	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:	**EUSIPA (European Structured Investment Products Association)**	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
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Reference	**Comment**	
General Comments	On behalf of its members, EUSIPA would like to state the following: EUSIPA appreciates the endeavour of the ESAs to discuss with market stakeholders ways to solve identified issues stemming from the implementation of the PRIIPs Regulation and the related RTS in their current format. However, our members would rather support a coordinated process of identifying needs to adjust and improve the current methodologies where necessary. Any such process must include extensive expert consultation and impact testing/analysis. In our view, the regular review of the PRIIPs Regulation's implementation legally foreseen now to	

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	be handled within 2019, should provide the ideal platform for doing so. EUSIPA is very concerned that quick-fix solutions decided upon without having a full grasp of their impact on the highly diverse product landscape in the national capital markets of the European Union will, as has been the case in the past, lead to insufficient or wrong information being displayed in the Key Information Document. As a general remark, we would like to voice our discomfort with the situation that the ESAs have not taken into account any of the EUSPPA recommendations made on the application of RTS, published by EUSIPA in September 2018 (link). These recommendations were based on extensive discussions within the industry and detail a number of consensus-based suggestions to improve the current methodologies.	
Q1	**No.** **EUSIPA takes the view that, insofar as structured products are concerned, past performance should not be included in the PRIIPs-KIDs.** The reasons for our view are based on the following considerations: 1. Past performance has **no added value outside actively managed financial instruments.** 2. Should past performance be simulated for products where there is none, **PRIIPs-KIDs become incomparable across product**/asset classes. 3. Simulating past performance poses **fundamental technical problems** that would very likely result in wrong/misleading information. 4. The display of past performance information generally, and that of simulated past performance in particular, will **expose retail investors to the danger of being mislead** and taking wrong investment decisions. 5. **Current KID space limitations** make it impossible to add new information required by using past performance data.	

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	Details on the before considerations are set out in our answers to question 2 below.	
Q2	**Yes.** **EUSIPA takes the view that there are massive challenges with displaying past performance information, in particular on products that have no real past performance, if such past performance were to be simulated.** **1. No added value outside actively managed financial instruments** Information on past performance is primarily relevant for actively managed funds, where the management quality is reflected in the past performance. For structured investment and leverage products, derivatives or any other "passive" investment products (e.g. ETFs) adding simulated past performance for either the underlying or the PRIIPs-products itself provides no value added. For PRIIPs Categories I and III products in particular, simulating past performance could lead to wrong information/misleading results. Before assessment actually is consistent with that made in the relevant UCITS Implementing Regulation which explicitly prohibits the use of past simulated performance for structured UCITS (article 36.1 of Commission Regulation (EU) 583/2010: "*The key investor information document for structured UCITS shall not contain the 'Past performance' section*"). **2. KIDs becoming incomparable across products** Adding past performance would also make KID documents less comparable with each other. Simulated past performance cannot be seen as equivalent to "recorded" real-life past performance. There would hence be two different sets of past performance data. As for the incomparability of "recorded" real-life performance with simulated performance for products where actual past performance do not exist, the following difficulties should be noted for all Category 3 PRIIPs, in particular:	Public

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	- the past performance data of a structured product does not exist before the product is issued (*i.e.* when a structured product is launched, there is no past performance available on any websites: only once the product is issued the actual "performance" (prices and/or valuations) becomes published on venues. It would be misleading to do any assumptions on past performance of a security that legally does not exist, and have, at the date of the issuance, no price history. - For event-linked performance paths, so products with a knock-out barrier or Credit Linked Notes (CLNs), the projections in the past would be meaningless because even if no event has occurred in the past that, it obviously cannot mean that such event will not occur in the future. - For structured products that fall under the definition of MOPs past performance data can simply not be computed because the composition of a unit-linked product is left to the choice of each investor. **3. Fundamental technical problems** Moreover**,** simulating a past performance is technically impossible for many products as often the relevant data (e.g. on past volatility) are simply not available. Generally, PRIIPs category I and III products pose great challenges when including past performance for various reasons, including: • the path dependent nature of many Category III PRIIPs; • the fact that any back tests for structured products, whether they are hold-to-maturity products or trading products, lead to results that are not comparable to funds; • the fact that any form of back testing of Category III PRIIPs involves discretionary elements; • computational feasibility considerations; and • the fact that any requirement to show back testing results would risk penalizing products designed to allow investors benefit from current market conditions.	

