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| 10 November 2015 |

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| Reply form for the Consultation Paper on PRIIPs Key Information Documents |
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| Date: 10 November 2015 |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper on PRIIPs Key Information Documents, published on the ESMA website.

*Instructions*

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

* use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
* do not remove the tags of type <ESMA\_QUESTION\_PRIIPS\_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
* if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

* if they respond to the question stated;
* contain a clear rationale, including on any related costs and benefits; and
* describe any alternatives that ESMA should consider

**Naming protocol**

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESMA\_ PRIIPS \_NAMEOFCOMPANY\_NAMEOFDOCUMENT.

E.g. if the respondent were XXXX, the name of the reply form would be:

ESMA\_ PRIIPS\_XXXX\_REPLYFORM or

ESMA\_ PRIIPS\_XXXX\_ANNEX1

To help you navigate this document more easily, bookmarks are available in “Navigation Pane” for Word 2010 and in “Document Map” for Word 2007.

***Deadline***

Responses must reach us by **29 January 2016.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input/Consultations’.

***Publication of responses***

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

***Data protection***

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the headings ‘Legal notice’ and ‘Data protection’.

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_PRIIPS\_1>

LSEG is a diversified international market infrastructure and capital markets business with exchanges and multilateral trading facilities based in London and Milan. LSEG currently operates two derivatives markets regulated under the Markets in Financial Instruments Directive (2004/39/EC):

* The Italian Derivatives Market, Borsa Italiana (IDEM) markets:
	+ IDEM Equity, the equity derivatives market segment
	+ IDEX, the energy commodity derivatives market segment
	+ AGREX, the agricultural derivatives market segment.
* London Stock Exchange Derivatives Market (LSEDM):
	+ UK, International Order Book (IOB) Turkish and Norwegian options and futures

These markets are authorised as “regulated markets” under the Markets in Financial Instruments Directive 2004/39/EC and offer trading in options and futures contracts, including: stock options, stock futures, dividend futures, index options and index futures. In September 2015 LSEG derivative markets had an average daily turnover of **216,000** derivativecontracts valued at **€6.9 billion**.[[1]](#footnote-2) The average daily notional amount of exchange-traded futures and options in Europe during September was approximately **€1.3 trillion[[2]](#footnote-3)**.

Despite their substantial size, European exchange traded derivative markets are expected to grow. Many over-the-counter derivative transactions are expected to transition to ETDs when the first central clearing mandates under the European Market and Infrastructure Regulation EU/648/2012 (EMIR) apply from June 2016. ETD volumes are expected to increase again when Art 24 of the Markets in Financial Instruments Regulation EU/600/2014 (MiFIR) introduces on-exchange/platform trading requirements for standardised derivative contracts (2018 est).

<ESMA\_COMMENT\_ PRIIPS\_1>

***Question 1***

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

<ESMA\_QUESTION\_PRIIPS\_1>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_1>

***Question 2***

1. *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?*
2. *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?*

<ESMA\_QUESTION\_PRIIPS\_2>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_2>

***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?*

<ESMA\_QUESTION\_PRIIPS\_3>

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<ESMA\_QUESTION\_PRIIPS\_3>

***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.*

<ESMA\_QUESTION\_PRIIPS\_4>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_4>

***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?*

<ESMA\_QUESTION\_PRIIPS\_5>

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<ESMA\_QUESTION\_PRIIPS\_5>

***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?*

<ESMA\_QUESTION\_PRIIPS\_6>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_6>

***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?*

<ESMA\_QUESTION\_PRIIPS\_7>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_7>

***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.*

<ESMA\_QUESTION\_PRIIPS\_8>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_8>

***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 is relevant, irrespective of the redemption characteristics?*

<ESMA\_QUESTION\_PRIIPS\_9>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_9>

***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?*

<ESMA\_QUESTION\_PRIIPS\_10>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_10>

***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?*

<ESMA\_QUESTION\_PRIIPS\_11>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_11>

***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?*

<ESMA\_QUESTION\_PRIIPS\_12>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_12>

