

## FINANCIAL SERVICES

# A PRIIP on the Horizon: Changes Impacting UCITS Fund Management Companies from 1 January 2023

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With less than six months for UCITS to comply with the new key information document requirements imposed by the PRIIPs Regulation, this briefing considers some of the key requirements and challenges for UCITS, fund management companies, financial advisors and distributors ahead of the 1 January 2023 deadline.

## BACKGROUND

The PRIIPs Regulation came into effect on 1 January 2018 and applies to all packaged retail and insurance-based investment products ("PRIIPs"). The definition of a PRIIP is broad and covers a range of products including UCITS and alternative investment funds that are made available to retail investors. In this context, a retail investor is any investor which is not a professional client as defined under MiFID II.

For UCITS, the European Commission granted an exemption from complying with the requirements of the PRIIPs Regulation until the end of 2022, which means that a UCITS that is made available to retail investors must comply with the PRIIPs Regulation by 1 January 2023.

The purpose of the PRIIPs Regulation is to require that manufacturers of PRIIPs, including UCITS fund management companies, must draw up a standardised key information document ("KID"), and publish it on its website before the PRIIP is made available to retail investors. Any fund management company that manages a UCITS which is made available to retail

investors must draw up a KID for each sub-fund and share class of the UCITS by 31 December 2022. Also from this date, anyone advising on or selling the UCITS to retail investors, such as financial advisors and distributors, will also be required under the PRIIPs Regulation to provide a copy of the KID to investors. For any UCITS that currently uses representative share class UCITS KIIDs, this practice may continue in respect of the KID as the regulatory technical standards published by the European Commission explicitly allow for the preparation of a representative KID covering multiple share classes.

Overall, the form and function of the KID is very similar to that of the UCITS key investor information document (the "UCITS KIID"), with some key differences. The purpose of this briefing is to highlight the similarities and differences between the two documents.

## IS A UCITS FUND MANAGEMENT COMPANY REQUIRED TO PRODUCE BOTH A KID AND A UCITS KIID?

No. The UCITS Regulations currently require that all UCITS prepare and publish a UCITS KIID. However, the UCITS Regulations were amended to state that, with effect from 1 January 2023, the production of a KID by a UCITS under the PRIIPs Regulation will satisfy these UCITS KIID publication requirements. Therefore any UCITS that produces a KID after 1 January 2023 will not be required under the UCITS Regulations to continue to publish the UCITS KIID.

The position however in the UK is different. The UK Financial Conduct Authority ("FCA") has not imposed the same deadline for UK UCITS to prepare a KID, but instead has extended the deadline by five years to 31 December 2026. As a result of the FCA's position, UCITS authorised in the EEA which are sold to retail investors in the UK must continue to provide a UCITS KIID. Therefore any UCITS sub-fund and/or share class that is marketed in both the EEA and the UK will need to prepare both a UCITS KIID and KID.

**DO THE PRIIPS REGULATIONS IMPOSE ANY OBLIGATIONS IN RESPECT OF A UCITS THAT IS NOT MADE AVAILABLE TO RETAIL INVESTORS?**

No. As the PRIIPs Regulation explicitly states that the KID must be provided whenever the PRIIP is made available to retail investors, it means a UCITS that is made available to non-retail investors only does not come within the scope of the PRIIPs Regulation and so does not need to produce a KID. In this case, the UCITS would continue to produce the UCITS KIID. However it may be difficult to police

the distribution of the UCITS to non-retail investors only, and so the cautious approach would be for fund management companies to produce the KID and make it available on the website in respect of the UCITS so that the risk of retail investors subscribing in the UCITS without receiving the KID is avoided.

In addition, the PRIIPs Regulation provides that all persons advising on or selling the PRIIP must provide a KID. Therefore, any investment advisers, distributors, institutional investors or nominee investors (which in practice will include

fund platforms and similar distribution channels) who advise on or sell the UCITS to retail investors will be required to provide a KID for the UCITS. In this case, they will likely expect the UCITS fund management company to provide them with a KID.

