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| | **Comments Template for Joint Consultation Paper concerning amendments to the PRIIPs KID (JC 2018 60)** | **Deadline**<br>**6 December 2018**<br>**23:55 CET** |
| Name of Company: | UK Structured Products Association (UK SPA) | |
| Disclosure of comments: | Please indicate if your comments should be treated as confidential: | Public |
| | Please follow the following instructions for filling in the template:<br>⇨ Do **not** change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool<br>⇨ Leave the last column empty.<br>⇨ Please fill in your comment in the relevant row. If you have no comment on a question or a cell, leave the row empty.<br>⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below.<br>**Please send the completed template, in Word Format, to CP-18-005@eiopa.europa.eu**<br>**Our IT tool does not allow processing of any other formats.** | |
| **Reference** | **Comment** | |
| General Comments | The UK Structured Products Association ("**UK SPA**") wishes, on behalf of its members, to provide input on the PRIIPS Regulation in response to the Joint Consultation Paper concerning amendments to the PRIIPs KID.<br><br>We hope that the issues and corresponding recommendations set out below may help to improve the information that consumers get about products, in line with the overarching requirement for KIDs to be "accurate, fair, clear and not misleading". Consumer testing appears to have been minimal according to the ESA consultation paper and MiFID Retail corporate businesses have been ignored. There was no reference to corporate usage of PRIIPs in the FCA's recent 'call for input'. Corporates classified as MiFID Retail are regular users of products under the PRIIPs | |

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| | umbrella, but predominantly for hedging purposes.<br><br>We find that such users are often confused by KIDs, yet they display an understanding of the products based on our marketing materials, and question whether the documents are of value.<br><br>The UK SPA is grateful to the ESAs for providing market participants with the opportunity to consider possible solutions to the material issues identified by them, which stem from the implementation of the PRIIPs Regulation and the related RTS. However, our members would favour a coordinated process, which identifies ways to adjust and improve the current methodologies, following extensive expert consultation and impact testing/analysis.<br><br>In our view, the review of the PRIIPs Regulation, which is scheduled for 2019, should provide the ideal platform for doing so. The UK SPA is concerned that implementing “quick-fix” solutions without analysing and understanding their full impact on the highly diverse product landscape in the national capital markets of the European Union may lead to insufficient or wrong information being displayed in the Key Information Document. This directly contradicts the overarching requirement for KIDs to be “accurate, fair, clear and not misleading”.<br><br>Please refer to the UK SPA’s response the FCA’s Call for Input, dated 27 September 2018, for further details of our recommendations. This can be provided to you on request. | |
| Q1 | **QUESTION**: Do you agree that information on past performance should be included in the KID where it is available?<br><br>**ANSWER**: NO - Members of the UK SPA are of the view that past performance should not be included in the PRIIPs-KIDs <u>**for structured products**</u>.<br><br>We set out our reasoning below:<br><br>1. **Appropriate for actively managed financial instruments only:** In our view, past | |

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| | performance has no added value outside actively managed financial instruments.<br>2. **Incomparability across products:** Where past performance is simulated for products where there is no existing data, the KIDs are rendered incomparable across product/asset classes.<br>3. **Fundamental technical problems with simulating past performance:** Simulating past performance poses fundamental technical problems that would very likely result in wrong/misleading information.<br>4. **Misleading investor information resulting in poor investment decisions:** The display of past performance information generally, and that of simulated past performance, will expose retail investors to the danger of being misled and taking wrong investment decisions.<br>5. **New information requirements in the context of the KID length restriction:** The requirement to add new information (past performance data) will likely be difficult considering the restriction to have a maximum of three sides of A4-sized paper when printed.<br><br>Details are set out in our answers to question 2 below. | |
| Q2 | **QUESTION**: Are there challenges to include past performance information for certain types of PRIIPs?<br><br>**ANSWER**: YES - The UK SPA takes the view that there are serious challenges to including past performance information, in particular on products that have no real past performance (and consequently would require simulated past performance).<br><br>**1. Appropriate for actively managed financial instruments only**<br><br>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-product itself provides no value added.<br><br>For PRIIPs Categories I and III products in particular, simulating past performance could lead to | |

wrong information/misleading results.

This would also be consistent with the approach taken by 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. Incomparability across products**

By adding past performance information, there is a risk that the KID documents are 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 does not exist, the following difficulties should be noted for all Category 3 PRIIPs, in particular:

- 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, this does not 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 composition of a unit-linked product is left to the choice of each investor.

**3. Fundamental technical problems with simulated past performance**

Simulating past performance is not possible for many products as the relevant data (e.g. on past volatility) is 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 penalising products designed to allow investors to benefit from current market conditions.

