



The Consumer Voice in Europe

# KEY INFORMATION DOCUMENTS (KID) FOR INVESTMENT PRODUCTS

## Proposal for a Regulation

BEUC position

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## Summary

BEUC welcomes the European Commission's proposal for a regulation seeking to create a key information document (KID) for investment products.

Saving and investing are not the exclusive privilege of the most affluent members of our society. There are large numbers of consumers who need savings and investment products in order to meet their future financial needs, whether this involves e.g. saving in order to acquire a future residence, financing children's studies or dealing with the reduction in income occasioned by taking retirement. The Commission's initiative is an important one because it makes it possible to respond to an earlier lack of information on the part of consumers at the time they made their decisions: the prospectuses, the summaries of prospectuses as well as all other precontractual information are generally drafted in too technical language, and are often too long to be truly accessible to consumers. Moreover, the content of the information provided varies as a function of the legal nature of the investment products being considered, even though in economic terms they are similar or very close and meet the same needs.

The main positive points of the regulation proposal are the following:

- Information rendered accessible thanks to plain language and a restriction to the key elements necessary for understanding the product;
- Comparison between products falling within the scope of application of the regulation made possible thanks to a harmonised framework for the KID, knowing that the details of the content can vary as a function of the particular features of each type of product;
- Obligation to provide the KID to the consumer prior to conclusion of the transaction;
- Responsibility placed on the issuers of the KID;
- Obligation for the issuers of investment products to participate in a system of alternative dispute resolution;
- Introduction of a sanctioning regime in the event of failure to respect the obligations of the regulation.

However, a number of aspects of the regulation proposal should be improved:

- The KID should be available not only for 'packaged' investments, but also for products that are not packaged and for products whose ultimate return is known in advance;
- The KID should include information other than that furnished by the issuer of the product: the entry fee which can vary depending on the distribution channel, the commissions and retrocessions collected by the non-independent intermediary as well as the tax regime which varies depending on the type of investment product and the country where it is distributed;

- The information on risks cannot be limited to having the KID adopt the risk indicator that already applies for UCITS;
- Warning of the consumer with regard to the misleading character of the past return if the latter is published;
- The KID should be submitted to the consumer when the intermediary or the advisor recommends a product to him, even if ultimately there is no transaction;
- Provision of a system for proving that the KID was submitted to the consumer;
- The exception to providing the KID in the event of a transaction using a means of distance communication must be eliminated;
- The decisions taken by the body in charge of the alternative dispute resolution must bind the intermediary or the insurance undertaking concerned;
- The exceptions to the publication of the sanctions must be eliminated.

## ***Introduction***

### **A long awaited improvement for consumers**

BEUC welcomes the long awaited Commission proposal on the Key Information Document (KID) for investment products.

Investing is not the exclusive preserve of society's most privileged members. Whether we see ourselves as investors or not, consumers are often exposed to financial risks:

- The ageing of the European population, combined with the financial situation of many Member States, makes it imperative – for those who can afford it – to supplement their state pension with personal savings.
- In some countries, the supplementary pension is received at the end of a working life in the form of capital. At that point, wise decisions need to be made so that this capital can cover the future needs of the pensioner.
- Many households save money to buy a house later in their life.
- In some Member States, ensuring that children can do post-secondary studies presumes a significant financial participation, which in turn requires prior savings.
- Saving for the medium or long term means doing more than just making short-term bank deposits, where the interest often does not even keep up with the inflation rate.

Investing is a perfectly normal activity, and should not be equated with speculation or the reckless pursuit of financial gain.

Moreover, the financial crisis has shown that many small savers had invested in financial instruments – often without realising it, and without anyone having clearly explained their implications to them like the structured products guaranteed by Lehman Brothers.

It is crucial that the consumer who wants to save or invest for future needs has access to understandable information and is in a position to compare the different savings or investment products that could suit his needs. Today, as each type of product has its own legislation, there is no standardised, short and understandable information covering all investment products. In this regard, the Commission initiative is particularly important to consumers.

## General remarks

### **Widespread need for short and easy to understand information**

Currently, prospectuses, summary of prospectuses or other pre-contractual material produced by banks or other financial institutions to inform consumers is generally too juridical or uses too technical jargon to be understood by them and help them to take an informed decision about which product to invest in. Unfortunately, the most understandable information is often available in marketing documents that generally focus on the advantages of a product or its highest possible return; the objective is to influence a consumer's decision and not to inform him about the key aspects of this product. In this regard, the KID will improve consumer information.

