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Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

amending Regulation (EU) No 1286/2014 as regards the extension of the transitional arrangement for management companies, investment companies and persons advising on, or selling, units of undertakings for collective investment in transferable securities (UCITS) and non-UCITS

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

Reasons for and objectives of the proposal

Regulation (EU) No 1286/2014[1] enables retail investors to better understand and compare packaged retail and insurance-based investment products (PRIIPs) and make better-informed investment decisions. PRIIPs include, but are not limited to, undertakings for collective investment in transferable securities (UCITS) and retail alternative investment funds (AIFs).

To meet its objectives, Regulation (EU) No 1286/2014 requires PRIIPs manufacturers to comply with a uniform set of product disclosure requirements and provide retail investors with a key information document (KID) on each PRIIP they offer. The disclosed information should enable retail investors to better understand the economic nature and risks of particular PRIIPs and to compare them. Greater transparency and harmonisation also benefit the internal market in financial services by creating a level playing field among PRIIPs and distribution channels.

Regulation (EU) No 1286/2014 establishes the form and content of the KID. It also empowers the European supervisory authorities (ESAs) – i.e. the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority (as established by Regulations (EU) Nos 1093/2010[2], 1094/2010[3] and 1095/2010[4], respectively) – to jointly develop regulatory technical standards (RTSs) specifying the presentation and the content of the KID, its standard format, the methodology for presenting risk and reward and calculating costs, the conditions and minimum frequency for reviewing the information in the KID and the conditions on providing the KID to retail investors. Commission Delegated Regulation (EU) 2017/653[5] lays down the RTSs.

Article 32 of Regulation (EU) No 1286/2014 provides for a transitional arrangement whereby management companies, investment companies and persons advising on, or selling, units of UCITS and non-UCITS are temporarily exempted from the requirement to provide retail investors with a KID. This arrangement currently applies until 31 December 2021 (‘transitional arrangement’).

This Regulation is accompanied by amendments to Commission Delegated Regulation (EU) 2017/653. Given the time needed to implement those amendments to Delegated

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1 Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) (OJ L 352, 9.12.2014, p. 1).

2 Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

3 Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

4 Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

5 Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (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 (OJ L 100, 12.4.2017).

Regulation (EU) 2017/653 and to reduce legal uncertainty, this Regulation extends the transitional arrangement to 30 June 2022.

The amendments to Delegated Regulation (EU) 2017/653 are based on draft RTSs jointly submitted by the ESAs on 3 February 2021. The draft RTSs involve:

- new methodologies for calculating appropriate performance scenarios and a revised presentation of the scenarios, with a view to ensuring that retail investors are not provided with inappropriate expectations as to possible returns;
- revised summary cost indicators and changes to the content and presentation of information on the costs of PRIIPs, to allow retail investors to better understand the different types of cost structure and to facilitate the use of this information by persons advising on or selling PRIIPs;
- a modified methodology for calculating transaction costs, to address practical challenges that have arisen when applying the existing rules, and issues regarding their application to certain types of investment;
- modified rules for PRIIPs offering a range of options for investment, to clarify the information on the cost implications.

The draft RTSs also lay down provisions in respect of past-performance information for certain types of UCITS, retail AIFs and insurance-based investment products.

This Regulation is also accompanied by amendments to Directive 2009/65/EC[6], in order to avoid a situation where, from 1 July 2022, investors receive two pre-contractual disclosure documents in respect of the same UCITS (i.e. the KID and the ‘key investor information’ in accordance with that Directive).

As a result of this proposal, Regulation (EU) No 1286/2014 will apply to management companies, investment companies and persons advising on, or selling, units of UCITS and non-UCITS from 1 July 2022, to coincide with the application of the amendments to Directive 2009/65/EC and Delegated Regulation (EU) 2017/653.

Consistency with existing policy provisions in the policy area

Articles 78 to 82, and Article 94 of Directive 2009/65/EC require investment companies and management companies for UCITS to draw up ‘key investor information’. Member States may decide to apply the same rules to non-UCITS funds.

The purpose of the ‘key investor information’ is to make investors ‘*reasonably able to understand the nature and the risks of the investment product that is being offered to them and, consequently, to take investment decisions on an informed basis*’. The ‘key investor information’ is a short document (two pages, or three for structured UCITS) in a standard format, with information presented in a specified sequence that facilitates comparisons between different UCITS. The information is conveyed in non-technical language, so as to be understood by retail investors. The ‘key investor information’ should be a self-standing document: its essential elements should be comprehensible to investors without reference to other documents and it should be consistent with the relevant parts of the UCITS prospectus. It is based on the overall requirement for disclosed information to be fair, clear and not misleading.

