

Content

❖ Summary	1
❖ 1 Objective of the thematic evaluation	2
❖ 2 Key objectives of PRIIPs regulation	2
❖ 3 Key information and informed investment decision	3
❖ 4 Comparability.....	6
❖ 5 Clarity and linguistic quality of KIDs	7

Summary

The requirement to publish a key information document (KID) when offering packaged retail and insurance-based investment products (PRIIPs) to retail investors came into effect from the beginning of 2018. Generally, there have been challenges to some extent in the application of PRIIPs regulation, and the Joint Committee of European Supervisory Authorities (ESMA, EBA and EIOPA) has also given interpretations on the application of PRIIPs regulation. The FIN-FSA has noted these challenges and in the thematic evaluation has focused more on the accessibility of KIDs from the perspective of retail investors.

The FIN-FSA's theme evaluation shows that the objective of PRIIPs regulation for a document containing the key information necessary to make an informed investment decision and to compare products belonging to different product groups is, in practice, challenging. In terms of product comparability, the most significant benefit to retail investors from PRIIPs regulation would appear to be the single coherent structure with which information is presented in all product groups.

On the basis of the FIN-FSA's observations, in structured products, for example, a balance must be struck between, on the one hand, what the key information is and, on the other hand, what information is necessary to make an investment decision. In some structured products, the focus has been more purely on the key information, and they are generally also clearer and easier to understand. Basing an investment decision on this information may involve uncertainty, however. With regard to the information required by regulation, the presentation of descriptions relating to the liquidity and premature sale of structured products also appears to be challenging and, in these, product manufacturers have room for improvement.

KIDs for the 'insurance wrapper' of investment-linked insurance policies provide very little concrete and useful information on, for example, the product's risks, costs or performance scenarios, which can be considered to be the most important information content of KIDs. In addition, descriptions of the actual investment assets and goals of insurance products are very general. As a result, there is limited scope for investors to compare these products or compare them with other investment products based on KIDs without selecting the investment assets and acquainting themselves with their information. For structured products and derivatives, there are more opportunities for comparing products offered by different manufacturers in the same product group, as long as there are similar products available in the market.

The FIN-FSA draws product manufacturers' attention to the quality of documents. KIDs have used ambiguous and complex terms, very limited or too general descriptions, and they have a significant number of typographic and translation errors. It is the responsibility of product manufacturers to ensure

that documents are high quality, so that investors read them and are able to use them to make investment decisions. Closer attention should be paid to quality assurance, particularly when using automation or machine generation in preparing KIDs, translating them or producing information contained in them.

1 Objective of the thematic evaluation

The FIN-FSA's thematic evaluation has examined the presentation of information, i.e. how the information presented in key information documents (KIDs) appears from the perspective of the retail investor. The objective has been to assess whether KIDs fulfil, in practice, the goals set for them in terms of facilitating informed investment decisions and the comparability of products.

The thematic evaluation is based on sampling and on a review and assessment of thematic entities. In Finland, there is an obligation under national law to provide KIDs and their updates to the FIN-FSA. During 2018, the FIN-FSA received over 200,000 KIDs or updates of KIDs. The thematic evaluation has examined key product groups, such as insurance products, structured investment products and derivatives. Investment and alternative investment funds are also subject to PRIIPs regulation, but in their case the transitional period granted to them has generally been exercised¹. These products have not therefore been subject to evaluation. In the thematic evaluation, 30 KIDs from different product groups have been taken for closer assessment.

The thematic evaluation has not assessed the correct application of the methodology used in determining numbers or values or the accuracy of numbers or values. The thematic evaluation is not of a kind that has comprehensively assessed document by document or topic by topic whether KIDs have been prepared in the manner required by regulation.

2 Key objectives of PRIIPs regulation

The basis of PRIIPs regulation is that retail investors can make investment decisions based on KIDs. KIDs should give the information necessary to make informed investment decisions and to compare different products. Moreover, it is desirable for the information to be in concise form and therefore, in practice, to focus on key information².