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	- <u>Path dependency of many Category III PRIIPs</u> When using real price data (i.e., for exchange traded products), past performance will often depend on contingent events (e.g., a barrier breach) that change the payoff profile of a PRIIP and affect its susceptibility to price movements going forward. Moreover, as the bond component matures and the option components draw closer to expiration, the price volatility also changes. Therefore, using past performance based on actual product prices for these products can be misleading. - <u>Lack of comparability between structured products and funds</u> As for simulated past performance (i.e., back testing) based on a hypothetical daily issuance of a product with similar features to the PRIIP on each day of the backtesting period and calculating its performance at the recommended holding period, apart from the drawbacks listed in the consultation paper, it is important to note that the meaning of the simulated results is different from those shown in the UCITS KIID. While the latter shows annual performance of each year over the last 10 years, the daily back test shows the performance at the end of the recommended holding period, which typically corresponds to the product's maturity for fixed-term products (e.g. 5-year return). - <u>Backtesting of structured products involves discretionary elements</u> The performance of a structured product chiefly depends on its price and/or the levels of its price dependent parameters (e.g., the participation rate or cap in a capped participation product). In order to meaningfully backtest a structured product, these parameters have to be adjusted to reflect the prevailing market conditions at the time of the hypothetical issuance of the product. In the case of a daily issuance on each day of the backtesting period, a fresh price would have to be calculated every day. As a full snapshot of all inputs used by a bank's pricing engine may not be readily available for each day in the back testing period, any repricing would necessarily involve	

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	assumptions and degree of discretion. It would potentially also impose significant demands on manufacturers' IT infrastructures, as it would require them to perform daily recalculations of historical prices for a large product set. If, on the other hand, a simpler repricing methodology were to be used, the historical prices would not be comparable to the product's current price, thereby reducing the utility of the back test. - <u>Computational feasibility</u> Many Category III PRIIPs manufacturers have invested heavily to ensure that the required PRIIP KID risk figures can be calculated on a daily basis for the large product universe many of them offer to investors. The simulations required for a PRIIP's SRI and performance scenarios would further exacerbate the already significant infrastructure challenges posed by the need to calculate historical product prices. Backtesting a PRIIP's behavior over, e.g., ten years would increase the valuation time per product by 25% (10 years times 250 business days equals 2,500 valuations on top of the 10,000 valuations currently required). - <u>Back testing / simulating past performance for an underlying/reference asset</u> Finally, as a separate point, we would note that if the ESAs decided to prescribe back tests not for the PRIIP itself, but for the reference asset (i.e., the second possibility mentioned in the consultation paper), there is a risk that showing the underlying asset's performance might mislead investors insofar as they might mistakenly compare them with the product's performance of a PRIIPs Category II. It is also questionable to what extent the presentation of historical reference data in isolation would be helpful to investors, as it would require them to carry out additional analysis to map the historical prices to the PRIIP's payoff features. Thus, neither solution proposed by the ESAs as for how past performance can be simulated is acceptable from a technical point of view. Summarizing and more generally speaking, simulating past performance would require the industry to be provided with a robust uniform and standardized methodology which, to our	

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	knowledge, is neither in the market nor academic world established today. **4. Investors face an increasing danger to be mislead and take wrong decisions** Fundamentally, adding simulated past performance to the KID significantly increases in EUSIPA's view the danger that investors are being mislead when seeking to analyse KID information and, following that, make an investment decision. Firstly, adding simulated or real past performance as such will trigger in many investors the misleading expectation that past performance is somehow predictive for future performances. More specifically, simulated past performance may create a selection bias against products designed to benefit investors in current market conditions may be created. If the focus of the performance scenarios were to shift to backtesting a PRIIP over a given historical period, PRIIPs designed to allow investors to benefit from current market conditions may be unfairly disadvantaged compared with PRIIPs with less beneficial features that perform(ed) better in a given historical context. It is important to note that this selection bias would not only favor PRIIPs specifically designed to perform well in a given historical period, but risks randomly penalizing any PRIIP that is designed and priced on a forward-looking basis. Beyond and more generally, investors seeking to compare different products will likely struggle to grasp the limitations of several sets of data presented to them (such as real-life past performance for actively managed products, simulated past performance for passive investment products and simulated future performance for both). It is even more likely that investor fail to understand that there is no or only a (highly) limited correlation between any data relating to past and future performance, when these are presented in a combined way to them. **5. Current KID space limitations contradict new information requirements** Last not least, the addition of new information also seems impossible with the requirement that KIDs should have 3 pages only, given that the industry struggles already today to provide the infomation necessary in this format. Especially for structured products, the 3-page limitation leads already today to a maximum utilization of space available without any further scope. Besides space limitation, the past performance simulation might generally make it necessary to elaborate	

