



BANKING STAKEHOLDER GROUP

CONSULTATION OF THE ESA'S JOINT COMMITTEE JC/2015/073 ON
"PRIIPS KEY INFORMATION DOCUMENTS"

General Comments and Replies to Questions

BY THE EBA BANKING STAKEHOLDER GROUP

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Foreword

The EBA Banking Stakeholder Group (BSG) welcomes the opportunity to comment on the Joint Consultation Paper JC//2015/073 on PRIIPS Key Information Documents. This response has been prepared on the basis of comments circulated and shared among the BSG members and members of the BSG's Technical Working Group on Consumer Protection and Financial Innovation. The response outlines general comments by the BSG, as well as detailed answers to the questions indicated in the Consultation Paper.

General comments

A critical aspect in retail distribution of any financial product is the transparency of product information. This represents not only the availability of all product information to retail clients but also the appropriate form of presenting the information to retail investors in the form easy to understand and enabling these investors to comprehend key product features and associated risks and costs. This is particularly important in respect of investment products and financial products (instruments) whose financial performance depends on uncertain and an often complex set of factors where significant risk of investor detriment exists.¹

The aim of regulation regarding disclosure under PRIIPs Regulation is twofold - in addition to enhancing transparency of packaged retail and insurance-based investment products it aims at setting up a harmonised template for comprehensive disclosure of information about PRIIPs which enables comparability of individual PRIIPs. This is designed to enhance informed choice for retail investors. This inevitably leads to careful consideration of complex issues related to comparability and comprehensibility of information which should be provided to retail investors in respect of individual types of PRIIPs.

BSG appreciates the highly demanding task of ESAs to develop suitable templates and methodology covering very diverse groups of investment and insurance products and aims at provide the ESAs with its contribution to their effort enhancing the standard of PRIIPs disclosure to retail investors.

¹ For example cf. Moloney N., *How to Protect Investors. Lessons for the EC and the UK*. Cambridge University Press. 2010. p. 191 et seq.

Responses to the consultation questions

Question 1

Would you see merit in the ESAs clarifying further the criteria set out in Recital 18 mentioned above by way of guidelines?

Some of the criteria included in Recital 18 of PRIIPs Regulation² represent terms of a general nature and do not refer to specific legal terms which could lead not only to diverse implementation in member states but also to confusion for retail investors and hinder comparability of KIDs. Strict interpretation could lead to the conclusion that most, if not all, PRIIPs represent complex products and *vice versa*. In this respect further guidance provided by the ESAs is welcomed.

Question 2

(i) Would you agree with the assumptions used for the proposed default amounts? Are you of the opinion that these prescribed amounts should be amended? If yes, how and why?

(ii) Would you favour an approach in which the prescribed standardised amount is the default option, unless the PRIIP has a known required investment amount and price which can be used instead?

Setting similar assumptions for all products would most likely result in retail investors not receiving relevant information and certain products outperforming others based on the KID although they might not be the best fit for all retail investors. In practice, actual amounts retail investors would use for comparison of PRIIPs could differ significantly among member states. Also retail investors in member states outside the EURO zone may find it difficult to compare PRIIPs using EURO denominated default amount. RTS should not lead to the provision of information that might be confusing or even misleading to retail investors. Therefore, fine-tuning should be in line with consumer behaviour at national level. Possible solutions could include setting a harmonized single default amount in EUR and provide an option for member states to set an additional default amount at national level in national currency where applicable.

Question 3

For PRIIPs that fall into category II and for which the Cornish Fisher expansion is used as a methodology to compute the VaR equivalent Volatility do you think a bootstrapping approach should be used instead? Please explain the reasons for your opinion?

The methodology under category III (involving bootstrapping and a minimum of 10.000 forward-looking simulations) is much more complicated than the one under category II (historical volatility over the last 5 years). We understand that bootstrapping used for category III and IV is used as a substitute in case historical data are not available. Instead of applying an excessively complex methodology to category II as well, the methodology behind category III products could be simplified.

² "[...] A product should be regarded as not being simple and as being difficult to understand in particular if it invests in underlying assets in which retail investors do not commonly invest, if it uses a number of different mechanisms to calculate the final return of the investment, creating a greater risk of misunderstanding on the part of the retail investor or if the investment's pay-off takes advantage of retail investor's behavioural biases, such as a teaser rate followed by a much higher floating conditional rate, or an iterative formula."