KIDs must be accurate, fair and clear. They must be presented and laid out in a way that is easy to read, using characters of readable size, and focus on the key information that retail investors need. In addition, the language and style should be concise and easy to read, which will help the reader understand the information.

¹ The key investor information documents required by UCITS and AIFMD regulations are prepared for investment and alternative investment funds.

² PRIIPs Regulation recital 15: "Retail investors should be provided with the information necessary for them to make an informed investment decision and compare different PRIIPs, but unless the information is short and concise there is a risk that they will not use it. The key information document should therefore only contain key information, in particular as regards the nature and features of the product, including whether it is possible to lose capital, the costs and risk profile of the product, as well as relevant performance information, and certain other specific information which may be necessary for understanding the features of individual types of product."

Extract from PRIIPs Regulation recital 22: Key information documents are the foundation for investment decisions by retail investors.

3 Key information and informed investment decision

3.1 Type of product

Descriptions of the type of PRIIP with respect to the legal form of the product are ambiguous in some KIDs. For example, in the case of insurance products, the descriptions vary and in many cases customers have to familiarise themselves with the product description or terms and conditions to confirm the legal form of the product.

Some KIDs mention, for example, the term “investment-linked savings life insurance” or “investment-linked capital redemption agreement”, which are well-established terms for regulated insurance policies. Commonly, more general descriptions such as “investment-linked savings insurance” or “investment insurance” are used, referring to insurance classes under the Act on Insurance Classes, or more extensive descriptions are presented. For insurance products, this is significant because, unlike in savings life insurance, in a capital redemption agreement there is no insured person. Unlike a capital redemption agreement, a beneficiary can be defined in savings life insurance.

In the case of structured bonds, the section relating to type of product discloses the bond nature of the product and often also the nature of the product’s underlying asset, for example “equity-linked bond”. The characterisation may also use terms derived from legislation, such as financial instrument, which is not necessarily, however, a precise term for describing the product to the average investor.

3.2 Performance and nature of product

In the case of complex investment products, such as structured products or insurance products, it is generally not possible, in practice, to present all of the main terms and conditions in the key information. The biggest challenge appears to be striking a balance between presenting key information and the information needed for an informed investment decision, so that both goals are realised.

Providing more limited information may omit from the KID information required in the investment decision and impair the usability of the KID in making an investment decision. On the other hand, an attempt to provide very detailed information may reduce the readability and clarity of the KID.

In the case of *structured products*, the product and its performance are described in various ways, depending of the product manufacturer. In some, the description of terms and conditions is very limited. In such cases, it is clear that only the presentation of key information is involved. If the calculation of the product’s performance is complex and includes many different terms and conditions, then it may be difficult to gain a precise picture of performance on the basis of this key information. In some KIDs, the terms and conditions of the product are described more extensively, and protection levels and valuation dates, for example, are mentioned.

At least with respect to the KIDs included in the thematic evaluation’s sample, there is an interesting connection between a product’s complexity and the level of detail of the information on a product’s performance. For example, in the case of products belonging to risk class 5, the terms and conditions of the product are often described in a very detailed and itemised manner, while in the case of products with a lower risk class, the description might include only some of the most essential terms and conditions and a brief account of performance. Brief descriptions are understandable, but it is clear that they do not disclose all of the detailed terms and conditions affecting the calculation of performance that are significant in determining final value.

The objectives of *insurance products* are described on a very general level, as are the means to achieve them. Investment assets are often mentioned, but only in rare cases are investment assets described in more detail and even then on a general level. Target markets are generally not specified in detail.

