Following the recent financial crisis, there is a strong drive to provide clearer information about investment products more directly to investors. The financial world is characterised by many interconnected parts often using specialist terminology which is unfamiliar to the layman. Policy makers globally are striving to de-mystify these complexities for investors.

In a February 2011 issue of ViewPoint, we highlighted that Packaged Retail Investment Products (PRIPs) will cover a range of investment products that are marketed to retail investors and sold as packaged products, including UCITS.

Inconsistencies in existing disclosure standards for these products can lead to competitive distortions in the retail investment market. The European Commission’s objective is to create a consistent framework and level playing field for all packaged retail investment products. It will seek to achieve this by amending conduct of business requirements in the Markets in Financial Instruments Directive (MiFID) and the Insurance Mediation Directive (IMD), as well as proposing a separate initiative to cover investor information. Disclosure of relevant information about PRIPs will be made in a Key Investor Information Document (KIID), and is expected to be largely based on the KIID developed for UCITS.

UCITS IV, the next iteration of the Undertakings for Collective Investment in Transferable Securities (UCITS) directive, is required to be transposed into the national law of each EU Member State by 1 July 2011. A February 2011 issue of ViewPoint provided a summary of the changes which we have highlighted below:

- Key Investor Information Document (KIID);
- A more effective cross-border regime for UCITS fund mergers;
- “Master/Feeder” UCITS permitted for the first time, including the ability for a domestic UCITS to feed into a cross-border master fund;
- Management of UCITS management companies to be subject to MiFID-style conduct of business rules. This supports the “passporting” of management companies, whereby a UCITS structure in one EU member state can be managed by a management company in another;
- Simplification and shorter timeline for the registration procedure for cross-border UCITS.

This ViewPoint provides a more in-depth commentary on the first change listed, Key Investor Information Document. This component of the revised directive is likely to have the most immediate impact on investment managers, distributors and investors. That impact is being felt now as product and service providers prepare to produce KIID documents for all their UCITS funds and their share classes; regulators confirm procedures for receiving and transitioning to the KIID; and distribution partners establish how to provide the appropriate KIID to end investors.

What is a KIID?

A KIID is a two-page (three-page for structured products), “factsheet” style document which constitutes the pre-contractual information which must be provided to investors prior to investment. The KIID replaces the Simplified Prospectus, which is largely viewed as having failed to meet the objective of providing clear, simple investment information to investors – an objective which the KIID seeks to address. The KIID sets out the essential characteristics of a fund or share class necessary for an investor to understand the nature and the risks of the fund being offered and make investment decisions on an informed basis.

In order to achieve the goal of educating investors, KIIDs must be written in concise, non-technical language.

The European Commission in consultation with European Securities and Markets Authority (ESMA) has developed a prescribed format and content, designed to promote harmonisation and comparability of investor information, organised under five key information headings:

- Objectives & Investment Policy
- Risk & Reward Profile
- Charges
- Past Performance
- Practical Information

The opinions expressed are as of April 2011 and may change as subsequent conditions vary.
The Risk & Reward Profile includes a "synthetic risk and reward indicator" (SRRI), which is a risk category calculated based on volatility of returns. The indicator is presented on a numerical scale of 1 to 7, where 1 is low and 7 high.

Implementing legislation sets out the precise wording for a number of statements which must be included in the KIID and the presentation required for the SRRI, the charges and past performance. Calculation of the SRRI and charges must also use a standard methodology to promote harmonisation and simplify comparison.

At the end of this paper, we have provided a sample KIID, reflecting the above format and content. While the final KIID will reflect additional changes, we anticipate this draft to be representative of what investors should expect.

When is the KIID being introduced?

Legally, the effective date of the new UCITS IV directive is 1 July 2011. However, ‘Grandfathering’ provisions allow the Simplified Prospectus to continue to be accepted through to 30 June 2012. Importantly, home Member States may set an earlier transition date or they may decide not to provide any transitional period at all. Germany, for example, will require KIID to be produced for German domiciled UCITS funds from 1 July 2011.