Question 4

Would you favour a different confidence interval to compute the VaR? If so, please explain which confidence interval you would use and state your reasons why.

Yes, we agree with the suggested confidence interval.

Question 5

Are you of the view that the existence of a compensation or guarantee scheme should be taken into account in the credit risk assessment of a PRIIP? And if you agree, how would you propose to do so?

The existence of a guarantee scheme could modify the level of risk as it potentially reduces the losses for relevant retail investors.

National compensation and guarantee schemes could be important components of the credit risk profile and hence these cannot be ignored in the CRM. A reference under the section “What happens if [PRIIP manufacturer] is unable to pay out?” does not provide sufficient information on credit risk. However, provision of additional information about the specific effects of such a scheme on an individual investor as part of the investor information/advice outside KID could be recommended.

The credit risk retail investors could be facing, when purchasing a PRIIP, is mostly the risk linked to a PRIIP manufacturer’s insolvency. If this risk is already mitigated by a guarantee scheme, then it may become immaterial for the retail investor. Therefore, if the PRIIP manufacturer is fully secured through a guarantee scheme, then the credit risk from the point of view of retail investor is immaterial and the PRIIP should be categorised CR1.

Question 6

Would you favour PRIIP manufacturers having the option to voluntarily increase the disclosed SRI? In which circumstances? Would such an approach entail unintended consequences?

The main purpose of KID for PRIIPs is to enhance comparability of PRIIPs thus introducing the discretionary option to voluntarily increase the disclosed SRI which would lead to more difficult comparison of similar types of PRIIPs.

Question 7

Do you agree with an adjustment of the credit risk for the tenor, and how would you propose to make such an adjustment?

Adjustment for the tenor could make the methodology more complex. However, as taking into account the tenor in the credit risk assessment could be considered the market practice (also applied in credit rating methodologies) a similar adjustment to tenor could be envisaged.

Question 8

Do you agree with the scales of the classes MRM, CRM and SRI? If not, please specify your alternative proposal and include your reasoning.

Regarding MRM indicator:

The criteria in Category I “up to 5 years”, seems an artificial barrier, as explained in Question 9.

The general comment regarding derivatives for hedging purposes, done in the “Introduction” is especially relevant here.

Regarding CRM:

It may be questionable to base the credit risk assessment only on external ratings as a number of entities, particularly smaller entities and insurance-based investment products' manufacturers, do not have a credit rating issued by an external credit rating agency. Also, cost implications of obtaining ratings for smaller entities are not negligible.

Regarding SRI:

A SRI is not the best approach for the analysis of risks. As credit and market risk are not comparable, a separate analysis of both risks is recommended.

Question 9

Are you of the opinion that for PRIIPs that offer a capital protection during their whole lifespan and can be redeemed against their initial investment at any time over the life of the PRIIP a qualitatively assessment and automatic allocation to MRM class 1 should be permitted? Are you of the opinion that the criteria of the 5 year tenor are relevant, irrespective of the redemption characteristics?

The allocation in class 1 for PRIIPS with capital protection during their whole lifespan and can be redeemed against their initial investment at any time over its life seems appropriate.

As stated in the answer to Question 8, the five years tenor criteria seems arbitrary, irrelevant and based on no specific evidence. A guaranteed product with a maturity of more than five years does not have a higher market risk than a similar product with a shorter tenor. This arbitrary 5 year cap could also mislead retail investors. For PRIIPs that offer a capital protection at maturity, a qualitative assessment and automatic allocation to MRM class 1 should be permitted regardless of their tenor.

The criteria of the 5-year tenor is justified in the document to address inflation concerns. The impact of inflation on the value of a PRIIP should not affect the market risk as inflation does not represent a risk inherent for PRIIPs but affects all investment products in the same way. In addition, this feature is not included in pre-contractual information disclosure for other products (MiFID and UCITS for instance) and could add unnecessary complexity. This distinction is not helpful, therefore, for retail investors nor does it increase comparability or transparency of products.

Question 10

Are you aware of other circumstances in which the credit risk assessment should be assumed to be mitigated? If so, please explain why and to what degree it should be assumed to be mitigated?

We consider that the existence of a compensation or guarantee scheme should not be taken into account as a mitigating factor in the credit risk assessment of a PRIIP because these schemes are diverse and it could be difficult for retail investors to assess the quality of the guarantee (ex-ante fully funded schemes vs. ex-post funded schemes, level of protection, eligibility of individual retail investor etc.). In addition, mostly such compensation and guarantee schemes provide compensation and/or guarantee only to a certain amount.