The objective may be described, for example, as “the objective is to achieve a positive performance in the medium or long term”, “the objective is to achieve a positive increase in value for insurance premiums”, “the product is intended for long-term saving and to grow the investor’s wealth through an increase in value of selected investment assets” or “the objective is to increase wealth via investment assets as well as financial security for beneficiaries”. Nothing is stated directly about the means to achieve the mentioned objective. Instead, the structure and features of the product are described, such as the investment assets that may be selected and the costs.

Investment assets are mainly described by telling about the assets connected with the insurance (investment funds and baskets, funds, investment bonds, annual fixed interest option [=with profit component], bonds, shares).

For *securitised derivatives* it appears to be possible to prepare KIDs whose information is at least of benefit in making an investment decision, but the final decision is mainly influenced by the market price of the product in the marketplace at the time in question. On the other hand, the KIDs for derivative contracts, such as interest rate swaps, do not appear to be so clearly of benefit in decision-making, as the product information has to be presented by way of example and the contract rate often depends not only on market interest rates at the time the contract is made, but also on customer-specific factors.

3.3 Liquidity and premature sale of the product

For structured products, one challenging area for product manufacturers is descriptions relating to a product’s liquidity, liquidity risk and premature sale, which were not sufficiently clear in many of the KIDs included in the sample.

In connection with the risk indicator, investors must be warned about the product’s poor liquidity or lack of liquidity if the product is either illiquid, as defined by regulation, or has a significant liquidity risk associated with it. In the case of some of the KIDs, the standard warning was completely absent, even though the need for its inclusion was evident in other parts of the document.

In addition, information on how and when it is possible for the investor to realise the product prematurely should be provided in the section of the KID “*How long should I hold the investment and can I take money out early?*” In this respect, it is often stated in KIDs, for example, that the investor cannot sell the product prematurely or that large costs or losses will be associated with this. Such descriptions are difficult from the investor’s perspective, as they are ambiguous and open to interpretation. They do not provide a clear picture as to whether the product can be sold prematurely with extra costs associated with this or whether the product can be disposed of at all before it matures.

Insurance product KIDs tell investors about the possibility of cancelling the insurance 30 days after entering into the agreement and, more often, about the possibility of terminating and surrendering the agreement. Related costs and terms and conditions are also mentioned. In general, nothing is stated about the liquidity of investment assets. If an insurance-related investment asset or part thereof is illiquid, the surrender value of the insurance cannot be determined or there may be a delay in receiving the money.

3.4 Risk indicator

Insurance product KIDs typically indicate a risk level of 2-6 on the risk scale, as applicable to the product in question. That the risk depends of the investment assets selected is also mentioned. Thus, the information provided by the risk indicator is, in itself, not very informative.

In connection with the risk indicator, information must also be provided about risks materially relevant to the product that are not adequately captured by the risk indicator. Such a risk is typically foreign exchange risk, for example. Sometimes the KID lists a number of such risk factors (for example secondary market risk, share premium risk and resolution procedure). Sometimes product manufacturers mention such a risk as a possibility that the product will mature before its planned maturity date.

The starting point for regulation is that the impact of presented risk factors must be explained to the investor. A mere list does not meet this requirement.

3.5 Performance scenarios

Generally, major challenges in terms of application are associated with presenting performance scenarios for products whose recommended holding period is less than one year or which do not require any initial investment. Performance is presented as thousands of per cent negative performance figures, negative performance figures in all scenarios, the same performance figures in all scenarios or they are not presented at all.

In some structured products, product manufacturers indicate in footnotes the performance outlook associated with the maturity of a structured bond before the planned maturity date in accordance with the terms and conditions. This practice attempts to resolve a challenging issue and to draw investors' attention to a feature of the product. The effort is worthwhile, but it shows at the same time that communicating the more difficult product features in the KID is not easy.

Life insurance policies sold in Finland and subject to PRIIPS regulation are mainly multiple option (MOP) products, i.e. they may contain a number of different investment assets. In their case, moreover, it is not necessary to mention performance scenarios in the same way and, in the KIDs included in the sample, only a couple mention potential performance. In some, performance is not mentioned at all, while in others it varies according to the value development of the investment assets.