***Question 13***

*Are you of the opinion that the current Consultation Paper sufficiently addresses this issue? Do you 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?*

<ESMA\_QUESTION\_PRIIPS\_13>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_13>

***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.*

<ESMA\_QUESTION\_PRIIPS\_14>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_14>

***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?*

<ESMA\_QUESTION\_PRIIPS\_15>

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<ESMA\_QUESTION\_PRIIPS\_15>

***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?*

<ESMA\_QUESTION\_PRIIPS\_16>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_16>

***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)*

<ESMA\_QUESTION\_PRIIPS\_17>

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<ESMA\_QUESTION\_PRIIPS\_17>

***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)?*

<ESMA\_QUESTION\_PRIIPS\_18>

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<ESMA\_QUESTION\_PRIIPS\_18>

***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?*

<ESMA\_QUESTION\_PRIIPS\_19>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_19>

***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?*

<ESMA\_QUESTION\_PRIIPS\_20>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_20>

***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?*

<ESMA\_QUESTION\_PRIIPS\_21>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_21>

***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?*

<ESMA\_QUESTION\_PRIIPS\_22>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_22>

***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?*

<ESMA\_QUESTION\_PRIIPS\_23>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_23>

***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?*

<ESMA\_QUESTION\_PRIIPS\_24>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_24>

***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?*

<ESMA\_QUESTION\_PRIIPS\_25>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_25>

***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?*

<ESMA\_QUESTION\_PRIIPS\_26>

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<ESMA\_QUESTION\_PRIIPS\_26>

***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.?*

<ESMA\_QUESTION\_PRIIPS\_27>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPS\_27>

***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.*

<ESMA\_QUESTION\_PRIIPS\_28>

In response to the question of whether there are significant impacts that have not been addressed in the Impact Assessment, we are writing to request that the scope of derivatives is narrowed to exclude exchange traded derivatives.

**Executive Summary**

LSEG supports the Commission’s objective in Regulation (EU) No 1286/2014 of the European Parliament and of the Council (the PRIIPS Regulation) of harmonising the disclosure of retail packaged products, to improve investors’ ability to compare products and understand their features. But LSEG believes that the rules should be calibrated as not to overextend to financial instruments which were not intended to be included in letter or spirit of this legislation.

LSEG does not seek to discuss the application of the PRIIPS Regulation to all MIFID categories of derivatives, but to exchange-traded futures and options (exchange traded derivatives “ETD”s), which we believe are outside of the letter and sprit of the PRIIPS Regulation.

The PRIIPS Regulation does not expressly include ETDs in the definition of a “packaged retail investment product” (PRIP), a definition designed to bring non-insurance based packaged retail investment products into the scope of the rules. However, the ESAs in drafting the level 2 PRIIPS KID regulatory technical standards have extended the scope of a PRIP to potentially all forms derivatives.

We have analysed the position of exchanged-traded futures and options (ETDs) and believe that they are out of the scope of the PRIIPS regulation. ETDs are financial instruments, not packaged products. They are not publicly offered through a primary market issuance and they are designed to be traded on exchange. While they are complex, this complexity alone does not equate to packaging, as such term is described in the KID Consultation. These financial instruments are merely the underlying “building blocks” of the packaged products specified in the PRIIPS legislation. In this paper we provide a detailed discussion of the proposed KID requirements how they would have to be substantially restructured to apply to ETDs.

We further wish to draw to the Commission’s attention the separate and distinct roles of market operators, such as LSEG, and product manufacturers. Operating a regulated market is a regulated activity under Title III of the Markets in Financial Instruments Directive 2004/39/EC (MiFID). These rules require market operators to admit contracts to trading by approving standardised terms relating to the trading and settlement of contracts between exchange members. A market operator is not a counterparty to an ETD or any other transaction between market participants and has no management or economic interest in the performance of any contract. However, a product manufacturer designs product features to meet specific investor objectives, has a contractual relationship with the investor and an economic interest in the performance of the contract.

