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PRIIPS Regulation: What is in store for UCITS funds?

After a tumultuous early start in life, the finalised draft technical standards amending granular rules currently applicable to PRIIPS KIDs **(Level 2 Measures)**[1] were finally adopted by the European Commission last month and are currently subject to scrutiny by the European Parliament and the Council of Europe.

The European Commission proposes the revised Level 2 Measures will apply to all PRIIPS KIDs from 1 July 2022. So why is this development causing UCITS management companies throughout the EU to sit up and take note?

In a "quick-fix" amendment being made to the PRIIPS Regulation itself[2], the European Commission has also proposed that a PRIIPS KID be prepared in relation to UCITS which are marketed to retail investors in the EEA from 1 July 2022.

If implemented as proposed by the European Commission, this would require all in-scope UCITS management companies to provide EEA retail investors with a PRIIPS KID from 1 July 2022 onwards, a task which should not be underestimated given the significant differences between the PRIIPS KID and the UCITS KIID which is currently produced.

In a separate quick-fix amendment proposed by the European Commission to the UCITS Directive, the obligation to produce a UCITS KIID under that directive will be deemed satisfied where the UCITS provides a PRIIPS KID which complies with the PRIIPS Regulation. This is in order to avoid a scenario where a UCITS is required to produce both a UCITS KIID and a PRIIPS KID.

[1] The revised technical standards amend Commission Delegated Regulation (EU) 2017/653
[2] Regulation 1286/2014/EU

Key Points to Note:

- **Any UCITS which is marketed to EEA retail investors must prepare a PRIIPS KID from the Application Date**
- **A PRIIPS KID can be used to replace a UCITS KIID to avoid a scenario where both documents must be prepared**
- **A PRIIPS KID must include forward looking performance scenarios**
- **A PRIIPS KID must use different cost methodology and disclosure to explain the fee structure and impact of same on the returns of the UCITS**
- **Significant increase in the type of data to be collected to populate the PRIIPS KID**

In this briefing, we analyse the scope of this obligation, provide an overview of the key features of the PRIIPS KID, highlighting where it differs and where it aligns with the UCITS KIID and outline next steps which should be taken by in-scope UCITS management companies as they implement their transition plans over the coming months.

Is this timeframe of 1 July 2022 set in stone?

No. As noted above, the European Commission has proposed that UCITS management companies managing UCITS that are marketed to EEA retail investors be required to prepare a PRIIPS KID from 1 July 2022.

However, the Economic and Monetary Affairs Committee of the European Parliament **(ECON**) has, in considering the quick-fix amendments to both the PRIIPS Regulation and the UCITS Directive, proposed amendments to both pieces of legislation[3] which would delay the relevant provisions from taking effect until 1 January 2023 in order to give stakeholders sufficient time to prepare for the obligation to produce a PRIIPS KID. The revised time-frame proposed by the ECON must now be considered by the Council of Europe.

For the purposes of this briefing, we refer to the relevant application date as being 1 July 2022 although if the revised timeframe as proposed by ECON is approved by the Council of Europe, readers should be aware that the application date will be pushed out to 1 January 2023 (**Application Date**). We will keep readers updated as and when any further clarity on this emerges.

In what circumstances will a UCITS management company be required to produce a PRIIPS KID?

Pursuant to Article 5 of the PRIIPS Regulation[4], a PRIIP manufacturer[5] will be required to draw up a PRIIPS KID in respect of the UCITS and to publish it on its website, before making that UCITS available to retail investors in the EEA.

The decision tree on the next page should help UCITS management companies in establishing whether or not they will be required to produce a PRIIPS KID from the Application Date.