3.6 Costs

In all product groups (structured products, insurance policies and derivatives), the main practice is that the cost figures mentioned are estimates. Cost information provided as estimates impairs the assessment of cost figures and their transparency. Applying such a practice under the regulation is only possible if so-called new PRIIPs are involved.

In the case of insurance products, there are also other factors in the presentation of costs that are relevant to the utilisation of cost information. From the KIDs it is not always evident whether cost calculations take into account the costs of both the insurance and the investments, and how the investment costs are taken into account. In addition, in the case of MOP products, cost ranges are typically mentioned, and these can be very wide. For example, in a 1-year investment period the costs might be 3-7% and over the recommended investment period 1-4 % per year. Such large ranges naturally impair the usability of information and comparability with other products.

3.7 Type of retail investor

The sections of KIDs that mention the retail investor to whom the product is intended to be marketed is often quite general in terms of the objectives of the regulation. At best, the descriptions have succeeded in highlighting the investor's perspective in relation to ability to bear risks and investment horizon. In contrast, descriptions relating to the expertise and knowledge required from the investor are more general in nature and overall less frequent.

In the descriptions, there are also distinct differences in quality between actors. When comparing product groups on the basis of this sample, in the case of insurance products the descriptions of retail investor types are generally more limited than in the case of other product groups belonging to the sample. The descriptions, moreover, are in some cases very short, for example "tolerant of value fluctuation", "long-term", "prepared to accept investment losses" or "professional and non-professional investors". Many highlight the fact that the type of investor depends on the investment option to be selected.

In the case of structured bonds, the characterisations of the target groups are, on average, more comprehensive, albeit variable. In general, the target group is delimited by characterisations relating to investment experience, investment objectives, ability to bear risk, and investment horizon. Some KIDs use the terms "knowledgeable" or "expert investor" in determining investment experience, with the terms defined in a footnote or in the description itself.

Sometimes, however, the characterisations are highly contradictory. The KID might say the product is suitable for the investor who wants to maintain capital but who at the same time must be prepared for a significant loss of capital. In another example, the product is stated as being suitable for an investor whose goal is to safeguard capital, even though the product's risk class is very high. Based on these observations, it appears that, in some cases, producing such information is linked to product features in a manner that would not necessarily always appear to produce consistent and correct information.

4 Comparability

4.1 Comparison of products belonging to the same product group

KIDs clearly facilitate comparison of products belonging to the same product group that are produced by different manufacturers – up to a certain point. Comparability can be utilised most when there are products with very similar terms and conditions on the market at the same time. Comparison opportunities are impaired, on the other hand, by the above-mentioned fact that there may be substantial differences between manufacturers in the level of detail of the section "What is this product?"

For example, it is possible to some extent to compare sufficiently similar securitised derivatives solely on the basis of KID information. Plain vanilla interest rate swaps are, in respect of their terms and conditions, often simple and similar, which was also evident from the KIDs included in the sample. Nevertheless, there are differences in, for example, the presentation of performance scenarios and costs in KIDs that indicate that different actors may apply the regulation in different ways and therefore the information is not comparable. This survey did not, however, go deeper into the application of the presentation requirements for performance scenarios and costs.

In the case of structured bonds, the review included a number of autocall products whose KIDs provided detailed information on their terms and conditions, which also facilitated more detailed comparison of them. However, the comparability of many lower risk products was complicated, for example, by the fact that the issue price was not mentioned at all in the KID in the case of nearly all of the products. With

respect to the performance scenarios of structured bonds, comparability is impaired by the fact that a number of actors mentioned in a table the maturity date of the products instead of the recommended holding period.

The KIDs of insurance products used different terms for products, so customers do not necessarily know whether they are comparing similar insurance policies (savings life insurance vs. capital redemption agreement). For other products, the legal names of products belonging to the same product group often differed, in practice, from each other, which adversely impacted comparability.

