# Final response to the ESAs' call for evidence on the PRIIP Regulation

THE INVESTMENT ASSOCIATION

## INTRODUCTION

**1. Please provide any general observations or comments that you would like to make on this call for evidence, including any relevant information on you/your organisation and why the topics covered by this call for evidence are relevant for you/your organisation.**

The Investment Association[1] (IA) and its members are highly supportive of the need to provide consistent, transparent, and meaningful information to help investors in their investment decision-making. In designing the frameworks for providing such information it is essential to recognise that EU households access – and will continue to access – financial products on a highly intermediated basis, particularly through banks and insurance companies. While there is no doubt that direct-to-customer distribution via mobile phones or other devices is the shape of the future, it is not the current reality.

The product disclosure landscape needs to be holistically reassessed with a more investor-focused approach rather than purely focusing on products and intermediaries. There are significant divergences between sectoral legislation (MiFID and IDD) and product disclosures under PRIIPs. In particular, the misalignment between the MiFID II and PRIIPs rules requires different cost figures to be produced, unnecessarily confusing retail investors. Moreover, the complexity and inappropriate reliance on assumptions inherent in the PRIIPs methodologies that underpin the presentation of performance and costs is unlikely to have improved investors' understanding of these products.

Standardised disclosure documents such as the PRIIP KID need to be consigned to history and replaced by smarter, digitally-adapted disclosures that can genuinely inform investors and help them make better decisions. Legislators need to shift the specification of the content and presentation of information into sectoral legislation and use product regulation to define technical methodologies to ensure the delivery of standardised data through the chain of intermediation. Where products are marketed direct to customers, product disclosures should read across from sectoral legislation to ensure consistency.

While the ambition behind the PRIIP KID was a positive one, its outcome appears far less so. The complexity and inappropriate reliance on assumptions inherent in the methodologies underpinning the presentation of performance and costs, designed to give the impression of comparability between dissimilar products, make it impossible to make meaningful comparisons between similar products. In the end, the information in the PRIIP KID has proved to have little value for intermediaries and alternative industry-led pan-European frameworks have become established to provide intermediaries of all types with the data they actually need.

We recommend the PRIIP Regulation should become a data standard and the review should focus on providing standardised performance, risk, and cost data that intermediaries can use to make investor-focused, digitally-adapted disclosures about their services and the products they offer, for

[1] The Investment Association champions UK investment management, a world-leading industry that helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 270 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage over €11 trillion for savers and institutions, such as pension schemes, insurance companies, and investment funds in the UK, Europe, and beyond. Of this total, €2.7 trillion is managed for EU investment funds that are due to transition to the PRIIPs regime at the end of 2022. More information can be viewed on our website.

which the design should be wholly within the realms of sectoral legislation. Any review should be guided by the following 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)
- 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

# CALL FOR EVIDENCE

## 4. Use of digital media

**18. Should changes be made to the PRIIPs Regulation so that the KID is better adapted to use on different types of media?**

Yes. Both customer expectations and the day-to-day experience of accessing information have transformed in the decade during which the PRIIP KID has been debated, with mobile devices increasingly becoming a default. The PRIIPs framework hinders the ability to offer digital solutions providing the most relevant information to investors in PRIIPs. The PRIIPs framework describes a rigid one-size-fits-all paper document, or durable image thereof, the maximum length of which is defined by reference to pieces of paper of a fixed size. It necessitates reliance on core assumptions when interactive digital solutions could allow investors to explore a range of personal circumstances. Effective digital solutions will rely on good quality, consistent core data uncompromised by assumptions.

By way of example, in respect of online cost calculator tools anticipated in the PRIIPs Regulation, recital 16 states that *"<u>in order that the calculators are as useful as possible to consumers</u>, they should cover the costs and fees charged by the various PRIIP manufacturers, <u>together with any further costs or fees charged by intermediaries or other parts of the investment chain</u> not already included by the PRIIP manufacturers."* This reflects the highly intermediated market for PRIIPs. Nevertheless, the cost information contained in the KID is based on assumptions about the size, time horizon, and future performance of an investment in a PRIIP that make it impossible to align with an individual investor's circumstances or to combine with the costs of intermediation.

In order to reflect the highly intermediated market for PRIIPs, the PRIIPs framework needs to complement the investor protection provisions of sectoral legislation (MiFID and IDD). These Directives require the intermediaries to disclose to their clients aggregated costs taking into account both their own costs and the costs of the products they sell (regardless of whether intermediaries' costs are extracted from product costs or levied directly on their clients). Therefore, the PRIIPs framework needs to provide consistent factual cost data to intermediaries in order to facilitate aggregation.