[3] https://www.europarl.europa.eu/doceo/document/ECON-PR-697633_EN.pdf and https://www.europarl.europa.eu/doceo/document/ECON-PR-697630_EN.pdf
[4] Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs)
[5] Although the definition of "PRIIPS manufacturer" under the PRIIPS Regulation does not expressly refer to a UCITS management company, Recital 5 of the PRIIPS Regulation suggests that a UCITS management company is the entity to be considered a PRIIP manufacturer of a UCITS product for the purposes of the legislation. Recital 5 states "PRIIP manufacturers - fund managers, insurance undertakings, credit institutions or investment firms — should draw up the key information document for the PRIIPs that they manufacture, as they are in the best position to know the product" References to "PRIIPS manufacturer" throughout this briefing should be read accordingly
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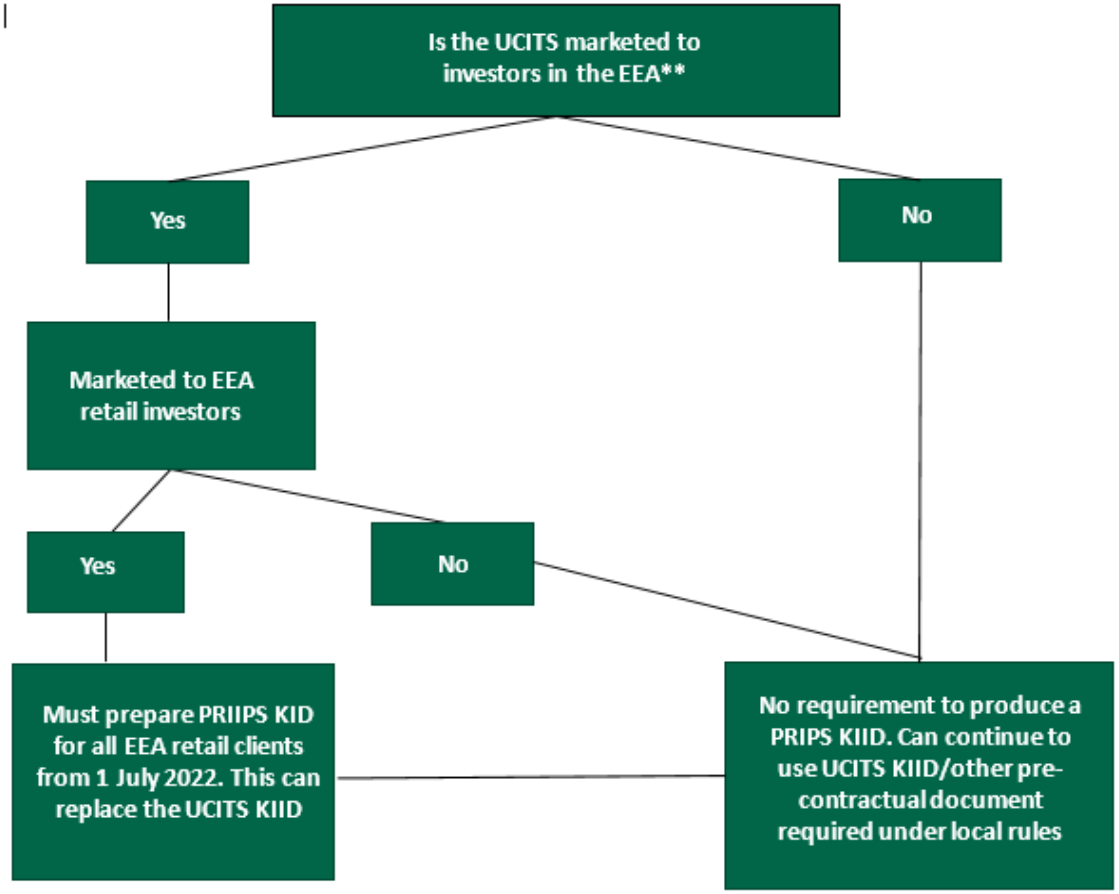

**It is worth bearing in mind that under the UCITS Directive, a UCITS must be promoted to the public within the EEA. The CBI requires that any UCITS seeking authorisation from it must indicate the EEA Member States in which it is intended to initially promote its shares.

A UCITS will be required to prepare a PRIIPS KID to the extent that it is marketed to "retail clients" in the EEA. What is meant by a "retail client" for this purpose?