The use of such short, simple and understandable documents to inform consumers is very much in line with the findings and recommendations of the study conducted for the Commission on retail investor behaviour<sup>1</sup>:

- **INITIAL RECOMMENDATIONS - INFORMATION**
  - *Don't rely on financial education as a silver bullet*
  - *Financial literacy/education has relatively small impact*
  - Do simplify product information disclosure
    - *Require/encourage presentation of a small number of key pieces of information*
    - *Clearly separated from extraneous information*
  - Do standardize product information disclosure
    - *The same information for different products within a class*
    - *And, where possible, across product classes (e.g. regular savings vs. pension)*
  - Do standardize information disclosure format
    - *So alignment of product information is straightforward*
  - *And pay close attention to the central importance of advice...*

The idea of short and understandable information should be extended to all savings and investment products, not only the packaged ones as proposed in the Commission proposal. There is no reason to limit the benefit of this information improvement for investor choosing packaged products. Inviting consumers to read carefully the KID will give an undue competitive advantage to products covered by the KID; this is not desirable as other products may be more suitable for consumers needs or even cheaper.

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<sup>1</sup> Consumer Decision-Making in Retail Investment Services. A Behavioural Economics Perspective; Nick Chater, University of Warwick; Roman Inderst, Goethe Universität Frankfurt; Steffen Huck, UCL.  
Presentation for the Conference organized by the Commission on 22/11/2010, especially slide 19:  
[http://ec.europa.eu/consumers/conferences/behavioural\\_economics2/docs/decision\\_technology\\_22112010\\_en.pdf](http://ec.europa.eu/consumers/conferences/behavioural_economics2/docs/decision_technology_22112010_en.pdf)  
Complete report: [http://ec.europa.eu/consumers/strategy/docs/final\\_report\\_en.pdf](http://ec.europa.eu/consumers/strategy/docs/final_report_en.pdf)  
Conference program, presentations and video:  
[http://ec.europa.eu/consumers/conferences/behavioural\\_economics2/programme\\_en.htm](http://ec.europa.eu/consumers/conferences/behavioural_economics2/programme_en.htm)

## **Need for a broader comparability**

Investment products proposed to retail investors range from bank deposits, bonds or notes issued by a bank or a company, shares issued by a company, UCITS 2 (with European passport), funds (without European passport), life insurance policies (with some guaranteed return or linked to the return of a fund) to structured products (with capital guarantee/protection or not). A same fund can be distributed as UCITS, as national fund, or as unit-linked insurance. Structured product with the same intrinsic characteristics can be distributed as UCITS, national fund, note, deposit or life insurance.

BEUC welcomes the KID as it would improve the comparability of those different products. However, as the KID is limited to packaged investment products (investment products where the assets are wrapped in a fund, a life-insurance contract or a structured product, without direct access for the consumer to the underlying assets), the consumer will still not be able to easily compare the broadest range of savings and investment products. This is the reason why BEUC asks for a broader scope for the KID Regulation: a KID should be available for all savings and investment products, deposits, plain shares and bonds included.

## **Consumer needs information from the distributor**

The KID is an information document drafted by the issuer of a packaged investment product. It has been designed from the issuer perspective and not from a consumer perspective; consumers need this information sheet to compare various products and choose the most appropriate one. The consequence is that some elements of the KID are wrong and risk misleading consumers and other key elements needed to take a good decision are missing.

For example: the entry costs (or initial fee) mentioned in the KIID for UCITS<sup>3</sup> (very similar to the here discussed KID) are the maximum costs an investor will be charged with. In some Member States, this fee is paid to the asset manager who rebates a part of this fee to the distributor who rebates a part to the client. In other Member States, the initial fee is directly paid to the intermediary and can be substantially lower than the maximum fee mentioned on the KIID. For instance, a KIID could indicate 7,25% as entry costs but the intermediary actually charges only 2,5% from the investor. The same will occur with this KID; it is a missed opportunity that such a good information sheet does not provide accurate information on costs which is key for investors.

When comparing different types of investments, the tax regime is also another key element to take into account. A same underlying asset may have different tax regimes according to the way the investment product is conceived: as a UCITS, as a life insurance or as a structured bond or note. No one can make a good choice without having a look at the tax regime. This is the reason why the KID should contain a short description of the tax regime applying to the public the distributor has targeted.

Finally, the MiFID review and the Insurances Mediation Directive review, still in discussion at the European Parliament and the Council, could provide that the

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<sup>2</sup> Undertakings for Collective Investments in Transferable Securities.