In order to provide the most coherent information to investors, product information specified under the PRIIPs framework needs to be a standard specification of data items that must be transmitted to intermediaries in order that they can fulfil their onward obligations to their clients most effectively. Rules concerning the format and layout of documentation should be stripped out of product regulation and specified instead, to the extent necessary, in sectoral legislation in a form fit for the digital era.

Achieving this requires a wholesale review of the PRIIP Regulation and the role it plays in the regulatory framework. Assumption-laden information should be stripped away to leave a reliable and consistent product data standard, and thereby providing a robust regulatory underpinning of the data required by intermediaries to fulfil their obligations under MiFID and IDD.

**19. Do you think it would be appropriate to apply the approach taken in the PEPP Regulation 2019/1238 (highlighted above) to the PRIIPs KID?**

Yes. Notwithstanding our view that the content and presentation of investor information should be the subject of sectoral legislation, we prefer the approach taken in the PEPP Regulation. In particular, the use of digital media, rather than paper, should be the norm.

Although it is too early to judge the impact of the PEPP approach in the market, IA consumer testing (2019) showed that the layering of information makes information more accessible and better suited to a digital format. In addition, inherent cognitive differences between individuals mean that investors should have the ability to select different presentations of core disclosure concepts (e.g. graphical or data table) provided these different visual presentations are all based on the same underlying data.

## 5. Scope of the PRIIPs Regulation

**26. Do you think that the concept of products being "made available to retail investors" (Article 5(1) of the PRIIPs Regulation) should be clarified, and if so, how?**

Yes. We think it would be helpful to clarify this concept in order to provide clarity on when it is, and is not, necessary to produce a PRIIP KID. It should be sufficient to regard a product as not being made available to retail investors when the marketing materials (including the prospectus) make it clear that it is being offered only to professional investors and is not intended for retail investors and the marketing and distribution strategy support this, and there is a minimum investment amount of €100,000.

## 6. Differentiation between different types of PRIIPs

**28. Do you think that the current degree of standardisation of the KID is detrimental to the proper understanding and comparison of certain types of PRIIPs? If so, which products are concerned?**

Yes. Although we support the ambition to create a single uniform disclosure document, the sheer diversity of types of PRIIP has led to the compromises necessary for such diverse products to produce the same disclosures making it impossible to compare products of the same type in a meaningful way.

Overall, the broad structure of the KID and the content of each section is satisfactory, but the KID has been derailed by an insistence that diverse products should be considered substitutable and hence must follow the same detailed methodologies. This has led to overly-complex, assumption-laden technical methodologies that do not fairly represent any of the different types of PRIIP. In effect, the best solution for each type of product has been discarded in favour of a sub-optimal solution for all products.

In our view, standardisation should go only as far as specifying the inclusion of appropriate information about the risks, rewards, and costs of a product with more emphasis being put on the need to “take into account the various types of PRIIPs, the differences between them and the capabilities of retail investors” in the development of the detailed technical methodologies underpinning the information presented. For example, past performance is widely accepted as the most appropriate performance information for UCITS, AIFs and IBIPs, but simulated performance is more appropriate for structured products. A risk indicator based on the volatility of historical price series is appropriate for vehicles investing in instruments that are actively traded in public markets, but is likely to misrepresent the risks associated with private investments and venture capital. Cost indicators expressed as reductions in yield are prone to underplay the significance or high entry costs in very long-term products, and the concepts underpinning an approach to calculating transaction costs that can give technically accurate negative costs that is incomprehensible to probably all retail investors.

**29. Do you think that greater differentiation based on the approaches highlighted above, is needed within the PRIIPs Regulation? If so what type of approach would you favour or do you have alternative suggestions?**

Yes. Political interventions have hampered the ESAs efforts to create meaningful differentiation between dissimilar products, and we applaud the ESAs tenacity in trying to find solutions. Nevertheless, these solutions are compromised by the constraints of level 1, and it would be helpful to establish some principles for grouping products. We note the ESAs have made progress in this area in the final advice submitted to the Commission in February 2021.

**30. Do you have suggestions for how a product grouping or product buckets could be defined?**

Product differentiation should be driven by characteristics such as being structured or non-structured, having a past performance record, the nature of the risks the investor assumes, and the purpose of the product.

More rigorous or legalistic groupings carry the risk of unintended consequences. For example, funds and listed investment trusts are generally substitutable and investors in each are often looking for similar investment risk profiles but with different exit terms. Funds are open-ended and redeemable through the fund manager, whilst investment trusts are closed-ended and traded on public markets. Past performance would be considered as the most appropriate performance information for both vehicles, yet investment trusts are excluded from Annex VIII of the ESAs February 2021 final advice because they are closed-ended AIFs.

## 7. Complexity and readability of the KID

**31. Would you suggest specific changes to Article 8 of the PRIIPs Regulation in order to improve the comprehensibility or readability of the KID?**

Yes. As set out in our answer to question 34, we recommend replacing “appropriate performance scenarios and the assumptions made to produce them” with “appropriate information on performance” in Article 8(3)(d)(iii).

