THE INVESTMENT ASSOCIATION

Making disclosure meaningful again

Top line IA position

It is essential both for customer confidence and the flow of reliable information through the distribution chain that regulators, industry, and other stakeholders work together to ensure that a **new generation of digital disclosure frameworks deliver meaningful information**. As the front-line point-of-sale document that will be extended to cover retail investment funds directly alongside other retail investment, insurance and banking products, getting the PRIIP KID right must remain a central priority, both in the EU and in a post-Brexit UK.

In practical terms, there are four key elements that need to be addressed:

- **Information about product charges and transaction costs that answers the question "What am I paying?" in as simple and accessible a form as possible**. This means headline numbers and not complex approximations based on multiple assumptions. Critically, this information should be consistent in form and content with similar information being presented across the market under MiFID II.

- **Information about past performance, where it is available, which provides a product's delivery history**, a point generally shared by customer groups rightly concerned about the identification of poor delivery.

- **Risk indicators** that provide a realistic assessment of all the risks associated with the underlying asset classes and/or strategy, not metrics concerned only with price volatility.

- **Abandon the use complex performance scenarios for non-structured products** and find a different way to communicate with customers about the investment process.

To protect the interests of retail investors, retail investment funds should continue to be exempt from the requirements of PRIIPs until these issues have been properly addressed. There is also a significant wider relevance of this work for other investment-dependant products, notably DC pensions and retirement income strategies. In this respect, the IA is looking to work collaboratively with wider stakeholders on these critical issues.

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How did we get here and what happens next?

The Investment Association has always supported the objectives of the PRIIPs framework – to help retail investors understand and, where relevant, compare the investment products offered to them.

The positive regulatory intention did not result in a positive outcome. Coherence was lost in pursuit of a desire to make dissimilar products comparable. The current technical details underpinning the information in the framework serve to confuse and even mislead investors and make it impossible to compare even similar products. For example, the UCITS Directive recognises the fundamental differences between structured and non-structured products, resulting in implementing measures stipulating the use of illustrative performance scenarios for structured UCITS and past performance for non-structured UCITS. In contrast, the PRIIPs Regulation abandons past performance and extends performance scenarios to all types of product. High-profile interventions by stakeholders, including Professor John Kay and Better Finance, have helped illustrate that the original PRIIP KID is widely regarded as a failure. The problems are recognised and documented by both the UK and EU authorities.

Providers of insurance, banking, and listed investment products have been producing PRIIP Key Information Documents (KIDs) since the start of 2018 and are due to be joined by investment funds, which are currently exempt, at the start of 2022. The Commission's review of the level one legislation, that was to inform measures to facilitate the end of the exemption, is overdue and not expected for a few more years. Meanwhile, proposals for technical fixes by EU authorities, intended to enter into force during 2021 ahead of the end of the exemption, currently appear likely to be compromised in order to clear their path to full ratification – compromises that render the proposals ineffective.

Fixes implemented in the EU after the end the EU withdrawal transition period will not apply in the UK, and UK authorities have not yet made proposals to fix the UK PRIIPs framework. This presents an opportunity to refine the UK framework, deliver meaningful information to retail investors and put their interests firmly back at the heart of the project.

A principled and pragmatic IA approach

The common theme in our PRIIPs-related work to date has been an attempt to provide principled, pragmatic solutions to technical challenges that are inherently problematic. Our approach is guided by five core principles:

- The information provided to investors must be meaningful and the methodology should not produce results that are misleading to investors
- Comparability between products should not be more important than providing meaningful information to investors
- The approach taken should be pragmatic and as simple as possible to calculate (without producing misleading results) and as simple as possible to explain to investors
- Firms that have fewer resources or are less able to incur additional data costs should not be put at a disadvantage by the chosen methodology
- The benefit of the approach to investors must outweigh the costs incurred to deliver the new methodology as ultimately costs are borne by the end investor

Towards a solution

In the EU, the development of, and subsequent attempts to fix, the PRIIPs technical standards have been hampered by a one-size-fits-all approach ignoring the diversity of available products, rigid legal interpretations at odds with consumer testing findings, and a refusal to review or consider even minor revisions to the level one legislation. It appears that these shortcomings have led to a loss of sight of the core objective - to help retail investors understand and compare the range of investment products that meet their objectives in a meaningful way.

The UK now has an opportunity to refocus on the needs of investors as it maps out a path to fix the problems with the KID and facilitate an integrated approach across all product types for both retail and professional investors. There should be a proper review of the full legislative package with a focus on *inter alia* the following matters:

- The use of digital media, rather than paper, should become the norm
- Delivery of coherent data to intermediaries, compatible with their onward disclosure obligations under MiFID II
- An appropriately nuanced approach to communicating the risks and rewards of different types of product

Such a review should consider the various types of PRIIPs and the differences between them. It should consider the timing of the integration of the parallel PRIIPs and UCITS regimes to avoid repeated changes to the disclosure documents presented to investors. To achieve this the existing exemption of UCITS should be extended significantly and the UCITS KIID should be modified to the extent necessary, for example, to align with the cost disclosures required by MiFID II. **Only when the PRIIPs regime is widely accepted as fit-for-purpose should consideration be given to extending it to UCITS.**

In the detail

Several steps have been taken to address specific issues arising from the detailed technical specifications within the KID. From a UK perspective, we welcome the pragmatism shown by the FCA to date. The key issues have been documented by the FCA (FS19/1: PRIIPs Call for Input Feedback Statement) and include:

- **Forward-looking performance scenarios appear over-optimistic and pro-cyclical in nature.** The FCA recognises this problem and worked closely with the ESAs to find a fix last year. The ESAs have drafted technical solutions that appear to have provoked the Commission to ask for alternative solutions.
- **Costs and charges information is distorted by embedded assumptions and is not compatible with regulations applying to product distributors.** The FCA believes problems with transaction costs are due to poor application of the methodology by firms. The ESAs have consulted on proposals to revise aspects of the transaction cost calculations and the presentation of costs and charges information in the KID.
- **Summary risk indicators (SRI) significantly understate the risk associated with products investing in illiquid assets.** The FCA recognises the problem which is due to relying primarily on volatility with insufficient regard for all the risks that may apply. The ESAs have not proposed any amendments in respect of the SRI.

- **Uncertainty about scope is causing unintended consequences in some sectors**, especially corporate bonds, where there has been a reduction of new issuances in retail denominations. FCA supported calls by the ESAs for clarifications on the scope.

Going forward, we see a significant opportunity for regulators and industry to work together and take these changes further in order to create a better environment for front-line retail disclosure based on the principles and elements of a solution set out above.