In essence, a retail client is any investor which does not fall within the definition of a "professional client" under MiFID rules. As a result, a UCITS which markets exclusively to entities regulated as banks, investment firms, asset managers, insurance companies or other funds (including pension funds) in the EEA or under equivalent third country rules or to high net worth individuals who meet certain qualitative or quantitative requirements will not be required to prepare a PRIIPS KID on the basis that the UCITS is not marketed to "retail clients" within the EEA.

What are the key differences between the UCITS KIID and the PRIIPS KID which UCITS management companies should be aware of?

In the table below, we outline the principal differences between the two categories of pre-contractual document, as well as identifying where existing UCITS KIID disclosures can be recycled in the PRIIPS KID. A further analysis of some of these provisions is set out subsequent to the table.

Relevant Provision	UCITS KIID	PRIIPs KID
Forward-looking performance scenarios	Not required	Forward looking performance scenarios are required to be calculated and presented in accordance with Annex IV and V to the Level 2 Measures. See below for further analysis.
Past Performance	Required to be displayed in the UCITS KIID itself	PRIIPS KID must contain a signpost to where past performance information can be accessed. See below for further analysis.
Risk and reward disclosures	The UCITS KIID must disclose the potential risks and rewards associated with investing in the UCITS using a synthetic indicator as well as a narrative explanation of the indicator, its main limitations and of material risks which are not covered by the indicator.	The summary risk indicator must be calculated in accordance with Annex II to the Level 2 Measures6 which differs significantly from the calculation methodology which UCITS funds currently use to calculate their risk and reward indicator. It must also be presented in the format set down in Annex III to the revised draft RTS. See below for further analysis.
	The summary risk and reward indicator (SRRI) ranges from 1-7 according to the	As per the UCITS KIID, the summary risk indicator (SRI) disclosed in the PRIIPS KID ranges from 1-7.

[6] This has been revised to allow PRIIPS manufacturers to increase the SRI if they consider that the SRI generated does not adequately reflect the risks of the UCITS. In such circumstances, the PRIIPS manufacturer should document the rationale for this increase in SRI.

Relevant Provision	UCITS KIID	PRIIPs KID
	increasing level of volatility/risk-reward profile.	Must disclose that the investor could lose all invested capital.
Investment Objective and Policy	Certain prescribed disclosures relating to (i) main categories of eligible financial instruments, (ii) redemption frequency, (iii) any industrial, geographic or other market sector target of the UCITS and (iv) whether the UCITS is being managed in reference to a benchmark.	As per UCITS KIID disclosure obligations, therefore existing disclosures can be recycled in the PRIIPS KID.
Civil liability for contents of the document	Cannot be incurred unless it is misleading, inaccurate or inconsistent with the relevant parts of the prospectus.	As per UCITS KIID rules. In addition, the PRIIPS KID cannot be inconsistent with the content requirements set down in Article 8 of the PRIIPS Regulation (which includes the requirement to disclose the risk-reward profile, costs etc. in accordance with relevant Level 2 Measures). Liability is imposed on the PRIIPs manufacturer.
Use of “representative” KIID/KID	Permitted	Permitted
Filing procedures	Must be submitted to the Central Bank for noting by it prior to distribution	PRIIPS KIDs are not currently required to be filed with the Central Bank prior to them being used.
Review of document	Must be reviewed: (i) at least every 12 months and prior to any proposed change to the prospectus or the constitutive document[7] and prior to or following any material changes to the information contained in the KIID	Must be reviewed: (i) at least every 12 months and every time there is a change which significantly affects or is likely to significantly affect the information contained in the KID. Article 15 of the Level 2 Measures sets down what needs to be verified as part of that review. (ii) No requirement to publish a revised KID containing updated data within a specific timeframe as is required under UCITS KIID rules.

