

Comments Template for Joint Consultation Paper concerning amendments to the PRIIPs KID (JC 2018 60)		Deadline 6 December 2018 23:55 CET
Name of Company:	Crédit Agricole Corporate and Investment Bank (CACIB)	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ <u>Do not change the numbering</u> in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇒ Leave the last column <u>empty</u>. ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a question or a cell, leave the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. <p>Please send the completed template, in Word Format, to CP-18-005@eiopa.europa.eu</p> <p>Our IT tool does not allow processing of any other formats.</p>		
Reference	Comment	
General Comments	<p>Crédit Agricole Corporate and Investment Bank (CACIB) welcomes the ESAs' initiative to collect feedbacks on potential amendments to the PRIIPs KID.</p> <p>Prior to answering to the specific questions raised by the consultation, we would like to stress that, in our opinion, a wider review of the PRIIPs Regulation is needed, including level 1 (scope and overall approach) as we think the current proposal does not solve all issues we are facing (for example because the Regulation was written with investment products in mind).</p> <p>Also, we responded to the consultation with a view to correct critical issues with current information being provided in KIDs. CACIB is manufacturer of unfunded derivatives and structured</p>	

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	<p>securities; responses below are, therefore, reflecting difficulties with KIDs for such product types only.</p> <p><u>Summary of our position on the critical issues:</u></p> <ul style="list-style-type: none"> (i) Past Performance should not be included; (ii) Performance Scenarios should be based on underlying simulations with historical drift (very biased in some cases) adjusted to the risk-neutral expectation for Rates and FX and the risk-premium expectation for Equities. The risk-premium expectation for Equities requires further work to derive appropriate rates per industry and country, which cannot be completed in the proposed time frame of this amendment; (iii) Scenario annualised returns should be calculated over the effective term and not over the relevant assumed holding period. Holding cash idle after early maturity is an unnatural assumption for investors, who then reverse engineer returns back to an effective rate. The year in which the early maturity occurred can be disclosed in comment; (iv) Reduction in Yield (RiY) should not be based on an arbitrary 3% return. Instead, the effect of the Total Costs (Selling Price – Fair Value + unwind costs) should be expressed as a percent of the nominal divided by the effective term, as well as RiY. This will counter the RiY where it is artificially low due to low final value; (v) The implementation of PRIIPs Regulation has already led to heavy implementation costs and CACIB agrees that amendments to the KID should limit additional costs. 	
Q1	We do not question the relevance of “actual” past performance for some products (e.g. non-structured funds). However, we strongly oppose the inclusion of information on past performance for OTC derivatives and structured notes (for which actual past performance data do not exist) because such information cannot be accurately simulated as explained in our answers to	

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	<p>questions 2 and 4. Category 1 and 3 PRIIPs should therefore be explicitly excluded from this obligation, in the same way the UCITS Commission Regulation prohibits the use of past performance in the KIID for structured UCITS (article 36.1 of the Commission Regulation N°583/2010).</p>		
Q2	<p>Challenges are extremely high to include simulated past performance for Category 1 and 3 PRIIPs in terms of defining a proper methodology as well as in terms of implementation efforts and costs.</p> <p>The terms of a structured product (e.g. strike, barriers, coupon, cap, floor, etc.) are determined at the time the product is priced, under the current market conditions and thus are irrelevant in the past. Not to mention the issue of data availability, applying the actual product terms to the past performance of the underlying will lead to very misleading results for investors. Also, it seems hardly possible to come up with an alternative back-testing methodology that would be robust enough to replicate a payoff priced today in the past. In addition, such methodology would have to be agreed, detailed and prescribed in the RTS, which seems far too ambitious within the time allocated.</p> <p>It is also worth mentioning that including information on past performance would bring technical complexity derived from the yet-to-be-defined backtesting methodology and would therefore result in high implementation costs and efforts that in our opinion are unnecessary.</p>		
Q3			
Q4	<p>No, we do not think information on simulated past performance should be included in the KID because we highly doubt that a robust methodology can be defined and therefore we fear that we would be providing Retail Investors with misleading results. Also, results derived from a biased simulation would not be comparable anyway with products that have actual past performances.</p> <p>Furthermore, displaying both past and future performances would result in making the KID more cumbersome and confusing for Retail Investors by showing many information that are not related, mean different things and would not help them make an informed investment decision. In that</p>		

