	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:	European Association of Co-operative Banks (EACB)	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
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Reference	**Comment**	
General Comments	The EACB notes the vote on 3 December 2018 by the European Parliament's ECON Committee on amendments related to the European Commission's proposed directive and regulation on facilitating cross-border distribution of investment funds, which have adopted extensions in the (i) exemption of the use of the PRIIPS KID by UCITS and relevant non-UCITS funds (Article 32(1) of the PRIIPS regulation) and (ii) deadline for review by the Commission of the PRIIPs regulation (Article 33(1), 33(2) and 33(4) of the PRIIPs regulation). The above outcome is generally supported by the EACB as it allows for temporary continued use of the reliable UCITS KIID until the pending technical issues in the PRIIPs KID are rectified. Such issues include: (i) the performance scenarios which	

have demonstrated for many products overly optimistic results, and in other cases, only losses regardless of the scenario or interim holding periods encouraging investors to exit the investment as soon as possible; (ii) the method of calculating transaction costs which has resulted in negative transaction costs; and (iii) the scope of certain financial instruments in the PRIIPs Regulation such as foreign exchange products, corporate bonds, and OTC derivatives.

Indeed, we also welcome the targeted amendments being proposed by way of this consultation to the PRIIPs Delegated Regulation, which provide a welcome basis to start a discussion on possible solutions to these problems.

Having said that, there are still important issues remaining such as the methodology for calculating transaction costs. It is disappointing that the above mentioned consultation does not address this.Such pending technical issues along with the proposal to transpose the current articles in relation to the UCITS KIID into the PRIIPs delegated acts based solely on a targeted review, are not conducive to investor protection.

Additionally, EACB members still face compliance challenges even with the extension in the UCITS exemption due to the new MiFID II cost disclosure requirements which are applicable to the investment firms and not asset managers

We note that ESMA Q&As provide guidance indicating that the PRIIPs KID fulfils the ex-ante costs obligations required by MiFID II (except for inducements and distribution costs), and even where there is uncertainty, data exchange templates (EMT) have been developed by the markets to facilitate compliance. However, similar assurance from the ESAs in terms of compliance of the UCITS KIID with the stated MiFID II obligations is not available. Asset managers are also reluctant to distribute cost information via the EMT due to risks of misleading information from the flawed methodology, and in any case they provide this information on a voluntary basis (they are not required by law to do so).

Finally, we believe that the deadline to answer the consultation is too short and makes it difficult for consumer testing to be arranged, which is essential for ensuring that retail investors correctly understand any proposed changes.

In view of the above, we ask that the ESAs consider the following concerns raised by the industry regarding:

A) <u>Performance scenario measures</u>

Simulation of future performances based on past performance (using a historical drift) can be very different from market anticipations, causing misleading results to be presented to investors included in the pricing of the sold products. Under such circumstances, it is wise for the clients to be advised that this is not what is expected in the future. The manufacturers are hence obliged to provide additional disclaimers and information to ensure that investors are properly informed, creating an inflation of documentation and some confusion, far from the initial PRIIPs' objective. Therefore, it undermines the whole retail marketing space, if not leading to a legal risk for manufacturers or distributors.

Where comparability means same methodology for a given asset class, it does not mean that all products' performances can be assessed the same way. This is very dependent on the way the product is built.
In principle, we generally oppose the idea to simulate future performances on the basis of past performance due to the historical drift and the different product structures, but in the case that this is the direction undertaken by the ESAs thenone could consider two main categories of products to which different methods can apply:

1. **Products whose elements are all decided in advance, which have predicted prices or can be compared to benchmarks**. For example: trackers, passive management products, active management products for which the management can be predictive; and
2. **Products which include a huge part of decision to be taken in the future with a wide range of underlying, therefore far from any known benchmarks**. For example: very diversified funds.

For the first category of products, one could calculate the performance directly based on the underlying or, on a proxy – a benchmark like. A neutral drift that is based on risk-neutral hypothesis can hence replace the historical drift. This approach will avoid the pro-cyclical effects of the current methods that fail to represent market expectations. The difference between real performance of the asset and the performance of the risk-neutral asset (called alpha) shall be added to that neutral drift. This method however demands a clear methodology to determine the value of the alpha for each asset class, which the industry could help the regulators develop.

For the second category of products, another method has to be found to better suit all asset classes and should be based on historical data. This approach will allow the investor to better understand future performances of comparable products. It also provides the manufacturers with a methodology that fits different categories of products while ensuring as much as possible a convergence in the methods.