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	on the used simulation approach and comment on assumptions used for the individula product at stake. Finally, there might even be data license issues for displaying performance data.	
Q3	Given that, as outlined above in our answers to questions 1 and 2, EUSIPA supports the view that no simulated past performance should be displayed for products for which no real past performance exists, we would not take a position on this question.	
Q4	**No.** As provided in our answers to Q2 and Q3 EUSIPA takes the view that if there is no actual past performance available, simulated past performance should not be included in the KID. We refer to our detailed reasoning set out in the answer to Q2.	
Q5	As outlined above in our answers given to Q2 and Q3m EUSIPA does not support the inclusion of simulated past performance for structured products in the PRIIPs KID.	
Q6	**Yes.** EUSIPA is of the opinion that the proposed new narratives will improve the clarity as for the nature of the scenarios presented in the KID. Nonetheless, EUSIPA would like to make the following suggestions and comments: 1. Instead of “Market developments in the future cannot be accurately predicted. These scenarios are only an indication of the range of possible returns.” it should be set out: “<u>Market developments in the future cannot be predicted. Actual returns may be different and in many cases could be worse. Investors should not base their investment decision on these performance scenarios. What you get will vary depending on how the market performs and how long you keep the product.</u>”	

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	2. Finally, investors should be explained in the KID what these scenarios represent as manufacturers keep hearing related feedback from many distributors of structured product. That is why we suggest to add: "These scenarios are based on future simulations. The stress scenario represents the worse 1% case at year 1 and 5% cases in any subsequent holding period. The negative scenario represents the worse 10% case. The moderate scenario represents the median case, and the positive scenario the 10% best case".	
Q7	Generally, EUSIPA is of the opinion that any process of identifying adjustments and improvements to the methodology defined in the PRIIPs RTS should follow the legally foreseen comprehensive review of the RTS instead of being the outcome of quick-fix solutions without sufficient expert counsel and impact testing of the product universe covered by the EU PRIIPs Regulation. EUSIPA would also express its view that any methodological changes to the establishment of future performance scenarios always should equally apply to all product categories (structured products, derivatives, funds and insurance products), so to allow for full comparability. We would hence like to make the following comments with regard to the suggestions outlined by the ESAs in their CP: **1. Usage of the risk-free rate** While the application of a risk free rate could in principle be a reasonable approach, we would reiterate that its consideration can only be decided following a thorough technical examination which includes extensive technical counsel and testing across asset classes ahead of its introduction. We also reiterate our position that, as a matter of principle, any new methodology or any changes to an existing one need to ensure, respectively not to endanger, the methodology's uniform applicability across asset classes. This extends in particular to the inclusion of PRIIPs Category II products/UCITs funds.	

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	A related question is whether for specific asset classes such as equity-linked products, a risk premium would probably have to be incorporated in any calculation model. Using a risk neutral distribution would not reflect the perspective of investors who rationally invest in this asset class because they believe that this asset class carries a risk premium. Considering though that there are currently no commonly agreed methodologies known to us as to how to calculate such risk premia and that it will foreseeably take time for all stakeholders (ESAs, manufacturers, retail investors representatives and distributors) to find a consensus on those, we suggest that a relevant methodological approach is being developed within the framework of the legally foreseen full review of the PRIIPs Regulation's implementation and the existing RTS rules, incorporating expert advice and extensive testing of any solution across the product universe in the various national markets of the EU. **2. Deletion of moderate and unfavourable scenarios:** EUSIPA strongly recommends to **not** reduce the number of scenarios in the current setup. Limiting the performance scenarios to two extreme scenarios would omit or obscure relevant information on the return profile of many products, as well as certain other important features (e.g., barriers and early redemption features). These features are neither not reflected in the summary risk indicator, as the market risk measure relates only to an extreme scenario (VaR 97.5%). Especially for structured products with partial capital protection (barrier products) the effect of the protection feature will not be understandable for the investors with only two scenarios of which one scenario will - highly probably - lead to a barrier knock (stress) and on the upside scenario to a cap. Other PRIIPs without protections features (hence higher risk and SRI) and "delta 1"- participation will have nearly the same stress scenario but at the and a better upside. The investor will be guided by the combination into higher risk products, as it is indicated that the	