If ETDs are included in the PRIPS Regulation, many KID requirements would be inapplicable to them. We believe that a separate KID regime would be needed to reflect their features.

**ETS in the PRIIPs framework**

The PRIPS Regulation Art 4(1)definition of “packaged retail investment products” (PRIPs) does not expressly include ETDs:

*Art 4(1) ‘packaged retail investment product’ or ‘PRIP’ means an investment, including instruments issued by special purpose vehicles as defined in point (26) of Article 13 of Directive 2009/138/EC or securitisation special purpose entities as defined in point (a) of Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council where, regardless of the legal form of the investment, the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor;*

But the ESAs have widely drafted the KID Discussion and Consultation papers to potentially include any form of derivative.

LSEG does not seek to discuss the application of the PRIIPS Regulation to all MIFID categories of derivatives, but to ETDs, which we believe are outside of the letter and sprit of the PRIIPS Regulation. Recital 6 of the PRIIPS Regulation contains additional conditions and guidance which do not apply to ETDs:

*“(6) This regulation should apply to all products, regardless of form or construction, that are manufactured by the financial services industry to provide investment opportunities to retail investors, where the amount repayable to the retail investor is subject to fluctuation because of exposure to reference values, or subject to the performance of one or more assets which are not directly purchased by the retail investor. Those products should be known as PRIIPs for the purposes of this Regulation and should include, among other things, investment products such as investment funds, life insurance policies with an investment element, structured products and structured deposits. Financial instruments issued by special purpose vehicles that conform to the definition of PRIIPs should also fall within the scope of this Regulation. Instead these products intercede between the retail investor and the markets through a process of packaging or wrapping together assets so as to create different exposures, provide different product features, or achieve different cost structures as compared with a direct holding”*

LSEG ETDs do not have a retail investment objective, an amount repayable by the manufacturer to the investor and are not “packaged” as such term is described in the level 1 and level 2 descriptions.

* **No retail investment objective.** Article 4(1) and Recital 6 refer to products designed to provide investment opportunities for retail investors, whereas ETDs do not have any retail specific or exclusive features or distribution. We further note that the examples of investments provided in the legislation – “*investment funds, life insurance policies with an investment element, structured products and structured deposits*” – are each financial products designed to meet specific investment objectives. ETDs are merely financial instruments which are “building blocks” used in the construction of these products.

The KID Consultation discusses other critical retail-related features which are absent in ETDs:

* The draft RTS in the KID Consultation states that a PRIIP has a *“target market identified by the PRIIP manufacturer’s product oversight and governance proces*s”, which takes into account “*the financial interests, knowledge, objectives and characteristics of the types of retail investors for whom the PRIIP has been designed, including ability to bear investment loss and their investment income*”. (Art 4.4)
* The KID Consultation Impact Assessment section finds that “…*PRIIPS are also heterogeneous in regards their features, though, as PRIIPS, they of course share many features too,* *and by definition all target accumulation and investment aims*.” (p93).
* **No amount repayable.** As noted, the PRIIPs Regulation defines the PRIP as product in which there is the obligation for the issuer to repay the investment upon maturity. But LSEG ETDs do not have any repayment at maturity. They require payment of premiums (for options) or margin payment (for options and futures) to which the broker may require his or her client to make a daily variation margin payment if the market moves against the client. These payments are designed to be risk management tool of the CCP, not a deposit toward the acquisition of the underlying asset (invested capital).
* **No packaging.** Per recital 6, ETDs do not involve the wrapping together of assets to create different exposures, different product features or cost structures. ETDs are merely financial instruments with no specific retail investor objective, purpose or performance scenarios. Simply stated, while these financial instruments are complex their complexity alone does not make them packaged.
* **Direct participation and price transparency.** The KID Consultation references in several sections that all PRIIPs are designed to allow investors engage in investment strategies that would otherwise be “inaccessible or impractical”. This is not true for ETDs, in particular futures contracts, which provide the right to delivery of the underlying asset. Regarding pricing, ETDs allow investors to buy and sell assets which prices are reliable and publicly available. Exchange operators are required to ensure clear ETD pricing under Regulation EU/1287/2006: “*regulated markets shall verify that the following conditions are satisfied: (a) the terms of the contract establishing the financial instrument must be clear and unambiguous, and enable a correlation between the price of the financial instrument and the price or other value measure of the underlying; (b) the price or other value measure of the underlying must be reliable and publicly available;…”*

Therefore, ETDs lack the essential features of retail packaged products and should not be included in the PRIIPS scope.

