

***UCITS IV***  
Key Investor  
Information  
Document – KIID

Asset Management  
November 2010

Further to the adoption of the Level 2 measures of the UCITS IV Directive that is due to come into force in July 2011, CESR issued in July 2010 a series of six technical advice papers related to the Key Investor Information Document (KIID as it is known among practitioners). A preferred layout and technical details are therefore beginning to take shape.

## Background

The Simplified Prospectus failed to bring into the UCITS world increased comparability and transparency regarding the core characteristics of investment funds, as it is seen as a much too technical document, varying in length and content from promoter to promoter. The regulators' response was therefore to replace the Simplified Prospectus with a simpler and, hopefully, a more engaging document, easier to understand and digest by the common retail investor.

As the European Commission's intention is to enforce tighter rules regarding investor protection for the whole spectrum of the investment products, the KIID might also be used as a first standard for all future retail investor communication regarding packaged retail investment products (PRIPs).

## Scope of the KIID

The KIID is designed as a concise document delivering critical information about the fund. It must be drafted in plain language and be easily understood by investors.

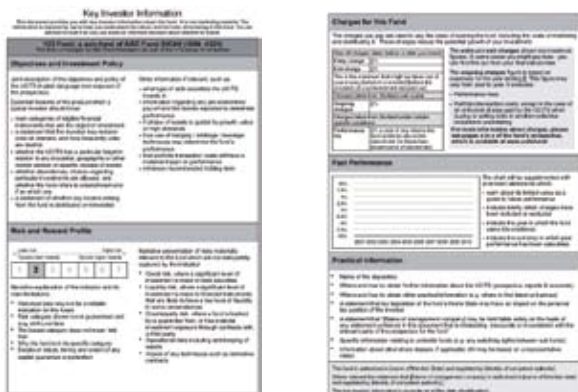
The Management Company of the fund has responsibility for the production of the KIID and for making it readily available at the points of sale (although in practice we might observe increased delegation to service providers), while the distributors will have the obligation to deliver the KIID prior to any sale – it is in essence a pre-contractual document.

## Core requirements

The KIID will have to be prepared at share-class level. Based on CESR recommendations, it will be relatively difficult to combine several share classes from the same fund in a single KIID. The document shall be delivered to the investors either in a paper format or via a durable medium easily replicable on paper.

### Two-page format

The format and length of the KIID will be highly standardised (it is not marketing material); it will not be more than two pages long (except for structured funds, where three pages are acceptable) and the capacity of promoters to bring their personal touch will be limited to the narrative sections and perhaps a small, unobtrusive company logo.



1 UCITS IV Key Investor Information – KIID

The KIID will therefore be comparable across a wide range of funds.

The KIID will be divided into five sections, each of them with specific requirements.

- Objectives and investment policy;
- Synthetic risk and reward profile (SRRI);
- Charges;
- Past performance;
- Practical information.

### Objectives and investment policy

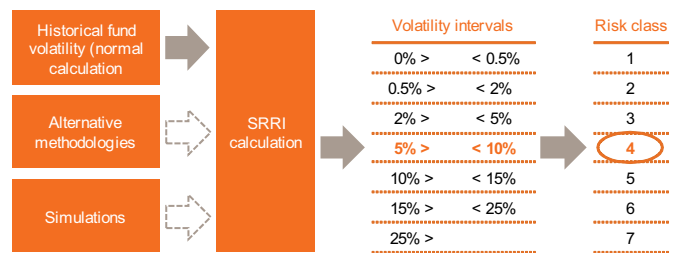
The first section will describe the objectives and the investment policy of the fund (and the main targeted investments) in plain language, not necessarily using the same technical language as that used in prospectuses.

### Synthetic risk and reward profile

The risk and reward profile will include a risk indicator and a narrative section.

CESR had issued a paper describing the various techniques for the SRRI calculation. UCITS funds have been divided into five main categories (market funds, life cycle funds, absolute return funds, total return funds and structured products), each with different calculation methodologies.

In a nutshell, the indicator is calculated based on the volatility of the underlying fund for the past five years and the values obtained is translated into one of the seven risk categories available based on pre-defined volatility intervals.

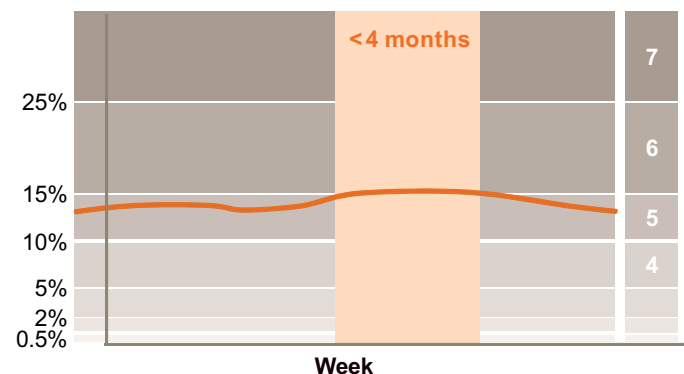


If past data is not available (for new funds) or not representative (UCITS changing its investment strategy significantly) then alternative methodologies shall be used, including volatility measurements of the portfolio model, target asset mix allocation or benchmark tracked.

