

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:	Portuguese Banking Association (APB)	
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"> ⇒ Do not change the numbering 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	<ul style="list-style-type: none"> i. Although understanding, and supporting, the need for the targeted amendments and their urgency, the consultation process - with a short period of public consultation and with no further public consultation on the legislative text of a draft RTS - is not considered to be the most appropriate. ii. If there's extra information to be added to the KID, it will be necessary to extend the 3 page space limitation, possibly to 4 pages. iii. The proposed amendments will imply time and adaptation costs. To mitigate 	

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	<p>such effects, the provision of Excel templates, with all the computations for a typical product in each category, from raw (market) data to the indicator, the returns and costs, and also the corresponding KID would prove helpful. It would provide a “benchmark” for software design, implementation and testing, leaving less room for assumptions and errors.</p> <p>iv. The provision of an “Investors Manual”, prepared by the ESAs, on how to read the KID and how to compare products could also be useful.</p> <p>v. The separation of costs and returns would also facilitate the interpretation of the KID and the comparison between products. To improve comparability, the scenarios section should only deal with gross returns (before taxes and costs) and the costs section should deal only with costs (as a negative internal rate of return). For investors the reasoning should be something as simple as, for example: <i>“with this product I expect to make X%, but it costs me Y%, per year, while this other alternative product provides a similar return but costs almost twice as much”</i>.</p> <p>vi. For category 3 (structured products), it could make sense to add an optional section to the KID, with information on what happened to the product since the issue date (paid coupons, capital redemption, etc), that may prove to be of interest for the average investor.</p>	
Q1	<p>We consider that information on past performance, complementing the current scenarios, should be included in the KID whenever it is available, since it may be useful for investors.</p> <p>Nevertheless, it is important to mention that this information will not necessarily solve the problem that <i>“scenarios can provide an overly positive outlook of potential returns,</i></p>	

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	<p><i>where a product has experienced positive returns over the previous five years, that can be seen as above the longer-term norm”, if the product also experienced positive returns in a longer period of time, now presented as past performance information. In addition, it will be a challenge under the current 3-page limitation.</i></p> <p>For Category 3 (structured products), the bootstrap method may already be considered as “past performance”. Adding back-test (“sequential” simulation) may not add much. A comparison between past (sequential or randomized) and future performance (simulated using pricing models and actual market parameters) could be more useful.</p>	
Q2	<p>Yes, there are challenges to include past performance information for certain types of PRIIPs: past performance information is sometimes lacking, implementation costs may be substantial, investment strategies that change over time pose a challenge and additional information may, as previously mentioned, impact the limit on number of pages.</p> <p>The challenges may be mitigated if incomplete underlying price series can be filled using other underlying daily returns as a proxy (for example using a comparable index or stock or combination of comparable stocks), before applying the payoff formula to determine the product internal rate of return.</p> <p>For Category 3 (structured products) using “back-test” as a proxy to “past performance” may be misleading, as it relies heavily on the momentum covered by the input data. A better alternative would be the use of historical simulation together with future simulation (using charts with the same scale, but different colours, shown side by side or superimposed).</p>	
Q3	We agree that for some linear types of PRIIPs (such as non-structured UCITS)	

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	<p>information on past performance can be based on the approach currently used in the UCITS KII.</p>	
<p>Q4</p>	<p>We consider that information on simulated past performance should not be included in the KID where actual past performance is not available.</p> <p>Information on simulated past performance will typically imply a series of assumptions to be made, namely regarding underlying assets, and is currently used exceptionally by UCITS (for e.g. a new share class of an existing UCITS may simulate its performance by taking the performance of another class, a feeder UCITS may simulate its performance by taking the performance of its master UCITS, if certain conditions are met).</p>	
<p>Q5</p>	<p>As previously mentioned, we consider that information on simulated past performance should not be included in the KID where actual past performance is not available.</p> <p>Nevertheless, if that option is not considered, we highlight that for Category 3 (structured products) the best approach could be to:</p> <ul style="list-style-type: none"> a) compute the underlying assets price returns over x years; b) randomly select returns to simulate the underlying assets path; c) use the simulated path to compute the payoff (internal rate of return); d) go to b) and repeat 10,000 times; e) compute frequency histograms of the returns where: the Y-axis would have the same scale for all products (0 to 100); the X-axis could be standardized (e.g., 1% range) where 0% (the central value) would indicate the same capital in 	

