

PRIIPs: IF THE INFORMATION SHEET CONTAINS A COMPREHENSIBILITY WARNING, THERE IS SOMETHING WRONG WITH COMMUNICATION

The acronym may sound onomatopoeic and convey the appearance of speed – but in fact, the impending introduction of the “PRIIPs” for the investment and insurance industry is troubled in several places. The most vehement criticism is that the new basic information sheets for packaged investment products lack these characteristics which is why they are to be introduced: transparency, comparability and above all comprehensibility.

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PRIIPs – the abbreviation stands for “Ordinance on Basic Information Sheets for Packaged Investment Products for Retail Investors and Insurance Investment Products”. Primarily, PRIIPs are funds, insurance policies with one investment element (e.g. unit-linked life insurance policies), certificates, structured bonds, exchange-traded futures and options as well as derivatives not traded on an exchange (e.g. swaps). All manufacturers of such financial products will have to draw up a Basic Information Sheet (BIB) from January 2018, actually as early as 31 December of this year. The aim of the legislator is to use these BIBs to make the respective investment products comparable by means of uniform product information in order to improve investor protection and strengthen the confidence of small investors in the financial market.

In the so-called PRIIPs Ordinance, the legislature has laid down precise specifications as to what the PRIIPs should look like. Only the manufacturer may produce the BIB, but not the distributor. The distributor may also not insert any supplementary information into the BIB, such as additional risk information. Funds are currently subject to a transitional period for the PRIIPs-BIB until 31 December 2019; the existing Key Investor Information Document (KIID) may be used for this period.

So much for the theory. But it is precisely with the objectives of PRIIPs – to achieve greater transparency, comparability and comprehensibility in the financial market – that there are still issues concerning this. There are a number of reasons for that.

Financial industry in the dark for eight months despite extension

Both manufacturers and distributors of financial products find the EU Commission’s working methods very frustrating. It was decided in Brussels in November 2016 to postpone the launch of PRIIPs by one year, until 31 December 2017. However, the extension of the deadline has not been used to promptly answer the financial industry’s questions or to substantiate the generally formulated requirements in the ordinance.

For example, a Q&A was not released until July 2017. For most of the year, the industry was therefore dependent on implementing the requirements to the best of its knowledge and belief.

The scenario analysis (performance scenarios) required by the BIB is a major challenge for manufacturers. On the one hand, they regard the prohibition of past performance as critical, and on the other hand, the requirement to align the scenarios with a recommended holding period. If their funds are part of a life insurance policy (underlying investment option) and the insurer has decided to calculate the ratios in accordance with the new PRIIPs regulation, the fund houses must supply raw data to the insurance companies. This includes, for example, the data for calculating the SRI (Summary Risk Indicator, SRI), which the insurance company must disclose.

In addition, the regulation requires a so-called comprehension alert on the BIB if the PRIIPs product is “particularly difficult to understand”. However, there are no concrete specifications as to when exactly this alarm should be set. There is therefore a risk of inconsistent approach, which runs counter to the objective of better comparability. For funds, for example, the question arises: Should investment products with hedge funds with similar strategies receive such an alert?

Distribution must know the contents of three “product information papers”

The uncertainties on the manufacturer’s side also make it difficult for distributors to implement the regulation in their processes. In addition, the effort for the distributors increases: The PRIIPs-BIB must also be made available in a timely manner in the consulting-free sales department, i. e. before the investment decision or order is placed. At the same time, however, an order has to be executed quickly, which can become a conflict that needs to be resolved beyond the online channels (e.g. telephone orders).

Thus, there are now three “product information papers” with PRIIPs: the new BIB, until December 31, 2019 the Fund’s CIID and for all other products (equities, classic bonds) the PIB (product information sheet) in accordance with securities trading each with its own legal background, which also the advisors know, have to be distinguished and observed.

If necessary, the consultant must also observe additional information on the PRIIPs-BIB, e.g. in addition to the SRI index, a more detailed narrative explanation for risk disclosure. Under certain circumstances, additional risks may have to be explained, such as the following a currency risk that is not explicitly included in the SRI.

Heavy criticism from the European Fund Association EFAMA

The European fund association EFAMA has also criticised three subjects: the lack of performance in the past in the BIB, the method for calculating transaction costs and the lack of comparability of costs. And if one looks at the list of products that are in the focus of PRIIPs, one can certainly question the comparability purely on the basis of a BIB.

The target market description in the BIB (intended investor) is expected to coincide with the Markets in Financial Instruments Directive (MiFID II) and its target market. If you now take both together, a customer who does not correspond to the target market description should better not acquire the product, or a consultant must well justify a recommendation for such a product. In order to be on the safe side, many consultants are hesitating to recommend the product at all. The customer must understand this without feeling patronized.

35 pages, 72 questions – but not a single one concerning the linguistic comprehensibility

It is highly doubtful whether the BIB will be able to achieve the goal of better comprehensibility. A catalogue of questions and answers presented by the three European financial supervisory authorities ESMA, EBA and EIOPA in July 2017 is 35 pages long and contains 72 questions – but not a single one deals with the linguistic comprehensibility of the BIB.

Is it even possible to expect a three-page information sheet with the prescribed „technical regulatory standards“ to provide investors with sufficient and comprehensible information on the characteristics, risks and differences between one financial product and the other in an investor-friendly manner? A comprehension alert leads such an undertaking completely ad absurdum.

The introduction of PRIIPs thus once again reveals a profound communication problem between fund companies and their clients: the demand of investors for more risk-adjusted returns and diversification is already colliding with ever more innovative but hardly comprehensible products. Therefore, it is above all necessary to demystify the terminology of the financial industry. Fund managers must learn to compress and impart their technical knowledge. Combining the overload of regulations with sophisticated product design and an increasing proliferation of investment opportunities, it is evident that fund companies are getting pressurized to communicate with their investors in a more effective way.

There is still time to improve the transparency and comprehensibility of the information sheets.

It would be a shame if the abbreviation PRIIP would only stand for Probably Really Irritating Investment Paperwork in the end.