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	<p>case, it will be very challenging for us to explain the rationale behind results arising from different methodologies to our clients. In this respect, we believe that disclosing future performance scenarios rather than simulated past scenarios is more appropriate to give a statistical information on how a product could perform.</p> <p>Lastly, the consultation paper mentions as an alternative to product past performance to disclose the underlying past performance. We do not favour this option as it would mislead investors into believing that the product will linearly perform like the underlying (which is often not the case with structured products) and it would not give a comparable information with other products.</p>	
Q5		
Q6	<p>Yes, we consider this proposal for amendment of the narratives as an improvement. Indeed, it is important to stress that performance scenario results are derived from a predefined methodology and influenced by its biases (here mostly the historical trend of the underlying). Results must be presented from a statistical point of view (since the return distribution is simulated and quantiles are extracted) and not from a predictive point of view. In this respect, we think that the language proposed is satisfactory and straighter to the point. Yet, it could be envisaged to adapt this wording depending on the potential amendments to the methodology suggested in the following section of the consultation paper (e.g. drift adjustment – see question 7).</p>	
Q7	<p><i>Future performances scenarios anchored in the risk-free rate of return</i></p> <p>As long as the approach remains consistent across categories of products to avoid unwanted competition issues, we welcome the opportunity to amend the methodology for simulating the future performance of a PRIIP. Indeed we think there is room for improvement to correct unrealistic and counter-intuitive results that might arise sometimes from the current approach. As pointed out by the consultation paper, one main issue lies in the impact of the historical trend of the underlying over the past 5 years which can lead to over-optimistic or over-pessimistic results as well as inconsistency between the stress scenario and other scenarios. This can be mitigated by adjusting the drift of the simulated daily log returns to a more reasonable level.</p> <p><u>Regarding fixed-income products (Rates and Foreign Exchange), we therefore support the</u></p>	

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	<p>proposal for a risk-neutral approach for all scenarios and we have seen that adjusting to the risk-free rate is satisfactory and a good starting point.</p> <p><u>However, regarding Equity products</u>, we are of the view that adjusting to the sole risk-free rate (currently defined net of historical dividends, which is backward looking) would not be an appropriate measure of the return expectations for investing in such asset class. In order to capture the risk premium of a particular asset, we would suggest to rather adjust to the risk-free rate increased by a risk premium (reflecting expected dividends and capital appreciation). Further analysis is needed to determine what the risk premium should be (by industry, country or other relevant characteristics) and this cannot be done on such short time frame. Consequently, we suggest to keep the historical approach for equity products until such analysis is completed.</p> <p><i>Amended approach and presentation for future performance scenarios to highlight the range of outcomes</i></p> <p>We do not support the removal of some scenarios. We believe that the main added-value of simulating the future performance of a PRIIPs is to give an idea of the whole return distribution of the 10,000 scenarios because this will allow Retail Investors to easily understand the return and risk profile of a product. Removing the moderate and unfavourable scenarios will hide relevant information on the product profile and will leave only a wide range of outcomes with no possibility to infer statistical probabilities, especially because the stress scenario and the favourable scenario are determined using different distributions. For example, the asymmetry of a product having a cap or a knock-out feature is easily apparent from the results of the 3 main scenarios whereas some vanilla OTC products would show a symmetrical distribution. Furthermore, two products with respectively a high-risk and a low-risk barrier (all things being otherwise equal), would show similar results in the stress and favourable scenarios but not in the moderate nor the unfavourable scenarios.</p> <p>In addition, presentation through a graph does not seem efficient to convey all relevant information, would be confusing for Retail investors that are used to the current table and would be costly to implement.</p>	

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	<p><i>Extend the historical period used to measure performance</i></p> <p>We do not oppose the extension from 5 years to 10 years as long as the initial minimum requirement (2 years of daily data) remains unchanged.</p>																
Q8	<p>We do not feel the need to change the performance scenario presentation. Based on our own experience, clients have never raised concerns on the way scenario results are presented or on the number of scenario disclosed. We think that the presentation through a table should not lead to misinterpretations as long as the narratives are clear enough.</p>																
Q9	<p><i>Products with an Autocall feature</i></p> <p>We do not agree with the proposal not to disclose any results in IHP or RHP when the product has autocalled earlier under a given scenario, which we think would be very confusing for Retail Investors when reading the KID. However, we agree that autocall events should be better addressed in the performance scenario section of the KID and we would like to make an alternative proposal that should also apply to other issuer callable products.</p> <p>Assuming no reinvestment of call payment, an approach could be to:</p> <ul style="list-style-type: none"> (i) calculate for each simulated scenario and for each reference period (IHP 1, IHP 2 and RHP) the annualized return over the actual term (if the product was called earlier) and not over the reference period; (ii) sort returns for each reference period (IHP 1, IHP 2 and RHP) independently of each other; (iii) add an indication of the occurrence of the call event and date directly within the table as showed below: <table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <thead> <tr> <th colspan="5">Investment EUR 10,000</th> </tr> <tr> <th>Scenarios</th> <th></th> <th>1 year</th> <th>5 years</th> <th>10 years (Recommended holding period)</th> </tr> </thead> <tbody> <tr> <td>Stress scenario</td> <td>What you might get back after costs</td> <td>X EUR</td> <td>X EUR</td> <td>X EUR</td> </tr> </tbody> </table>	Investment EUR 10,000					Scenarios		1 year	5 years	10 years (Recommended holding period)	Stress scenario	What you might get back after costs	X EUR	X EUR	X EUR	
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	Average return each year	x%	x%	x%
Unfavourable scenario	What you might get back after costs	X EUR	X EUR	X EUR
	Average return each year	x%	x%	x%
Moderate scenario	What you might get back after costs	11 000 EUR	11 000 EUR	11 000 EUR
	Average return each year	10% Ω (Y1)	10% Ω (Y1)	10% Ω (Y1)
Favourable scenario	What you might get back after costs	X EUR	11 000 EUR	11 000 EUR
	Average return each year	x%	10% Ω (Y3)	10% Ω (Y3)