It is expected that most UCITS fund management companies will in practice produce a KID for the UCITS they manage, even for those UCITS that are made available to non-retail investors only.

Similarities to the UCITS KIID	Differences from the UCITS KIID
<b>General – Form and Function</b>	
The purpose of both the KID and the UCITS KIID is to provide investors with a short document that distils the pertinent details about the UCITS. Both documents are pre-contractual documents that must be provided to investors before subscribing in the UCITS, and must be accurate, fair, clear and not misleading, and consistent with the UCITS prospectus. Both documents must be standalone documents, without cross references to other marketing material.	The KID may be <b>three pages</b> in length, whereas the UCITS KIID (other than for structured UCITS) was limited to two pages.
<b>Description of the Fund</b>	
Both the KID and the UCITS KIID must disclose the name of the UCITS and its fund management company, as well as invest investment objective, investment policy, a description of the assets and markets in which the fund may invest, whether the fund is actively or passively managed, and whether the fund uses a benchmark.	<p>This section must also include: (i) <b>the environmental and/or social objectives targeted</b>; (ii) <b>how the return of the UCITS is determined and the main factors on which return depends</b>; (iii) <b>a description of the target retail investor</b>; (v) <b>an indication of dealing frequency</b>; (vi) <b>whether dividend income is distributed or reinvested</b>.</p> <p>This section also includes disclosures that were located elsewhere in the UCITS KIID, such as the name of the depositary, the other share classes available in the UCITS, how to obtain copies of the prospectus and financial statements of the UCITS, and where to obtain other information such as the latest price of the shares of the UCITS.</p> <p>In the context of the environmental and/or social objectives referred to above, there is currently no distinction under the PRIIPs Regulation for UCITS that come within Article 8 (i.e. light green) / Article 9 (i.e. dark green) / solely Article 6 under SFDR<sup>4</sup>.</p>
<b>Risk Indicator and Description</b>	
<p>Both the KID and the UCITS KIID have a numeric indicator of risk, ranging between 1 and 7.</p> <p>Both the KID and the UCITS KIID calculate this numeric indicator based on historic volatility of the fund over a rolling period.</p> <p>Both documents must include brief narrative descriptions regarding liquidity risk and currency risk, as well as any other materially relevant risk.</p>	<p>The numeric indicator is now known as the “<b>summary risk indicator</b>”. The methodology for calculating the summary risk indicator depends on the aggregation of two figures, the market risk measure (“<b>MRM</b>”, which measures the historic volatility of the UCITS over a rolling period) and the credit risk measure (“<b>CRM</b>”, which is a measurement of counterparty risk). The method for calculating each of the MRM and CRM figures will depend on the PRIIPs category that the UCITS will come within. Full details of these methodologies and categories is set out in Annex II of the PRIIPs regulatory technical standards<sup>5</sup>.</p> <p>The UCITS must determine an appropriate <b>recommended holding period</b>, and warn that risks may be higher when the investment is not held for the recommended holding period (the “<b>RHP</b>”). The RHP is more appropriate for insurance-based investment products. For UCITS, it would be determined by the UCITS fund management company based on a consideration of the risk and reward profile of the UCITS, and any time-sensitive cost and tax implications for investors when redeeming.</p>

<sup>4</sup>Sustainable Financial Disclosures Regulation 2019/2088

<sup>5</sup>Commission Delegated Regulation (EU) 2017/653

### Performance

Both the KID and the UCITS KIID contain performance-related disclosures.	<p>Past performance is no longer disclosed in the KID, however it is still required to be disclosed on a website or other referenced document, as set out below in the section "Other Relevant Information" (see further below).</p> <p>The performance section of the KID now includes a section that covers <b>four performance scenarios, namely a stressed scenario, an unfavourable scenario, a moderate scenario and a favourable scenario.</b></p> <p>In each case, performance is no longer presented as a graph, but rather as figures (in both monetary and percentage terms) for each scenario. These figures must disclose the performance figures if the investor exits the UCITS over three different time periods – after 1 year, after a period of half the recommended holding period, and after the RHP.</p>
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### Contingency if Fund Management Company becomes Insolvent/PRIIP Manufacturer cannot pay out