Question 11

Do you think that the look through approach to the assessment of credit risk for a PRIIP packaged into another PRIIP is appropriate?

In practice, it may be challenging to apply the look through approach for the complex PRIIPs. In order

to make this approach generally feasible, all relevant data and explanations have to be provided by manufactures of underlying PRIIP.

Question 12

Do you think the risk indicator should take into account currency risk when there is a difference between the currency of the PRIIP and the national currency of the investor targeted by the PRIIP manufacturer, even though this risk is not intrinsic to the PRIIP itself, but relates to the typical situation of the targeted investor?

Currency risk should be taken into account if it is part of the PRIIP market risk - typically for structured products - if it can materially alter the value of the guarantee if given in another currency.

In the case where the PRIIP is denominated in a currency that is not the currency of the retail investor domicile, then additional explanation should be provided by a distributor outside the KID.

Question 13

Are you of the opinion that the current Consultation Paper sufficiently addresses this issue? Do you think it is made sufficiently clear that the value of a PRIIP could be significantly less compared to the guaranteed value during the life of the PRIIP? Several alternatives are analysed in the Impact Assessment under policy option 5: do you see any additional analysis for these assessment?

The PRIIPs Regulation sets out a specific section of the KID dedicated to the description of what happens if consumers take out money early.³ Thus, retail investors are informed in this section about specific consequences if the investor exits/sell the PRIIP before maturity. We are of the opinion that this information should not be duplicated in a KID as this may lead to confusion.

Question 14

Do you agree to use the performance fee, as prescribed in the cost section, as a basis for the calculations in the performance section (i.e. calculate the return of the benchmark for the moderate scenario in such a way that the return generates the performance fee as prescribed in the cost section)? Do you agree the same benchmark return should be used for calculating performance fees for the unfavourable and favourable scenarios, or would you propose another approach, for instance automatically setting the performance fees to zero for the unfavourable scenario? Please justify your proposal.

All scenarios should use the performance fee related to returns under relevant scenario - the fee applicable for the scenario should be used in calculation of return under such scenario. In the case where fees are not included in the calculation the information for the retail investor is incomplete and could lead to confusion and typically to investor detriment as the real outcome does not match the model outcome under relevant scenario.

Question 15

Given the number of tables displayed in the KID and the to a degree mixed consumer testing results on whether presentation of performance scenarios as a table or a graph would be most effective, do you think a presentation of the performance scenarios in the form of a graph should be preferred, or both a table and a graph?

³ In art. 8 par (3) let. (g) point (iv) requires manufacturer to include in a KID "information about the potential consequences of cashing in before the end of the term or recommended holding period, such as the loss of capital protection or additional contingent fees;".

The addition of a recommended holding period in itself adds complexity to any performance presentation. In practice retail investors (consumers) find it difficult to assess the period for which they expect to hold an investment. Nevertheless, the visualisation of performance scenario in the form of a graph could possibly provide retail investors with an easier—to-understand way of presenting complex structured data.

Question 16

Do you agree with the scope of the assets mentioned in paragraph 25 of Annex VI on transaction costs for which this methodology is prescribed? If not, what alternative scope would you recommend?

In the costs section the alignment with MiFID 2 is crucial, bearing in mind that while KID discloses manufactures' costs, MiFID 2 regulates disclosures of costs at the level of the firm providing investment services to retail investor such as selling the PRIIP.

Regarding costs in Annex VI: Spread is not a cost. Presenting a spread as a cost may create an impression that it is possible to conclude a trade at mid-price. The bid/mid spread is a measure to mitigate credit risk, that the bank would be imposed by the trade, as well as the cost of hedging the position.

Question 17

Do you agree with the values of the figures included in this table? If not, which values would you suggest? (please note that this table could as well be included in guidelines, to allow for more flexibility in the revision of the figures)

No comment

Question 18

Do you agree that the monetary values indicated in the first table are a sum of costs over the respective holding periods? Or should the values reflect annualized amounts? If you prefer annualized amounts, which method for annualisation should be used (e.g. arithmetic average or methods that consider discounting effects)?