<sup>3</sup> Commission Regulation (EU) n° 583/2012

intermediary must disclose to the investor the commissions he eventually receives from the asset management firm or the manufacturer in relation with sales of its investment products. Currently commissions may vary from an investment product to another. BEUC considers that – as long as commissions and inducements remain authorised – if any commission or inducement is paid in relation with a transaction, it should be disclosed through the KID as it is one of the key information needed to take an informed decision.

There is no reason to multiply documents and sources of information for consumers. Consumer should only consult a single information sheet to understand all key features of a specific product and compare different products that could suit his needs. BEUC considers that such approach complies with the objective of the KID.

### **Testing the efficiency of the KID**

BEUC particularly appreciated the way the European Commission prepared the KIID for UCITS. Workshops were organized with all stakeholders by CESR (now ESMA) at the request of the European Commission and a big test was carried out with real consumers before adopting the final layout of the KIID. The same methodology should be adopted when designing the KID. Testing the effective impact of the planned KID on consumers is a key of its success, particularly when designing the layout or the risk disclosure.

## **[Analysis of the proposed provisions](#)**

### **Article 2**

As mentioned above, the scope of this Regulation should not be restricted to ‘packaged’ investments or investments with a (partly) unknown return. All savings or investments products without any exception should have a KID available for consumers. This is a key condition to let consumers acquire the reflex to always consult the KID whatever saving or investment products proposed to them. Term deposits, deposit certificates and bonds should be included in the scope. When the aim of legislation is to help consumers to compare risks and merits of different kinds of savings or investments, a KID should be available for all of them. For example, some structured products are proposed to consumers as an alternative to bank deposits; a KID would be available for structured products but it would be difficult to compare it with a bank deposit for which no KID is required.

Some of the exceptions mentioned in Article 2 (c) are not justifiable from a consumer perspective, like securities proposed by Members States, local authorities or international bodies, or non-equity securities issued in a continuous or repeated manner by credit institutions. Such exemptions do not comply with the objective to put the consumer in a position to compare the different savings or investment products that suit his needs.

Regarding occupational pensions, even when consumers do not have to take decision in this area, it remains important for them to easily understand the risks and probable outcome of their occupational pension. When consumers have to decide what to do with their money, they have to assess their needs and financial resources for the middle and long term. They also need to know which financial risks they are already exposed to in order to diversify their savings and investments. In this regard, information on the occupational pensions is needed for an adequate risk

diversification and for a correct assessment of what consumers can really expect to compensate the income reduction when retiring.

### **Article 3**

BEUC supports this article: products that fall within the scope of the Prospectus Directive or the Solvency II Directive should also be covered by this Regulation.

### **Article 4**

As explained in our general remarks and under Article 2, the scope of this Regulation should be broadened. In this regard, the definition of investment product (Article 4 (a)) should not be restricted to 'packaged' investments where the investor is exposed to fluctuation of assets which are not directly available for purchase by the investor.

The person selling the investment product is not defined by the proposed Regulation. The sale is a too narrow concept as some intermediaries do not 'sell' the investment product but create the contact between the consumer and the manufacturer (e.g. insurance undertaking). Furthermore, the advisor should be concerned by the Regulation whether or not an investment takes place (a sale takes place or not). The person selling is mentioned not only in Article 4 (f) but also in Articles 12, 13, 15 and 19. Therefore, BEUC suggests defining the concept of a person who sells in a new subparagraph.

### **Article 5**

BEUC supports the general duty for the manufacturer to draw up a KID. However, the manufacturer's information should be completed with information added by the distributor.

Firstly, the local tax regime of the investment product (IP) is essential to compare an investment product with others (each type of investment product may have its own tax regime). When an IP is actively distributed to consumers of a Member State, its tax regime in that Member State should be mentioned.

Secondly, the costs linked to the investment may vary from a distributor to another.

Thirdly, if MIFID and IMD still allow some commissions and retrocessions to be paid to intermediaries, they must inform their client about the commissions and retrocessions paid to them. The disclosure of this information must be standardised so that it can be easily found by the consumer allowing him to make comparisons with commissions/retrocessions charged by other intermediaries. This information should be made available at the same moment than the information foreseen by the proposed Regulation in the KID.

Without that supplementary information (tax regime, costs and remuneration), a choice based on the KID will be incomplete and preventing consumer from correctly comparing and choosing the right product. BEUC suggests that the KID should contain 2 parts: the first containing the manufacturer's information, the second the distributor's information.

