**EFAMA’s comments on the ESAs’ Joint Consultation Paper PRIIPs Key Information Document[JC 2015 073]**

# Additional comments relating to the draft RTS not covered in the Questions

In addition to our answers to the ESAs’ questions, EFAMA would also like to provide the ESAs with the following detailed comments on the draft RTS and its Annexes.

**Article 3: Identity section**

Article 3(f)

**“**The date of the production and of any *subsequent* revision of the key information document” is required sub-paragraph (f) to be stated in the KID. The wording “any *subsequent* revision” could be misunderstood to refer to the dates of all the subsequent revisions, adding no useful information to the investor. **We therefore propose that the article instead refers to “the date of the production and of the *latest revision* of the key information document”.**

**Article 4: ‘What is this product?’ section**

Article 4(3)

According to letter b. the description of the PRIIPs “underlying investments or reference values” has to be very detailed. A generic description is possible only where the “number of specific investments is large”. In the case of UCITS the criterion of the number of investments is inadequate because the investments of UCITS are made on the basis of the principle of risk diversification. Also a considerable number of retail AIF managed on the basis of UCITS risk diversification rules or comparable rules for the specific market segment. In addition, actively managed UCITS and AIFs are not built upon a stable portfolio, but comprise assets that are bought and sold in accordance with the agreed investment strategy.

Therefore, more flexibility is needed under the general description of letter (b). **Thus letter (b) should be amended as follows**: “(b) on underlying investment assets or reference values may only refer to market segments or instrument types where the number of specific investments **are numerous or can be continuously purchased and sold according to the investment policy and strategy of the PRIIP*”***.

Article 4(4)

Article 4(4) proposes to include “the target market identified by the PRIIP manufacturer´s product oversight and governance processes”. The referenced Article 8(3)(c) of the PRIIP KID Regulation merely requires “a description of the type of retail investor to whom the PRIIP is intended to be marketed, in particular in terms of the ability to bear investment loss and the investment horizon”. The addition of “product oversight and governance processes” does not exist in the Level-1 Regulation and thus would require non-MiFID firms, such as UCITS Management Companies and AIFMs, to apply the MiFID II product governance and oversight rules for product manufacturers, which was not intended in the Level-1 Regulation. **Therefore the above mentioned sentence should be amended as follows: *“the target market identified by the PRIIP manufacturer.”***

Moreover, the ESAs’ proposal goes even further by stating that these product oversight and governance processes need to take into account *“the financial interests, knowledge, objectives and characteristics of the types of retail investors for whom the PRIIP has been designed…”.* This goes beyond the product oversight and governance processes[[1]](#footnote-1) requirement of the to-be-released draft MiFID II Delegated Directive, which are not expected to require the product manufacturer to specify a target market according to *financial interests, knowledge and objectives*. The PRIIP KID Regulation is meant to provide product disclosure and should not introduce new governance requirements through the Level-2 measures. **These aforementioned requirements should therefore be replaced with a reference to Art. 16 para. 3 of MiFID II and Art. 25 of draft IDD**.

**Article 6: Performance scenarios**

Taking into consideration our reply to Q14, we agree with Article 6(2) that “performance scenarios shall be defined for the recommended holding period and for certain holding periods in between, when appropriate.” In order to receive further necessary clarity, we suggest that the ESAs establish guidelines (as suggested in para. 7) that further define (i) for which PRIIPs it is appropriate to provide performance scenarios and (ii) when it is appropriate to do performance scenarios for periods before the end of the recommended holding period.

With regards to the three suggested scenarios, we are generally supportive of the ESAs’ approach to defining unfavourable, moderate and favourable scenarios as presented in Annex IV and we also support the ESAs’ intentions to provide further technical guidance in Level-3 guidelines for non-linear products such as structured products and life-cycle funds.

Having said this, it is important that the ESAs deliver these guidelines without undue delay to provide PRIIP manufacturers with the necessary specificities to properly and appropriately design and calibrate these scenarios. Given that the drafting of and consultation on these guidelines will understandably take some further time, it is very likely that the publication of these guidelines will happen well after the publication of the PRIIP KID Implementing Regulation. This underlines the need for a delay in the PRIIP KID Regulation coming into force, to allow national competent authorities and industry enough time to implement the rules.