- Path dependency of many Category III PRIIPs

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.

- Lack of comparability between structured products and funds

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 back testing 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).

- Backtesting of structured products involves discretionary elements

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). To meaningfully back test a structured product, these parameters must 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 back-testing 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 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.

- Computational feasibility

Many Category III PRIIPs manufacturers have invested heavily to ensure that the required PRIIP KID risk figures can be calculated daily 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. Back testing a PRIIP's behaviour 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).

- Back testing / simulating past performance for an underlying/reference asset

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 to how past performance can be simulated is acceptable from a technical point of view.

Summarising and more generally speaking, simulating past performance would require the industry to be provided with a robust uniform and standardised methodology which, to our knowledge, is neither in the market nor academic world established today.

**4. Misleading investor information resulting in poor investment decisions**

It is the UK SPA's view, adding simulated past performance to the KID significantly increases the risk that investors might be misled when seeking to analyse KID information and, following that, make an ill-informed 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

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| | designed to benefit investors in current market conditions. If the focus of the performance scenarios were to shift to back testing 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 favour PRIIPs specifically designed to perform well in a given historical period but risks randomly penalising any PRIIP that is designed and priced on a forward-looking basis.<br><br>Beyond this 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 investors 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.<br><br>**5. New information requirements in the context of the KID length restriction**<br><br>It is problematic for market participants, those that manufacture and distribute more complex PRIIPs such as structured products, to comply with the existing restriction that KIDs must be a maximum of three sides of A4-sized paper when printed. The addition of new information requirements will make this requirement harder for market participants to comply with. Furthermore, the past performance simulation might necessitate additional narrative explanations on the used simulation approach and commentary on the assumptions used for the individual product at stake. | |
| Q3 | **QUESTION:** Do you agree that it is appropriate for this information on past performance to be based on the approach currently used in the KII? If not, please explain your reasons and if an alternative presentation would be more appropriate and for which types of PRIIPs?<br><br>**ANSWER:** Please refer to our comments on past performance above. | |

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| Q4 | **QUESTION:** Do you think that information on simulated past performance should be included in the KID where actual past performance is not available? If not, please explain your reasons.<br><br>**ANSWER:** Please refer to our comments on past performance above. | |
| Q5 | **QUESTION**: If you think that information on simulated past performance should be included in the KID, what approach do you think should be used to simulate the past performance, and how should this be presented in the KID?<br><br>**ANSWER:** Please refer to our comments on past performance above. | |
| Q6 | **QUESTION:** Do you consider these amendments to the narrative explanations to be an improvement on the current performance scenario approach?<br><br>**ANSWER**: Yes. Members are broadly of the view that the narrative amendments are an improvement (although please note our general comments above implementing "quick-fix" solutions without analysing and understanding their full impact on the highly diverse product landscape).<br><br>However, the UK SPA suggest the following changes:<br><br>1. In the paragraph following the second bullet on the CP's page 16 we would suggest that:<br><br>Instead of "*<u>the</u> range of possible returns*", it should be "*<u>a</u> range of possible returns*". This change makes it clear that the scenarios do not necessarily cover all possible outcomes.<br><br>Instead of "*Market developments in the future cannot be accurately predicted. These scenarios are only an indication of the range of possible returns*.", a possible compromise would be "*Market developments in the future cannot be predicted. Actual returns may be different and, in many cases, could be worse. Investors should not exclusively 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.*" | |

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| | 2. Finally, investors should be informed in the KID what these scenarios represent. Manufacturers frequently receive this feedback from distributors of structured product.<br><br>Therefore, the following should be added: "*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 | **QUESTION**: Do you have any comments on the analysis set out in this Section of other possible options to improve the future performance scenarios?<br><br>**ANSWER:** As expressed above, the UK SPA believes that adjustments and amendments to the PRIIPs methodology should be made following a full and thorough review of the PRIIPs Regulation. This should involve extensive impact testing and analysis to understand the full impact of the changes on the highly diverse product landscape.<br><br>We would like to make the following comments about the proposals set out in the CP:<br><br>**1. Usage of the risk-free rate**<br><br>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.<br><br>We also reiterate our position that, as a matter of principle, any new methodology or any changes to an existing methodology needs to ensure the methodology's uniform applicability across asset classes. This extends to the inclusion of PRIIPs Category II products/UCITS funds. | |

Having said this, some members believe that the risk free rate approach, in respect of fixed income products, could be implemented quickly and would constitute a satisfactory solution to address the current issues related to the overly optimistic, and potentially misleading, performance scenarios when using the current PRIIPS methodology

**Risk premium: A** related question is whether for specific asset classes such as equity-linked products, a risk premium would need 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:**

The UK SPA does not agree with the proposal to delete the moderate and unfavourable scenarios.

