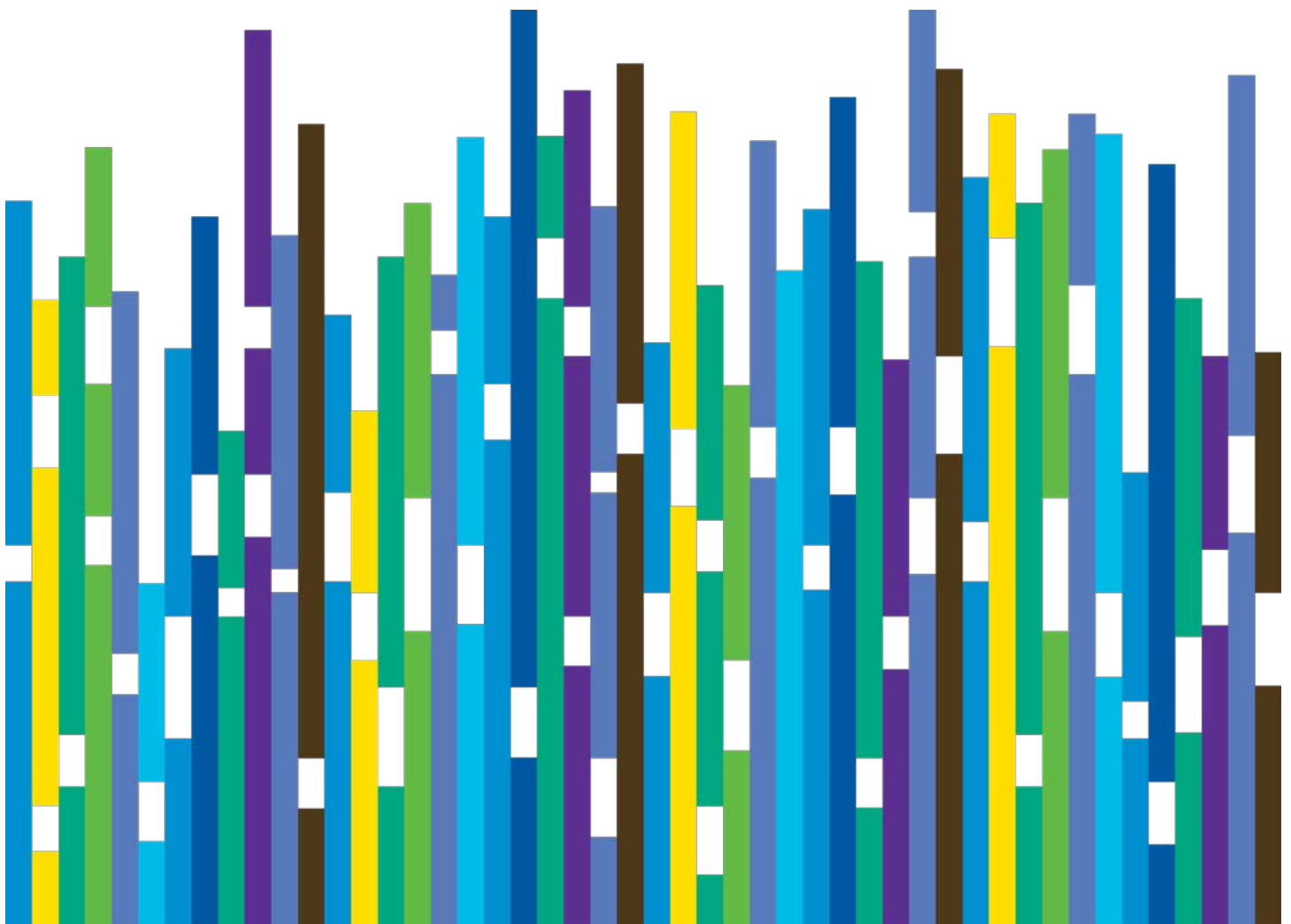


ISSUE BRIEF: PACKAGED RETAIL INVESTMENT PRODUCTS

Investor Disclosure Considerations for a Key Information Document



PACKAGED RETAIL INVESTMENT PRODUCTS

Investor Disclosure Considerations for a Key Information Document

Packaged retail investment products (PRIPs) are products that contain an element of packaging or wrapping that is applied to an underlying investment opportunity, including shares, bonds, and other assets. These products enable retail investors to gain exposure to securities markets and financial instruments that might otherwise be prohibitively difficult or inefficient to access. Accordingly, PRIPs enable retail investors to allocate their savings in a more efficient manner.

However, concerns have been raised by investment professionals about sales practices associated with investment products. In the [2013 CFA Institute¹ Global Market Sentiment Survey](#), members in Europe, Middle East, and Africa (EMEA) most frequently identified mis-selling of products by financial advisers as their top ethical concern.

The problem of mis-selling is exacerbated by poor disclosures. Currently, the disclosures provided to investors in PRIPs are often complex, lengthy, and incomparable; moreover, disclosure practices and regulations are divergent within the European Union (EU). Consequently, product transparency is deficient.

The EU's [draft regulation](#) on PRIPs addresses product disclosures through proposals for a key information document (KID). The KID is designed to provide concise and standardised information on the key characteristics of different products to facilitate consumer comprehension and comparability.

A particular challenge of the KID proposals is to determine the relevant fees and costs to be disclosed for different types of PRIPs. Costs are a key determinant of the net return an investor will receive on his or her investment. Among many retail investors, however, the effect of costs on investment returns is not well understood. Consequently, fees and costs are often overlooked or are not given sufficient weight in the investment decision-making process.

Transparency over costs is essential to facilitate the purchase of suitable products by investors and to achieve an efficient allocation of savings.

In the CFA Institute report [Packaged Retail Investment Products: Investor Disclosure Considerations for a Key Information Document](#), the various fees and costs associated with the most common types of PRIPs are examined, including retail investment funds, insurance products with an investment component, and structured products. Policy considerations for the PRIPs KID are addressed on the basis of the findings.

