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Ladies and Gentlemen

### **PRIIPS Regulation – significant uncertainties**

We are strongly in favour of the policy direction which motivated the Packaged Retail and Insurance-based Investment Products Regulation<sup>1</sup> (the "Regulation"). We agree that, as set out in the recent Commission green paper on retail financial services<sup>2</sup>, the integration of the EU retail product market will produce "choice, transparency and competition in retail financial services to the benefit of European consumers". A single, harmonised EU-wide Key Information Document (KID) is an important step towards the development of this market, and it clearly supports the objective to give retail investors clear and accurate information on the range of PRIIPs and the ability to compare them for suitability and value without being misleading.

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<sup>1</sup> 1286/2014

<sup>2</sup> COM(2015) 630

However, there are still four very significant issues relating to the scope of the PRIIPs regulation which remain unclear, and this lack of clarity could produce serious detriment to EU producers and consumers of PRIIPs. To some extent these are issues which have become clear as the thinking of policymakers as to the development of KIDs has developed. Moreover, they are all issues which arise from the form of the regulation itself, and as such cannot be resolved within the scope of ESMA's existing mandates under the regulation. We are writing this letter to request that these issues be resolved through the issue of guidance, by the commission and ESMA, as to the construction of certain specific terms of the regulation.

## **1. Scope**

The most important of these is the question of which products the regime applies to. PRIIPs is expressed to apply to "investments", but this is not a term with an established EU law meaning. It seems clear that the primary intended meaning of the term "investments" in this context is products which an investor purchases for the sole purpose of obtaining a return on the amount invested – that is, a term investment product in which investment is made at the beginning of an investment period, a return is paid at the end of that period, and a return is calculated by reference to a formula. It is also clear that the definition is intended to be based on functional rather than legal characteristics. This interpretation is supported by Recital 1, the definition of PRIIP in Art 4(1) of the Regulation and the European Commission's Memo (14/299) that indicates that "PRIIPs are the investment products retail investors would typically be offered by their bank when they want to make an investment, e.g. to save for a target amount of money such as buying a house or paying for their children's education".

The PRIIPs Regulation applies to sales of products to a wide variety of commercial entities - municipalities, local authorities and many commercial companies<sup>3</sup>. These entities have a positive requirement for risk management or hedging products, as well as for foreign exchange forwards and derivatives. Risk management and hedging products do not fall within the intended meaning of the definition of 'investment' as reflected by the prescriptive requirements of what a KID needs to include for example a 'risk reward profile' which does not lend itself to these products which are created and sold for non-investment purposes.

The use of KIDs for such products is likely to be completely uninformative, since these products are not purchased as investments, but as risk management tools. Consequently we believe that the imposition of a KID requirement on such products does not support the objective of the information provided to retail investors being accurate, clear and allowing for any meaningful comparability to other products created and purchased for different purposes.

There are three ways in which this problem might be addressed. One would be to confirm that products which do not have an investment purpose are not "investments" as the term is used within the Regulation, and therefore do not require a KID to be prepared. Another might be to provide that, where a product is sold for risk management rather than investment purposes, a pro-forma KID making that fact clear would be required. Such a KID would omit the risk information required for a normal KID, and would simply state that the product concerned should not be regarded as an investment in the normal sense. It is also possible that there may be other available policy options. However, if something is not done to address this issue, the consequence may be to prevent the financial services system from providing essential risk management products to those who require them. An alternative approach for risk management and hedging products would be to provide a separate industry standardised document that would administer the same benefits derived from a KID for the Retail Investor such as transparency and comparability. This document could offer an appropriateness test providing price transparency partnered with a scenario analysis that is relevant

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<sup>3</sup> All of these are, or are capable of being, non-professional clients within the meaning of Annex II to MiFID.

and appropriate to risk management and hedging products to assist the retail investor to understand breakages. This approach would provide clear and fair information to the retail investor and would allow comparability across the product range whilst clearly differentiating from products with the purpose of investment rather than of risk mitigation.

