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 Savings and Retail Banking Group	
Disclosure of comments:	Please indicate if your comments should be treated as confidential: Public	Public
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General Comments	ESBG appreciates the ESA's initiative to examine how to improve the PRIIPs KID, in particular having in mind the extension of the scope to funds that might become a reality in 2020. Nevertheless, the Consultation Paper only reflects some minor problems of the PRIIPs Regulation. Many of the major problems with the current legal requirements are not targeted in the Consultation Paper. The ESAs themselves state on various occasions in their paper that given the short timeframe the amendments had to be limited. ESBG believes that it does not make sense to address only a limited number of amendments to the Regulatory Technical Standards. The amendments should cover key issues arising from the application of the PRIIPs Regulation, which is not the case with this Consultation Paper. ESBG in particular deplores that the proposed changes will not go through consumer testing whereas they were at the basis of the decisions	

made for the current RTS.

With regard to the immense problems identified, the Commission should give the ESAs a mandate to propose amendments to the Commission Delegated Regulation 2017/653. The amendments should follow a thorough analysis of the existing problems. Furthermore, they should be subject to a public consultation in order to get feedback by manufacturers and distributors of PRIIPs as well as representatives of consumers.

Before commenting on the questions raised in the Consultation paper, ESBG wants to highlight some of the major problems with PRIIPs that should be considered when deciding how to proceed further:

A. <u>The KIDs contain false and misleading information</u>

The Key Information Documents (KIDs) that are drafted in full compliance with the legal requirements laid down at level 2 contain information that can be false and misleading for investors. Manufacturers and distributors of PRIIPs are confronted with many questions regarding the contents of the KIDs. Most of them have introduced further explanations to adequately inform investors of the products. While ESBG sees and appreciate the efforts to address some of the issues through Q&As, they are not sufficient to rectify all problems stemming from level 2 measures.

Many supervisors and regulators are well aware of the problems. Just to name a few examples:
- Concerning KIDs for OTC derivatives, the ESAs have stated in their Q&A that "*the prescribed wording creates a risk that the retail investor will be misinformed about the characteristics of the product*" and have adjusted the text laid down at level 2. Further modifications via Q&As have already been published, and other aspects are discussed.
- On January 24 2018, the FCA has stipulated that the performance scenarios can be misleading.
- On May 11 2018, the German government has stated in a reply to a parliamentary question

that they are aware of the problems. The German government has claimed that the problems caused by EU regulations need to be addressed at European Level.

B. Review of Delegated Regulation 2017/653

Due to the amount of problems caused by the methodologies foreseen at level 2, ESBG considers that the priority is the legislative review of the PRIIPs regime. In the interest of effective investor protection, the risk of false or misleading information in the PRIIPs KID should be eliminated as soon as possible. Such an initiative is also being requested by many consumer organisations who likewise have stated their concerns regarding the contents of the KIDs and the effect they may have on consumers.

From ESBG's point of view, at least the following problems should be addressed in the review process foreseen in Article 33 of the PRIIPs Regulation:

- The scope of the PRIIPs Regulation is not fully clear for some products (especially foreign exchange derivatives and corporate bonds), which creates legal uncertainty.

- The methodology laid down at level 2 to calculate the performance scenarios and costs causes major problems. The scenarios displayed in many KIDs are overly optimistic and can lead to false expectations by investors. The PRIIPs standards require calculation of future performance scenarios based on past performance figures for the last five years. For most products, this means that the excellent market performance of the last five years is indiscriminately projected into the future. ESBG has noticed very important issues also with interest-rate simulation, with historic drift and using a principal component analysis as requested by Annex IV and II respectively. For instance it results in the 3M EURIBOR showing simulations all converging towards -1%, whereas for 3M USD LIBOR After 15Y the lowest path shows about 500%, the highest path shows about 4000%, the median is almost 1500%. Those figures are obviously very different from the market expectations. Overall, ESBG doubts that the complete universe of investment products can be handled within one single generic simulation technique. In order to have doable and reasonably simple rules, many compromises are required, meaning that many outcomes are at least doubtable.

- In many cases the methodology foreseen at level 2 to determine transaction costs for funds results in misleading information on costs, such as negative cost figures. For instance, the methodology requires determining transaction costs as the difference between the execution price and the mid-market price of an asset. It assumes that in every market and for every asset, there is a valid and determinable "arrival price" as a reference for the calculations. This is absolutely not the case.