The objective of this research is to inform the EU policy debate and regulatory developments from the perspective of investors, with the goal of improving transparency and investors' protection.

¹CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behaviour in investment markets and a respected source of knowledge in the global financial community. The end goal is to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 117,000 members in 139 countries and territories, including almost 110,000 Chartered Financial Analyst® charterholders, and 138 member societies. CFA Institute promotes fair, open, and transparent capital markets and advocates for investors' protection.

Summary of Findings

Investment Funds

In the EU, the majority of funds sold to retail investors are qualified as Undertakings for Collective Investment in Transferable Securities (UCITS). Recent UCITS legislation regulates the provision and disclosure of key investor information through the UCITS KIID (key investor information document), applicable since July 2012. Under the charges section of the KIID, the following costs must be presented:

- Entry and exit charges
- Ongoing charges
- Performance fee (if applicable)

Insurance Products with an Investment Component

Currently, there is no single pre-contractual information document in the EU that summarises key information on insurance products. Various national initiatives have been developed that provide for different types of product disclosures. Examples include Belgium's financial info sheet, the Netherlands' financial information leaflet, the United Kingdom's key features document or illustration (which includes a tabular presentation of the effect of charges over certain time horizons), and Portugal's KIID for complex financial products (including life insurance products).

Structured Products

The costs and charges associated with structured products are typically embedded in the price of the product and derive from the combination of assets used to structure the issue, particularly the derivatives held within the structure. Because the pricing of these instruments is complex, it is difficult for retail investors to ascertain the specific cost components or to compare costs among products. National rules and disclosures regarding pre-contractual information on structured products vary widely.

Summary Policy Considerations

Based on the findings in the report *Packaged Retail Investment Products: Investor Disclosure Considerations for a Key Information Document*, we recommend the following policy considerations for the development of the PRIPs KID.