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	<p>and out; the bars would give a sense of the entire distribution of outcomes as a shape. Being centred at 0, cues our visual system on the likelihood of losses (heavier shape on the left) or profits (heavier to the right). It also shows, immediately, how discontinuous the payoff is, how likely are the worst outcomes (leftmost), how likely are we to get the best outcomes (rightmost) and where do we stand most often (where does the largest part of the shape lies).</p> <p>To be of better use, this historical simulation should be shown, side by side, with the future simulation (actual distribution of returns that comes out of the models used to price the product).</p> <p>By placing both simulations it will be easy to infer that past performance does not guarantee future performance (the charts will be different), adds new information (past based on historical prices; future based on replication costs) and, most of all, shows clearly how different the past and the future are in terms of distributions. The histograms could be complemented with bars marking the unfavourable (10%), moderate (50%) and favourable (90%) scenarios.</p>	
Q6	<p>Narrative explanations are important. Experience shows that many investors just quickly scan the text. The longer the text, the more difficult it is to interpret it. Therefore, improved and reduced texts are positive.</p> <p>We consider that explanation on Element D (on the stress scenario) should be kept, since this concept is not straightforward for a regular investor.</p>	
Q7	<p>Future performance scenarios anchored in the risk-free rate of return</p> <p>The calculation of future performance scenarios anchored in the risk-free rate of return, may be misleading to investors, by not capturing the risk premium of assets</p>	

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	<p>and the skewness and kurtosis typically present in asset's return distributions.</p> <p>An alternative approach would be to use the outcome of the models used for pricing the product using actual market data, that includes risk premiums and implied volatility.</p> <p>Amended approach and presentation for future performance scenarios to highlight the range of outcomes</p> <p>The inclusion of only the favourable and stress scenarios in the future performance scenarios would only provide the least probable scenarios and an excessive bias in significant unfavourable impacts of the product in extreme market circumstances (extreme volatility measures and extremely low returns).</p> <p>Extend the historical period used to measure performance</p> <p>We do not support this proposal, because we consider that, as it is mentioned in the Joint Consultation Paper, it is <i>"not considered to bring material improvements to the methodology that outweigh its drawbacks"</i>.</p>	
Q8	<p>The past performance and the future performance could be shown side by side in separate histogram/bar charts or in the same bar/chart with different colours, with associated data labels for each scenario, thus facilitating the comparison between past performance and future performance, i.e., between historical data and market (current and forward looking) data.</p> <p>In either case, the x- and y-axis should be standardized to allow comparison between historical and future performance.</p>	

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Q9

Other specific amendments

MRM calculation for regular investment or premium PRIIPs

We consider that it is better to have a single methodology for the MRM calculation.

Products with an autocallable feature

We consider that performance should only be shown up to the call or cancellation periods.

Narratives for the Summary Risk Indicator (SRI)

Although agreeing with the importance of explaining risks not included in the SRI, we consider that the narrative must be concise, taking into consideration the number of pages limit.

Narrative for Performance Fees – composition of costs table

Although agreeing with the importance of explaining how performance fees are charged, we consider that the narrative must be concise, taking into consideration the number of pages limit.

Growth assumption for the reduction in Yield (RIY) calculation

We consider that we shouldn't remove the main driver of cost computing, by assuming a fixed rate of return of 3% (or some other artificial value). The costs should

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	<p>be compatible and comparable with the performance section.</p> <p>Other minor amendments</p> <p>We caution the ESAs on proposing future amendments to the PRIIPs Delegated Regulation without a public consultation on the legislative text of a draft RTS.</p>	
Q10		
Q11		
Q12	No, although implementation costs to including information on past performance may be material for certain types of PRIIPS.	
Q13	Not at present.	