

# Changes to PRIIPs regulatory framework: helping or hindering retail investors to better understand products?

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## Introduction

In 2014, following an increase in the offering of packaged retail and insurance-based investment products (PRIIPs) to retail investors, EU Regulation 1286/2014 was issued, governing information in connection with the sale of or advice on PRIIPs to retail investors.<sup>(1)</sup> Regulation 1286/2014 was followed by EU Commission Delegated Regulation 2017/653 in 2017, which sought to clarify and specify Regulation 1286/2014's general rules.<sup>(2)</sup>

According to Regulation 1286/2014, the wide variety of options and the complexity of the PRIIPs being offered to retail investors led to some parties making investments without fully understanding the associated risks and costs, which sometimes caused unforeseen losses. Thus, also in accordance with Regulation 1286/2014, the European Union determined that there was a need to regulate information requirements in connection with the sale of or advice on PRIIPs to retail investors to help them better understand their investment.

In late 2019 the European supervisory authorities released a joint consultation paper on proposed amendments to Delegated Regulation 2017/653, following a review of the matter. Insurance Europe and Insurance Sweden both submitted generally negative responses to the consultation paper. This article examines the proposed changes and the potential impact on the Swedish insurance market.

## PRIIPs regulatory regime

A 'packaged retail investment product' ('PRIP') is defined under Article 4 of Regulation 1286/2014 as an investment where the amount repayable to a retail investor is subject to fluctuations due to exposure to reference values or the performance of one or more assets which are not directly purchased by said investor. In addition, Article 4 defines an 'insurance-based investment product' as an insurance product where the maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations. Consequently, a PRIIP is a product that is either a PRIP, an insurance-based investment product or both.

Pursuant to Article 5 of Regulation 1286/2014, PRIIPs manufacturers must draw up a key information document (KID) on products before they are made available to retail investors. The form and content of KIDs are specified in Articles 6 to 12 of Regulation 1286/2014, which state that KIDs must be (among other things) accurate, fair, clear, not misleading and clearly separated from a PRIIP's marketing material. In addition, KIDs must be provided to customers in a durable medium, in an official language and with the document structure and headlines as set out in Regulation 1286/2014.

An important and complex area of the PRIIPs regulatory framework, which is addressed in Articles 10 to 14 of Delegated Regulation 2017/653, concerns the use of KIDs in relation to PRIIPs with a range of options for investment (so-called 'multi-option products' ('MOPs')). Delegated Regulation 2017/653 provides two different options for PRIIPs manufacturers in case the underlying investment options in a MOP cannot be provided within a single and concise KID. Manufacturers may either provide:

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- one KID for each underlying investment option; or
- a generic KID covering the types of investment option offered, and separate information on each underlying investment option.

### **Proposed changes to Delegated Regulation 2017/653**

In February 2019 the European supervisory authorities released their final report on the potential changes to Delegated Regulation 2017/653. The report stated that MOPs were a priority area for the coming review and that there are "challenges for retail investors to understand the interaction between the 'generic kid' and the 'specific information' for the underlying investment option". Similarly, the European supervisory authorities argued that the challenges also extend to situations where retail investors attempt to compare different MOPs. Therefore, the European supervisory authorities concluded that a general examination of Delegated Regulation 2017/653's rules relating to MOPs were needed to determine whether the rules were helping retail investors to better understand their investment options.

The European supervisory authorities' subsequent review and analysis, presented in the consultation paper, generally states that the application of the rules on MOPs in practice provides some "significant challenges regarding the clarity and usefulness of the information currently provided". This is said to be due to two main issues:

- First, the European supervisory authorities argue that it is difficult for retail investors to identify the total costs relating to a particular investment option due to generic KIDs showing only a range of possible costs, which make it unclear for retail investors what costs would arise from specific investment options.
- Second, many MOPs allow investors to allocate their premiums between different underlying investment options. Information on such a combination of options is neither explicitly required by Delegated Regulation 2017/653, nor usually provided within KID documentation in practice.

According to the European supervisory authorities, the optimal solution would be for PRIIP manufacturers to include total costs in each option-specific information. However, it is recognised that such a measure would not be proportionate due to the significant practical challenges that would arise for PRIIP manufacturers. Instead, a new approach is suggested in the consultation paper where PRIIP manufacturers would be required to provide more complete information on the most relevant options or combination of options, with a minimum of four. In addition, there are several proposed changes to the current approach. For example, it is proposed that the specific information document (SID), produced for each investment option, would be required to contain a reference to the PRIIPs through which the investment option is available. Further, it is suggested that a statement be included in SIDs, indicating whether the presented costs include all of the costs of the PRIIP should the retail investors invest only in that investment option.

### **Response to consultation paper**

As noted above, Insurance Europe voiced serious concerns about the proposals in the consultation paper. While generally agreeing with Insurance Europe's concerns, Insurance Sweden submitted its own primarily negative response, focusing specifically on the proposed changes relating to MOPs. Insurance Sweden presented several arguments on why the proposed changes would negatively affect the Swedish insurance market. Insurance Sweden argued that most PRIIPs offered in Sweden are MOPs, with a wide variety of underlying investment options. To fulfil the current requirements of Delegated Regulation 2017/653, PRIIP manufacturers must rely on drawing up a generic KID and that each of the underlying investment options produces a SID for their specific option. With this system, PRIIPs manufacturers can include a wide variety of underlying investment options for retail investors, while only being required to draw up a generic KID.

However, the proposed changes would require SIDs to have specific references to the PRIIP in which they are included. According to Insurance Sweden, this would significantly hamper the efforts to include a wide variety of underlying investment options in their PRIIPs. Further, while the proposed changes would result in significant practical challenges, they will not help retail investors to better understand their potential investment. On the contrary, Insurance Sweden has argued that the amount of information would be excessive and clutter the KID. This would consequently undermine the effort set out in Regulation 1286/2014 to present a clear and concise KID that is easy to understand.

Finally, Insurance Sweden has argued that the proposed changes of Delegated Regulation 2017/653 would conflict with the wording of Regulation 1286/2014. Pursuant to Article 6(3) of Regulation 1286/2014, PRIIPs must contain a reference (generic or specific) to the underlying investment options but not the other way around. Therefore, Insurance Sweden has argued that it would go against the regulation to include a demand for the SID to contain references to specific PRIIP KIDs.

## Comment

It appears that the proposed changes to Delegated Regulation 2017/653 would entail higher costs and practical challenges for Swedish PRIIPs manufacturers. Reasonably, this would affect the range of underlying investment options offered in a PRIIP. However, with multiple underlying investment options and a generic PRIIP showing only a range of costs, it may be hard for retail investors to fully understand what the different underlying choices would entail. As mentioned by the European supervisory authorities, this is also true when retail investors allocate the investment between different underlying options.

The legislative challenge would be to find a balance between allowing PRIIPs manufacturers to offer a wide array of investment options and to give retail investors the best possible chance to understand their investment. If the implication of the suggested changes would fail to foster a better understanding among retail investors, then it would be difficult to accept the challenges that the proposed changes would bring. The potential gain for retail investors must therefore be adequately supported through thorough assessment and consumer testing to clearly show the benefits that legislative change will bring to help retail investors better understand their potential investments. With the review of Regulation 1286/2014 and Delegated Regulation 2017/653 being in a relatively early stage, further developments on suggested changes to the PRIIP regulatory framework are to be expected in the near future.

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## Endnotes

- (1) EU Regulation 1286/2014 on key information documents for PRIIPs.
- (2) EU Commission Delegated Regulation 2017/653 supplementing EU Regulation 1286/2014 on key information documents for PRIIPs by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents.

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