In addition, we have concerns regarding interpretations relating to Article 9 in relation to performance scenarios. The fund industry currently uses past performance as the indicator for investors as to how the fund is run and provides them with valuable information. The UCITS KIID currently requires performance to be shown by way of annualised past performance. We would be very concerned if the requirement to produce performance scenarios in the PRIIPs KID would ultimately mean that on conversion to the PRIIPs KID, the view was taken that funds could no show past performance – it might, for example, be interpreted as ‘diminishing the significance of the key information document’. **We would therefore be grateful for confirmation by the ESAs that producing documentation which included past performance would still be acceptable following the introduction of the PRIIPs KID for funds.**

For more technical observations, please regard our comments on the Annex IV below.

**Article 7: ‘What happens if [the name of the PRIIP manufacturer] is unable to pay out?’ section**

An additional paragraph providing information on the structure of funds is necessary to complement para. 2 on investor compensation and guarantee schemes. This paragraph should explain that a fund’s assets are held separately from the management company and safeguarded by a depositary. A pay-out of the fund’s assets is thus not affected by a management company’s financial position or potential default.

Please also regard our answer to Question 5.

**Article 10: ‘How can I complain?’ section**

While we are generally in agreement with the drafting of Article 10. However, it currently requires the PRIIP manufacturer to provide information on “the person advising on, or selling, the PRIIP on the relevant website”. This assumes a direct connection between the PRIIP manufacturer and distributer, which is not always the case. In particular, for funds information about who will be advising on or selling the PRIIP is rarely known by the manufacturer. **This information should thus be deleted.**

**Article 11**

“Without prejudice to ad hoc reviews” should not be part of the information on the updating period. It could just be omitted because this information is not relevant for the investor. It conflicts with the plain language requirement and the restriction to three pages.

**Articles 12-15: Specific provisions on the key information document (i.e. Multi-investment option PRIIPs)**

We are thankful for the clarification that the PRIIP manufacturer is responsible for the provision of the KID, but nevertheless think that the ESAs’ current drafting oversteps the Level-1 text[[2]](#footnote-2) which merely necessitates Multi-investment option PRIIPs (MOPs) to provide “at least ***a generic description*** of the underlying investment options and ***state where and how more detailed pre-contractual information documentation*** relating to the investment products backing the underlying investment options ***can be found***.” This is due to the fact that Articles 12-15 (in particular Articles 12(1)(a) & (b) and Article 15(2)) as currently consulted on by the ESAs would de-facto require asset managers to provide “PRIIP KID-like” data to other providers, such as insurance companies. This unwarranted outcome is even acknowledged by the ESAs in the consultation paper[[3]](#footnote-3).

The Level-1 text, for this very reason, therefore specifically requires only “pre-contractual information documentation” such as the UCITS KIID. Until the review of the UCITS exemption in 2019, the ESAs should allow such to be as sufficient, since it would otherwise undermine the UCITS KIID’s pre-contractual nature before the legislators’ decision on the matter. Only in 2019, if the co-legislators decide not to prolong the UCITS KIID going forward and instead require the PRIIP KID for all types of PRIIPs, should the full PRIIP information then be required for funds currently providing a UCITS KIID. But, in any case, the KID of the MOP wrapper (a KID itself) would still provide at least the “generic description” mentioned in Article 6 paragraph 3 of the Level-1 Regulation.

Furthermore, the ESAs should also take into consideration what type of pre-contractual information will be presented to retail investors in the near to medium future. Since UCITS are legally required to provide a KIID until at least 2019, investors will always receive a KIID when investing directly into a UCITS. If MOPs were required to provide a PRIIP KID for the underlying investment options, then retail investors would receive different pre-disclosure information based on whether they are investing into a UCITS directly (i.e. KIID) or through a unit-linked insurance (i.e. KID). This is unsatisfactory, and will create unnecessary confusion for consumers.

Therefore, Articles 12-15 need to be redrafted in order to comply with the Level-1 framework.

See also our response to Question 11 regarding the risk indicator shown by the insurance MOP wrapper.