[7] Such a review must be carried out where the changes to the prospectus/constitutive document are not caught by the annual review process

Relevant Provision	UCITS KIID	PRIIPs KID
	(ii) Must be updated to include revised past performance data within 35 business days of 31 December in each year;	However the obligation to calculate costs and performance scenarios using data from the previous year, coupled with the obligation to ensure that information contained in the KID is not misleading or inaccurate, is likely to result in the KID being updated on at least a yearly basis.
Complaints	N/A	Must disclose steps to be followed to lodge a complaint about the UCITS or conduct of the PRIIP manufacturer.
Term	N/A	As a UCITS does not typically have a maturity date, the PRIIPS KID must confirm the circumstances in which the PRIIPS manufacturer can unilaterally terminate the relevant fund and circumstances in which the fund can be terminated automatically.
What happens if the PRIIPS manufacturer is unable to pay out	N/A	PRIIPS KID must disclose whether a retail investor could suffer a financial loss as a result of the default of the PRIIPS manufacturer or any other entity.
Recommended holding period	Generally no disclosure required.[8]	The recommended holding period for the UCITS, together with information on any consequences of redeeming from the fund before the recommended holding period has expired must be disclosed[9]
Intended retail investor	No disclosure required	Must include a description of the type of retail investor to whom the UCITS is intended to be marketed, taking into account needs, characteristics and objectives of the type of investor the UCITS is suitable for. May be able to leverage off

[8] UCITS KIID must contain a specific risk warning where a recommended holding period is disclosed in the prospectus/marketing materials of a UCITS or where it is an essential element of the investment strategy

[9] The recommended holding period disclosed in the PRIIPS KID should be consistent with any minimum recommended holding period used in MiFID product governance assessments/EMTs etc as well as any description of a recommended holding period included in the prospectus when describing the profile of a typical investor. Article 6 of the PRIIPS Level 2 measures suggest that this relates to the consequences of redeeming shares before the recommended holding period has expired include impact on the risk or performance profile of the UCITS and/or any fees/penalties incurred in such circumstances.

Relevant Provision	UCITS KIID	PRIIPs KID
		existing disclosure of "profile of a typical investor" which is required to be included in the UCITS' prospectus.[10]

Costs Disclosures

Costs over Time Table

As noted above, the "Costs over Time" table must include a summary total cost indicator figure which is intended to illustrate how costs reduce the investor's return over the holding period, assuming an investment of €10,000.

This disclosure will vary depending on the recommended holding period of the relevant UCITS. For example, for UCITS with a recommended holding period of between 1 and 10 years, this costs figure must be shown:

(i) based on redemption at the end of the first year; and
(ii) based on redemption at the end of the recommended holding period.

The narrative accompanying this figure must explain that the total costs figure will vary depend on how much is invested, how long the product is held and how well the product does.

Composition of Costs Table

Similar to the UCITS KIID, the PRIIPS KID must disclose information on the entry costs, exit costs and performance fees which may be borne by the investor. However while the UCITS KIID must disclose the amount of the performance fee charged during the last financial year as a percentage figure, the PRIIPS rules require performance fee disclosures to be calculated using historical data covering the last 5 years so that the investor is provided with an estimate of the performance fee they may be charged based on the average charged over the past 5 years.

[10] Any description of the intended retail investor should also be consistent with the target market group identified under MiFID II product governance rules where the UCITS is being sold via MiFID investment firms.

One significant change from the UCITS KIID is the requirement for a PRIIPS KID to disclose transaction costs, expressed as a percentage of the value of the investment per year. This figure must be calculated on an annualised basis, based on an average of the transaction costs incurred by the UCITS over the previous 3 years. A different methodology must be used where the UCITS is in existence for less than 3 years[11]. This new disclosure obligation will mean significantly greater data collection and verification of such data on the part of in-scope UCITS management companies.

Under the revised Level 2 Measures, it appears that these costs must be disclosed in both monetary and percentage terms calculated on the presumption of an investment amount of €10,000 and, similar to the Costs over Time figure disclosed in Table 1, must be disclosed based on (i) the investor holding shares at the end of the first year and (ii) the investor holding shares at the end of the recommended holding period.