Scope

1. The initial scope of the PRIPs regime should be packaged products that provide for exposure to the performance of an underlying investment portfolio or other assets. Ultimately, the packaging provides the conduit for the investment exposure, and it is this packaging that determines the primary costs and other key features of the product. If, after review, the initial PRIPs KID is successful with consumers, the scope could be extended beyond packaged products.

Format

2. The PRIPs KID could use the UCITS KIID (given its recent introduction) as the baseline for developing the content of disclosures. The UCITS KIID disclosures could be tested against different types of PRIPs to determine how well the baseline disclosures fit the product concerned. Appropriate amendments could then be made to the disclosure content based on product testing.
3. To allow flexibility, consideration should be given to setting a maximum length for the KID document, rather than a fixed number of pages. This approach would allow those products that require additional detail to be adequately disclosed, rather than left out or reduced to insufficient disclosures.

The number of pages should, of course, be few (for example, a maximum of three pages) to maintain a concise presentation.

Costs

4. Costs should be disclosed under a standard label and location within the KID, but the content of cost disclosures could embody a small degree of flexibility beyond common components. Common components could include:
 - Entry fees (including any subscription, acquisition, or initial transaction fees)
 - Exit fees (including any redemption, reimbursement, or sale fees)
 - Ongoing charges
 - Performance fees
 - Transfer fees, buying or selling charges, and any penalties, where applicable
 - Any other administrative charges
5. Cost disclosures should include a statement specifying the total amount in percentage terms that the product manufacturer or sponsor receives from distribution arrangements (inducements), if any.
6. For life insurance products, a tabular presentation that illustrates the effect of costs in standardised monetary terms over predefined time horizons should also be provided. Given space constraints in the PRIIPs KID, at a minimum, this type of disclosure should be signposted to a website containing the relevant information.
7. Cost disclosures for structured products should include a narrative explanation of the total costs included in the amount paid for the product. For example, a sentence might explain that the issuance price includes an issuer concession or markup of x%, or that the amount invested in the underlying assets or instruments is reduced by an equivalent amount of the explicit cost.
8. Structured product disclosures should include standardised numeric details of any fees and costs associated with buying or selling the security during the life of the product, as well as any early redemption or termination charges.

Risks

9. The risk of the product, as reflected by the summary risk indicator, should incorporate its volatility. If volatility calculations (such as the standard deviation of returns) are not possible, either owing to the type of product or a lack of historical data, the KID should at least provide for adequate narrative disclosures of risk. Such disclosures should include an explanation of the risk associated with the product's benchmark or the index or asset(s) it references or is linked to.
10. In the case of products with set maturities and predefined payoffs (such as structured products), risk should be measured with regard to the variability or range of possible outcomes at maturity, with appropriate disclosure of how this risk may vary during the life of the product (and hence, the risk associated with early redemption or exit from the product).
11. Narrative disclosures should also include (among other things) details of significant risks arising from the investment strategy of the product, details of any national financial compensation scheme protecting investors in the event of default or failure of the product manufacturer, and details of the creditworthiness of the issuer where appropriate.

Performance

12. Past performance data should be presented in an analogous manner to the UCITS KIID — namely, in the form of a bar chart that shows yearly net performance in percentage terms alongside relevant narrative disclosures. These narrative disclosures should include (but would not be limited to) the basis of the return calculation, such as the measurement period; the treatment of any income arising over the period; and the fees and costs that the return is net of. Specifically, return data should take into account ongoing charges and transaction costs.
13. Past performance information should be limited to those products that have sufficient actual performance history. Proxy performance data, or simulated performance data, should not be used instead of, or linked to, actual performance history.
14. For structured or guaranteed products and funds, a tabular presentation of performance scenarios would be appropriate in place of past performance data (located under a different section of the KID). To facilitate comparability, the number and type of scenarios for structured funds and products should be prescriptive and uniform in the KID.