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Insight Briefing

Draft PRIIPs rules will mislead consumers

Mistakes in Regulatory Technical Standards must be urgently corrected

The aim of the EU Regulation to create key information documents (KID) for packaged retail and insurance-based investment products (PRIIPs) is to provide consumers with a clear understanding of different investment products.

This is intended help them to make better buying decisions, which is an objective that Insurance Europe strongly supports.

However, now that the European Supervisory Authorities' (ESAs) final draft Regulatory Technical Standards (RTS) for the regulation have been made public, it is obvious that a rushed compromise to meet the Regulation's deadlines has led to significant design faults.

If these faults are not corrected immediately, the draft KID would mislead consumers when comparing PRIIPs.

How will consumers be misled?

In particular, the draft KID would misrepresent two important aspects of insurance-based investment products: how much they cost and the risk they pose to consumers.

Regarding cost, insurance-based investment products provide insurance protection to investors that other investments products do not include.

However, because the draft KID would not explain this properly it makes insurance-based investment products seem more expensive than other products, without explaining that the other products do not include this additional protection.

In-depth analysis: cost
The regulation states that the KID should clearly show costs "associated with an investment in the PRIIP". Yet the final draft RTS include the cost element of the biometric risk premium — which is not an investment cost, since it relates to insurance cover — in the investment cost section of the KID. The only way to ensure that consumers can compare PRIIPs in a meaningful way is to disclose the biometric risk premium for insurance cover in a separate section of the KID.

In terms of risk, the PRIIPs Regulation requires one indicator that consumers can easily understand. However, the methodologies which have now been used to derive this indicator for the KID are not fit for purpose and as a consequence could overstate the risk of insurance-based investment products.

Finally, according to the PRIIPs Regulation, the KID should be no more than three pages long. Given the amount of information that the final draft RTS would require to be included, this is now highly unlikely, particularly when translated into less concise languages.

Rushed to meet unrealistic deadline

All of these issues are at least partially due to the unrealistic implementation timeline.

It must be noted that the stakeholder consultation process was also flawed, as crucial elements of the final draft RTS are new

In-depth analysis: risk

According to the regulation, only risks "materially relevant to the PRIIP" should be presented in the KID. Market risk is the only truly relevant risk for insurance-based investment products. Yet the proposed risk indicator aggregates market risk and credit risk. However, because most insurers do not have a credit rating, they could be automatically allocated to credit-risk class 3, regardless of the fact that insurers are well regulated by the robust new Solvency II regime.

In addition, the provisions that could allow for a better credit-risk class allocation for insurance-based investment products are poorly worded and may therefore be ineffective. This could result in insurers being given a high risk indicator for no justifiable reason. Any insurance-based investment product manufactured by an insurer subject to the Solvency II regime should automatically be classified in the credit-risk class 1.

(such as the configuration of performance scenarios) and were therefore not put out for public consultation.

Under the existing timetable, the RTS, which were published late by EIOPA on 7 April 2016, would now need to be adopted and translated by the Commission and then presented to the European Parliament and Council, which can take up to three months to accept them. This would mean that the final RTS would only be available in the autumn, yet companies are supposed to have drafted, tested and introduced KIDs for all PRIIPs by 1 January 2017.

However, the insurance industry needs sufficient time to program, test and launch the KID correctly, so that it delivers its objectives and allows consumers to better compare and understand these products. Therefore, the (at best) three to four months allocated for them to do this is totally unrealistic.

So what next?

Insurance Europe understands that the European Insurance and Occupational Pensions Authority (EIOPA) plans to "correct" any shortcomings of the RTS through a level 3 initiative, in the form of a Joint ESAs Committee Questions & Answers (Q&A).

However, level 3 is only meant to further explain and refine level 2, not correct it. In addition, Q&A sections on the ESAs website do not generally have legal value, but because of this process, would de facto be given legal value, despite not being put out for public consultation.

Therefore, in Insurance Europe's view, the issues raised should have been and indeed can still be addressed in the RTS.

It is now up to the Commission to take the appropriate steps to ensure that the original PRIIPS objectives are actually delivered.

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Unrealistic implementation timeline