Past Performance

A UCITS KIID must disclose detailed information on the past performance of the relevant UCITS.

While the PRIIPS KID itself is not required to contain past performance information, the revised Level 2 Measures oblige UCITS funds to disclose not only forward-looking performance scenarios but to also include a link to the website (or a reference to the document) to provide access to information on the past performance of the relevant UCITS.

This follows significant pressure from a number of the ESAs, including ESMA, which publicly expressed the view in October 2020 that any PRIIPS KID which did not contain past performance information would be “detrimental to retail investors”[12].

Helpfully, the past performance information which must be referenced in the PRIIPS KID must generally be calculated in accordance with the relevant methodology currently applicable to UCITS funds under the UCITS KIID rules.

Synthetic Risk Indicator

As noted above, there are some key distinctions between the calculation methodology to assess the volatility of a UCITS portfolio which must be used for a UCITS KIID and that which will be required to be used in a PRIIPS KID.

Unlike the SRRI calculation used in UCITS KIIDs, the SRI calculation which must be used in PRIIPS KIDs includes a credit risk dimension.

[11] The finalised Level 2 Measures allow all UCITS funds (regardless of the length of time in existence) to use the calculation methodology for calculating transaction costs applicable for newly established PRIIPS until 31 December 2024.
[12] https://www.esma.europa.eu/sites/default/files/library/esma71-99-1421_steven_maijoor_speech_irish_fund_industry_association.pdf

It also assesses market risk using a different market risk measure (MRM) to that required to be used for UCITS KIIDS, with the MRM to be used depending on the class of MRM to which the UCITS is assigned. In this regard, UCITS with insufficient historical data are considered to be "Category 1 PRIIPS", UCITS funds other than structured UCITS are considered to be "Category 2 PRIIPS" and structured UCITS funds (i.e. non-linear products) are considered to be "Category 3 PRIIPS".

Because of the fundamental difference in calculation methodology used, the SRI disclosed for a UCITS in its PRIIPS KID is likely to be lower than the SRRI figure disclosed by that UCITS in its UCITS KIID to date. This does not mean that the UCITS is less risky as the lower number is simply as a result of the different calculation methodology being used. Where a UCITS is sold via MiFID investment firms, consideration should also be given to whether this revision of the SRI figure will impact on the categorisation of the UCITS under MiFID product governance/target market requirements.

While the UCITS KIID rules require the SRRI to be calculated using returns from the previous five years, the PRIIPS KID SRI must be calculated using returns for the previous five years where available, but if not available, a shorter period may be used. In the case of a UCITS with daily prices, a period of 2 years of observed returns may be used while in the case of UCITS with weekly prices, a period of 4 years of observed returns may be used.

Forward looking performance scenarios

Under the PRIIPS regime, in scope UCITS funds must include forward looking performance scenarios which provide an indication of expected performance of the UCITS in four different scenarios:

(i) a favourable scenario;
(ii) a moderate scenario;
(iii) an unfavourable scenario; and
(iv) a stress scenario.

The Level 2 Measures set out different rules for the calculation of each of the above different performance scenarios depending on the product/category/availability of historical data.

For UCITS which do not have sufficient historical data, a benchmark (proxy) can be used to supplement the values of the PRIIP.

For UCITS with a recommended holding period between one and 10 years, performance in each of the four scenarios must be shown at two different holding periods: at the end of the first year and at the end of the recommended holding period.