**Article 16-20: Review, revision and republication of the key information document**

*Recital 19: Use of mailing lists*

**Recital 19 needs to be either deleted or clarified further**, as it states that *“[t]ools, such as mailing lists or email alerts, might be implemented to inform existing retail investors when key investor documents are revised*“, which creates untrue statements. First, the KID is a pre-contractual document and is thus not designed to update current investors. Secondly, the current wording blurs the roles and responsibilities between manufacturers and distributors. It is the sole responsibility of the manufacturer to review, revise and republish the KID on his website. If possible, it can inform its known distribution network of the revised KID. It is not possible for the manufacturers to inform the investors, as most manufacturers are not aware who the end investors are and often do not have direct contact with them.

*Recital 20: Periodic review of a PRIIP on a secondary market*

First, please consider our comments to Q28 above.

Second, in order to create more clarity among practitioners, **we suggest Article 16(1) is amended as follows: “The PRIIP manufacturer shall review the information contained in the key information document *at the latest* by”.**

**Article 17: Ad hoc review of the key information document**

**Article 17 is missing an all-important “materiality” reference.** This exists in the UCITS KIID requirements and ensures that only material changes trigger an ad hoc review of the KIID. This is important, as it ensures that minor and inconsequential changes do not require the PRIIP manufacturer to perform an ad hoc review.

The triggers should be substantial, meaning that the change should have a significant impact on the investment risk, return scenarios and/or cost, taking into account how relevant the change is from an investor perspective. Subjective criteria’s might be appropriate to some extent (e.g. it should be clarified when changes in the technical risk indicator trigger a requirement to update the KID).

**Article 20: Conditions on good time[[4]](#footnote-4)**

The conditions for delivery in good time should make reference to the relevant passages in MiFID II, IDD and the PRIIP KID to ensure consistent application of the distribution requirements for all types of PRIIPs. **We therefore suggest to align Article 20 with Article 80(1) of the UCITS Directive 2009/65/EC).**

**Annex I: Overall KID template**

We have no particular comments on the template of the KID, but wonder how prescriptive its design is and how close a PRIIP KID has to resemble Annex I (not relating to its content, but rather to its formatting, font, colour, size, etc.)?

Furthermore, it is not totally clear how the mock-up contained in Appendix 1 of Annex III will work with the template in Annex I. For example, the template refers to Summary Risk Indicator and narrative text pursuant to Article 8(3)(d) and Appendix 1 of Annex III provides various ‘elements’ a – o which may or may not need to be included. The chart provided on page 49 of the 1-7 scale, includes words in brackets underneath the scale alongside a warning triangle. But that wording does not equate to the wording provided in the various elements a - o. So, does this mean that the chart is meeting PRIIP KID Regulation Article 8 3.(d)(i) (‘a summary risk indicator supplemented by a narrative explanation of that indicator, its main limitations, etc.) and the elements a - o meet the requirements of Article 8 3 (d)(ii)?

**Annex II: Methodology of risk calculation**

**Part 1: Methodology for the market risk assessment**

First and foremost, we unfortunately must note that the current drafting of the “methodology for the market risk assessment” is of poor quality, to the extent that certain passages are illegible and therefore unusable. We urge that this section be redrafted for easier understanding.

**Para. 1-19: PRIIP categories**

Please first consider our important comments to Q3 and Q8 regarding the creation of a separate MRM class for PRIIPs where the maximum loss may exceed the money invested.

*PRIIP categories from a fund’s perspective*

Taking the above comments into consideration, we are very unclear into which PRIIP category UCITS and AIFs fall, which is of utmost importance, as the MRM calculation is dependent on the PRIIPs categorisation. It is our general understanding that funds may fall into the following categories:

* *Category I(a)*

E.g. a fund with maturity of up to five years with an unconditional protection of capital by a third party? It should also be clarified that the unconditional protection of capital refers to all the capital and not only to a percentage of it (e.g. 95%).