Since some PRIIPs (especially insurance-based investment products) have terms that sometimes stretch over decades, only annualised costs are comparable for different PRIIPs in a consistent and stable manner. In the case where the total costs were to be included, a product with a longer term would typically – even if it is cheaper – look more expensive than a product with a shorter term. An option presenting the total costs for the whole investment period would not allow for an effective comparison between, for example, a product with a few months investment period and one characterised by a 35 years investment and would be nothing but misleading for retail investors.

Question 19

Do you think that estimating the fair value of biometric risk premiums as stated in paragraph 55(b) of Annex VI would raise any technical or practical difficulties?

In order to achieve meaningful comparisons between products, the biometric risk premium and the investment costs cannot be aggregated in one figure and must be presented in separate sections of the KID.

The PRIIPs Regulation aims at enhancing retail investor protection and confidence by improving the transparency and comparability of PRIIPs. It is, therefore, extremely important that the features of

insurance-based investment products are appropriately presented in the KID.

We support the view of ESAs that the aggregation of the investment costs and the full biometric risk premium would be inappropriate. It is indeed the insurance sector's views that such an aggregation would (1) not seem to be in line with the PRIIPs Regulation; (2) would not be in the interest of consumers who will not be in a position to compare what is comparable; and (3) would create an unlevel playing field for insurance-based investment products.

If this separation is not made, the consumer will not be provided with appropriate information and would not be in a position to compare what is comparable:

The cost indicator of an insurance-based investment product will be deceptively higher than that of other PRIIPs, and retail investors (especially consumers) will not be in a position to compare the investment part of different insurance-based investment products available on the market.

The amount of the insurance premium will not be clearly visible to consumers and this will prevent them from comparing the insurance cover, including the potentially high benefits if the insurance cover payment is granted.

Question 20

Knowing that the cost element of the biometric risk premium is included in the total costs calculation, how do you think the investor might be most efficiently informed about the other part of the biometric risk premium (i.e. the fair value), and/or the size of biometric risk premium overall? Do you consider it useful to include the fair value in a separate line in the first table, potentially below the RIY? Or should information on the fair value be disclosed in another part of the KID (for instance, the "What is this product?" section, where the draft RTS currently disclose biometric risk premiums in total, and/or in the performance section)? What accompanying narrative text do you think is needed, and where should this be placed, including specifically narrative text in the cost section?

Insurance-based investment products comprise an insurance cover, consisting of protection against biometric risks faced by consumers, alongside an investment element. When freely choosing an insurance-based investment product, a consumer is looking for both beneficial investment opportunities and for insurance protection his or her family against biometric risks. The life insurance part of an insurance-based investment product may offer a number of benefits:

- (a) Protection of surviving dependants: first and foremost, death benefits provide surviving family members with funds allowing them to maintain their living standards. For instance, it can provide funds for college education when the principal income earner is deceased and/or a financial safety net to offset the impact of estate taxes upon the policyholder's death.
- (b) Income protection: benefits that ensure a stable living income in the event that the consumer is not able to exercise his/her profession or work in any capacity, either temporarily or permanently.
- (c) Succession planning: allows a customer to save or invest money for his/her children or grandchildren while keeping control over the funds and the time of pay-out (e. g. not automatically after a certain period of time).
- (d) Long-term care: the organisation and delivery of a broad range of services and assistance to people who become limited in their ability to function independently on a daily basis over an extended period of time due to mental and/or physical disability.
- (e) Consistent saving: compared to saving accounts, regular payments of a premium offers the consumer a more disciplined way of saving.

All these benefits are unique to insurance-based investment products and are secured by the payment of the insurance premium (i.e. the price to pay in exchange for these insurance services). A sharp and clear distinction must, therefore, be made between investment costs associated with the insurance-based investment product and the insurance premiums paid. Premiums — which are payments that directly finance the insurance benefits of the products — should never be considered as costs. This is simply because the consumer knowingly receives insurance benefits for these payments and in fact specifically chooses an insurance-based investment product in order to receive these benefits along with investment returns. If the consumer is not interested in receiving additional insurance benefits, he or she would not opt for an insurance-based investment product in the first place. However, if consumers are interested in receiving additional insurance benefits, the presentation of insurance premiums as investment costs would not give them the appropriate and necessary information on the product.

Effective comparison should be ensured for consumers. Meaningful comparison remains the key objective of the PRIIPs Regulation and the insurance sector considers that only separating the full biometric risk premium from the investment costs could achieve such an objective.