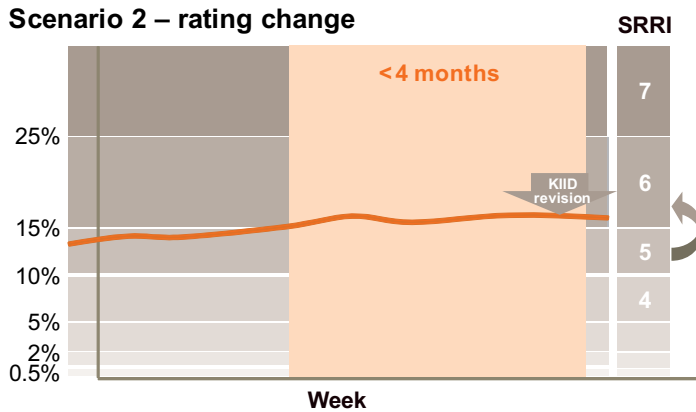
For structured funds a reverse engineering corresponding to the 99% Value at Risk has to be calculated. And as a last resort method, if none of the above techniques can be used, then simulations have to be performed.

If the weekly calculation of the SRRI yields a higher or lower SRRI consistently over a four month period, then an updated KIID, containing the new SRRI, must be produced and circulated.

### Scenario 1 – no change



## Scenario 2 – rating change



The SRRI will be complemented by a narrative section, briefly explaining how the indicator was calculated, and what other material risks are not captured by it (liquidity or counterparty risks, for example).

### Charges

The charges section will include three sets of figures (all in percentage points): entry/exit fees, ongoing charges and performance fees.

The entry/exit fees will describe the percentage of one-time charges taken out of the subscribed/redeemed amounts.

Ongoing charges will replace the existing Total Expense Ratio (TER) and will represent the annualised ratio of total costs related to the assets of the fund. The calculation is based on a standardised methodology which identifies specific items for inclusion and exclusion.

All fees paid in relation to the Management Company, the Custodian, Directors of the UCITS or investment advisers have to be accounted for. In addition, all fees paid in relation to specific delegated activities (fund administration, accounting, valuation, distribution, legal and regulatory fees, etc) also have to be accounted for.

If collateral deposits, margin calls, interest on borrowing or soft commissions do not have to be included in the calculation, it is however not clear yet how certain costs like fee-sharing agreements or inherent to stock lending programs initiated by the Management Companies need to be interpreted.

### Past performance

The presentation of past performance will include a bar chart showing ten years (or five in specific cases) of annualised performance history (calculated following the calendar year). If a benchmark is mentioned in the section 'Objectives and investment policy' then an additional column with the benchmark must be included.

### Practical information

The practical information section will include a series of relevant information regarding the fund: contact details, depositary bank, law applicable to the fund, where to find additional information etc.

However, the content of this section is also highly standardised, without offering the possibility of adding too much additional information besides that specifically required.

### Revision of the KIID

The KIID must be updated as frequently as needed in order to preserve its accuracy. Any material change regarding investment policy has to be promptly updated, and the same applies for a material change in the ongoing charges figure or an increase/decrease of the risk indicator.

The past performance must be updated 35 business days after the end of the calendar year.

### Standalone document

The context in which the KIID is being delivered must support its objective – offering critical information to investors – therefore it should be a standalone document. The KIID may be attached to other documents provided its importance is not diminished by this.

Signposts to other sources of information (e.g. to the Prospectus) are acceptable, provided that the referred information is not fundamental to the investors' understanding of the fund's essential elements.

### No civil liability

If there is no inconsistency with the Prospectus, the KIID will not bear any civil liability for the Management Company.

## Main business implications for the UCITS industry

### Impact on product range

- Promoters distributing a wide array of funds might choose to reconsider the rationale for having several funds within the same risk category and consequently rationalise their fund range.
- The SRRI will be a critical risk measurement, with the potential to influence the attitudes of retail investors (and distributors).

### Impact on distribution

- Promoters have to look into how the KIID is going to disrupt distribution settings and if this will require an overhaul of fee arrangements and remuneration schemes.
- Since the KIID should facilitate comparison between products, they may be an increased need to monitor competition. This would allow both the product range and costs to be adapted to market levels.

## Operational challenges

- Large asset managers will have to find effective ways to handle, in a timely manner, a significant number of KIIDs.
- The KIID revision requirement, if not properly managed, risks leading to more frequent updates than just the annual performance review, therefore creating an additional source of pressure and costs.
- The calculation methodology for the risk indicator could be cumbersome in the case of missing historical performance data or a planned change in the investment strategy.
- Fund administrators expect the burden of creating the document to rest on their shoulders, since they have the capacity to handle the various data streams. They have to develop new tools to handle 'enterprise content management'.
- Existing fee arrangements should be mapped and challenged based on the MiFID-like inducement rules that will be applicable to all management companies of UCITS and self-managed UCITS. A process should be put in place to facilitate the calculation and monitoring of the ongoing charges figure.
- The 'plain language' requirement necessitates a potentially laborious process to ensure technical content is adequately conveyed through simple words. The open question still remains whether the European regulators will be able to issue, in time, a European glossary of terms which could be made available to the public. *(Continued overleaf)*

## Operational challenges (continued)

- Avoiding inconsistencies with the prospectus (which would generate civil liability) will be challenging for UCITS funds using complex investment strategies, which cannot be easily explained in a few words.
- Promoters will have to find effective ways to streamline their distribution flow and ensure that distributors have easy access to the documents and that they are knowledgeable about their responsibilities towards investors.

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