[6] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302, 17.11.2009, p. 32).

In addition to identifying the UCITS and briefly describing its investment objectives and investment policy, the ‘key investor information’ contains:

- a section on **costs and charges**, according to a standard format for the presentation and explanation of charges, including relevant warnings, so that investors are appropriately informed about the charges they will have to incur and their level as a proportion of the amount of capital invested in the fund;
- a section on **risks and rewards**, which includes detailed rules on the presentation of the product’s risk and reward profile, using a synthetic indicator, complemented by narrative explanations of the indicator itself and the risks not captured by it. The ‘key investor information’ can be cross-referenced to the UCITS prospectus, which discloses more detailed information on the relevant risks;
- a section on **performance**, which presents past performance or, in relevant cases, prospective performance scenarios.

The ‘key investor information’ has become the benchmark for disclosures in the PRIIPs framework. The disclosure provisions of Regulation (EU) No 1286/2014 borrow heavily from Directive 2009/65/EC. Based on the ‘key investor information’ model, the KID is a standardised factsheet presenting the key features (including costs and potential risks and rewards) of a given PRIIP in a simple, understandable and comparable manner. Regulation (EU) No 1286/2014 also contains detailed rules on when and how manufacturers and those selling, or advising on, PRIIPs are to provide the KID to retail investors.

More broadly, Regulation (EU) No 1286/2014 aims to provide retail investors with potential means to make better investment decisions and to steer away from sub-optimal or mis-sold products, thereby helping to restore trust in the financial system. Compared with the ‘key investor information’ provisions, the KID rules are deliberately designed to facilitate comparison of a much wider range of retail investment products, including (but not only) UCITS and retail non-UCITS, investment-based insurance products, derivatives and structured products, and other packaged insurance and investment products.

Disclosure standards for functionally similar and substitutable PRIIPs improve transparency and comparability, while mitigating confusion from the use of sector-specific concepts. This helps retail investors understand and trust the products they buy, while preventing regulatory arbitrage and promoting regulatory consistency, which in turn should facilitate supervision, reduce costs and support price competition. The ‘targeted standardisation’ in the PRIIPs framework is not a ‘one size fits all’ approach, but involves dividing PRIIPs into four categories and tailoring the disclosure requirements accordingly. One category is for products that track an underlying investment in a linear manner – this covers most UCITS, retail AIFs and unit-linked insurance products. At the same time, the KID ensures the uniform presentation of key information, irrespective of category, where the PRIIPs are similar enough to allow this.

At the time of its adoption in 2014, the transitional arrangement for UCITS and non-UCITS was justified by the relatively short period since the introduction of the ‘key investor information’ (1 July 2011). In recital 35 of Regulation (EU) No 1286/2014, the co-legislators specified that it would be ‘*proportionate to provide such UCITS a transitional period of five years*’ and that ‘*after the expiry of that transitional period and in the absence of any extension thereto, UCITS should become subject to this Regulation*’.

Regulation (EU) 2019/1156[7] of the European Parliament and of the Council extended the transitional arrangement to 31 December 2021, with the caveat (recital 14) that '*all institutions and supervisory authorities involved should endeavour to act as fast as possible to facilitate the termination of that transitional exemption*'.

To meet that objective, the ESAs jointly adopted RTSs amending Delegated Regulation (EU) 2017/653 and submitted them on 3 February 2021. In summary, the RTSs concern the following:

Performance scenarios

The ESAs reduce the risk of **over-optimistic performance scenarios** across all PRIIPs types, with a general option for PRIIP manufacturers to use lower percentiles of the estimated distributions of future returns to generate the scenarios, where justified. This would allow PRIIPs manufacturers to generate scenarios that are more conservative if they believe there is a material risk of the scenarios as prescribed giving rise to inappropriate expectations on the part of investors. However, the methodology does not allow PRIIPs manufacturers to use higher percentiles.

Based on the results of consumer testing, the ESAs add the **minimum return** of the product to the areas to be covered in the performance scenarios for all PRIIPs.