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 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 where 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 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.

As an alternative, we propose deleting the interims scenarios and showing only the scenarios for the RHP. This has two advantages: (i) The KID would gain space for more explanatory narratives; and (ii)misleading results would be reduced as the interim scenarios are mostly liable to obscure the numbers.

**3. Extension of observation history from 5 to 10 years:**

We strongly recommend not using 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

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| | corporate actions may contain market conditions which are significantly different from the reality today.<br><br>**4. Change of the presentation for future performance scenarios to a graph**<br><br>The UK SPA does not agree with this change.<br><br>The current presentation of the performance scenario results table is clear and from our experience, does not raise any questions from retail investors. As was furthermore exposed in the market study done prior the RTS drafting, retail investors understand the table and narrative more than a graph. Moreover, any such amendment would be extremely costly in terms of necessary IT adjustments. | |
| Q8 | **QUESTION**: Do you have any views on how the presentation of the performance scenarios could otherwise be improved?<br><br>**ANSWER**: As expressed above, the UK SPA believes that adjustments and amendments to the PRIIPs methodology should be made following a full and thorough review of the PRIIPs Regulation. This should involve extensive impact testing and analysis to understand the full impact of the changes on the highly diverse product landscape.<br><br>The UK SPA is of the view that any methodological changes to the establishment of future performance scenarios should apply equally to all product categories (structured products, derivatives, funds and insurance products). This should allow for full comparability across product ranges. | |
| Q9 | **QUESTION:** Do you agree with the proposals described in this section?<br><br>**ANSWER:** As expressed above, the UK SPA believes that adjustments and amendments to the | |

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| | PRIIPs methodology should be made following a full and thorough review of the PRIIPs Regulation. This should involve extensive impact testing and analysis to understand the full impact of the changes on the highly diverse product landscape.<br><br>The UK SPA is of the view that any methodological changes to the establishment of future performance scenarios should apply equally to all product categories (structured products, derivatives, funds and insurance products). This should allow for full comparability across product ranges.<br><br>**1. Autocallable feature proposal**<br><br>The UK SPA does not agree with the proposals set out in the CP.<br><br>Please refer to the UK SPA's response to the FCA's Call for Input dated 27 September 2018 for full details of our recommendations (which can be provided on request). Such recommendations include the following:<br><br>• Auto-call payments should not be accrued to the RHP;<br>• In calculating IHP values, auto-call payments should be considered with their time value; and<br>• The principles outlined above should also be applied to other types of early payments, such as coupon payments or instalment payments.<br><br>**2. Universal 3% growth assumption for the reduction in yield calculation**<br><br>The UK SPA views this amended approach as an improvement to the current methodology since it should increase clarity and consistency across the KIDs. | |

In order to allow for comparability between manufacturers, the RTS must clearly state that the proposed 3% scenario means:

- 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 undergo a thorough analysis.

Within such a fundamental review, alternative solutions to the 3% approach should be examined and the impact of any cost methodology changes on the asset classes covered by the PRIIPs Regulation should 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 RHP of less than one year, the UK SPA supports the solution provided by the ESAs in the last update of their Q&A document. Nevertheless, the Q&A update does not comply with the requirement as provided for in the Delegated Regulation. The UK SPA would therefore suggest amendments to the Delegated Regulation.

**4. Narratives for summary risk indicator and performance fee narrative**

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| | The UK SPA agrees with 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 under 4.2.4.<br><br>**5. Other minor changes – product term narrative**<br><br>Regarding 4.2.2. the UK SPA is of the view that the product term should be included 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 | **QUESTION:** Do you have any comments on the proposed approaches in relation to the analysis and proposals in this section?<br><br>**ANSWER:** In order to compare across product ranges, the presentation of costs should 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 a comparison across products and maturities. This is something that should be considered by the ESAs. | |
| Q11 | **QUESTION**: Do you have any comments on the preliminary assessment of costs of benefits?<br><br>**ANSWER**: The UK SPA has no comments. | |
| Q12 | **QUESTION:** Are you able to provide information on the costs of including information on past performance for different types of PRIIPs?<br><br>**ANSWER**: The UK SPA believes that including past performance for PRIIP categories I and III may result in misleading data. Further, from a technical point of view, including the past performance using one of the methodologies described in the consultation paper might prove technically challenging for some products. | |

| Q13 | **QUESTION:** Are there significant benefits or costs you are aware of that have not been addressed?<br><br>**ANSWER:** The UK SPA is of the view that the RTS should 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. | |