Regarding the availability of the KID, the European Commission proposes that the manufacturer publishes the KID on a website of its choice. BEUC considers that everywhere the prospectus is published and accessible for retail investors, the KID – at least the manufacturer's part of it – should be also available on the same place.

And it would be preferable that all KIDs are easily accessible on an official website of the control authority.

### **Article 7**

BEUC considers it as fundamental that the KID must be understood by the public the intermediary is addressing to. In this regard, the proposed Article 7 can be problematic: as a result of its wording, the KID can be offered to a retail investor in a language that is not (well) understood by the consumer. In Belgium, German is an official language but the German speaking population is less than 1% of the entire population. The other 90% generally do not understand German enough to make an informed choice based on a document drafted in German.

### **Article 8**

BEUC welcomes the Q&A format proposed by the European Commission but some improvements are needed as regards the content of the KID.

As the KID is mainly intended for the non-sophisticated investor, it should remain as simple as possible and consumer testing should be a part of the assessment of the possible contents and layouts before the Commission adopts the delegated acts in this regard.

#### **Article 8.1**

The question of costs is an important criterion for choosing an investment product. As the statement under the title of the KID has an important awareness raising effect on the consumer, costs should be mentioned in this statement.

#### **Article 8. 2. (b) vi) performance scenarios**

Structured products are often designed to offer the possibility of high but unrealistic returns. When 3 scenarios are published without any mention of their respective occurrence probability, the consumer understands that each of the scenarios has the same probability. Moreover, this presentation exploits a well known cognitive bias which is the tendency to overestimate favorable or pleasing outcomes. For those reasons, when publishing performance scenarios, the probability of those scenarios should be taken in account.

#### **Article 8. 2. (c) ii) compensation schemes**

The protection granted by a compensation or a guarantee scheme can be of different shapes: the investor compensation scheme protects the customer against the loss of the instrument by the investment firm, not against financial losses due to the volatility of underlying assets or insolvency of the issuers of those underlying assets. The Regulation should be more precise to avoid any misuse of this provision.

#### **Article 8. 2. (d) What is it for?**

BEUC welcomes this provision; the recommended holding period and the expected liquidity profile are two particularly important elements to allow the customer to assess the suitability of the investment.

#### **Article 8. 2. (e) What are the risks and what might I get back?**

BEUC is concerned by the information on risks.

- The current risk/reward indicator in the UCITS KIID needs to be improved. A lot of people understand the first degree of the scale from 1 to 7 as a risk-free situation,

particularly when intermediaries advise such products for conservative and risk-averse investors.

But based on the past volatility of the underlying assets, the risk/reward does not reflect the risk which might occur during a possible next market downturn, financial bubble or financial crisis. Example: We came across a structured investment product linked to real estate funds. Its risk category was 2 on a similar risk/reward scale. At the end of the 3 years term of this investment, the loss amounted to 58% of the amount invested! It is therefore necessary in all cases to mention what the maximum possible loss is.

- The risks that are not encompassed by the risk/reward indicator (counterparty risk, exchange rate, liquidity risk) are significant. Those risks are potentially higher for other investment products than UCITS as there is no compulsory diversification in the underlying assets. The way those risks are disclosed in the KIID for UCITS is not satisfactory: it is sometimes a description of the risk's kind, but without any idea of how high the risk is and how it can affect the invested money. It is crucial that the targeted customers are able to understand and assess the risks they will bear. If it is not the case, those products are not suitable to be sold without investment advice.

Those problems could be addressed by creating a label (layout and number of levels to be determined after rigorous consumer testing) combining risks and complexity. On the first level, the product must be understood by almost everyone and the risk reduced at his minimum, for instance state bond with high rating or deposit guaranteed by a deposit guarantee scheme. The higher the risk and/or the complexity, the higher should be the level on the scale. All investment products that cannot be understood by a non-sophisticated consumer, and all investments where more than the invested capital is at risk should be ranked in the highest level. For this last category, the KID should warn the consumer that he should not invest in those products without being advised.

In any case, the way the synthetic risk-reward indicator SRRI is currently implemented for UCITS, as well as any change to the SRRI or the addition of complementary information should be thoroughly consumer tested.

#### **Article 8. 2. (f) What are the costs?**

BEUC supports that all costs must be disclosed, whether they are direct (like entrance fees or yearly management fees) or indirect (like the cost of a structure incorporated in a structured product). The TER (total expense ratio) currently used by issuers of UCITS does not encompass all costs borne by the UCITS and is therefore not satisfactory.

