The FCA propose to amend COBS 13.1.1R, 13.1.3R and 14.2.1R so that these rules, in relation to providing a key features document and KFI for each packaged product, do not apply to packaged products that are PRIIPs where disclosure requirements will be superseded by the PRIIPs Regulation requirements to prepare a KID and no exemption applies – and so where an obligation will arise under the PRIIPs Regulation to prepare a KID. This will, for example, encompass investment trust savings schemes.

The FCA provide some useful indications in CP 16/18 for some specific circumstances:

- **UCITS ManCos**

UCITS management companies will be able to continue to produce the UCITS KIID as they have an exclusion from the PRIIPs Regulation for the initial five years.

- **NURS managers**

To allow NURS managers flexibility, until 31 December 2019, the FCA is proposing to allow authorised fund managers to produce either a KID or a document equivalent to a UCITS KIID – a NURS-KII document. Post the end of this year, the FCA expect either a NURS-KII document or a KIID to be prepared for each NURS, the existing modification by consent will cease to apply after 30 December 2016, and the rules introduced pursuant to CP 16/18 will replace it.

The FCA propose a transitional provision so that NURS-KII documents produced using the modification by consent can continue to be provided for a period up to 18 March 2017 (i.e. after the rules will apply) until managers have replaced them with updated versions following their next review.

Where a NURS-KII document is prepared, the FCA intend to continue to require NURS managers to follow the requirements of a UCITS KII Regulation allowing for necessary differences, so as to minimise disruption. A new COLL Rule, COLL 4.7.3A, is to set out the form and content of a NURS-KII document setting out where the wording in the KII Regulation applies in a different way to a KII-compliant NURS and how a NURS-KII document should reflect them.

- **Managers remuneration policy**

A UCITS KIID from 2017 under the UCITS Directive requires a disclosure statement about the manager's remuneration policy for directors and staff and signposting that the details

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of the up to date remuneration policy are available from a website. The FCA propose that a NURS-KII document should include a similar disclosure that investors can receive a copy of the manager's remuneration written policy on request, since AIFMD does not require website publication. A new COLL 4.7.2R(6b) rule is proposed.

- **Money market funds**

There will be a quirk for money market funds that are NURSs. A NURS KII document will still need to disclose a fund's status as a short term money market fund, money market fund or a qualifying money market fund.

- **Feeder NURS**

There is a concern about feeder NURS – which will be PRIIPs and for which a KID or NURS KII document will be required – regarding information being provided for the underlying master scheme. The FCA propose guidance setting out the FCA's expectation that relevant documents that disclose information about a qualifying master scheme's investment aims, risks and charges should be cross-referenced in the KID, or where there is a NURS KII document to comply with the adapted requirements for master/feeder disclosures in the UCITS Directive and UCITS KII Regulation.

- **AIFs and unregulated CIS**

For PRIIPs which are alternative investment funds (AIFs), the overlap with the AIFMD provisions relating to disclosure of specified information need to be addressed. This AIFM information can be included within the prospectus (which is unaffected by the PRIIPs Regulation) or in another disclosure document – see the proposed FCA Guidance at FUND 3.2.4BG.

For full scope UK AIFMs marketing unauthorised AIFs to retail clients, firms will not need to duplicate information already disclosed in the KID when meeting the FUND 3.2 AIFMD disclosures. Set out in FUND 3.2 – and new Guidance at COBS 18.5.10BG should make this clear.

The position is slightly different for small authorised UK AIFMs and residual CIS operators dealing with unauthorised fund documents for retail clients. The disclosure documents in COBS 18.5 apply. The FCA intend to amend COBS 18.5.5R and 18.5.10E to make it clear that such firms must still offer and, if requested, produce information for retail clients but that this is expected to supplement rather than duplicate the contents of a PRIIPs KID. Guidance is intended to be included at COBS 18.5.6AG.

- **Insurance-based investment products**

For insurance-based investment products, Solvency II has, from 1 January 2016, required specific information for each life policy and COBS 13.2.3 currently allows this information to be included in a KFD, KFI or any other document. This flexible approach in updated form will be retained so, in relation to

PRIIPs, if Solvency II information is required and not provided in the KID, then it can be provided in another document.

Interaction with MiFID

Finally, but not least, there is a need to consider the interaction with MiFID II. Whether it comes in as directly applicable or by way of equivalence basis, disclosure of costs and charges will need to be carefully considered.

MiFID II will require the disclosure by investment firms to all clients of information about costs in connection with investment services or financial instruments. This expands upon the MiFID I existing requirements of when disclosures of costs and charges should be made.

The PRIIPs Regulation requires the manufacturer to disclose costs associated with investment in the PRIIP, both direct and indirect costs.

A major issue for firms though is the need to provide information up and down the chain, not just for a particular product manufacturer to prepare a PRIIP in relation to its own product. This similar issue applies in respect of MiFID II compliance where MiFID investment firms will need to have reliable information about costs and charges from manufacturers – note the FCA observe that they expect Recital 78 of MiFID II to enable firms to be able to rely on the content (but not completeness) of the costs and charges information which are published in an approved prospectus, UCITS KIID or a PRIIPs KID, when preparing costs and charges information.

When will the RTS be finalised?

The European Supervisory Authorities (ESAs) submitted one RTS document combining Technical Standards for three purposes in respect of PRIIPs and the Commission duly issue a draft Delegated Regulation on 30 June. As soon as the RTS are finalised, we intend to publish a consolidated text document with the PRIIPs Regulation and integrated RTS text and make this available on our website.

The EU Parliament's Economic and Monetary Committee have however rejected the Commission's June draft and unanimously voted to send the proposals back to the European Commission for revision. As recorded in their 1 September press release, the RTS proposals are regarded as "misleading" and flawed proposals.

Whilst, due to the breadth of the scope of PRIIPs, some sort of compromise text was to be expected, questions are now being raised as to whether or not the draft RTS offers a workable compromise. Attention focuses on the new requirements to indicate how products might likely perform in the future based on three scenarios, unfavourable, moderate and favourable. Of course, from the UK perspective, there has always been some regulator scepticism about the benefit of including past performance at all in materials given to prospective investors, but

at least this was manager's specific data and did provide historic indications of the relevant product provider's ability to perform. A second key issue which will likely re-emerge, should the RTS debate be re-opened, will be the proposed approach for calculating and disclosing transaction costs.

It would seem unlikely that the PRIIPs Regulation should come into force without the RTS being finalised. This development may therefore potentially force the Commission to delay the implementation date.

The final answer on this will hopefully be forthcoming post the September Parliament vote on whether to send the RTS proposals back to the European Commission for revision. For the present, implementation plans should continue apace in the expectation of the implementation date remaining 31 December 2016.

If you require any assistance in formulating your PRIIPs implementation plans, please contact Kirstene Baillie, John Dooley or your normal contact at Fieldfisher for specific guidance.

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