* *Category II: Linear pay-off profile UCITS and AIFs*

Category II appears to include linear pay-off profile UCITS and AIFs and thus the bulk of fund products. If this assumption is correct, we ask the ESAs to redraft in particular the last two paragraphs of para. 10[[5]](#footnote-5) that seem to be applied together. First, the second last paragraph on page 35 states that

“*where these PRIIPs have, either directly or on a synthetic basis, a delta one or a leveraged exposure on underlying asset(s) that pays a constant multiple of a market price or index”*

which creates questions about what is meant to be captured by “a constant multiple of a market price or index” and whether the reference to leverage is also linked to any definition of leverage within the AIFM Directive. Second, the last paragraph on page 35f states that

“*where at least 2 years of historical daily prices or 4 years of historical weekly prices are available, or, in the case where such minimum data are not available, where a natural benchmark or proxy exists (e.g. recently created ETF on a liquid market index), such that the data of this benchmark or proxy shall be used, on a complementary basis, in the calculation of the market risk.”*

We do not understand the intended meaning of a “natural” benchmark and wonder whether the ESAs meant “pre-existing” benchmark? In any case, it is important to note that there are no linkages with the currently agreed Benchmark Regulation, which creates further requirements around the use of a benchmark.

* *Category III: Non-linear pay-off profile UCITS and AIFs (i.e. structured UCITS and AIFs)*

We ask the ESAs to take the above remarks into consideration and amend the RTS accordingly. **The correct definition of Category II funds is paramount, as Category III funds are simply defined as “any AIFs and UCITS not falling under Category II”.** An imprecise Category II definition could result in some types of funds to be considered as structured funds for its MRM calculation.

Furthermore as Category III funds are simply defined as “any AIFs and UCITS not falling under Category II**”**, it seems that also funds with an insufficient amount of data would fall under Category III. These types of funds should be excluded from Category III.

This is particularly relevant for two points of para. 17[[6]](#footnote-6). As explained further below (Para. 20-29), we believe that use of daily prices will create unnecessary noise for the calculations. Instead, at most weekly or monthly prices should be used. Secondly, the reference to 500 historical data prices contradicts the later mentioning of 5 years’ data.

* *Category V: Fund with insufficient amount of data or holding illiquid assets*

In our understanding, to assess the MRM for funds with insufficient history and for which is not possible to use a benchmark or proxy a qualitative approach should be used. The ESAs suggest a table with different risk categories on the basis of the “type of the funds”.

We have some concerns about this proposal because the MRM class for a new absolute return or total return fund with a dynamic allocation seems always to be 5 at the minimum and this would not always be correct. An incorrect risk representation could also incur for other types of funds which have a dynamic asset allocation between the same “type of funds”. We also ask the ESAs to clarify para. 13(a)(ii) with regard to insufficient data. Indeed, the added value of this statement is unclear, as there are other paragraphs already dealing with rules on insufficient data: Category II, par. 10 last sentences ((2 years historical daily prices or 4 years of historical weekly prices/proxy are available) and Category V, par. 17.

**Para. 20-52: Calculation methodology of MRM**

We regrettably also consider the drafting of the MRM methodologies of overall low quality and in some places technically wrong, as was confirmed by the ESAs through the publication of an errata. The initial feedback we received by experts was that the current drafting is unnecessarily complex and should thus be simplified. Notwithstanding our below comments, it is of utmost importance that the language and formulas used (i.e. convention of terminology, symbols, and formulas) in this section is understood by quantitative analysts that are ultimately responsible for the calculation of the MRM. Going into more detail, we have the following remarks.

**Para. 20-29: “Cornish Fisher” VaR for Category II PRIIPs**

The ESAs suggest to use daily prices for the VaR calculation. Daily prices produce much “noise”, which will distort the VaR calculations. Instead, weekly prices or monthly should be used, which will still allow for enough sample data to be collected. The use of weekly prices or monthly prices, where possible, in line with the UCITS SRI methodologies also overcomes operational problems for funds that do not have a daily NAV.

Also, the VaR calculation is based on the recommended holding period (RHP) in years (para. 28). Since this assumed RHP may be different from one manufacturer to the next, this may result in different MRM for the same underlying of a PRIIP due to differently assumed RHPs.

**Part 2: Methodology for the credit risk assessment**

*No credit risk assessment for AIFs and UCITS*

We strongly support para. 54 (p. 40), which states that credit risk shall not be assessed for AIFs and UCITS. Nonetheless, a statement is missing that these UCITS/AIFs are therefore automatically categorised as CR1. Additionally in order properly to inform investors, the KID should include a short statement that these UCITS/AIFs do not carry Credit Risk (CR).