Good quality cost disclosure has become compromised by over-regulation with both sectoral and product legislation trying to define what should be disclosed. We are hopeful the Commission’s work later in 2022, supported by the ESAs, will take steps to resolve this. In particular, we recommend shifting the specification of content and presentation of cost information into sectoral legislation and using product regulation to define technical methodologies to ensure standardisation. For example, PRIIPs should define how to calculate one-off, ongoing, transaction, and incidental costs and require their electronic transmission to intermediaries in percentage terms. MiFID should define how cost information is combined and presented to end investors and how intermediaries' costs should be separated from product costs, or aggregated with them, as the case may be.

To support this approach we recommend deleting "and, to ensure comparability, total aggregate costs expressed in monetary and percentage terms, to show the compound effects of the total costs on the investment" from the first paragraph of Article 8(3)(f) and "so as to enable the retail investor to understand the cumulative effect that these aggregate costs have on the return of the investment" from the second paragraph. This would keep the requirement to show costs by means of summary indicators, which should be simple, annual percentages for each of the main types of cost according to the driver, and to highlight that intermediaries may impose additional costs.

Finally, these changes should be accompanied by a new direction to the ESAs to develop draft regulatory technical standards specifying the presentation and content of this information, which should take into account the various types of PRIIPs and the differences between them.

**32. How could the structure, format or presentation of the KID be improved e.g. through the use of visual icons or dashboards?**

As set out in our answer to question 31, detailed specification of the structure, format, or presentation of information to retail investors should be the subject of sectoral information. Notwithstanding this view, we support the PEPP approach of electronic communication being the default position and support the layering approach to the presentation of information. The PRIIP regulation should focus on the technical methodologies for calculating the necessary data and ensuring it is made available to the parties that need it.

## 8. Performance scenarios and past performance

**33. Do you agree with the ESAs' assessment in the Final Report (JC 2020 66) regarding the treatment of past performance?**

Yes, we agree with the ESAs preferred approach of including past performance in the KID. We would prefer not to include scenarios at all as they are potentially misleading.

We have long-supported a form of past performance presentation in the KID, and we believe this should replicate the approach currently used in the UCITS KIID. Such an approach would provide a simple and familiar form of factual information to investors. This presentation, based on a series of discrete one-year periods, is effective at illustrating the volatility of returns that can arise.

In this regard, the position of the industry has been consistent since the advent of the UCITS KIID, which both included past performance and tested the views of consumers to justify that inclusion. Although the research[2] is now over a decade old, we have seen no evidence that invalidates its key findings which state that past performance was "*generally correctly interpreted*" and "*information that consumers expected to see*" which also led to a conclusion that "*its exclusion could reduce likelihood to engage with the document altogether*".

[2] UCITS Disclosure Testing Research Report Prepared for the European Commission by IFF Research and YouGov, June 2009, p.13 and p.89

Information about past performance should be included, 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. Abandon the use of complex performance scenarios for non-structured products and find a different way to communicate with customers about the investment process.

**34. Would you suggest changes to the requirement in Article 8(3)(d)(iii) of the PRIIPs Regulation concerning the information on potential future performance, and if so what would you specifically change in the Regulation?**

In Article 8(3)(d)(iii), we recommend replacing "appropriate performance scenarios and the assumptions made to produce them" with "appropriate information on performance". This change should be accompanied by a new direction to the ESAs to develop draft regulatory technical standards specifying the presentation and content of this information, which should take into account the various types of PRIIPs and the differences between them.

## 10. Alignment between the information on costs in the PRIIPs KID and other disclosures

**39. Taking into account the proposals in the ESAs' final draft RTS, do you consider that there are still other inconsistencies that need to be addressed regarding the information on costs in the KID and information disclosed according to other retail investor protection frameworks?**

Information about product charges and transaction costs should answer 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. In particular, the use of reductions in yield should not be used to present costs and charges information, prone as it is to mask the existence of one-off charges spread over long holding periods, and transaction costs should not be calculated using slippage, which relies on benign markets and random trading strategies to validate its inherent assumptions. Critically, this information should be consistent in form and content with similar information being presented across the market under MiFID.

To support this approach, and as set out in our answer to question 31, we recommend deleting "and, to ensure comparability, total aggregate costs expressed in monetary and percentage terms, to show the compound effects of the total costs on the investment" from the first paragraph of Article 8(3)(f) and "so as to enable the retail investor to understand the cumulative effect that these aggregate costs have on the return of the investment" from the second paragraph. This would keep the requirement to show costs by means of summary indicators, which should be simple, annual percentages for each of the main types of cost according to the driver, and to highlight that intermediaries may impose additional costs.