

Financial Risk&Regulation

Actions following compliance: challenges arising from the amended PRIIPs regulation

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As of January 1, 2023, after several deadline modifications, the amended EU regulation¹ on Packaged Retail and Insurance-based Investment products (PRIIPs) has come into effect. The revision focussed on the removal of the exemption from the application of KID (Key Information Documents) for retail investors. From this date on, KID is required for all packaged investment products, including those which previously applied the Key Investor Information Document (KIID) required for Undertakings for Collective Investment in Transferable Securities (UCITS) funds (or „key investor information” as it is named in the domestic legislation), typically applied for open-ended EU investment funds and open-ended domestic (alternative) investment funds.

Background

The KID is a document of summarized information to investors providing basic information about the investment product in a specific format and content as defined by the PRIIPs regulation. It is somewhat longer and prescribes a different methodology and data content than the KIID which was previously required for open-ended investment funds.

Although investment products that produced KIID have been exempted from the PRIIPs regulation for years (including European UCITS and Hungarian open-ended investment funds), as of January 1, 2023, compliance with the PRIIPs regulation's provisions will also be required for these investment funds - with some local alteration.

In Hungary, the expiration of the PRIIPs exemption is of great importance because the Act XVI of 2014² requires the KIID, originally only applicable

to UCITS funds, to be also applied to domestic alternative investment funds, while the PRIIPs KID became applicable for the closed-ended investment funds at the date set by the regulation originally. Therefore, the changes to the information documents practically affects the entire range of investment funds in Hungary, on the one hand through the replacement or updates of the KIIDs, on the other hand by the new methodology to be applied for already accepted KIDs.

Focusing on retail investors

Since the global financial crisis of 2008, the financial sector has placed particular emphasis on protecting retail investors and strengthening consumer protection in finance. Today's market is fundamentally shaped by the demand for transparency and fair competition, creating a regulatory environment that is constantly becoming

¹ 1286/2014/EU regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs)

² Act XVI of 2014 on Collective Investment Trusts and Their Managers, and on the Amendment of Financial Regulations

more stringent for retail products. In light of these initiatives, the PRIIPs Regulation has been introduced which provides key information on retail investment packaged products and has been in effect since January 1, 2018. Its primary objective is to increase confidence of retail investors in insurers and asset managers, as well as in their complex products (such as structured investment funds and unit-linked life insurances), and to promote informed investment decision-making by ensuring easy comparability of similar products.

The relevant rules cover structured retail securities, structured deposits, and structured insurance products (PRIIPs), primarily investment funds and investment-based insurance policies.

Regulatory milestones

According to the PRIIPs Regulation, the creation of KIDs (Key Information Documents) for closed-ended investment funds has been mandatory since January 1, 2018. As a next step, the application of the regulation would have become mandatory earlier for UCITS asset managers, investment companies (UCITS funds), and advisors of PRIIPs products, but due to the difficulties of market participants in compliance, the temporary scope of the exemption has been extended for these products, including alternative funds using UCITS-type KIIDs. The latest Delegated Regulation [\(EU\) 2022/975](#), adopted on March 17, 2022 and published on June 24, 2022, amended both the PRIIPs KID Regulation (Delegated Regulation [\(EU\) 2017/653](#)) and the subsequent Delegated Regulation [\(EU\) 2021/2268](#) ("RTS"), postponing the application deadline and extending the transitional rules under Article 14(2) of the PRIIPs KID Regulation. These provisions allow UCITS fund managers, investment companies, and those providing advice on or selling UCITS investment units to apply the less extensive KIID instead of the KID required as the general rule.

As a result of the modification, both regarding the layout and content of KIDs has changed, including the methodology for calculating and presenting the risks, returns, and costs. The new regulation entered into force on January 9, 2022 and the new requirements were originally supposed to be applied from July 1, 2022.

These regulatory milestones have spurred the exemption for the application of KIDs, which had been thus in effect until December 31, 2022. Finally, the legislator did not extend the deadline any further: as of January 1, 2023, the participants of the European capital market became obliged to comply. From this date, every institution under

the scope of the PRIIPs Regulation must apply the KID. However, the amendment of the Act XVI of 2014 in Hungary, also entered into force on January 1, 2023, somewhat nuances the application of the provisions in this paragraph, which we will elaborate on later.

KID requirements

The KID is a pre-sales information document, aiming the protection of retail investors by providing them with the necessary information to make informed investment decisions. The design of the KID is strictly regulated and standardized, in some cases not only in format and layout, but also in wording, so retail investors can easily compare products.

The appendix I of the PRIIPs KID regulation sets out the KID template document. The KID can be up to maximum three pages long and must contain clear information about the product, based on which investors can make informed investment decisions.