**Exchanges as market operators, not product manufacturers**

We understand that the Commission and ESAs may be considering proposals which may designate market operators as product manufacturers for any exchange traded PRIIPS. Recital (12) of the PRIIPS Regulation provides an indicative list of entities that are PRIIPS manufacturers, entities “*that are in the best position to know the product*”. The list provided: “*fund managers, insurance undertakings, credit institutions or investment firms*”. The inclusion of a market operator would be a materially different type of entity from these insurance and investment firms. We wish to explain the nature and role of market operators and how these differ from the role of a PRIIPS manufacturer.

* **Role of market operators.** The responsibilities of a market operator of regulated markets is set out under MiFID, Title III, Regulated Markets, in particular Art 40, Admission of financial instruments to trading. This section creates rules to ensure that “*any financial instruments admitted to trading in a regulated market are capable of being traded in a fair, order and efficient manner, and in the case of transferable securities, are freely negotiated*”.

LSEG approves the types of contract specifications detailed in Appendix 1. These are standardised terms relating to trading: market hours, lot sizes, settlement and clearing methods, and end-of-day market pricing. The derivative counterparties agree the specific economic terms of each contact (size and value, clearing and settlement instructions) and have economic liability for the trade. A market operator is not a counterparty to the trade and has no economic interest in the performance of the contract.

* **Role of PRIIPS product manufacturers**. Conversely, the KID Consultation notes that a manufacturer controls “*risk, reward and cost profile of the investment*” (p19) and may be in a position “*to terminate the PRIIP unilaterally*” (p24), exercising discretion over the design and performance of the contract. A manufacturer will have contractual relationship and receive fees separate from the capital invested, *The KID of a structured product, derivative and CFD should enable retail investors to identify within the issue price of a PRIIP, (i) the amount that will be captured by the manufacturer, and (ii) the amount that will be used to provide/generate a return to the retail investor (invested capital). The amount that will be captured by the manufacturer should be disclosed in the entry costs*.”(p81 of the KID Consultation).

We have identified the following additional features and obligations of a product manufacturer under the PRIIPS Regulation which are at odds with the services LSEG performs as a market operator:

* + Disclosure of target investor – Art 8 of the PRIIPS Regulation requires a manufacturer to disclose in the KID “*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*”. In admitting ETDs to trading, exchanges do not approve any such features.
	+ Default management disclosure – As noted earlier, Article 8 also requires a manufacturer to disclose whether a default or loss is covered by an investor compensation or guarantee scheme and whether there are limitations to this cover. It is critical to note here that exchanges are not regulated firms, and if deemed product manufacturers, retail clients would not have access to investor compensation schemes.
	+ Liability for a KID contractual documentation – a market operator is never an ETD counterparty and would struggle to identify and ensure that KID is distributed among every exchange member, its clients and indirect clients. Such liability would present a fundamental change to the nature of the relationship between a market operator and its members.
	+ “Costs borne by the manufacturer” - the KID Consultation states that hedging costs, legal costs and capital costs must be disclosed, but no such costs accrue to a market operator. (p86)

Finally, we note that during 2015 more than **48 million[[3]](#footnote-4)** ETDs were traded on LSEG markets. On 29 January 2016, Borsa Italiana had over **24,000 option** contracts admitted to trading on its markets. A single issuer, Telecom Italiana, was the underlying asset related to **610 options**. Should the LSEG be classified as PRIIPs product manufacturer of the ETDs traded on its markets, LSEG would have huge organisational impact. The production of a KID per single ETDs ISIN would be operationally unworkable for LSEG and any other exchange.