Nevertheless, while certain UCITS and AIFs are exempted, the explanatory text for para. 55 lit(b), page 76, makes direct references to AIFs, which requires further clarification from the ESAs. Instead of “AIFs”, we believe it should correctly refer to “structured notes”.

*Credit risk classes*

First, after the EU co-legislators’ efforts to reduce the dependency on Credit Rating Agencies (CRAs), we find it surprising that the credit risk measured is to be based solely on external credit ratings. We suggest that this section should levy more on other pieces of legislation and legislative frameworks rather than “hard wiring” certain CRAs into the PRIIP KID Level-2 RTS.

As to the explanatory text for para. 55 lit. (c), the ESAs may consider lowering the credit assessment by one credit risk class in the case of a 100% third-party guarantee (dual layer of protection of investment through the fund’s investment strategy and the third party-guarantee).

*Credit quality steps*

Please note that that paragraph 62 erroneously refers to “paragraph 57(c)” instead of “paragraph 57(iii)”.

**Part 3: Aggregation of market and credit risk into the summary risk indicator**

Again, as mentioned above and for the avoidance of doubt by retail investors, it should be clarified that UCITS and AIFs within the meaning of para. 54 should fall within the CR1 credit risk-class.

Generally speaking, it seems that when aggregating market and credit risk into the summary risk indicator, credit risk is underrepresented when compared to market risk. We believe that MRM and CRM should carry equal weightings.

**Part 5: Liquidity risk**

While we have no major remarks regarding para. 74-76, we would ask for further clarity around the language that is being used in the relevant paragraphs.

For example para. 76(d) talks about “significant” early exit penalties. Does this have any significance for funds with predefined maturity, and when must early exit penalties be considered “significant”? It should also be ensured that that such penalties cannot simply be classified as “costs” in order to escape this assessment and its subsequent disclosure as an additional risk. Also, please provide further clarification as what is considered to be a “long” disinvestment notice.

**Part 6: Currency Risk Assessment**

Please see our answer to Question 12.

**Annex III: Methodology for the presentation of summary risk indicator**

**Appendix 1: Format of Presentation of the Summary Risk Indicator**

With regards to the presentation of the currency risk, please consider our above comments and our answer to Question 12.

**Annex IV: Technical rules of performance scenarios**

Please also consider our answer to Question 14 as well as comments to Article 6(7) above.

**Annex V: Presentation of performance scenarios**

Please also consider our answer to Question 14 as well as comments to Article 6(7) above.

Generally speaking, guidelines are required to avoid that PRIIPs manufacturer will potentially spawn a multitude of various approaches and a risk/return that this will be used as a competition or marketing element.

**Appendix 1: Presentation of Performance Scenarios**

With regards to the proposed presentation in Appendix 1, we wonder why there are two almost identical tables presented on page 55? Should one consider that the first table is used for one-off investments, whereas the second table is meant for investment connected to an investment plan (as it includes “accumulated invested amount”)? We seek clarification.

**Annex VI: Methodology for calculation of costs**

***Part 1: List of costs of the different types of PRIIPs***

**Section I: List of Costs of investments funds (AIFs and UCITS)**

We understand that this list of costs of investment funds is based on the currently applicable CESR guidelines. In particular, it seems that the underlying motive for this new cost list was to define as many costs as possible with different terminologies, instead of describing the underlying reason(s) for these types of costs to occur in the first place. This creates unnecessary ambiguities that can be avoided by using the approach used in the UCITS KIID guidelines. In particular, since it already covers all costs described in the “one-off” and “recurring” section.

*One-off costs*

Keeping our above comments in mind, we ask for further clarification of what is meant by a cost “borne by the fund” (para. 2). Our understanding would be that such a cost is a recurring cost rather than a one-off cost. Additionally, we do not understand the term “loading costs” (para. 3(b)) and wonder whether this is the same as subscription costs?

*Recurring costs*

We have several observations on the recurring cost section.

First, para. 6(b) sub point (v) contains both “securities lending” and “property management”, which are two distinctively different outsourced services and should thus be separated in their own sub points. Furthermore, “capital expenditure” should not be included in the costs together with other operating expenses. “Capital expenditure” is a capital investment made directly on the assets with the effect of increasing the value of an asset (i.e. repairing the roof of a building) and thus is not an outsourced service. Its reference should be deleted.

