

Memorandum

PRIIPs Regulation — Frequently Asked Questions

October 2017

When does the PRIIPs Regulation take effect?

The PRIIPs Regulation¹ will apply from 1 January 2018.

What does PRIIPs mean?

PRIIPs stands for packaged retail and insurance-based investment products. PRIIPs come in two forms:

1. A PRIIP – a packaged retail investment product where the amount repayable to the investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets that are not directly purchased by the investor; and
2. An insurance-based investment product – an insurance product that offers a maturity or surrender value, and where that maturity or surrender value is wholly or partially exposed (directly or indirectly) to market fluctuations.

Examples of PRIIPs include alternative investment funds (or AIFs), UCITS funds and structured products (e.g., CLOs). Insurance-based investment products covered by the PRIIPs Regulation include unit-linked policies, with-profits policies and purchased life annuities.

Who does it apply to?

PRIIPs Regulation applies to “manufacturers” (e.g., fund managers) and distributors of PRIIPs “made available” to retail investors. For these purposes, a PRIIP can be “made available” to retail investors even if the manufacturer (or distributor) does not take proactive steps to market the product to such investors (e.g., in the case of an unsolicited approach or “friends and family” investors).

It should also be noted that PRIIPs that are not directly offered to retail investors by the product manufacturer may nevertheless be subject to the requirement to produce a Key Information Document (KID) if they are sub-distributed to retail investors. A typical scenario would be an EU private bank that invests in an AIF through a nominee vehicle on behalf of its advisory clients. Such a private bank would require a KID in order to satisfy its obligations to its clients when advising them to invest in the AIF.

¹ [Regulation EU \(No\) 1286/2014](#) of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

What does the PRIIPs Regulation require?

A PRIIP manufacturer is required to prepare a KID for each of its PRIIPs and publish these KIDs on its website. A distributor of a PRIIP must provide a KID to each retail investor to whom it sells, or advises on, a PRIIP.

Who is a retail investor for these purposes?

For the purposes of packaged retail investment products (such as AIFs), a retail investor is any person that does not meet the definition of a professional client or eligible counterparty in MiFID II. A typical example of a retail investor is a high-net-worth individual who is not capable of being categorised as an “elective professional” because he or she does not meet at least **two** of the following three criteria:

1. the client has invested in similar investment products (e.g., AIFs) in significant size at an average frequency of ten per calendar quarter;
2. the size of the client’s investment portfolio exceeds EUR 500,000; and
3. the client works or has worked in the financial sector for at least one year as an investment professional (provided such position involves knowledge of investing in similar products).

When categorising private individuals investing in AIFs as elective professionals, the test in (1) above is not typically relevant given that no such investor is likely to make 40 investments in AIFs in any given year. As such, the elective professional categorisation would normally only be available to high-net-worth individuals who are also (or were in the past) investment professionals.

What exactly is a KID?

A KID is a concise document (no more than three A4 pages when printed) that provides key information on the product being offered and forms part of the “pre-contractual” disclosure to a retail investor. A KID is a stand-alone document separate from the prospectus, offering memorandum or any marketing materials. A KID template can be found in the PRIIPs Delegated Regulation.²

PRIIPs Regulation requires KIDs to be translated into the local language of each EU member state where the product is being distributed.

When is a KID not required?

Offers to retail investors closed by 31 December 2017

If the PRIIP (e.g. the AIF) is not made available to any new retail investors in the EU with effect from 31 December 2017, and if any changes to existing investor commitments are subject to contractual terms and conditions agreed to before that date, a KID will not be required.³ This also means that any further subscriptions or new commitments from existing EU retail investors (that were not agreed to before 31 December 2017) may not be accepted after 31 December 2017.

² [Commission Delegated Regulation \(EU\) 2017/653 of 8 March 2017](#)

³ See paragraph (12) of [Guidelines on the application of the PRIIPs Regulation](#) (“Guidelines”).

Only non-EU retail investors are permitted to invest

If the PRIIP is only made available to retail investors outside the EU, a KID is not required.⁴

PRIIPs made available to retail investors against no consideration

If a retail investor is able to acquire the product without making a payment (including any risk of future financial commitment by the retail investor), there is no requirement to provide such investor with a KID. This exception could be relevant in the context of certain employee incentive schemes that do not require employees to contribute to the scheme (e.g., through an upfront cash payment or salary sacrifice).