**KID restructuring required for ETDs**

If ETDs remain in the PRIPS Regulation scope, the Commission and the ESAs would be required to create a separate regime for ETDs reflecting their unique features. We set out below the inconsistency of key KID requirements with the functioning of ETDs, highlighting the inapplicability of the information to be disclosed.

* **Number of KIDs applicable to ETDs.** A market operator approves the type of contract (future/option), underlying, maturity, strike price, American/European exercise, cash/physical settlement, settlement price, etc. But under a single contract specification a huge number of financial instruments (ISINs) can be admitted to trading, each with single parameters (i.e. different strike prices; different maturities; etc.). A requirement to publish a KID for every financial instrument (ISIN) would be very burdensome for the manufacturer and the distinction between ISINs would not add any benefit to retail investor. Further, new ISINs can be admitted to trading on request during the trading day. With such a short notice, manufacturers would not be able to meet a pre-publication KID requirement.

We recommend that KID requirements are aggregated for ETDs, and that the manufacturer is allowed to create a single KID per type of contract (future/option). Alternatively, product manufacturers should be allowed to produce a single KID applicable to all contracts relating to the same underlying asset - the manufacturer would not be required to provide a KID for each different strike price or maturity.

* **Content of KID for ETDs**
	+ **“*What is the product*”** This section does not fit with the nature of ETDs, which are not exclusively designed for retail investors. ETDs are normally designed considering that these products are mainly traded by professional investors, and they are always traded directly by the exchange members, that are investment firms.
	+ ***“What are the risks and what could I get in return?”*** The KID Consultation Paper includes a risk indicator that balances the market risk and the credit risk for the entity to whom the investor are exposed. The ESAs have assigned ETDs to the highest market risk category (MRM 7), based on a qualitative assignment that make redundant the evaluation of the credit risk.

 *-*  Considering that ETDs are centrally cleared by CCPs who have the role to mitigate to the maximum extent the counterparty risk, we believe it this should be clarified that for ETDs the credit risk should not be assessed, as already provided by AIFs and UCITs (Annex II, paragraph 54 of the KID Consultation Paper). Moreover, in our view the request to assess the credit risk defining ex-ante one or more external rating agencies is not applicable with reference to ETDs being not clear who should be rated (the Exchange? the CCP? all the market participants?). As a general point, we also question if this would not encourage an overreliance on the rating.

 *-* Article 5 of the KID Consultation requests a narrative explanation of the liquidity risk, if any, indicating that selling the PRIP before the *recommended holding period* may not be possible and may imply significant costs or losses. Annex II, paragraph 76, specify a number of criteria according to which a product shall be considered by the manufacturer as illiquid or having a material relevant liquidity risk. We endorse the work that ESMA has done in the MIFID RTS context to define general criteria to classify as liquid/illiquid the financial instruments for price transparency purposes, and urge the Commission and ESAs to adopt these liquidity standards for PRIPs. This would avoid having the same financial instrument classified as liquid or illiquid at the same point in time. The benefit of having a single liquidity definition criteria has already been recognised in the CSDR Regulation, where for the settlement discipline purposes reference has been made to the MIFID liquidity criteria.

* ***Performance scenario.*** The performance scenarios are designed to demonstrate the functioning of the PRIP under different market conditions. For ETDs, the outcome of the performance scenario in different market conditions depends also on:
* *Long / short positions*

An ETD investor will have either a long or short position, creating different risk profiles for the same financial instrument. For example the return of a long position in a call option is positive or neutral (net from the strike *cost*), but the return of a short position in the same call option (net from the strike *profit*) is unlimited. This adds an additional level of complexity in the definition of the performance scenario for an ETD that unlikely can be contained in a single KID.

* *Holding periods*

ETDs allow investors to buy/sell the contract at any time until the contract maturity. But a type of contract can have multiple maturities, with maturities of different terms created after the original contract is purchased.

We recommend that the performance scenario for ETDs is based on the theoretical behaviour of the ETD in three underlying asset performance (favourable, moderate, unfavourable) for a holding period equal to the maturity of the most liquid contract, for the long and the short position.