- With regards to annualisation for products that are traded with no premiums (e.g. IR Swaps, FX Swaps, FX Forwards, etc.), they could end up in scenarios with negative results. In this case it is not possible to do standard annualisation using continuous, daily and yearly compounding. The standard formulae do not yield real numbers then. It is possible to do annualisation without compounding, but that is not relevant for standard investment products. There would therefore be two methods showing different numbers in cases where both are applicable. How is it possible to solve this?

- Furthermore, when the cost disclosures is based on yield calculations, it is problematic when a yield is not defined, for instance for IR Swaps, FX Swaps, FX Forwards, etc. If those products remain under the scope of the PRIIPs Regulation, and the cost calculation still should stem on yields, precise guidance on how to do this is necessary.

- Also on the methodology on the cost calculation, for the Foreign Exchange Transaction Cost Analysis (TCA), ESBG encourages the ESAs to introduce a definition of the denominator in the performance calculation. It is relevant to clarify this point due to the importance on the marketing side and because it can lead to different methodologies.

- With regard to OTC derivatives, ESBG would be very happy if the Commission reconsidered whether these products are in scope of the PRIIPs Regulation since in most cases OTC derivatives are not investment products. As mentioned above, the ESAs have already altered the prescribed wording in the KIDs for OTC derivatives. If the Commission is nevertheless of the opinion that OTC derivatives are within the scope of the PRIIPs Regulation, the Commission should at least foresee another KID template taking account of the particularities of OTC derivatives.

C. <u>Amendments proposed in the Consultation Paper are insufficient</u>

Many of the problems mentioned above have not been addressed in the Consultation Paper. The amendments that have been proposed in the Consultation Paper will not solve the problems described above. On many occasions in the Consultation Paper, the ESAs have pointed out that within the short time frame it is not possible to develop new approaches or methodologies. Furthermore, the ESAs have stated that the new proposals cannot be subject to consumer testing, meaning that the effects that the amendments will have on consumers' behaviour and understanding will not be assessed.

With regard to the amount of problems identified with the existing methodology it is indispensable to carefully examine the problems and develop new approaches that need to be consulted and tested by consumers.

D. <u>Prolongation of the exemption period for funds</u>

UCITS and other retail funds are currently exempted from the scope of the PRIIPs Regulation until 31 December 2019. In the absence of legislative actions, the exemption from the scope will expire. Hence, retail funds will be bound to produce PRIIPs KIDs from 1 January 2020 onwards.

	One of the major decision foreseen in Article 33 is whether the exemption period for UCITS and other retail funds shall be prolonged or if the UCITS KIID should be replaced by the PRIIPs KID. In the absence of this decision, funds would fall within the scope of the PRIIPs Regulation, meaning that retail funds would be bound to produce PRIIPs KIDs from 1 January 2020 onwards. Article 33(1)(2) explicitly states that the review shall assess whether the transitional arrangements shall be prolonged. ESBG understands that the Commission is actually planning to replace the existing provisions on key investor information in Directive 2009/65/EC (UCITS) without carrying out a comprehensive review of the existing requirements under PRIIPs and the problems they cause. The decision to extend the scope of the PRIIPs regulation to funds raises strong concerns as long as the problems caused by the current provisions have not been tackled in a comprehensive review process. It would be detrimental for investors to receive KIDs for funds that contain misleading information while the UCITS KIID is providing satisfactory information. Furthermore, expanding the scope of PRIIPs to funds irrespective of the massive problems would run counter the principle of better regulation. In the interest of effective investor protection, the Commission should therefore propose or support extending the exemption period. Only after a throughout review of the PRIIPs Regulation, the legislator should decide whether to extend the PRIIPs regulation to funds. In this context, ESBG welcomes the European Parliament's ECON Committee report on the cross-distribution of funds where they propose to extend the UCITS exemption. ESBG therefore calls for Review of the PRIIPs regulation as soon as possible, along with an extension of the UCITS exemption to leave sufficient time for it to take place in good conditions. It is also extremely important, not only for manufacturers but also for distributors of funds, that the decision on the regime applicable to funds is made as soon as possible so that they can adjust their IT systems and process flows in order to provide the required document.	
Q1	ESBG is of the opinion that the opportunity to include the presentation of past performance is not an easy question to answer. Indeed, it mostly depends on the type of product and begs the question of the sustainability of the PRIIPs' premise that all KIDs should be compared using identical methodologies.	