However in the case where the insurance-based investment product contains no or only minimal (negligible) protection against biometric risks, the nature of the product should be approximate to underlying investment and treated as a "regular" investment product.

Question 21

Given evidence as to the difficulties consumers may have using percentage figures, would you prefer an alternative presentation of the second table, solely using monetary values instead? As with the first table, please also explain what difficulties you think might arise from calculating monetary values, and whether this should be on an annualized basis, and if so, how?

Disclosure of the costs should be aligned with MiFID 2 and hence the table should include both percentage figures and monetary values.

Question 22

Given the number of tables shown in the KID, do you think a more graphic presentation of the breakout table should be preferred?

The example of a graphical breakdown presentation offered on page 14 of the consultation paper adds little in terms of clarity for clients compared to a table.

Question 23

The example presented above includes a possible way of showing the variability of performance fees, by showing the level for all three performance scenarios in the KID, highlighting the 'moderate' scenario, which would be used for the calculation of the total costs. Do you believe that this additional information should be included in the KID?

Additional information regarding different performance fees should be included in the KID. By their nature performance fees are rather incidental than recurring.

Information on different fees could be included in the last row of the Table 2 - we suppose that these are the same as performance fees used for scenario calculations.

Question 24

To reduce the volume of information, should the first and the second table of Annex VII be combined in one table? Should this be supplemented with a breakdown of costs as suggested in the graphic above?

Reducing the volume of information should only be done if there is no lack of clarity. The combination should be done in a way that guarantees a better result than the separate tables.

Question 25

In relation to paragraph 68 a) of Annex VI: Shall the RTS specify that for structured products calculations for the cost free scenario have always to be based on an adjustment of the payments by the investor?

We agree to the proposed method.

Question 26

Regarding the first table of the cost section presented in Annex VII, would you favour a detailed presentation of the different types of costs, as suggested in the Annex, including a split between one-off, recurring and incidental costs? Alternatively, would you favour a shorter presentation of costs showing only the total costs and the RIY?

The breakdown of one-off, recurring and incidental costs could be seen as adding unnecessary complexity to the information presented in KID. This approach mixes defined and possible costs as well as distribution and product costs. Specifically, as for mentioning distribution costs in a KID, cost information in the KID should be limited to product costs, as distribution costs may vary depending on the party distributing the PRIIP. In which case, information on distribution cost could be more appropriately provided outside the KID.

Question 27

Regarding the second table of the cost section presented in Annex VII, would you favour a presentation of the different types of costs showing RIY figures, as suggested in the Annex, or would you favour a presentation of costs under which each type of costs line would be expressed differently, and not as a RIY figure -expressed as a percentage of the initial invested amount, NAV, etc.?

Expressing costs as a percentage of the initial invested amount is preferred as a clear and simple way of presenting relevant information.

Question 28

Do you have any comments on the problem definition provided in the Impact Assessment?

Are the policy issues that have been highlighted, in your view, the correct ones? If not, what issues would you highlight?

Do you have any views on the identified benefits and costs associated with each policy option?

Is there data or evidence on the highlighted impacts that you believe needs to be taken into account?

Do you have any views on the possible impacts for providers of underlying investments for multi-option products, and in particular indirect impacts for manufacturers of underlying investments used by these products, including where these manufacturers benefit from the arrangements foreseen until the end of 2019 under Article 32 of the PRIIPs Regulation?

Are there significant impacts you are aware of that have not been addressed in the Impact Assessment? Please provide data on their scale and extent as far as possible.

The Impact Assessment included in the Consultation Paper is a very detailed, complete and structured study. However, regarding policy issues, two of them are missed:

The guidance on providing of the KID to the retail investor remains overly general in nature, especially when it comes to situations where there is no physical meeting between the distributor and the client. The criteria mentioned in art. 20 of the draft RTS relate solely to the timing of the delivery of the KID, and do not provide any guidance on any of the other practical issues of the provision of the KID and additional information to retail investors such as the manner in which the KID can be delivered to the retail investor (bundled with other KIDs distributor's website, by means of a hyperlink or as an attachment to electronic communication, etc.).

Further clarification should be provided specifying PRIIPs for which a KID must be prepared and distributed as of 1 January 2017 e. g. only for new products launched as of 1 January 2017 or products which will be launched before this date but could be subscribed/purchased by the retail investors on that date as well?

Submitted on behalf of the BSG

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Chairperson.