* ***“What happens if [the name of the PRIIP manufacturer] is unable to pay out?”*** The PRIPS Regulation requires disclosure relating to the default of the manufacturer and the presence of an investor compensation or guarantee scheme. The KID Consultation goes beyond the level 1 requirement, requesting that the manufacturer discloses if the investor is “*exposed to the default of an entity, whether the retail investor may face a financial loss with only partial or no capital reimbursement, and the identity of the entity where the entity is not the PRIIP manufacturer*” (Article 7(1)). For an ETD, According to level 1, this risk is the risk of the exchange default (if the exchange is deemed the ETDs’ manufacturer) but the Exchange is never the counterparty or the issuer.
* ***“What are the costs?”*** The KID Consultation requires disclosure of “*costs over time*” and the “*composition of costs”*. With reference to cost over time “*a single figure shall be shown as the summary cost indicator of the total aggregated costs of the PRIIP […]. This figure shall be expressed in monetary and percentage terms*”. This is not applicable for ETDs because an investor’s costs depend mainly on his contractual agreement with the broker that is the exchange member. Hence a representation of the exchange trading fees would be misleading for retail investors.

In the calculation of transaction costs for investment funds, listed derivative costs are computed using a standardised percentage defined taking into account actual market conditions (Annex VI, paragraph 25, *“listed derivatives: cost % (bps) 0,001 per agreement*”). We propose to adopt the same approach for the KID ETD, where a flat percentage cost should be disclosed, adding the condition that the retail investors have also to consider the - bilateral negotiated - broker fees. If this approach is not considered to be viable, then the content of Annex V.II should apply to ETDs. But we note that the list of costs described there does not take into account the specificities of ETDs.

From an investor’s perspective, the ETDs’ one-off costs that do not depend on the broker’s fee structure are only the implicit costs, expressed by the bid-ask spread. In this regard, implicit costs in term of bid-ask spreads may differ significantly even for the same type of contract with the same underlying, depending on *when* the trade is executed, and on the specificity of the instrument chosen (strike, price, maturity), that could present significantly different levels of liquidity. Hence, a significant average measure of the level of the real bid-ask spread cannot be determined ex-ante and such figure cannot be provided in the KID.

As such, we suggest that disclosure of implicit costs should be considered only for illiquid ETDs (according to MIFID 2 RTS), for which the market conditions concretely represent an exit-cost. In these cases, we would suggest the following:

(i) for contracts with market makers, the spread can be assumed equal to the spread obligation of the market maker (representing a conservative measure of the real bid-ask spread, that could be lower, even significantly);

(ii) for contracts without market makers, a qualitative sentence stating that it is not possible to provide a reliable measure of the spread should be added;

(iii) investors would be informed that the spread could be significantly higher than that above, considering that market making obligations do not cover all contract series.

Finally, we note that for ETDs there are no recurring cost.

**Conclusion**

Based on this analysis, we do not believe that the scope of PRIIPS Regulation can or should extend to ETDs. These contracts are financial instruments the admission to trading and the sale of which is governed by MiFID investment rules, they are not retail packaged products and should not be subject to PRIP rules. Should the ETDs be kept in scope, we have set out the key features of the PRIIPS KID which would require substantial amendments: changes to the publication rules, revision of “target market”; performance scenarios and costs sections.

Further, we have set out why market operators, in admitting contracts to trading, are performing a role separate and distinct to a PRIIP product manufacturer. By the way of example, we provide a contract specification defined by the Borsa Italiana and approved by Consob and a specification from the London Stock Exchange.

We ask that the PRIIPS KID RTS are amended to make clear that exchange-traded futures and options are omitted from the PRIIPS Regulation scope and that exchanges remain outside of the scope of product manufacturers.

To support the Commission’s objective of harmonisation of retail disclosure standards, we recommend that the Commission pursues a strategy of harmonising the disclosure requirements for all European retail investments by harmonising requirements under the existing applicable rule sets (eg MiFID for ETDs other financial instruments outside the PRIIPS scope, UCITS for collective investments and PRIIPS for package retail investment products) to maintain the consistency and coherence of financial services rules. We further recommend that disclosure obligations remain with the market participant that has the primary financial interest in the performance contract.