UCITS funds

Although UCITS funds are PRIIPs, the obligation to produce a KID in respect of such funds will not apply until 31 December 2019. During the transitional period, UCITS funds are required to comply with the existing requirements to produce key investor information document (KIID) under the UCITS Directive.

What disclosures must be contained in a KID?

A KID must contain the following sections:

1. *“General information”* – such as the name of the PRIIP, legal name of the product manufacturer, date of production and name of the manufacturer’s regulator;
2. *“What is this product?”* – this section must describe the legal form, investment objectives, underlying assets (e.g., investment policy and investment restrictions); the target retail investor to whom the product may be marketed (e.g. such investor’s needs, characteristics and investment objectives); and the term or maturity of the PRIIP;
3. *“What are the risks and what could I get in return?”* – this section must include: (i) a risk indicator; (ii) a description of the risk and reward profile of the PRIIP and appropriate risk warnings (including whether the product is illiquid based on a prescribed liquidity risk measurement methodology and the applicable currency risks); (iii) an indication of the possible maximum loss; and (iv) performance scenarios based on the methodology specified in the PRIIPs Delegated Regulation;
4. *“What happens if the PRIIP manufacturer is unable to pay out?”* – an indication whether the investor may suffer financial loss due to the default of the PRIIP manufacturer (or any other entity) and description of any investor compensation or guarantee scheme available;
5. *“What are the costs?”* – this section must set out information on all costs and charges relevant to the PRIIP (including any transactional costs relating to underlying investments) calculated in accordance with the methodology specified in the PRIIPs Delegated Regulation;
6. *“How long should I hold it and can I take my money out early?”* – this section must state the recommended (or minimum required) holding period for the PRIIP and a description of the procedures for disinvestment (e.g., sale) or redemption of the PRIIP (including any applicable fees and penalties for early redemption or disinvestment);
7. *“How do I complain?”* – this section must outline the procedures for lodging complaints about the PRIIP, its manufacturer or distributor;

⁴ See paragraph (10) of the Guidelines.

8. “*Other relevant information*” – any additional information or documents that may be provided or made available to investors should be referenced in this section.

The PRIIPs Regulation requires product manufactures to review and update the KID every time there is a material change affecting the information contained in the KID and, at a minimum, every 12 months.

What is required for the risks and rewards disclosure?

The product manufacturer must assign a summary risk indicator (SRI) to the PRIIP based on a numerical scale (from 1 to 7). This section of the KID must also include a narrative explaining the risk classification assigned to the product in accordance with the templates provided in the regulation. The methodology for measuring each of market, credit and liquidity risk underlying the SRI and liquidity risk warning is specified in the PRIIPs Delegated Regulation.⁵

The risks and rewards disclosure must also include illustrations of four performance scenarios — favourable, moderate, unfavourable and stress — calculated and presented in accordance with the technical guidance provided in the PRIIPs Delegated Regulation.⁶

What costs and charges must be disclosed in a KID?

The list of costs and charges that must be disclosed, and the methodology for calculating various types of costs for PRIIPs that are investment funds, are set out in the Annexes of the PRIIPs Delegated Regulation.⁷ These costs include: (i) one-off costs (e.g., distribution fee); (ii) recurring costs (such as operational expenses, management fees, depositary and administrator fees, research fees, transaction costs, taxes, etc.); and (iii) incidental costs (e.g., performance fees or carried interest).

The methodology for calculating transaction costs in respect of a PRIIP that is an investment fund (e.g., an AIF or UCITS) requires costs to be calculated as the difference between the “price” of the underlying financial instrument at the time of the order and the net realised execution cost. Other transaction costs, such as dealing commission, stamp duty and other transaction taxes, FX costs, etc., are also included in the calculation.

For disclosure purposes, transactional costs are calculated on an annualised basis based on an average of the transaction costs incurred by the fund over the previous three years, if the data is available. If the data is not available (e.g., with a new fund), the disclosure must be based on estimated costs calculated in accordance with the prescribed methodology.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel.

⁵ See Annex II of the [PRIIPs Delegated Regulation](#) for the methodology of calculating the risk exposure and Annex III for the presentation format.

⁶ See Annex IV for the calculation methodology and Annex V for the format.

⁷ See Annex VI, Part I, section 1 for the list of costs and methodology for calculating costs; Part II sets has technical guidance on calculation of summary cost indicator and compound effect of the costs. Annex VII sets out the format for presenting costs and impact of the costs on returns in a table format.

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