- The costs mentioned by the manufacturer should be presented as maximum costs and the costs to be effectively paid should be refined in the distributor's part of the KID which BEUC suggests to be added (see our general remark and our comments for Article 2). Justification: the costs mentioned in the KIID for UCITS, are not helpful as they mention the maximum costs and not the costs that are really paid when investing through a specific intermediary. Example: a KIID mentions 7,25% for entrance fee and the marketing material of the intermediary mentions 2,5%. Such contradiction affects the credibility of the KIID towards the marketing material.

- When it comes to structured products, consumer needs to be informed about the real value of the structured part (containing derivatives) of this product. This real value is usually lower than what the manufacturer pays when buying it from a specialised firm. The costs are hidden in the premium and are not disclosed to the

consumer. The only way to diminish the information asymmetry between the customer and the manufacturer is to reveal the fair value and the price paid for the structure.

***Article 8. 2. (g) How has it done in the past?***

The past performance can be misleading. A product that has produced a high return during a 'bubble' may have taken excessive risks. It is therefore far from certain that this exceptional return will happen again. If past performance is mentioned in the KID, it may only be disclosed with due and effective warning that past performance is not indicative of how the investment will perform in the future. Manufacturers may not determine freely the period they will take in account when publishing past performance, otherwise they will choose the best period for them and there will be no harmonization. It should be determined by delegated acts.

***Article 8. 2. (h) What might I get when I retire?***

BEUC welcomes the mention of what a long term investment outcomes will be. To avoid any misleading use of this information when the projection is not certain, it should be clear that there is no guarantee and the inflation can affect the real value of the capital or annuity.

***Article 11.2***

A consumer is generally not able to prove that the loss is effectively caused by the non-compliant KID. BEUC asks that when the consumer decision to invest is based on the KID and if the KID information is wrong or misleading, the burden of proof should be borne by the issuer of the wrong or misleading information. This means that the issuer will not be obliged to compensate the loss if he can prove that the loss does not result from the use of the information contained in the KID.

***Article 12***

***Article 12.1***

Regarding the issue of when the intermediary must deliver the KID, the proposed first paragraph of Article 12 does not address that advice or a simple recommendation often happen separately from a transaction. Advice or recommendation should not be given without referring to and delivering the KID. It is well known that a decision to invest is taken in the first moments when a recommendation is given. It is one of the first lessons to all sellers. If the KID is not delivered at the same moment as the recommendation, its efficiency will drop dramatically.

***Article 12.2***

BEUC is concerned by the exception proposed to the delivery of the KID prior to the transaction when the transaction occurs using a means of distant communication. This exception creates an important loophole in the KID Regulation. If we consider that the KID is necessary to take an informed investment decision, it should not be possible to invest without having had the possibility to read it. Otherwise, a bank seller could contact his client by phone, recommend a product and collect the investment order before the client has had the possibility to read the KID. Reading the KID after the investment is not protecting the client, unless a right of withdrawal is granted by this regulation.

### **Article 12.3**

If a long time elapsed since the provision of the KID or if the KID has been updated, the first provision of the KID should not be considered as sufficient for further transactions.

### **Article 13**

#### **Article 13. 1**

Our Danish member, who participates in the Danish ADR scheme for investments services, mentions that in a lot of cases, it is unclear if the equivalent of the KID (KIID for UCITS or Danish equivalent for other investment products) has been delivered or not. Therefore it is important that the intermediary must carry the burden of proof that the KID has been delivered according the provisions of the regulation.

#### **Article 13. 3**

As provided by Article 12.1., the KID should be provided *in good time before the conclusion of a transaction relating to the investment product* (see Art. 12.1.). When the investment recommendation is provided in person (face to face), or when the investment order is given in person, e.g. at a bank counter or in the intermediary's premises, the KID must be provided in paper form.

### **Article 15**

BEUC welcomes warmly that alternative dispute resolution is made compulsory for the manufacturer and the intermediary.

However, BEUC does not agree with Article 15. 1 (a) that provides that the procedure results should not be binding. BEUC supports that decisions should be binding for the industry, not for the consumer. In countries like UK and Denmark, decisions are binding for the industry and the proposal under (a) would mean a step backwards for consumers in those countries.

### **Article 22**

The exceptions to the publication of sanctions should be deleted. The breaches mentioned in Art. 19 (1) are not of such a kind that their publication could seriously jeopardise financial markets. As long as the names of issuers or intermediaries condemned are not made public, there will never be any deterrent effect preventing illegal practices and it will always be advantageous to commit offenses.

**END**