## **2. Territoriality**

The PRIIPs requirements as currently drafted apply whenever a PRIIP is sold by an EEA entity to a person who does not fall within the definition of "professional investor" set out in MiFID. The Regulation is silent in the case of where the non-professional investor resides outside of the EU. Accordingly if, for example, a Chinese distributor offers a Chinese retail investor in China a product issued by an EEA entity, it is unclear whether the EEA issuer is thereupon required to create and publish a KID. Given that the legislation is silent and in light of the experience of differing EU regulators in other areas to date, we think it likely that competent authorities will take different views on this issue: therefore, EEA manufacturers in one jurisdiction may be obliged to produce KIDs for non-EEA investors; whereas in other jurisdictions they may not.

We assume that the intention, and the correct position should be, that the KID should not apply outside of the EEA. Otherwise, the above scenario would effectively require the EEA issuer to disregard the rules which apply in the retail investor's domestic market. It is also possible that such publication could constitute a direct breach of the rules applicable in the retail investor's home market. This is particularly problematic where the product concerned is manufactured by a non-EEA branch of an EEA institution for the purposes of being sold in the domestic market of that branch.

Given that the aim of the PRIIPs regulation is to create a common standard for products within the EU, we feel that it is vital that guidance be given that the PRIIPs requirements apply only where the retail investor concerned is in the EEA.

If this is not the case, then detailed thought (including further consultation) may be necessary to consider how the requirements of the proposed RTS should be addressed where they overlap with other competing requirements in the domestic market of the customer concerned.

## **3. Secondary Trading Issues and Grandfathering**

PRIIPs traded in the secondary market should not automatically be regarded as being 'made available to retail investors'. We do not think that trading in a secondary market is actually a relevant criterion for determining whether or not a PRIIP is 'made available'. Some PRIIPs which are not traded on a market (such as a unit linked insurance policy) can be 'made available' by insurers actively marketing them throughout the life of the product. We are of the view that 'made available' should be interpreted within its literal meaning, i.e. somebody actively 'makes a product available for sale' by allowing retail investor to purchase it after a (usually closed) initial offering period.

If the view were taken that secondary market availability, regardless of whether the PRIIPs has been 'made available for sale', triggered a requirement to prepare or update a KID, this could strongly disincentivise the development of such markets, thereby depriving investors of a positive liquidity benefit. Even as regards PRIIPS, originators of PRIIPs could eliminate this risk by ceasing to offer liquidity in their products through markets, but this would be an active detriment to investors for no benefit to anyone.

This issue is wrapped up with the issue of the treatment of existing products (i.e. products which have been offered prior to the commencement date of the Regulation, and are traded in the secondary market). If secondary market trading triggers a requirement for a KID to be updated, manufacturers

will be required to create KIDs for all of the products which they offered prior to PRIIPs commencement date, which they simply would not be able to do due to the impossibility to source accurate historical data (for instance data about costs or past performance). Hence we would recommend that no KID should be required for a product where information cannot be accurately sourced on a retrospective basis, on the condition that the manufacturer commits not to make these existing products available to investors. It seems clear that the mere fact that a product was created before the commencement date of the Regulation is not necessarily determinative of this point – the application of the requirement should be triggered by when ‘availability is made for sale’ (such as a sale, or active marketing), not when the product was created.

It would therefore be helpful to provide guidance that the mere fact that a two-way secondary market exists in respect of an existing product does not constitute "making a product available" to retail investors, irrespective of the initial offering date being prior to or following the commencement date of the regulation.

#### **4. Gold-plating**

Finally, we understand that a number of national authorities are contemplating "gold-plating" KID requirements by mandating specific content into the KID in their jurisdictions. National authorities are of course free to impose retail customer protection measures in their jurisdictions which go beyond EU minima. However, we believe that both the Commission and ESMA should take a strong line against measures which directly affect the form of the KID itself. It is an essential element of the creation of a single EU retail product market that the core customer information document should be the same across the EU.

Yours faithfully,



Mr. Alderman Timothy R. Hailes, JP

**Timothy R Hailes**  
**Chairman, Joint Associations Committee**