# ANNEX 2

# Proposal for Performance Scenarios Methodology


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## Disclaimer

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## Introduction

This report contains a comment regarding policy issue 7: choice of performance scenarios.

As stated in previous Discussion Papers, there are three main objectives when prescribing the methodology for the calculation of performance scenarios:

- To to reduce manufacturer discretion as far as possible in order to avoid the risk of arbitrary choices, potentially resulting in performance information that does not appropriately reflect realistic possible outcomes of the product.
- To increase comparability across PRIIPs and manufacturers.
- To present helpful information to consumers, while avoiding confusing scenarios with a promise of a future result.

Three main options have been considered so far:

- **What if-manufacturers choice:** Scenarios are market situations selected by the manufacturer following some guidelines. Probabilities of occurrence are not disclosed.
- **What if-prescribed scenarios:** Scenarios are prescribed market situations, the same for all products and manufacturers. Probabilities of occurrence are not disclosed.
- **Probabilistic approach:** Scenarios corresponds to certain percentiles of the product P&L distribution.

The following table shows how these different options fulfil the previous objectives:

| | **Reduces manufacturer discretion** | **Increases comparability** | **Helpful information** |
|---|---|---|---|
| What if-manufacturer choice | NO | NO | YES |
| What if-prescribed scenarios | YES | YES | NO |
| Probabilistic approach | YES | YES | Probabilities are difficult to understand |

The retained option (what if-manufacturers choice) only complies with one objective. Moreover, it maximizes manufacturer discretion while minimizes comparability. On the positive side, it is the cheapest option for both manufacturer and regulators. The second option (what if-prescribed scenarios) have a major drawback which is impossible to overcome, namely, it is impossible to prescribe meaningful scenarios for the whole spectrum of PRIIP's. Regarding the third option, the only drawbacks are the higher costs and the fact that investors have difficulties when dealing with probabilities.

In view of this situation we would favour a hybrid approach, where unfavourable, moderate, and favourable scenarios are based on the percentiles of the losses distribution (probability approach), but the corresponding probabilities are not disclosed to the investor. We believe that this approach maximizes the three mentioned objectives and it means no new costs for manufacturers (as the computations are carried out for the SRI). The only drawback is the cost for the supervisor. In the next section we provide a detailed description of this proposed approach.

## Methodology

According to the categories defined in the Draft RTS, Annex II, Part 1:

### PRIIPs falling in Category II or III

Three scenarios should be disclosed:

- **Unfavourable scenario:** Should represent the market situation corresponding to the 10% percentile of the P&L distribution of the product. If the 10% percentile does not show losses but a lower percentile does, the situation corresponding to the maximum percentile showing losses should be disclosed.
- **Moderate scenario:** Should represent the market situation corresponding to the 50% percentile of the P&L distribution of the product.
- **Favourable scenario:** Should represent the market situation corresponding to the 90% percentile of the P&L distribution of the product.

The computation of the P&L distribution should be carried out under the same assumptions specified to compute the MRM for each category[1].

These scenarios are shown as they were the manufacturer's choice and presented according to Annex V in the current Draft RTS. No probability of occurrence shall be disclosed.

[1] As mentioned in our response to the Consultation Paper, Cornish-Fisher methodology could lead to large errors and bootstrapping methodology is preferred.

**PRIIPs falling in Category I which are derivatives**

If there are enough historic data according to Annex II, Part 1, point 17, the same methodology as for PRIIPs falling in Category III should be applied. Otherwise, the methodology specified in the following subsection should be applied.

**The rest of PRIIPs**

For the rest of PRIIPs the current retained methodology, that is, what if-manufacturer choice, should be applied.

## Pros and Cons

The following table shows some of the pros and cons of this new approach.

| **Pros** | **Cons** |
|---|---|
| High Comparability<br>Meaningful scenarios<br>No need for investors to understand probabilities<br>No subject to manipulation<br>No increase in manufacturer costs as computations are carried out for the SRI | Higher cost for supervisor |

The following table shows the fulfilment of the objectives:

| | **Reduces manufacturer discretion** | **Increases comparability** | **Helpful information** |
|---|---|---|---|
| What if-manufacturer choice | NO | NO | YES |
| What if-prescribed scenarios | YES | YES | NO |
| Probabilistic approach | YES | YES | Probabilities are difficult to understand |
| **New approach** | **YES** | **YES** | **YES** |

## Conclusion

We believe that this approach maximizes the three main objectives previously expressed by the ESA without increasing the cost for manufacturers. The main drawbacks of the other options are overcome with the exception of the supervisory cost.