PRIIPS - navigating complexity

The PRIIPs (packaged retail and insurance-based investment products) Regulation, which will enter into force on 01 January 2018 aims at standardising and improving product information in order to allow retail customers to make more informed investment choices. Although the European Commission started working on the PRIIPs concept before the financial crisis, the events of 2008 made it clear that a significant number of retail investors did not have a good understanding of the risks inherent to investment products.

Further, charges were not always presented in a way which made it easy for customers to understand their overall amount and their impact on performance over time. It was therefore necessary to both improve transparency and rebuild trust in the financial industry in order to sustain the public policy objectives of encouraging consumer savings and ensuring inflows into financial markets in order to ultimately sustain the "real" economy.

The PRIIPs Regulation aims at tackling both areas through a more visual description of risk, which is reminiscent of the grading introduced for UCITS funds, and a presentation of costs which is both expressed by categories (entry/exit costs, but also on-going and incidental costs) but also shown over time as the reduction in yield. For the first time in a standardized format, costs presented in the Key Information Document (KID) will include both direct and indirect costs, and the cumulated amounts shown by categories (in tabular format) will aggregate both insurance costs (e.g. administrative costs of the insurer, biometric risk premium, distribution costs etc.) but also costs relative to the investments (e.g. asset management and transaction costs, custody fees etc.).

The reduction in yield will allow prospective investors to get a feel for the impact of charges over time (after one year, at the end of the recommended holding period and after half the recommended holding period has elapsed), based on a simulated (moderate) performance of the investment. A novelty also introduced by the PRIIPs KID is the computing of various performance scenarios, which are a marked departure from the past performance tables in their UCITS cousins (KIID – Key Investor Information Document). This new perspective is notable to the extent that product providers have scrupulously been warning investors for years that past performance is no indication of the future.

Still, Europe-wide consumer testing has shown that individuals have a marked preference for prospective rather than past data and the Regulation, acknowledging this behavioural bias, strives to ensure objectivity and comparability by providing a strict methodology for their computation. In particular, a stress scenario has been introduced in the final version of the Technical Standards to illustrate conditions of strong market turbulence (volatility), which has become a somewhat more regular feature of our modern economies. Finally, insurers get a "bonus" scenario illustrating the value of the insurance benefit payout on occurrence of the insured event.

While the aim of improving customer understanding through standardisation of the information is laudable (another aim of the Regulation is also to allow customers to compare the essential features between several PRIIPs more easily), it is clear that the Regulation was drafted primarily for (relatively non-complex) products targeted at retail investors (for example, a unit-linked life insurance product offering a limited choice of investment funds).

Taking into account the fact that PRIIPs KIDs must be remitted to the customer in good time before any transaction is concluded, the complexity of computing data in order to put together KIDs for PRIIPs which involve discretionary asset management will rapidly become apparent to the practitioner. Indeed, the success of Luxembourg as a financial centre partly relies on unit-linked insurance products and in particular "dedicated funds", which are internal insurance funds with a theoretically unlimited investment universe (subject to the qualitative and quantitative limits of Circular Letter 15/3 of the Commissariat aux Assurances) managed by an external asset manager with a discretionary mandate. In this scenario, the insurer must establish how to compute the various indicators in the KID (summary risk indicator, performance scenarios, tables of costs and reduction in yield) while in theory all types and combinations (and therefore costs and prices) of assets are possible. In parallel, the KID, while a standardised document, must be sufficiently relevant to the customer in order to enable the retail client to make an educated choice about whether or not to invest into the product.

To solve this conundrum, a methodology using data provided by the external (discretionary) asset manager was jointly developed in Luxembourg by Lombard International Assurance S.A. and a small group of insurance players offering tailor-made products in order to achieve the objectives of the Regulation while providing a workable model for the industry. With the support of the Association of Insurance Companies of Luxembourg (ACA–Association des Compagnies d'Assurance et de Réassurance), a data template was developed accordingly and rolled out to members and asset managers. This data template (the LPT, or Luxembourg PRIIPs Template, a version tailored for the industry built on the European PRIIPs Template, or EPT) aims at capturing the external asset manager's model portfolios or investment strategies (which are expressed as the combination of strategic asset allocations and benchmarks or proxies) and is communicated to the insurer in order to provide the raw data for the calculation of summary risk indicators and performance scenarios. The LPT also contains data on asset management costs, which will be aggregated with those of the insurer.

With the combination of the EPT for external funds and LPT for internal insurance funds (discretionary managed insurance dedicated funds and internal collective insurance fund), leading Luxembourg insurance players have worked together to create a full data collection suite and methodology which will enable the industry to comply with the PRIIPs Regulation - another example of the Luxembourg financial industry's capacity to adapt, influence and innovate.

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Lombard Int'l acquires HSBC Life Assurance portfolio

Lombard International Assurance, a global leader in wealth structuring solutions, announced that it has entered into an agreement to acquire a portfolio of life insurance policies from HSBC Life Assurance (Malta) Ltd, subject to regulatory approval.

This acquisition of an in-force book of policies will further strengthen Lombard International Assurance's position as the leading provider of multi-jurisdictional, wealth planning solutions to high net worth individuals and their families. The acquisition is subject to regulatory approval and is expected to complete in 2018.

Lombard International Assurance will gain approximately € 500m of assets under administration, integrating a book of Italian clients. These clients will benefit from Lombard International's long term commitment and local presence in the Italian market including high quality policy reporting and excellent client service. Lombard International Assurance has a proven track record of integrating existing portfolios, demonstrated by its acquisition of Zurich Eurolife S.A. in July 2016, including € 2.3 billion of assets under administration and the integration of over 700 policyholders.

Axel Hörger, CEO Europe of Lombard International, said: "This acquisition further demonstrates Lombard International's global growth ambitions both through organic and inorganic opportunities. Following the Zurich Eurolife acquisition last year, the announcement of our joint venture in Mexico, coupled with our US and Asia footprint, we are increasingly able to serve our clients successfully on a global scale, leveraging our in-house expertise."