	For PRIIPs products in category 1 and 3, ESBG does not see how the presentation of past performance will be benefitting the consumer. First, the major problem with the performance displayed in the KIDs is that in many cases the figures are overly optimistic which might be misleading for investors. The problem goes back to the requirement to calculate the future performance scenarios based on past performance figures. For most products, this means that the excellent market performance of the last five years is indiscriminately projected into the future. As the ESAs state in the Consultation Paper, this problem will not be solved by the amendments proposed. From our point of view, the problem will even be compounded if not only the overly optimistic future performance will be displayed (which is derived from the past performance) but also the past performance (which is the ground for the future performance). The investor's impression that they will generate high yields will be encouraged if past and future performance are displayed. Second, including past performance information can be challenging if not impossible as actual past performance does not exist for those products or depends 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. As a consequence, the ESAs should go in the opposite direction and, for these categories of products, reflect on whether future performance scenarios should be based on past performance at all. ESBG is also concerned that further figures will be even more confusing for retail investors who already are shown up to 12 possible outcomes. The additional inclusion of past performance would contradict the idea of information that focusses on the main information and is easy to understand. This would definitely not support a better understanding of the range of possible returns displayed in the future performance scenarios, especially without explaining the relationship between the past and the future and the conclusion to be taken from it. The scenarios displayed on page 17 clearly demonstrate that it would be detrimental for investors if past and future performance were displayed in the KIDs. Investors would hardly be capable to	

	understand both tables and the different reasoning behind the figures. In addition, manufacturers would be faced with the problem that they have to include another scenario in the KIDs that cannot exceed three pages. However, the information could be useful for the PRIIPs products in category 2, where it makes sense with regards to their characteristics. Also, it should be clarified the impact of the biometric risk premium in this context. Nevertheless, ESBG considers that for those products a different methodology should be developed. In any case, the PRIIPs KID should favour the presentation of future performance scenarios as they are the only metrics that allow for a comparison between all products.	
Q2	There will generally be no past performances for certificates, meaning that past performances would have to be simulated. A complex set of rules would have to be drawn up, although the significance of such a simulation would be low. Finally, the introduction of past performances would lead to considerable effort in the technical implementation and create high implementation costs.	
Q3	ESBG opposes the introduction of information on past performance for the product types where it does not make sense (strikes, barriers, coupons depend on market at issuance). Furthermore, ESBG disagrees with basing the information on past performance on the approach currently used in the KII, as it would be in total contradiction with the UCITS Regulation that strictly prohibits the use of historical data for structured products (Article 36(1) of UCITS Regulation).	
Q4	The introduction of past performance should be limited to products where data on past performance is available. Otherwise, a complex set of rules would have to be drawn up for many products, although the benefit of such an additional simulation would be very low. Furthermore, it would have no significant impact on the quality and comparability of information disclosed and distributed to investors, especially if no distinction in products categories is made.	
Q5		
Q6	As mentioned in the general remarks, the false and misleading performance scenarios that are calculated in full compliance with the level 2 requirements are one of the major problems under	

	PRIIPs. Many of the figures can be misleading for investors. This issue has to be addressed in a thorough review. In the meantime, it would be an improvement if the explanation accompanying the scenarios were refined. This would be in line with the approach of many manufacturers and distributors of PRIIPs who have introduced disclaimers in their communication with investors warning them not to rely on the figures displayed in the KIDs. ESBG takes note however that the ESAs might not welcome it as indicated in the paragraph 4.1.7 on "Ongoing work by the ESAs to assess market practices related to the performance scenarios". In this respect, ESBG wants 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 sensible figures displayed in the KIDs. The amendment of the disclaimer cannot be a substitute for a thorough review of the current methodology.	
Q7	ESBG welcomes the risk-neutral approach that will diminish the procyclical effect mainly responsible for misleading the investors. However, it shall be noted that such an approach does not work for all types of products, especially those with very discretionary management, or with a lot of uncertainty related to their future value (typically the assets that have no liquid market). 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 unfavourable 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 unfavourable 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, the idea to limit the presentation to two future performance scenarios (page 19) would not be an improvement. Limiting the presentation to two future performance scenarios makes the information even less valuable for investors, and goes against the requirements of MiFID II to present information that	