Difficulties arising for multi-option products

Many EU insurance providers offer "multi-option products" with UCITS as underlying investment options e.g. unit linked insurance products. These "multi-option products" or "MOPS" must also produce a PRIIPS KID under the PRIIPS Regulation. To date such product providers have been permitted to rely on the UCITS KIID produced by the underlying UCITS funds in order to meet certain disclosure obligations under the PRIIPS Regulation. However from the Application Date, it will no longer be possible to use the UCITS KIID to discharge such disclosure obligations. While the relevant underlying UCITS will be required to produce a PRIIPS KID from the same date, the providers of such multi-option products will have insufficient time to update their own PRIIPS KID to comply with the new disclosure obligations from the same date if the UCITS itself only makes its own PRIIPS KID available from that date. UCITS management companies managing UCITS which are offered under such MOPs can expect significant engagement from insurance companies over the coming months as industry grapples with practical implementation issues arising from the fact that insurers will want to ensure that they are in a position to comply with their own disclosure obligations under the PRIIPS Regulation from the Application Date.

UK position

In the UK, a statutory instrument has been signed into law which extends the exemption afforded to UK UCITS management companies from being required to prepare a PRIIPS KID until 31 December 2026. In the explanatory memorandum which accompanied the publication of the statutory instrument, HM Treasury explains that UCITS providers will need to continue to produce a UCITS KIID for the next five years, rather than being required to move to produce a PRIIPS KID from 31 December 2021.

This may result in a scenario where an EU UCITS management company managing a UCITS fund will be required to prepare a PRIIPS KID from the Application Date for marketing the UCITS fund to EEA retail investors while a UCITS KIID will continue to be required where the UCITS fund is being marketed to retail investors in the UK.

Action to be taken

UCITS management companies should initiate a PRIIPS KID implementation project to the extent that this has not already begun. Such a transition plan is likely to incorporate some or all of the following:

(i) Conducting a mapping exercise of the marketing and distribution strategy applicable to UCITS under management to determine whether a PRIIPS KID must be prepared for each UCITS from the Application Date;

(ii) Identification of internal team tasked with responsibility for implementing the transition plan, any external resources which the UCITS management company will engage to support it through the transition to PRIIPS KID and related budgetary forecasting and approval;

(iii) Assessment of each of the relevant provisions of the PRIIPS KID(s) to identify changes to existing disclosure requirements applicable under the UCITS KIID regime;

(iv) Identification of all new data points required and where such data will be sourced (whether internally, from delegates or from third party service providers). This will range from data required to populate the forward looking performance scenarios, data required to calculate the SRI based on the PRIIPS methodology and data needed to revise all costs disclosures in line with the Level 2 Measures;

(v) Testing of all relevant calculations required to be carried out under the Level 2 Measures;

(vi) Designing the template PRIIPS KID in line with Annex 1 to the Level 2 Measures and identifying and making changes to IT software and other systems (if this is being managed in-house) or identifying the appropriate software provider if relying on a third-party service provider (bearing in mind the continued focus of the Central Bank on operational resilience as outlined in its recent consultation paper);

(vii) Building an internal governance framework which involves verifying the narrative statements included in the PRIIPS KID(s);

(viii) Arranging for translations of the PRIIPS KID(s) where relevant and updating relevant websites to add the new PRIIPS KID(s) from the Application Date;

(ix) Engaging with the UCITS distributor(s) to ensure that they are required to provide retail investors in the EEA with the relevant PRIIPS KID(s) from the Application Date; and

(x) Presenting the finalised PRIIPS KID to the board of directors of the UCITS management company, and where relevant, the board of directors of the UCITS fund, for their consideration and approval prior to issue.

How Dillon Eustace Can Help

Dillon Eustace can assist UCITS and UCITS management companies in the implementation of their transition plans to the PRIIPS KID by the Application Date by:

(i) advising on the technical requirements of the PRIIPS Regulation and Level 2 Measures;
(ii) assisting in the determination of whether or not a PRIIPS KID will be required to be prepared from the Application Date in order to continue the UCITS' current offering;
(iii) drafting of narrative disclosures for the PRIIPS KID;
(iv) providing advices on the governance framework which should underpin each PRIIPS KID transition project; and
(v) drafting / updating policies and procedures relating to the PRIIPS KID in order to ensure compliance initially and on an ongoing basis with regulatory requirements .

Should you have any questions in relation this briefing, please contact any of the authors or your usual contact in Dillon Eustace.

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