For category-2 PRIIPs (which includes most UCITS and non-UCITS), the ESAs propose a revised methodology for calculating the 'favourable', 'moderate' and 'unfavourable' performance scenarios, to reduce the incidence of **pro-cyclicality** and minimise the potential for **misleading estimates**, which risk creating inappropriate retail investor expectations. In particular, this methodology extends from 5 to 10 the number of years of data underpinning the calculation of the scenarios, in order to address issues of pro-cyclical estimates. It also sources scenarios directly from a distribution of past returns, in order to clarify for retail investors the mathematical link between past returns and the scenario values.

For the stress scenario, the ESAs retain the current methodology, as this has proven to be an effective indicator of the effect of extreme adverse market events, such as the initial financial shock in 2020 from the COVID-19 crisis.

Past performance

In the 'Other relevant information' section of the KID, the ESAs include a link to an alternative online source or external document containing **standardised past-performance data**. They also **standardise the content and methodology** of past performance in a new Annex VII to Delegated Regulation (EU) 2017/653. The proposed methodology is based on the approach for the 'key investor information', with specific adjustments where necessary. For PRIIPs other than category 2, the ESAs maintain the current approach of showing performance scenarios only.

Costs

The ESAs revise the **summary cost indicators** and change the content and presentation of information on the costs of PRIIPs to allow retail investors to better understand the different types of cost structure and to facilitate the use of this information by persons selling or advising on PRIIPs, *inter alia* by requiring that detailed cost information for packaged retail

[7] Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014 (OJ L 188, 12.7.2019, p. 55).

investment products (as covered by Directive 2014/65/EU[8], MiFID II) be presented in monetary amounts, in line with Article 50(2) of Delegated Regulation (EU) 2017/565[9]. For insurance-based investment products, costs are still expressed as 'reduction in yield'.

The ESAs modify the methodology for calculating **transaction costs** to address practical challenges with the application of the distribution rules. They also prevent negative transaction costs by setting a minimum at the level of the explicit costs.

Article 33 of Regulation (EU) 1286/2014 requires the Commission to assess whether the transitional arrangement for UCITS and non-UCITS should '*be prolonged, or whether, following the identification of necessary adjustments, the provisions on key investor information in Directive 2009/65/EC may be replaced by or considered equivalent to the [KID]*'.

In this regard, the ESAs' proposal for a revised set of RTSs contains a number of adjustments that justify replacing the 'key investor information' with the KID for the products in question:

- The requirement to include in the KID an external link to product-specific **past performance** information, calculated according to a standard methodology, helps retail investors to continue using such information to assess how well each product has fared against its benchmark, which is important for comparing actively managed products.
- The introduction of standardised **performance scenarios** for UCITS and non-UCITS products will give investors a more complete illustration of the types of performance outcome that can be expected from the product, while facilitating comparability with other types of retail investment and insurance product.
- Investors will benefit from greater comparability thanks to a standard framework for the disclosure of aggregate **costs** across all PRIIPs, including UCITS and non-UCITS. In addition, several of the proposed amendments to the RTSs directly address concerns expressed by manufacturers of UCITS-type products, including the amended methodology for calculating transaction costs and aligning the detailed cost information for packaged retail investment products more closely with the MiFID II cost disclosure framework. These changes will limit the costs for the asset management industry of adapting to the PRIIPs cost disclosure rules.
- The 'key investor information' and the KID both require the calculation of a synthetic, numerical, single-summary **risk** indicator based on an aggregation of various risks (as far as possible) and accompanied by sufficient narrative explanations. Currently, the methodologies for calculating this indicator differ slightly between the two disclosure frameworks, which may confuse retail investors trying to make comparisons across frameworks. The switch to a common methodology will improve comparability. At the same time, the change in methodology may put some products in a different risk category, potentially giving the misleading impression that they have become less risky. This has been partly remedied by the option given to manufacturers to revise the risk indicator upwards (but not downwards), subject to certain conditions.

[8] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

[9] Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council (MiFID II) as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 87, 31.3.2017, p.1).

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

Legal basis

Like Regulation (EU) No 1286/2014, which it seeks to amend, this proposal is based on Article 114 of the Treaty on the Functioning of the European Union.