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	downside is nearly the same, but the upside chances are better. - As an illustrative example for the issues mentioned above, consider two products where one bears a high-risk barrier at 80% and another at a lower level of 50%, and all other economics are equal. In such a case, the proposed two scenarios would present the same returns, while the unfavourable scenario might highlight the benefits of the latter product. In addition, presenting only the tail scenarios would greatly increase the occurrence of significant changes when monitoring for significant changes in the KID (right now it is determined by the moderate scenario). Finally, we would like to stress that the moderate performance scenario result is used to calculate the reduction in yield (RIY) displayed in the KID. It does not seem appropriate to "hide" data that is also used to calculate other information provided to the investor. Alternatively to the deletion of the two scenarios we propose to <u>delete the interims scenarios</u> in general and show only the scenarios for the RHP. This has two advantages: The KID would gain space for more explanatory narratives and misleading results would be reduced as the interim scenarios are mostly liable to abstruse numbers. **3. Extension of observation history from 5 to 10 years:** We strongly recommend to not use a longer history as the 5 years history already has a smoothing effect and a delayed increase/decrease of the risk in new market conditions. A 10 years history might result in very stable risk classes, but – maybe – significantly different from the experienced market conditions of the more recent past. Furthermore, long histories for e.g. shares with many corporate actions may contain market conditions which are significantly different from the reality today. **4. Change of the presentation for future performance scenarios to a graph** EUSIPA does not support such change. The current presentation of the performance scenario results table is clear and from our	

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	experience, does not raise any question from retail investors. As was furthermore exposed in the market study done prior the RTS drafting, retail investors better understand table and narrative than graph. Moreover, any such amendment would be extremely costly in terms of necessary IT adjustments.	
Q8	Generally, EUSIPA is of the opinion that any process of identifying adjustments and improvements to the methodology defined in the PRIIPs RTS should follow the legally foreseen comprehensive review of the RTS instead of being the outcome of quick-fix solutions without sufficient expert counsel and impact testing of the product universe covered by the EU PRIIPs Regulation. EUSIPA would also express its view that any methodological changes to the establishment of future performance scenarios always should equally apply to all product categories (structured products, derivatives, funds and insurance products), so to allow for full comparability.	
Q9	Generally, EUSIPA is of the opinion that any process of identifying adjustments and improvements to the methodology defined in the PRIIPs RTS should follow the legally foreseen comprehensive review of the RTS instead of being the outcome of quick-fix solutions without sufficient expert counsel and impact testing of the product universe covered by the EU PRIIPs Regulation. EUSIPA would also express its view that any methodological changes to the establishment of future performance scenarios always should equally apply to all product categories (structured products, derivatives, funds and insurance products), so to allow for full comparability. **1. Products with an autocallable feature** EUSIPA does <u>not support</u> the proposal made by the ESAs in the CP as this results in a lack of information that would reduce the comparability of KIDs between products and potentially lead to many questions from retail investors. Moreover, it would imply not to disclose (*i.e.* to hide to the investor) data to be used to compute the RiY.	

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	As a general comment on correctly dealing with autocallable products, we would refer to the EUSIPA recommendations with respect to the asset class of autocallable products setting out the industry view developed throughout a series of extensive technical workshops (please see EUSIPA recommendation nr 4 issued as part of a broader RTS guidance document on 27 September 2018 by EUSIPA -link). EUSIPA is under the impression that, regarding performance scenarios for autocallable products, a basic concept is fundamentally disregarded: Whether it is advantageous for the investor if the product is called early or not always depends on the product's specific features and the available alternative investment options at the time the product terminates. As such, it would be inappropriate to assume that an early redemption is necessarily always more beneficial from an investor's perspective. Specifically, when comparing a scenario with an early call after 1 year and a 7% return and another with an early call after 2 years and a 14% return, in normal market conditions, the latter ordinarily would be considered more favorable to the investor from a financial point of view. It seems the suggested methodology in the consultation paper uses IRR to sort the scenarios, thereby favoring the first scenario. Moreover, using IRR for ranking is not in line with the RTS methodology used for the MRM (where the ranking is done using a present value). This will lead to different ranking of scenarios between the MRM and the performance scenarios. In addition, to comply with point 24 (c) of ANNEX IV in the RTS, for the same scenario line (i.e. stress, unfavourable, moderate and favourable) the vast majority of manufacturers have implemented a methodology that can lead to a situation where different paths from among the 10,000 scenarios are selected at different holding periods. Therefore, for the favourable scenario as an example, at the one-year holding period, a scenario where the product is called after one year might be compatible with the 90th percentile, while at the three-year holding period, a scenario called after two years might be compatible with the 90th percentile. This concept is	