With regard to para. 6(i), we agree on the wording, but we strongly disagree with the explanatory text on page 79. Option premiums are not costs. Generally speaking, the total price paid to invest into an asset (whether it be a stock, a bond or an option) is not a cost. Only a little part of the total price is cost (like brokerage fee). Furthermore, this explanatory text contradicts §18(c) on page 61.

As regards costs of underlying investments, the wording in paragraph 6(l) and (m) is very ambiguous and should be rectified by deleting the first subparagraph and starting right away with the respective subparagraph (i). In our view, the correct provision should read as follows (taking the example of 6(l)):

(l) the costs of acquiring or disposing of units in UCITS or AIFs shall be taken into account in accordance with the following steps:

(i) Where a fund invests its assets in UCITS or AIFs, its summary cost indicator and recurring ratio shall take account of the charges incurred in the underlying UCITS/AIFs. The following shall be included in the calculation:

(ii) if the underlying is a UCITS its most recently available recurring and entry/exit charges figure shall be used; this may be the figure published by the UCITS or its operator or management company, or a figure calculated by a reliable third-party source if more up-to-date than the published figure; […]

Lastly, we believe that para. 6(q) contains a drafting error: it should be referencing either “section II” not “paragraph 2”, or para. 37 (page 65f) which discusses “implicit costs of PRIIPs other than investments funds”. It seems to refer to implicit costs of derivatives entered into by funds. Those derivatives often do not qualify as PRIIPs, so their implicit costs will not be disclosed by counterparties. Para. 37 and following could not be applied, because asset managers are not able to compute the “fair value” with the same accuracy as investment banks. If the implicit costs incurred by funds have to be disclosed, then regulation should oblige counterparties (investment banks) to disclose them to asset managers.

*Transaction costs*

Please consider our answers to Questions 16 and 17.

Furthermore, the reference to customised derivatives is not understandable and in contradiction with para. 6(q) on page 59.

*Performance Fees*

For more detailed comments on the presentation of the Performance Fees, please consider our comments above on Annex V.

**Section II: List of costs of PRIPs other than investment funds – including structured products, derivatives and contracts for difference (CFDs)**

With regards to para. 32 on page 65 we suggest adding the following item: “direct or indirect costs associated to the structure of the product in relation to prudential requirements (own funds, liquidity, etc.)”. Also, we suggest adding the following to para. 26: “any recurring cost similar to those listed in paragraph 32”.

**Section III: List of Costs of Insurance-based investment products**

Please consider our response to Question 19 above.

In addition, all costs incurred in a fund that can be incurred by an insurance company in the manufacturing/managing of a PRIIP should be included. Alas, the same rules should be applied.

***Part 2: Summary indicators***

While having no technical remarks on the actual Reduction-In-Yield methodology, we question whether the concept “RIY” is understood by the average retail investor. We therefore propose (see comments on Annex VII’s presentation of costs) to circumscribe RIY with something more understandable such as “equivalent annual percentage rate”.

\*\*\*

Brussels, 25 January 2016

[16-4007]

1. MiFID II Commission Delegated Directive; Article 9(9)-(12) [↑](#footnote-ref-1)
2. PRIIPs Regulation Art. 6(3) [↑](#footnote-ref-2)
3. Page 123 on MOPs Costs: “[…] *In so far as the insurance undertaking requests that the UCITS to already prepare KID compliant information for the insurance undertaking – though this is not directly required under the PRIIP Regulation -- this would have the practical impact of undermining the temporary exemption in the Regulation and requiring UCITS to produce simultaneously a KII and KID-compliant information*.” [↑](#footnote-ref-3)
4. For the avoidance of doubt and given that there are two Articles 20 in the CP, we are referring to page 31. [↑](#footnote-ref-4)
5. Please note that the UCITS Directive is also wrongly referenced, as it currently refers to MiFID II. [↑](#footnote-ref-5)
6. “The MRM of Structured PRIIPs shall be assessed based on the methodology detailed in Paragraphs 30 to 48, provided that at least 500 historical daily prices of such Structured PRIIPs’ underlyings are available in relation to the last 5 years. Where such data is not available, the Structured PRIIP shall be assigned to Category V.” [↑](#footnote-ref-6)