

## FCA FINALISES AMENDMENTS TO UK PRIIPS REGIME

On 25 March 2022, the FCA published a **policy statement** (PS22/2) setting out finalised amendments to the UK PRIIPs regime. The amendments clarify the scope of the UK PRIIPs regime, replace the requirement for PRIIPs KIDs to contain performance scenarios with a requirement for PRIIPs KIDS to contain performance information and make tweaks regarding the calculation and disclosure of transaction costs. While the revised rules entered into force on 25 March 2022, the FCA has included a transitional period with the result that firms have until 31 December 2022 to ensure that they comply with the new requirements.

### Background

Regulation (EU) no. 1286/2014 on key information documents for packaged retail and insurance-based investment products (the “EU PRIIPs Regulation”) came into force on 1 January 2018. It aimed to improve the information provided to retail investors in packaged products (“PRIIPs”), such as investment funds, derivatives and structured deposits.

The key obligation introduced by the EU PRIIPs Regulation was for those who produce, advise on or sell PRIIPs to provide a short, easily-understandable key information document (“KID”) to retail investors in those products. The content and form of the KID must comply with detailed, prescriptive requirements. Following Brexit, the UK has onshored the EU PRIIPs Regulation into the UK (the “UK PRIIPs regime”), with the result that the UK continues to apply obligations originally derived from the EU PRIIPs Regulation.

For some time, there have been concerns that the prescriptive requirements for the content of the KID may result in the provision of misleading information to investors. As a result, in July 2018 the FCA published a Call for Input seeking views on market participants’ experience of the PRIIPs regime. This was followed in July 2021 by an FCA Consultation Paper proposing targeted amendments to address key concerns with the PRIIPs regime (see our **earlier briefing**). The FCA’s 25 March 2022 policy statement (PS22/2) contains the finalised versions of those amendments.

### Key takeaways

- In July 2021, the FCA published a Consultation Paper (CP21/23) proposing targeted amendments to address concerns with the UK PRIIPs regime.
- On 25 March 2022, the FCA published its finalised amendments. The amendments fit into three categories:
  - clarifications of the scope of the UK PRIIPs regime;
  - amendments regarding the performance and risk information that must be included in PRIIPs KIDs; and
  - amendments regarding the calculation and disclosure of transaction costs in PRIIPs KIDs.
- Broadly, the amendments apply when PRIIPs are made available to retail investors in the UK.
- Firms have until 31 December 2022 to ensure that they comply with the new requirements.
- A more holistic review of the UK PRIIPs regime is also expected at a later date.

## The FCA's amendments

The FCA makes amendments in three key areas:

### 1. Scope of the UK PRIIPs regime

The FCA has introduced the following amendments with regards to the scope of the UK PRIIPs regime:

Issue	Amendment
<ul style="list-style-type: none"> <li>Lack of clarity over the application of PRIIPs requirements to products that were issued before 1 January 2018 but that are still available for trading on secondary markets.</li> </ul>	<ul style="list-style-type: none"> <li>The FCA has introduced a new rule into the FCA Handbook to confirm that a financial instrument issued prior to 1 January 2018 is not a PRIIP (and, as such, not subject to the UK PRIIPs regime).</li> </ul>
<ul style="list-style-type: none"> <li>Lack of clarity over the application of PRIIPs requirements to corporate bonds.</li> </ul>	<ul style="list-style-type: none"> <li>The FCA has introduced new rules stating that: <ul style="list-style-type: none"> <li>debt securities are not PRIIPs if they meet certain criteria (notably, that the issuer's default risk is wholly or predominantly determined by the economic performance of the commercial or industrial activities of the issuer; and the terms of the debt security do not impose any modification, structuring or conditionality on the issuer's obligation to pay interest or repay the principal);</li> <li>debt securities are PRIIPs if they meet certain criteria (such as if the interest payable is linked to fluctuations in stock market indices); and</li> <li>certain features (such as certain fixed coupon rates, variable coupons and put options) do not cause a debt security to be a PRIIP.</li> </ul> </li> </ul>
<ul style="list-style-type: none"> <li>Lack of clarity over when a PRIIP is 'made available' to retail investors in the UK.</li> </ul>	<ul style="list-style-type: none"> <li>The obligation to provide a KID applies where a PRIIP is 'made available' to retail investors in the UK. The FCA has introduced guidance stating that a financial instrument should not be considered to be 'made available' if certain conditions are met. The conditions are, in summary, that: <ul style="list-style-type: none"> <li>the marketing materials disclose that the financial instrument is only offered to professional clients and eligible counterparties and is not intended for retail investors;</li> <li>the issuer or distributor of the financial instrument takes reasonable steps to ensure that the offer and marketing are directed only to professional clients and eligible counterparties; and</li> <li>a denomination or minimum investment of £100,000 (or non-sterling equivalent) applies to the financial instrument.</li> </ul> </li> </ul>

## 2. Information on performance and risk that must be included within the KID

The FCA has introduced the following amendments regarding performance and risk information in the KID:

Issue	Amendment
<ul style="list-style-type: none"> <li>The methodology for calculation and presentation of performance scenarios within the KID can produce misleading illustrations.</li> </ul>	<ul style="list-style-type: none"> <li>The FCA has removed the requirement for PRIIPs manufacturers to display performance scenarios in the KID and instead requires PRIIPs manufacturers to describe, in narrative form, the factors likely to affect future performance.</li> </ul>
<ul style="list-style-type: none"> <li>The 'Summary Risk Indicator' included within the KID delivers lower risk ratings than expected when the PRIIPs' underlying or reference asset is illiquid.</li> </ul>	<p>The PRIIPs regime requires the KID to contain a standardised risk score of between 1 and 7, calculated in accordance with a mandatory methodology. The FCA now requires:</p> <ul style="list-style-type: none"> <li>– PRIIPs manufacturers to upgrade their products' Summary Risk Indicators if they consider that the risk rating produced by the methodology is too low.</li> <li>– PRIIPs issued by Venture Capital Trusts to be assigned a Summary Risk Indicator score of no less than 6.</li> </ul> <ul style="list-style-type: none"> <li>In addition, the FCA has increased the previous 200-character limit within which PRIIPs manufacturers are allowed to explain significant risks that are not covered in the Summary Risk Indicator calculations to 400 characters.</li> </ul>

## 3. Transaction costs disclosure requirements

The FCA has introduced the following amendments regarding the disclosure of transaction costs:

Issue	Amendment
<ul style="list-style-type: none"> <li>Funds that use anti-dilution may find that the benefit to the fund from anti-dilution is more than the transaction costs that it has incurred over the same period, leading to the reporting of negative transaction costs in the KID.</li> </ul>	<ul style="list-style-type: none"> <li>The FCA's amendments require: <ul style="list-style-type: none"> <li>– firms using an anti-dilution mechanism to disclose anti-dilution benefits in the KID; and</li> <li>– that the anti-dilution benefit must not be considered, if and to the extent that the benefit would take the total transaction costs below explicit transaction costs.</li> </ul> </li> </ul>
<ul style="list-style-type: none"> <li>Calculation of transaction costs.</li> </ul>	<ul style="list-style-type: none"> <li>The FCA has introduced additional provisions regarding how transaction costs should be calculated, in particular for (i) OTC transactions; (ii) non-financial assets; and (iii) situations in which a low number or low value of transactions have been undertaken.</li> </ul>

### **Key changes from the FCA's consultation paper**

For those familiar with the proposals in the FCA's consultation paper, the key changes between the rules as consulted upon and the finalised rules are that:

- the FCA has introduced an implementation period, with the result that firms have until 31 December 2022 to ensure that they comply with the new requirements; and
- the FCA has removed its proposed requirement for firms to notify the FCA if a PRIIPs manufacturer upgrades a product's Summary Risk Indicator score.

### **FCA views on whether certain products fall into the definition of a PRIIP**

Interestingly, in its general commentary on the changes, the FCA includes views on whether certain products may fall within the definition of a PRIIP. Statements include that:

- generally, the FCA would not expect SPACs to fall within the scope of the PRIIPs regime where they are publicly-listed and follow the traditional model whereby an investor can swap their shares in the SPAC for shares of the merged company or redeem when the acquisition is complete.
- the FCA would typically consider a royalty company to be outside the scope of the PRIIPs regime where the assets held by investors are publicly-listed corporate shares.
- the manufacturers of sukuks and regulated covered bonds will need to consider whether the product is a PRIIP on a case-by-case basis.
- the FCA does not consider sovereign bonds to fall within the scope of PRIIPs.

### **Application of the amendments**

The amendments apply in line with the general application of the UK PRIIPs regime. The UK PRIIPS regime applies when PRIIPs are made available to retail investors in the UK. As a result, the amendments will apply to UK firms and to non-UK firms when PRIIPs are made available in the UK.

In the UK, the exemption from PRIIPs requirements for UCITS has been extended to 31 December 2026. For consistency with the UK's extension of the exemption from PRIIPs requirements for UCITS, the FCA has also extended the ability for the manager of a NURS to choose whether to provide a PRIIPs KID or a NURS-KII until 31 December 2026.

### **Amendments to the EU PRIIPs regime**

The EU has been considering amendments to the EU PRIIPs regime simultaneously to the UK, with the result that the EU and UK PRIIPs regimes will increasingly vary from one another. Key points to note include:

- *divergence between the position for UCITS*: while the UK has extended the exemption from PRIIPs requirements for UCITS until 31 December 2026, the EU is expected to only extend this exemption until 31 December 2022. The UK has not confirmed whether it will be possible for EU UCITS that are marketed into the UK

after 31 December 2022 to provide the new EU PRIIPs KID in the UK. If they are not permitted to do so, they will need to continue to provide the UCITS KIID in the UK.

- *divergence over content of PRIIPs KIDs*: the EU has also amended its technical standards for PRIIPs KIDs. These amendments are not aligned with the FCA's amendments.
- *wider retail reviews*: both the EU and the UK are expected to undertake, independently of one another, wider reviews of the landscape for retail investments. These could result in more significant changes to their respective PRIIPs regimes.

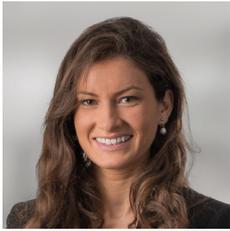
### Next steps

The FCA's amendments take effect from 25 March 2022. However, the FCA has introduced a transitional period until 31 December 2022. Firms should use the transitional period to ensure that they will be ready to meet the amended requirements by the end of the year.

The FCA has also emphasised that the amendments made under PS22/2 are targeted amendments only. The FCA has indicated that in the future it intends to consider how to ensure that the format of the PRIIPs KID is suitable to digital investments. HM Treasury has also committed to conduct a more wholesale review of the disclosure regime for UK retail investors.

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