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	missed from the consultation paper's suggested methodology. Finally, in addition, two additional comments are worth mentioning: • The suggested presentation of autocallable scenrios is still confusing, as when a product is called between two holding periods, the information regarding when the product is actually called is still missing. • Another common feature is the issuer callability (e.g. callable reverse convertible products), where the issuer has the option to call the product. The methodology for dealing with this feature is not described in the RTS nor in the consultation paper. In this case, issuers typically will call the product when they believe it is more favorable for them to do so. We hence would reiterate our message that the ESAs review the methodological approach set out in the EUSIPA recommendation paper published September 2018 (see link above). **2. Growth assumption of 3% for the RIY calculation:** Making a growth assumption for the RIY calculation could potentially be seen as an improvement to the current methodology in terms of clarity and consistency. While we understand the problem which the latest Q&A aimed at solving, limiting the solution (using the 3% scenario instead of the moderate scenario) only to a case of a total loss will lead to inconsistency with RIY calculations of other cases. More generally, this approach leads to more generic cost figures as the performance of the product is excluded from the calculation. While this solves most of the remaining calculation problems, the downside is a misleading figure as it is extracted out of the context (reduction in yield) based on a generic yield, not the one calculated in the scenarios. Should the approach nonetheless be followed it seems adviseable that in order to allow for comparability between manufacturers the RTS must clearly state that the proposed 3% scenario means:	

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	• 3% return on the PRIIP (not the underlying assets) • The 3% is net of costs (including embedded entry cost) • It is a compounded return (i.e. EUR 10,000, then EUR 10,300 (after 1Y), then EUR 10,609 (after Y2), etc.) • Assumes no early call for products with this feature (so an early exit fee is assumed at intermediate holding periods) Generally, any change to the current cost methodology should to be reviewed more fundamentally, ideally as part of the legally foressen review process, before being put into practice. Within such fundamental review alternative solutions to the 3% approach should be examined and impacts of any cost methodology changes on the asset classes covered by the PRIIPs Regulation, be thoroughly tested. **3. Clarification of narrative of products with a maturity below one year** With regard to narratives provided for KIDs relating to products with a Recommended Holding Period of less than one year EUSIPA generally supports the solution provided by the ESAs in the last update of their Q&A document. Nevertheless, the Q&A change does not comply with the requirement as provided in the Delegated Regulation. Therefore, EUSIPA proposes to amend the latter accordingly. More generally EUSIPA would, with regard to the future handling of performance scenarios and related information for products with short maturities hint at its recommendation 1 made as part of a set of recommendations on the PRIIPs implementation, published on 27 September 2018 (link). **4. Narratives for summary risk indicator and performance fee narrative:** EUSIPA supports the exclusion of the narrative that risk can be higher for products with an SRI 7 and the proposed change for making it possible to elaborate on the performance fee as set out	

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	under 4.2.4. **5. Other minor changes (4.2.2.) – product term narrative** Regarding 4.2.2. we would propose the inclusion of the product term in the 'What is this Product?' section. However, it will be useful to allow for a narrative in the term clause in case of products with a callability feature (e.g. Term: 5 years, unless called earlier).	
Q10	Generally, EUSIPA is of the view that, for reasons of comparability, the presentation of costs needs to be unified between UCITS and PRIIPs. UCITS present "raw" costs, which are clear and easier to understand, while PRIIPs present RIY, which has the benefit of allowing to compare across products and maturities. This topic has not been discussed in the consultation paper.	
Q11		
Q12	As mentioned above, EUSIPA is of the opinion that for other than PRIIPs category II, the inclusion of past performance could create misleading results. Regardless, from a technical point of view, including the (simulated) past performance using one of the methodologies described in the consultation paper might prove technically impossible for many products.	
Q13	EUSIPA is of the view that the RTS need to provide clarity regarding the redundancy of documents that will be produced by UCITS and PRIIPs after unification of the regulation. Non-retail investors currently receive KII Documents for UCITS, while KIDs are only provided for PRIIPs and only to retail clients. Clearly, maintaining both documents and methodologies concurrently poses a significant additional cost, with potential misleading differences.	