No similarities. This section is new in the KID.	<p>This section, which addresses what happens if the PRIIP manufacturer cannot pay out, is more appropriate for insurance-based investment products. For UCITS, this will likely be interpreted as relating to <b>the insolvency of the fund management company which in practice would not cause investors to incur losses as the UCITS depository performs safekeeping duties</b> in respect of the assets of the UCITS. Wording to this effect will be disclosed in this section of the KID.</p>
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### Costs

Both the KID and the UCITS KIID contain disclosures on the total aggregated costs of the UCITS. Both documents disclose entry and exit costs, as well as performance fees, in percentage terms.	<p>There will be two tables in this section, labelled "<b>Costs over time</b>" and "<b>Composition of Costs</b>". The first table "<b>Costs over time</b>" will indicate the <b>total aggregated costs of the UCITS</b> (using a reduction in yield methodology) and disclosed as both a percentage figure and also in monetary terms, over the same three time periods as outlined above, i.e. after 1 year, after a period of half the recommended holding period, and after the RHP.</p> <p>The second table "<b>Composition of Costs</b>" indicates the <b>entry and exit costs, management fees and other administrative or operating costs, any recurring costs such as portfolio transaction charges</b> (adjusted for market movements), and <b>any performance fees or carried interest</b>. Each of these costs will be disclosed in percentage terms.</p>
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### Length of Investment Holding

No similarities. This section is new in the KID.	<p>This section will <b>disclose the RHP</b>, as well as the reasons for the determination of the RHP, and information on the impact of redeeming from the UCITS prior to the RHP.</p>
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### Complaints

No similarities. This section is new in the KID	<p>This section will disclose a <b>summary of the steps to be followed for lodging a complaint</b> about the UCITS, the UCITS fund management company, the financial advisor or the distributor, as well as including a link to the website, and any postal or email address, to submit complaints.</p>
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### Other Relevant Information

No similarities. Most of the information in the equivalent section of the UCITS KIID has been moved to the start of the KID.	<p>This section will disclose a link to a website or other document where the past performance of the UCITS is available, and also disclose the number of years for which <b>past performance</b> is presented. The disclosure requirements relating to past performance otherwise track the equivalent UCITS requirements.</p>
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**ARE ANY CHANGES TO THE PRIIPS KID CURRENTLY BEING CONSIDERED?**

On 2 May 2022, the European Supervisory Authorities (the “ESAs”) published technical advice to the European Commission following their review of the PRIIPs Regulation. The main recommendations were as follows:

- encouraging the European Commission to consider a broad review of the PRIIPs Regulation and undertake consumer testing on the sequence and structure of the KID;
- to allow UCITS to replace the performance scenarios with the ability to disclose past performance instead;
- to allow for the use of a digital KID and present information in a layered format which could be used on electronic devices such as smartphones;

- to allow UCITS to prominently disclose whether they have a sustainable investment objective or that they promote environmental and/or social characteristics to financial products under Articles 8 and 9 of SFDR; and
- clarity on the requirements to file PRIIPs KIDs with national competent authorities, and on the requirements to provide existing investors with updated KIDs whenever the KID has been amended.

There is currently no timeframe on the review of these proposals and so it is not expected that the PRIIPs Regulation will be amended to accommodate these proposals before 1 January 2023.

**NEXT STEPS**

In light of the new and additional disclosure requirements and calculation methodologies applicable to the KID when compared with the existing UCITS KIID, UCITS fund management companies should start working now with advisors and KID service providers to begin preparing draft KIDs to ensure that they can comply with all relevant requirements by 1 January 2023. The boards of UCITS fund management companies and UCITS funds should be informed about the work being done to comply with the PRIIPs Regulation by this deadline.

If you would like to discuss the foregoing in the more detail, or require assistance on the disclosure requirements under the PRIIPs Regulation, please contact your usual Arthur Cox contact, or any member of our team.



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