# Not everyone understands a key part of new EU financial regulation

In the past few years there has been a cavalcade of regulations imposed on European capital markets. While most of these changes are observable only to practitioners, some of them have had immediate visible effects for retail investors. One such rule is the necessity for a ‘key investor document’ (KID) for certain investment products.

A principle aim of global regulators has been to increase the transparency of financial markets and to fully allow investors large and small to accurately calculate how much they are paying for a service. In Europe one example of this is the PRIIPs rules (packaged retail investment and insurance products), which came into force at the start of this year. There is an exemption for UCITS funds (Undertakings for Collective Investments in Transferable Securities), considered the gold-standard for investment vehicles. They follow the dominant fund structure in Europe, and can use the previous template known as a “key investor information document” until December 2019.

The goal of these regulations is to create a way in which investors can easily compare the key risks, returns and particularly the costs of different investment products. The rules specifically mandate the production of a short and easy to read key information document. This document is designed to give even the layman a quick and simple way to compare the costs of different investment products.

This could be a game-changer. We should see retail investors naturally move away from the high-cost, poor-value products that many providers distribute with slick marketing, but an opaque pricing structure, towards better value funds with a fairer pricing structure. In tandem, we should see providers lowering the costs of their services. Competing on costs becomes a more attractive strategy, which creates a better environment for savers.

The methodology for production of a KID is set out in the PRIIPs regulatory technical standards and is designed to ensure that different products are comparable. For some niche providers and smaller asset managers this is a challenging addition to their regulatory burden, as many of these firms lack the ability to produce such complicated documents in-house. For most if not all KIDs there is a need for high quality data and modelling assumptions that can be outside the skill set and scope of the investment manager.

The document can also require the use of advanced mathematical analytics for detailed scenario analysis, alongside the need for deep knowledge of the underlying investments and comparable securities. All of these factors make the PRIIP rules far from a trivial matter. The specialist knowledge required places the production of KIDs and PRIIPs outside the comfort zone of many compliance and marketing departments. We are seeing evidence that many providers are unprepared for the additional obligation, and a smaller subset of providers are simply not fulfilling their obligation.

Even the largest financial service firms have in some cases been unprepared. Upon PRIIPs implementation earlier this year, many retail distributors across Europe had to adjust their offering. In the UK, the retail platform Hargreaves Lansdown, which connects retail investors to fund managers, had to remove almost 300 investment trusts and 900 ETFs from its offering when fund managers could not produce a KID on demand, despite every firm having both a compliance department and a dedicated compliance officer who would have been tracking the development of the regulations.

The poor provision of these documents is something that can and will change as investment service providers become increasingly aware and comfortable with their obligations and an increasingly astute retail market demands the relevant information. (Either individually or more likely through an investment provider.)

The main points of the regulations are that

1. The key information document should be made available to retail investors sufficiently prior to their investment decision, so that they are able to understand and take into account the relevant PRIIP information when making that decision.
2. Advisors are expected to provide a KID before a transaction is legally binding

- The underlying investments are expected to be monitored so that if a change in circumstance requires a new document, it will be provided. This adds another layer of cost to the provider.

Currently most investors, and some advisors, are unaware of the need for a KID. The legislation will become better known over the next few years and increase the transparency of European markets. By allowing retail investors an easier way of comparing complicated products, the PRIIPs rule should help develop better understanding from end-users, and this can only be good for the financial markets.

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*Notes:*

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