Thank you for your consideration, and we hope to have the opportunity to discuss these points with you.

**Annex 1: Sample Derivative Contract Specifications**

|  |  |
| --- | --- |
| **Characteristics** | **Italian Stock Option Description** |
| **Underlyings** | Shares listed on Borsa Italiana Exchange |
| **Option Style** | American |
| **Trading hours** | 9.00 am - 5.50 pm |
| **Quotations** | Stock option contracts are quoted in Euro. |
| **Premium settlement** | Cash settled on the CC&G open day following the trading day by [Cassa di Compensazione e Garanzia](http://www.ccg.it/). |
| **Contract value** | The value of the contract is determined by the product of the strike price (in Euro) and the respective lot.**Example:** if the price of an option on XY with strike price of 31.45 € is equal to 0.6500 €, the contract value is 31.45 € x 500 =15.725 € |
| **Option price (premium)** | Equal to the value of the option premium multiplied by the respective lot.**Example:** if the price of an option on XY with strike price of 31.45 € is equal to 0.6500 €, the premium is 0.6500 € x 500 = 325 € |
| **Tick** | The tick is € 0.0005 |
| **Expiries** | 10 expiries: the 2 nearest monthly expiries, the 4 following quarterly expiries of the 'March, June, September and December' cycle thereafter, and the 4 following semi-annual expiries of the 'June and December' cycle thereafter. A new monthly (quarterly or six-month) expiry is quoted on the first trading day following expiry |
| **Expiry day** | The contract expires on the third Friday of the expiration month at 8.15 am. If the Exchange is closed that day, the contract expires on the first trading day preceding that day |
| **Last trading day** | Trading in any contract closes the day before the expiry at 5.50pm. |
| **Daily closing prices** | The daily closing price is established by [Cassa di Compensazione e Garanzia](http://www.ccg.it/) |
| **Settlement price** | The settlement price is the closing auction price of the underlying share on the last trading day. |
| **Exercising an option** | Exercising an early option is possible during any trading day from the first to the last trading day. Early exercise is suspended under the following conditions:1. on the trading day before dividends of the underlying stock are paid;
2. on the trading day before any operations on the capital of the underlying stock;
3. on the last day of a total public offer.

Borsa Italiana gives notice of suspension of early exercise of the option if the Exchange has suspended trading in the underlying stock of the option.In-the-money options are exercised automatically on expiry day.Exercise by exception is possible up to 8.15am on the expiry day. When the option buyer exercises his option, the [Cassa di Compensazione e Garanzia](http://www.ccg.it/) designates the writer by means of a draw. |
| **Settlement** | Physically settled on the second open TARGET calendar day following the early exercise or the expiry day through [Cassa di Compensazione e Garanzia](http://www.ccg.it/). |
| **Limit on number of positions open or exercised** | None |
| **Exercise prices** | Exercise prices are generated at intervals as shown in the table below:

|  |  |  |
| --- | --- | --- |
| **Excercise prices (Euro)** | ***Expiries up to 12 months***Intervals (Euro) | ***Expiries from 12 to 36 months***Intervals (Euro) |
|  |  |  |
| 0.0050 - 0.1800 | 0.0050 | **0.0100** |
| 0.1801 - 0.4000 | 0.0100 | **0.0200** |
| 0.4001 - 0.8000 | 0.0200 | **0.0400** |
| 0.8001 - 2.0000 | 0.0500 | **0.1000** |
| 2.0001 - 4.0000 | 0.1000 | **0.2000** |
| 4.0001 - 9.0000 | 0.2000 | **0.4000** |
| 9.0001 - 20.000 | 0.5000 | **1.0000** |
| 20.0001 - 40.0000 | 1.0000 | **2.0000** |
| More than 40.0001 | 2.0000 | **4.0000** |

 |
| **Number of exercise prices** | For the four six-month maturities: at least 21 exercise prices shall be traded for both the call and the put series (= 168 ISIN minimum per underlying)For the two monthly and four quarterly maturities: at least 15 exercise prices shall be traded for both the call and the put series (= 180 ISIN minimum per underlying) |
| **Margins** | [Margin table](http://www.ccg.it/jportal/pcontroller/NavigatorHandler?nodo=12819) |
| **Give-up** | Available |