The KID must contain the following information:

- a. the name of the product and the identification of the manufacturer, the type of PRIIP and its investment objectives;
- b. the types of investors for whom the financial product is intended;
- c. c) the risk/return profile of the financial product, which includes the overall risk indicator, the maximum loss that can be suffered on invested capital, and the templates and descriptions of appropriate scenarios related to the performance of the product;
- d. d) information on collateral, covered and uncovered risks (if the PRIIP issuer is insolvent);
- e. e) the evolution and composition of costs over time (costs associated with investing in the financial product are borne by the investor);
- f. f) information on the recommended holding period and withdrawal of investment, as well as applicable fees/possible penalties;
- g. g) information on how and to whom investors can make a complaint about the behavior of the product, the product manufacturer, the person providing advice on the product or the person selling the product;
- h. h) a warning about the complexity of investment products that may be difficult to understand, in the following form: *"You are about to purchase a product that is not simple and may be difficult to understand"*.

Challenges in compliance with the regulation

Service providers in the scope of the PRIIPs regulation primarily face the challenge of presenting performance scenarios and costs, because the calculation methods behind need to be updated. The adjustment of the methodology underlying the performance scenarios was necessary to ensure that those are not based on methods resulting in a scenario that increases the observed returns. It is also crucial that these scenarios are based on returns observed over a longer period, thus, by including both positive and negative periods provide more stable performance scenarios over time and minimizes pro-cyclical outcomes.

Regarding the presentation of costs, it is essential to ensure the comparability of total costs, for which the clarification of the meaning of aggregated cost indicators was needed. This also required a more distinctive approach, for example, to eliminate market movements with greater statistical certainty for PRIIPs that do not generate sufficient transactions.

Practical effects

The extension of the exemption for the application of the KID provided an opportunity to prepare for the transition to KID properly for those who had previously applied KIID. In addition to them, the changes in certain requirements of the KID also gave task for product manufacturers that were already obliged to create KID, as they had to perform calculations with the new methodology. The extended deadline was indeed necessary for the fund management sector, as the new PRIIPs RTS requirements regime - as mentioned above - includes a modified methodology of performance scenarios, changes in the presentation of transaction costs, and other modifications as well. For those who began implementation when these changes were published, this could have meant significant methodological and developments to implement.

The modification of regulations also aimed to clarify the effect of the PRIIPs regulation for corporate bonds, making it clear that these products are not deemed PRIIPs based on certain common characteristics.

A local twist

In the Hungarian capital market, primarily open-ended investment funds were enjoying the exemption from the PRIIPs amendment, allowing them to use the shorter KIID document until December 31, 2022, according to the regulation.

Section 103 of the Act of XVI. of 2014 has already required open-ended investment funds to produce a KIID regardless of whether they qualify as UCITS. With the amendment to the Act taking effect from January 1, 2023, however, it introduced an ease for the institutions by allowing them not to use the KID for those funds where KIID has been used so far (EU and domestic open-ended investment funds), if the content of the KIID meets the requirements of the PRIIPs Regulation KID. This eliminates the obligation of the issuer to have both a KID and KIID for a given product, but it is an essential requirement that the KIID includes all the information required by the KID, so the impact of this regulatory change is more substantive rather than formal. The legislator also builds upon the fact that the KID is more comprehensive and detailed, making it unnecessary to have the KIID with narrower scope of content for the same product at the same time. In short, the Act allows for the preservation of the format if there is substantive equivalence with the information requirements for the KID.

Beyond the implementation

The Hungarian investment fund and insurance sector has completed the first phase of implementation, and the modifications have been essentially completed on time. However, it may be worthwhile to validate ex post, the success of the implementation and certain domestic interpretations for which not all market participants have received satisfactory answers during the implementation phase. Examples for such issues may be on the interpretation of credit rating for Hungarian government bonds or the methodology for cost calculations. So far, only the first phase of the work has been completed, and the majority of improvements and fine-tuning are starting now, still before the first supervisory inspection which is a natural but an essential part of complex implementation processes requiring significant resources.

Our services related to PRIIPs regulation

The harmonization of the processes for creating and publishing documents that use concise language to facilitate the comparison of PRIIPs is an important task, including the standardization of granularity, the frequency of updates, the determination of the reasons and process of extraordinary updates, the harmonization of price determination according to KID, and the standardization of the ex-ante cost calculation process. We assist our clients in creating KIDs more efficiently and accurately and their compliance with the new regulations. The KPMG financial risk management and regulatory team can support the entire process of creating and producing KIDs and can liaise in interpretation issues with ESMA or local regulators through its international network.

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Témához kapcsolódó blogposztunk: [2023-ban felügyeleti fókuszban a befektetési termékek értékesítési gyakorlata](#)

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