CESR (now ESMA) guidelines for the transition from Simplified Prospectus to KIID issued in July 2010, offer a pragmatic view that supports ‘grandfathering’ of the Simplified Prospectus until July 2012. Clarity on this will not be achieved until each of the EU Member States transpose the directive into national law. However, it is important to note that where a Home State regulator supports the ‘grandfathering’ provisions, no EU Member State where that fund is distributed will be able to restrict the rights of any inwardly notified UCITS fund and the Simplified Prospectus can continue to be used for as long as the Home State allows. Local marketing rules may also still apply which could, for example, mean that additional information have to be provided to investors in a specific jurisdiction such as the details of any local representative.

In Luxembourg, Dublin and the UK, the grandfathering provision to July 2012 will be permitted. This will alleviate the impact of cross-border fund providers all transitioning on the same date. At this stage, relatively few Member States have finalised implementing legislation or produced additional guidance. Product providers who are currently running detailed implementation plans will need to be prepared for additional changes or guidance from their domestic regulators. This may affect both the final content of the KIID and the way in which it is provided to end investors and intermediaries.

A number of cross-border fund providers, BlackRock included, are aiming to be in a position to deliver KIID in the course of 2011 for all their UCITS fund ranges. In practical terms however, given the anticipated volume of KIID that will be produced, a ‘big-bang’ approach could be extremely challenging for the industry, regulators and clients to deal with, so the actual transition plan from Simplified Prospectus to KIID is still to be worked through.

How frequently must the KIID be produced and updated?

Each KIID must be updated at least annually, within 35 business days of year-end, to include refreshment of performance data to the end of the previous calendar year. Interim updates may be triggered throughout the year based on a number of potential events, with some examples provided below:

Passive Changes:
- SRRI update if there is a change to the indicator value over a four month rolling basis due to market /performance volatility.

Active Changes:
- Update to Fund name, investment objective, benchmark or charges as part of the development process of investment funds.

What are the practical challenges of introducing the KIID?

Each manager and distributor will be impacted differently based on the fund range(s) involved. The number of funds, the number of share classes, and the distribution in multiple languages create scale challenges that require an automated solution.

BlackRock, for example, will produce KIID to support different UCITS fund ranges domiciled in Germany, Ireland, Luxembourg and the UK. This equates to more than fourteen thousand KIIDs, of which over ten thousand, including translations, will be required to support our flagship Luxembourg BlackRock Global Funds range. A multi-disciplined implementation team has been assembled and has been working full-time for a number of months to meet this challenge.

In practical terms, many providers will opt for a separate KIID per share class of a Fund. Provided the document does not lose clarity, there is the possibility to amalgamate share classes into a single KIID through a “representative class” or a multi-class KIID, (where SRRI values, performance tables and charges figures are shown for multiple Share Classes). This could be more complex for Distributors and end investors and difficult to achieve within the 2-page format. This is particularly the case where cross-border fund ranges support a variety of share classes with different pricing structures, dealing or hedged currencies and income distribution cycles. The performance, charges and risk...
profiles of different classes of the same fund will therefore vary. In order to accommodate the automated solution required for this scale of production and to facilitate appropriate distribution of translated KIIDs into the respective EU markets, a share class one KIID approach is preferable and is the route a large number of asset management firms, including BlackRock, are reportedly taking.

Distributors will need to adapt their systems and process and train their advisors on how to use and select the most appropriate KIID for their clients from the vast array available.

Sample Key Investor Information Document (KIID)

BlackRock is making a constructive contribution to advancing a policy agenda that brings clear, concise and comparable information to investors. For this reason, BlackRock is currently heavily engaged in developing KIIDs across our suite of UCITS products. In time, as regulation develops, we would expect to roll out the KIID to comparable packaged retail investment products, ensuring that an appropriate balance is struck between offering a wide choice of investment solutions to clients, without compromising investors’ understanding of the product in the process.

Conclusion

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A redrafted version of the Prospectus objective, following clear and simple language guidelines.

The SRRI indicator scores the fund on a risk and reward profile, 1 to 7 based on the volatility characteristics of the fund.

The BlackRock KIID will be produced at the share class level and identified uniquely through its ISIN number.

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