Notwithstanding the approach detailed above, the performance scenarios displayed in one KID shall be comparable, which is why we support the application of a unique method to all scenarios regardless of the product category. As such, the stress scenario that uses a different method (neutral drift + stressed volatility) does not provide that comparability. We hence propose to keep the 3 initial scenarios (favorable, moderate, unfavorable), as they are the ones that can give a better idea to the investor of the performance distribution of his investment.

B) Calculation of costs

The presentation of the costs in the KID can also be very difficult to understand by a consumer. The costs presented in the KID are actually the Reduction in Yield (RiY), which shows the annual impact of those costs on the return expected based on the results of the moderate performance scenario. Problems may arise when, due to the calculation of what is actually a reduction in yield, the KID presents to the investors "costs" that are negative. It indeed requests the manufacturers to give additional explanations, which are not always easy to understand. This contributes to jeopardize the clarity and transparency objectives of the KID. As a matter of fact, the current method of calculation of costs adds together two types of prices. The first type is a "commission-like" cost that is similar to commissions on equity stocks. It is a real cost that is incurred to the investors. For FI products it would likely correspond to standard bid-ask spreads in a normal market environment. The second type however is profits or costs that depend on the best execution of the transaction. It is a result of a formula that compares an arrival price to an execution price. The difference is induced by market variations between the time of the order/last MTM and the time of execution. Accordingly, we think a change in terminology would be more understandable for the investor, but we still wonder which terminology would be best. Our position would hence be to use the larger PRIIPs review to assess the impact of a change in the presentation of costs, in order to give more clarity to the investors and hence avoid confusion caused by negative transaction costs.

If implemented, the changes proposed in paragraphs (a) and (b) would considerably improve the information provided in the KIDs to investors. Nonetheless, we understand that the ESAs are constrained by time to consider and implement such amendments, especially without further consultation of the stakeholders or consumer testing. Therefore, if such fundamental changes cannot be addressed in this review then we strongly advise that they are considered in the wider PRIIPs review that will be conducted by the European Commission which we emphasise should be addressed far ahead of the new 31 December 2019 deadline.

C) <u>Scope</u>

The scope of the PRIIPs Regulation is not fully clear with regard to different products (especially foreign exchange derivatives and corporate bonds) which creates legal uncertainty whether some of these products fall under the PRIIPs Regulation.

We are also aware that the Commission has put OTC derivatives within scope of the Regulation. Indeed, we note that the ESAs have already altered the prescribed wording in the KIDs for OTC derivatives. However, we have reservations whether these products are in scope of the PRIIPs regulation since in most cases OTC

	derivatives are not used as investment products and there is no past performance data available on these instruments at all. We understand that the ESAs already had similar concerns and in this respect support the ESAs' letter to the Commission dated 19 July 2018 (JC 2018 21) on 'Implications of the uncertainty as to the scope of the PRIIPs Regulation (1286/2014) and request for Commission guidance'. We urge that the Commission clarifies its position on the above and publishes related guidance. **D) <u>MiFID II</u>** On a final note, we propose that in order to address the MiFID II compliance issue (that shall be prolonged due to the extension in the UCITS exemption),one of two actions is necessary to be taken by the ESAs in their final report to this consultation, that is, a public statement or Level 3 measure is to be published: 1. confirming that the UCITS KIID is compliant with the MiFID II cost disclosure requirements; or 2. that UCITS manufacturers are required to report the product costs (especially costs of transactions within the investment fund) in accordance with the MiFID II requirements that apply to all investment firms. In the event that our particular proposals on performance scenario measures and costs calculations cannot be considered in full in this review, we still take the occasion to reply to the questions in the consultation.	
Q1	As already stated in the General Comments, we do not necessarily see the usefulness of past performances to investors even when the information is available, because in many cases figures are overly optimistic. However, this may still be included for certain PRIIPs depending on the category of products the KID comprises.	