Ω Product matured early, in the period specified in brackets.

This approach would also make the RiY calculation easier and more intuitive where some fees are defined on a running basis since the RiY would also be annualized over the effective term.

Narratives for the Summary Risk Indicator

We do not oppose the proposal but question the added-value of adding 100 characters.

Growth assumption for the Reduction in Yield (RiY) calculation

We are not in favour of using a fictitious 3% return with costs for simulations showing a total loss of capital in the moderate scenario (i.e. a return of -100%) or more. We also do not support the proposal to extend this approach to any PRIIP regardless of the moderate scenario outcome. The 3% assumptions seems disconnected from the original scenario and the KID would lack consistency across sections. Calculated in such a way, the RiY will be very difficult to explain to Retail Investors, all the more so as it already appears to be the most difficult concept to understand for clients.

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	<p>To counter the problem of artificially low effect of costs on return where final value is very low or zero, we would rather disclose, on top of the current RiY, the total costs as the raw costs annualized percentage.</p> <p>The costs table could be presented with 3 lines:</p> <ul style="list-style-type: none"> • Total costs: total raw costs (Selling Price – Fair Value + exit costs, where applicable) • Total Expense Ratio (TER) per year: calculated based on the total costs for an investment of [EUR 10 000] and annualized over the effective term • Impact on return (RIY) per year: calculated using the current methodology in the RTS using returns annualized over the effective term <p>This information would be non-ambiguous, easy to understand for Retail Investors and would better meet MiFID II costs and charges disclosure obligations.</p> <table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <thead> <tr> <th colspan="4">Investment EUR 10 000</th> </tr> <tr> <th>Scenarios</th><th>If you cash in after 1 year</th><th>If you cash in after 5 year</th><th>If you cash in at the end of the Recommended holding period)</th></tr> </thead> <tbody> <tr> <td>Total costs</td><td>EUR 100.00</td><td>EUR 100.00</td><td>EUR 100.00</td></tr> <tr> <td>Total costs p.a over the effective term</td><td>1.00%</td><td>1.00%</td><td>1.00%</td></tr> <tr> <td>Impact on return (RIY) per year</td><td>1.11%</td><td>1.11%</td><td>1.11%</td></tr> </tbody> </table>	Investment EUR 10 000				Scenarios	If you cash in after 1 year	If you cash in after 5 year	If you cash in at the end of the Recommended holding period)	Total costs	EUR 100.00	EUR 100.00	EUR 100.00	Total costs p.a over the effective term	1.00%	1.00%	1.00%	Impact on return (RIY) per year	1.11%	1.11%	1.11%	
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Q10

Q11

Our comments are summarized in the table below:

Policy element	Comments on benefits	Comments on costs
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	Include information on past performance	We question the relevance of such information for Retail investors and think that simulated past performance will lead to misleading and non-comparable results.	Even if it is difficult to quantify implementation costs at this stage, we agree that such costs are likely to be very high to implement an additional backtesting methodology and update the KID template.	
	Amend narrative explanations for performance scenarios	We agree.	We agree.	
	Use of the risk-free rate of return rather than historical prices to anchor future performance scenarios	We agree, subject to our comments to Q7.	From our point of view, implementation costs for drift adjustment should be fairly reasonable. However, there will be additional costs in deriving and agreeing within the industry the risk premium for equity underlyings (by country/industry and any other relevant characteristic).	
	Presentation of Future performance scenarios as range either in tabular or graphical graph	We disagree that the graph or a simplified table showing only 2 scenarios would better inform Retail investors as explained in Q7.	Such approach will not reflect the overall return profile of the PRIIP. Implementation costs could be significant if performances scenarios had to be displayed in the form of the proposed graph.	
Q12	Since the methodology for simulating past performance for PRIIPs for which actual past performance is not defined yet, it is not possible to estimate precisely the implementation costs			

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	at this stage. However we anticipate high costs as it will be very challenging from a technical point of view to replicate a payoff in the past using a complex methodology.	
Q13	We find the proposed costs-benefits analysis comprehensive and clear, subject to our comments to Q11 and Q12, and we do not have additional comments.	