Subsidiarity (for non-exclusive competence)

According to the principle of subsidiarity, Union action may be taken only if the envisaged outcomes cannot be achieved by Member States acting alone. Union intervention is needed to remove barriers to the internal market in financial services and products by introducing a uniform approach to disclosures relating to PRIIPs. The legislation that is being amended is adopted in full compliance with the principle of subsidiarity and any amendment to it must be made through a Commission proposal.

Proportionality

This Union action is necessary to ensure the effective application of the PRIIPs rules by competent authorities and PRIIPs manufacturers. It will ensure that the objectives of Regulation (EU) No 1286/2014 are achieved across the internal market, thus ensuring a high level of market transparency and retail investor protection.

3. RESULTS OF *EX POST* EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

This proposal is not accompanied by a separate impact assessment, as an impact assessment has already been produced for Regulation (EU) No 1286/2014.

This proposal neither alters the substance of the Regulation, nor does it create new obligations for market participants. It concerns only an extension by 6 months (i.e. to 30 June 2022) of the transitional arrangement for management companies, investment companies and persons advising on, or selling, units of UCITS and non-UCITS (Article 32 of the Regulation). The purpose is to ensure legal certainty for the industry and the competent authorities as they prepare for the application the new rules in Delegated Regulation (EU) 2017/653 and Directive 2009/65/EC, as amended.

4. BUDGETARY IMPLICATIONS

The proposal does not have a budgetary impact for the Commission.

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(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Economic and Social Committee[10],

Acting in accordance with the ordinary legislative procedure,

Whereas:

(1) Article 5 of Regulation (EU) No 1286/2014 of the European Parliament and of the Council[11] requires manufacturers of packaged retail and insurance-based investment products (PRIIPs) to draw up a key information document ('KID').

(2) Article 32(1) of that Regulation, however, contains an exemption to produce a KID for management companies as defined in Article 2(1), point (b), of Directive 2009/65/EC of the European Parliament and of the Council[12], investment companies as referred to in Article 27 of that Directive and persons advising on, or selling, units of UCITS as referred to in Article 1(2) of that Directive until 31 December 2021 ('transitional arrangement'). Article 32(2) of Regulation (EU) No 1286/2014 stipulates that where a Member State applies rules on the format and content of the key investor information, as laid down in Articles 78 to 81 of Directive 2009/65/EC, to non-UCITS funds offered to retail investors, the transitional arrangement is to apply to management companies, investment companies and persons advising on, or selling, units of such non-UCITS funds to retail investors.

10 OJ C […], […], p. […].

11 Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) (OJ L 352, 9.12.2014, p. 1).

12 Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302, 17.11.2009, p. 32).

(3) Commission Delegated Regulation (EU) 2017/653[13] supplements Regulation (EU) No 1286/2014 by laying down regulatory technical standards with regard to the presentation, content and standard format of the KID, the methodology for the presentation of risk and reward and the calculation of costs, as well as the conditions and minimum frequency for reviewing the information contained in the KID and the conditions on providing the KID to retail investors.

(4) On [*OJ Please insert the date*], the Commission adopted Commission Delegated Regulation (EU) …/2021[14], amending Delegated Regulation (EU) 2017/653, *inter alia*, to make it easier for management companies, investment companies, and persons advising on, or selling, units of UCITS and non-UCITS to make use of the presentation, content and standard format of the KID. The date of application of Delegated Regulation (EU) …/2021, however, has been set on 1 July 2022 to give those management companies, investment companies, and persons advising on, or selling, units of UCITS and non-UCITS sufficient time to prepare for the end of the transitional arrangement and thus for the obligation to draw up a KID. Because the date of application of Delegated Regulation (EU) …/2021 has been set on 1 July 2022, and because it is necessary to ensure that the end of the transitional arrangement coincides with the date of application of Delegated Regulation (EU) …/2021, it is necessary to extend the duration of the transitional arrangement by six months, that is until 30 June 2022.

(5) Regulation (EU) No 1286/2014 should therefore be amended accordingly.

(6) Given the very short period left until the original end of the transitional arrangement, this Regulation should enter into force without delay,

HAVE ADOPTED THIS REGULATION:

Article 1

In Article 32(1) of Regulation (EU) No 1286/2014, the date ‘31 December 2021’ is replaced by ‘30 June 2022’.

Article 2

This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the European Parliament *The President*	*For the Council* *The President*

[13] Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (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 (OJ L 100, 12.4.2017, p. 1).

[14] OJ C […], […], p. […].