	Such a change would only bring real value for discretionary products (2nd category of products), as the anticipations assessing the ability to make the relevant decision for investment is what needs to be measured. The real way of doing this is by looking at the past performances. Indeed, for these products, disclosing past performances for the last 10 years is a good way to better inform on the performances the investor can expect from his asset manager. Furthermore, in case of a change in the management of the product, the disclosure of past performances may not be relevant for the investors. It hence could be appropriate for manufacturers to be allowed to not disclose the past performances that would show the results of a management that is not applied at the time of the issuance of the KID. For the 1st category of products, the risk of having a bias is very important and far from reflecting the way the products itself has been priced by the manufacturer. For derivatives and structured products (PRIIPs of categories 1 and 3) as well as MOPs, including past performance information can be challenging if not impossible as actual past performance does not exist or depend on the choice of each investor (for MOPs). Disclosing past performances for those products can hence be even more confusing for the investor.	
Q2	As mentioned in question 1, including past performances data in the KID is not appropriate for all sorts of products. It can furthermore be very misleading to investors in some cases. For example, for derivatives and structured products (PRIIPs of categories 1 and 3) as well as MOPs, including past performance information can be challenging if not impossible as actual past performance does not exist or depend on the choice of each investor (for MOPs). For Category 3 PRIIPs for example (structured products), past performance data does not exist before the product is issued so disclosing simulated past performances will be irrelevant and possibly lead to more confusion. For manufacturers, another challenge is that of introducing past performance for further scenarios in the KIDs without exceeding the three-page limit.	

	The introduction of past performances will also lead to considerable effort in the technical implementation and create high implementation costs.	
Q3	See all the above. No. First of all it is not economically correct, but moreover it would be in total contradiction with the UCITS Regulation, which strictly prohibits the use of historical data for structured products.	
Q4	No. Such a change will incur additional implementation costs for manufacturers with no significant impact on the quality and comparability of information disclosed and distributed to investors, especially if no distinction in product categories is made.	
Q5	No, as previously mentioned we consider that any methodology proposed by the ESAs eventually results in less comprehensive information / misleading information for the customer.	
Q6	We welcome changes on the narratives that will allow more clarity for investors. The amendment on page 16 of the consultation may not provide such clarity as it states that the scenarios of the simulated future performance are an indication of "the range of possible returns". Since the scenarios displayed in many KIDs are overly optimistic, they do not in actual fact indicate the range of possible returns. In this respect we wish to highlight that the amendment of the narrative explanation can only be an interim solution until the current methodology to calculate performance has been replaced by a methodology that leads to realistic figures displayed in the KIDs. The amendment of the disclaimer can under no circumstances replace a thorough review of the current methodology.	
Q7	**We welcome the risk-neutral approach** that will diminish the pro-cyclical effect mainly responsible for misleading the investors. However, it shall be noted that such	

	an approach does not work for all types of products (see general comments). In any case, in order to ensure consistency in the results, a unique method shall be applied to all scenarios. Using a neutral drift only for the unfavorable scenario can for example lead, in a context of a bearish market, to results where the moderate scenario (using the historical drift) could appear worse than the unfavorable one (using the neutral drift). A unified approach will hence avoid the use of cap and floors by manufacturers trying to provide consistency in the results. **Regarding the reduction of the number of scenarios proposed by the ESAs, we agree that the approach shall be simplified**. A minimum of 3 scenarios shall be displayed, as it would comply with the MiFID II rules' interpretation. If less scenarios are considered, manufacturers may need to distribute to investors another document displaying the 3 scenarios mandatory. Moreover, the moderate scenario is used for calculating the RiY: it appears unfortunate to delete this scenario as it would hide data to the investors that are used to calculate other information displayed in the KID. Nonetheless, if, as explained in the general comments, the performance scenarios methods are changed, the unfavorable scenario will show real unfavorable results. We would hence advise to dismiss the stress scenario, which method is specific. As mentioned above, using different methods in performance scenarios of the same product can be a source of confusion and can lack consistency, which is not aligned with the PRIIPs' objectives. However, if the method remains unchanged and the unfavorable scenario remains over optimistic, the choice shall be given to the manufacturer to decide whether to use the stress scenario as a way to display real unfavorable results. This choice would allow manufacturers to provide accurate data. The narratives shall also mention the choice made in this case. **The extension of historical data from 5 to 10 years could be a good option**, although is limited by lack of full review offundamental changes in the methods, as well as, absence of stress scenarios (e.g. if the extension is introduced in 2020 then it will not reflect the financial crisis). Two options can be considered in this regard. First,	