	is fair, clear and not misleading, which ESBG could interpret as requiring three scenarios. Furthermore, if the four scenarios display unrealistic figures (which is the case in many KIDs), withdrawing two of them will not make much difference. The performance scenarios can only be improved if the methodology laid down at level 2 becomes subject to a comprehensive review. Furthermore, the moderate scenarios should not in any case be removed as it serves as a basis for the calculation of the RIY. It should therefore be presented to the investor. The same applies to the idea to present the performance scenarios in a graph that shows a range (page 20 and 39). If the calculated figures are misleading, the form of the presentation is irrelevant. Again, consumer testing should take place when experimenting with new ways of presenting information. With regards to the idea to extend the historical period used to measure performance (p. 21), ESBG considers that, although it would have the benefit of smoothing procyclical effects, it would not resolve the general problems; it would even get more difficult as it is a challenge to obtain reliable market data for such a long time span. As the ESAs have stated, the impact of the approach would be very limited if the extension was introduced in 2020 (which means that the financial crisis would not be reflected). Therefore, the approach cannot be a substitute to a thorough review of the current methodology and its weaknesses.	
Q8	ESBG would like to share some views on how to improve the performance scenarios: 1) In some cases, the stressed scenario performs better than the others do. That could be avoided, if the same drift as for the standard scenarios is re-established after shocking the volatilities (which can easily be back calculated). 2) Market participants have stated that in rare cases the shocked volatility of the stressed scenario is not higher than the original one. This could easily be handled by a rule like: volStressFactor = max(k_min, sig_stress/sig), where k_min could be for instance 1.1. Also, 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.	
Q9	As a general comment, ESBG regrets that the proposed changes have not gone through the same rigorous consumer testing process as for the current version of the RTS. However, as the ESAs are determine to go forward, we can provide the comments below. With regard to products with auto callable features, ESBG supports the approach that performance is only shown at the intermediate holding period up to the call or cancellation. This approach takes into account the particularities of the relevant products and should lead to figures that are more realistic. Furthermore, there should be information about the biometric risk feature calculated under the moderate scenario over the recommended holding period. It should be explained in the section of the biometric risk feature. ESBG welcomes the possibility of adding optional texts in the narratives for the risk indicator as proposed under 4.2.3 of the Consultation Paper. The extension of the possibility to add additional information would help manufacturers to introduce further explanations that take into account the particularities of the relevant product. As regards the growth assumption for the RIY calculation, ESBG supports the proposed amendments but would like to highlight that clarification is needed on how this would work in detail for complex products. ESBG recommends providing example calculations for complex products with several payments: bonds, IR swaps, etc. The most problematic ones are the products where the investor pays and receives cash flows, like IR swaps, FX swaps, FX forwards, etc. Here, one cannot easily apply a yield calculation. ESBG would also like to note that it would be very difficult to explain to clients this amendment.	
Q10	As already mentioned in the general remarks, the exemption period for funds has to be prolonged in order to avoid that investors receive a KID that contain misleading information. The prolongation of the exemption period should be accompanied by a clear signal that a thorough review of the current requirements is carried out. In the process of the review, the legislator has to decide on the relevant amendments to consider the particularities of funds when drawing up KIDs for funds.	

	ESBG strongly opposes the idea mentioned on page 30 that the UCITS KII may still be provided to professional investors even if for retail investors the KID has to be provided. This would mean that UCITS managers have to draw (and update) two different documents. Furthermore, this would mean that professional investors would receive valid information while retail investors would receive a document that is generally considered misleading. ESBG do not see how the amendments proposed under 4.3.2 to 4.3.5 would significantly improve the quality of the KIDs for funds. The many problems that the ESAs have mentioned in the Consultation Paper will not be solved with the amendments proposed. This would mean that from 2020 onwards retail investors who purchase funds would receive information that is far less reliable than the current information provided through the UCITS KIID.	
Q11	As mentioned above, most of the amendments proposed would not lead to a significantly improved PRIIPs KID. However, what is certain is that the implementation of these changes would cause high costs for manufacturers. Time would also need to be invested to implement the changes, which cannot be justified for the products for which it is not relevant. This result is reflected in the table under 5.1.4 where for most measures the costs exceed the benefits by far.	
Q12	At least as far as Category 3 PRIIPs are concerned, ESBG assumes high implementation costs, especially for the products where past performance would have to be simulated. There is therefore above all a problem of relevance for several categories of products.	
Q13	The inclusion of information on past performance will trigger costs, require time for implementation, be sometimes irrelevant, and bring more confusion to clients. However, the use of the risk-free rate of return will be beneficial, as it would bring unambiguous market implied drifts compared with drifts out of 2 to 5 years of historic data.	