**UK Stock Option Description**

|  |  |
| --- | --- |
| **Parameter**  | **Description**  |
| **Contract Underlying**  | United Kingdom stocks listed on the London Stock Exchange’s (LSE) and listed in the London Stock Exchange Derivatives Market Product List on the LSEG Website.  |
| **Type of Contract**  | Physically settled Call and Put Option Contracts for Order book trading, Block Trading and manual Trade Reporting. Cash settled Call and Put Option Contracts are also available for Block Trading and manual Trade Reporting only.  |
| **Central Counterparty**  | LCH.Clearnet.  |
| **Trading Hours**  | 08:00 – 16:30 London time for Order book trading and Block Trading 07:30 – 17:30 London time for manual Trade Reporting.  |
| **Exercise Window**  | 18:10 – 18:40 London time on Expiration Day.  |
| **Multiplier**  | 100 or 1000 Shares, as per the Exchange’s Product List This may change in specific cases in accordance with the Recalculation Rules.  |
| **Currency**  | GBX, British Pence, p  |
| **Quotation display**  | Option Premium in GBX up to two decimal places  |
| **Tick Size and Tick Value**  |  **Tick Size**  | **Tick Value**  |
|   | 0.25 GBP 0.25 (contract size 100)/ GBP 2.50 (contract size 1000) |
|  |
| **Settlement style**  | Physically settled: Physical Settlement by Delivery of the Underlying stocks on Expiration Day with Daily Cash Settlement throughout the lifetime of the Contract. Cash settled: Cash Settlement on Expiration Day with Daily Cash Settlement throughout the lifetime of the Contract.  |
| **Option style**  | American style Options for Order Book trading. American style and European style Options for Block trading and manual Trade reporting.  |
| **Listing day**  | The Monday following the Expiration Day each month. Where this is not a normal Trading Day, the following Trading Day shall be used.  |
| **Expiration Day**  | Standard, The third Friday in the Expiration Month. Where this is not a normal Trading Day, the preceding Trading Day shall be used, Flexible, on any normal Trading Day out to 5 years  |
| **Contract lifetimes and Expiration Months**  | Out to 12 months: First two serial months and next four quarterly months of the “March, June, September and December” expiry cycle.  |
| **End of Day Price**  | Used for margining purposes, based on the volatility surface, itself dependent on; quotes per series (if available), Underlying spot price, applicable interest rate, dividend amount (if applicable), ex-dividend date (if applicable), the second order interpolation and the arbitrage free surface.  |
| **Exercise Settlement Price**  | The London Stock Exchange Derivatives Market shall take the official closing price of the Underlying on the London Stock Exchange on Expiration Day and round up to the nearest two decimal places to establish the Exercise Settlement Price.  |
| **Exercise Settlement**  | Physically settled: Two Bank Days after Exercise for Physical Delivery against payment of Exercise Settlement Amount. Cash settled: One Bank Day after Expiration Day for payment of Exercise Settlement Amount.  |
| **Premium Settlement**  | One Bank Day after the Trade Day.  |
| **Tailor-made Contracts: Flexible Parameters**  | * Expiration Day (any Trading Day out to Five years)
* Premium (to four decimal places)
* Strike Price (to two decimal places)
* Settlement style (Cash, Physical)
* Option Style: American or European
 |

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1. <http://www.londonstockexchange.com/statistics/monthly-market-report/dec-15.pdf> [↑](#footnote-ref-2)
2. <http://www.bis.org/statistics/d1.pdf>, $USD conversion to € as of 01/22/16 [↑](#footnote-ref-3)
3. [↑](#footnote-ref-4)