	such a change shall be subject to testing by manufacturers, in order to make sure that extending the historical data period will benefit the investors' understanding. Second, it shall be noted that the data period is used for the calculation of the MRM and the MRM is used to calculate the SRI. The data period shall then be aligned between the different indicators. **The presentation of performance scenarios in a graph shown as a range could be misleading,** (pg 20 and 39) as it suggests that values outside the range are not possible. **The proposal for additional supplements to the KID (section 4.1.7) should be avoided,** as it causes operational burden to the manufacturer (who will need to draw it up) and the distributor (who will need to provide it to retail investors in addition to the existing KID). This may also cause operational risk. In addition to the applicable regulatory review and revision requirements, it should be avoided that the content of the KID is subject to a continuous process of amendments. In the same section, we note the ESAs' consideration whether it is appropriate to address further guidance in separate communication or in a final report. We are of the opinion that if the amendments will not consider fundamental changes, then **we are in favour of a further public consultation on the possible future changes in the KID**, as this may have a significant impact on both manufacturers and distributors.	
Q8	Proposing a graph to represent performance scenarios without testing it on consumers does not ensure it will improve significantly the understanding of investors, but will demand time for implementation, IT-wise. Furthermore, it is generally considered that the only way to accurately describe the future is by means of an "if …then…" approach based on the final payout profile, i.e. it is accurate to state "if at maturity the underlying is at this level the payout will be XY EUR". In this case, no further explanation or disclaimer has to be added. If the ESAs / the legislator should decide, that due to the short time frame it is not possible to take over the "If….., then….." approach, we suggest at least to delete the	

	interim scenarios in a quick fix. In our opinion, only the scenario for the recommended holding period should be shown, as the intermediate scenarios can contain unrealistic values and therefore have no added value for the investor.	
Q9	As mentioned in the general comments, our position is to consider only minimal and necessary amendments through this consultation, while fundamental changes need to be considered with the wider PRIIPs review. Hence, we would prefer to wait for the larger review to consider amendments as proposed by the ESAs and we urge that this also covers the transaction costs calculation issues as this is not addressed in this section. That said, we still provide some feedback below: **Section 4.2.2:** With regard to products with autocallable features we support the approach that performance is only shown at the intermediate holding period up to the call or cancellation (page 25). This approach takes account of the particularities of the relevant products and would lead to more realistic figures displayed in the KIDs. **Section 4.2.3:** We welcome the possibility of adding optional texts and additional 100 characters proposed in the narratives for the SRI as this would help manufacturers to introduce further explanations that take account of the particularities of the relevant product, thus enhancing clarity for the investors. We do not think that the inclusion of examples of what could be stated in this context would provide added value, because of the wide scope of the PRIIPs-Regulation. We agree with the intention that the warning in Annex III Point 3 (a) of the PRIIPs Delegated Regulation is only applicable for PRIIPs where the SRI is less than 7. **Section 4.2.4:** Regarding the narrative for performance fees, additional flexibility is welcome.	
Q10	As stated in the general comments, it is hard to consider the transposition of the relevant UCITS KIID articles in the UCITS delegated regulation directly to the PRIIPs	

| | delegated regulation based solely on a targeted review. The same applies to the proposal of simply cross-referencing to those requirements in the PRIIPs delegated regulation which is not in line with the EC's own stated ambitions of better EU Regulation for EU citizens

However, we must say that we strongly oppose the proposal that the UCITS KIID keep being provided to professional investors whilst no longer remaining available to retail investors. First of all, this will create a situation where manufactures with a broad potential target market identification (i.e. both professional and retail investors) will have to produce and update two different products which is something our members have long opposed. Such situation has a huge operational impact and is confusing to investors – once again not in line with aim of PRIIPS KID. Second, it will mean that until the flawed information in the KID is sorted out, then professional investors will receive valid information whilst retail investors will receive misleading information.

Whatever the decision, we reiterate our proposal on the MiFID II compliance implications to UCITS fund managers and that these be taken into account in this review as this issue still impacts the information provided to investors.

And on a final note, we wish to bring the ESAs' attention to the 'member state option' under article 7 of the PRIIPs Regulation to allow other languages to be used for information documents. The authorised languages currently differ between member states under PRIIPs and UCITS, and therefore situations exist whereby the KIID in one country may be provided in English and the native language whereas the KID is only provided in native tongue.

The ESAs and NCAs should be aware of possible differences in implementation between member states and the possible negative side-effects this might entail. If the NCA chooses to not use the member state option, this might be a barrier to the freedom of capital market movement in general and may reduce the range of investment options available particularly for retail investors. | |

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Q11	As mentioned in the general comments, the amendments proposed will, in any case, need to be reviewed as part of the PRIIPs' larger review by the European Commission. Implementing them will induce additional costs for financial institutions that will be difficult to pay off. We also draw attention to the difficulty of implementing some suggestions that need IT-developments. Indeed, such changes take time and without a consumer testing, its understanding from the investors cannot be evaluated.	
Q12	Cf. question 11	
Q13	Cf. question 11	