4.2 Comparison of products belonging to different product groups

When comparing the products of different product groups, the greatest benefit to the investor is that there is one consistent structure with which information is presented. The investor finds the same sections, for example costs, risks and performance scenarios, in “familiar places” in the documentation and is therefore able to review more quickly a larger number of products when trying to identify potential investment options.

In addition, for example, the required standard text on the purpose of the KID and the possible warning on the complexity of the product are important elements. They provide a clear basis for less knowledgeable investors to understand the nature of both the product and document. As regards the presentation of this standardised information, no shortcomings were observed in the FIN-FSA’s thematic evaluation.

Comparison of *actual information* between different product groups is difficult, however. This is most evident when comparing MOP products with other products. On the basis of KIDs, insurance policies are not comparable with other products, because most insurance policies may be linked to many, even dozens of, separate investment assets whose features vary and influence the overall performance expectation, risks and costs of the insurance. On the basis of KIDs, insurance policies are therefore not comparable with each other or with other products without more precise selection of investment assets.

Another issue impairing comparability, arising from the basic nature of the products, is the fact that, in practice, recommended investment periods typically differ greatly between derivatives, structured bonds or insurance policies.

Differing application of the regulation in different product groups may also impair comparability. For example, in the descriptions of the section “What happens if the PRIIP manufacturer is unable to pay out?” there are clearly differences, even though there is no obvious reason why this should be so. In the case of structured bonds, it is generally mentioned that the product is not covered by either a deposit guarantee or a compensation and guarantee scheme. The KIDs of insurance products often state that there is no deposit guarantee or investor protection fund. They often contain, however, descriptions of capital adequacy arrangements, regulatory oversight of the insurance company or the pre-emption right of insurance claims in bankruptcy.

5 Clarity and linguistic quality of KIDs

5.1 Clarity

In general, the KIDs included in the sample are clear in their presentation. They follow the given template and do not refer to marketing material. The use of colours and other effects is not misleading. In some

products containing many terms and conditions, however, the text is very dense and therefore not particularly easy to read.

The language of the KIDs is mostly rather technical general language, but there are some very long and complex legal descriptions that do not correspond to the requirements set for KIDs with respect to easy-to-understand language. This is most clearly evident in the product name or product type sections, which are often pure legal or technical definitions.

At their most extreme, the KIDs display greater shortcomings relating to precision and comprehensibility, in that their different sections contain information about product features that is contradictory or ambiguous. One example of ambiguous presentation and inconsistencies between different sections concerned those KIDs that did not provide information on the issue price, but in which a warning was given about the risk of losing some invested capital due to a share premium.

In addition, the figures presented in some KIDs are inconsistent so that, for example, a product's total costs are more than 100 per cent or losses more than 100 per cent in products which have no additional payment obligation. It appears that figures produced by formulas are presented very mechanically without sufficient control of their results.

5.2 Linguistic quality

In contrast, surprisingly many weaknesses were observed in the linguistic expression of the KIDs. These observations suggest that document review has not been performed with sufficient care or not at all.

The sample also included KIDs that appear to have been produced and/or translated mechanically, and because of possible coding errors, for example, they contain clear errors such that numerical data is absent from tables or the language of the document changes to another in the middle of a sentence. The sample also revealed individual cases in which the KID was completely unfit for use due to poor quality or errors³.

5.3 Comprehensibility

Products' terms and conditions are often so complex that it is clearly challenging to write the "What is this product?" section of the KID, for example, in language that is clear, concise and comprehensible, as required by regulation. Copying individual terms and conditions of the product as such to this section of the KID, for example from the required product brochure, is not a recommended course of action, at least without mentioning what the contractual nomenclature of the terms and conditions, which often deviates from general language, means in practice.

³ For example, KID translated as the word child (lapsi).