

European Securities Markets Authority
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London, January 29th 2016

ESAs Joint Consultation Paper on PRIIPs Key Information Documents

Dear Sirs,

Markit is pleased to submit the following comments to the ESAs in response to its Joint consultation paper on *PRIIPs Key Information Documents* (the “**Consultation Report**”).

Markit¹ is a leading global diversified provider of financial information services.² Founded in 2003, we employ over 4,000 people in 11 countries and our shares are listed on Nasdaq (ticker: MRKT). We are a leading provider of RegTech³ solutions with many of our innovative services designed to allow firms to comply with regulatory requirements across asset classes and throughout the trade workflow. Our RegTech services facilitate and reduce the costs and risks of firms’ compliance with regulatory requirements, thus lowering barriers to entry and fostering competition in the market place.

Markit has been actively and constructively engaged in the debate about regulatory reform in financial markets, including topics such as the implementation of the G20 commitments for OTC derivatives and the design of a regulatory regime for benchmarks. Over the past years, we have submitted more than 140 comment letters to regulatory authorities around the world and have participated in numerous roundtables.

Introduction

Over the years Markit has developed numerous innovative solutions to help firms comply with regulatory requirements in an effective and efficient manner. We have extensive experience in providing analytical RegTech solutions to the market place that helps firms assess market risk and transaction costs. Specifically, in the context of this Consultation Report, the following services are relevant:

- Markit’s Transaction Cost Analysis (**TCA**) tool⁴ is an independent offering that helps financial institutions conduct analysis on their execution costs. Specifically, it provides firms with actionable insight on the quality and costs of execution in various asset classes that they will use to enhance and synchronise their execution quality management, compliance and management reporting capabilities and comply with regulatory best execution requirements.

¹ See www.markit.com for more details.

² We provide products and services that enhance transparency, reduce risk and improve operational efficiency of financial market activities. Our customers include banks, hedge funds, asset managers, central banks, regulators, auditors, fund administrators and insurance companies. By setting common standards and facilitating market participants’ compliance with various regulatory requirements, many of our services help level the playing field between small and large firms and foster a competitive marketplace.

³ RegTech can be defined as services that harness technology in automating regulatory reporting and compliance requirement. See FCA consultation: <https://www.fca.org.uk/news/call-for-input-regtech>

⁴ See <https://www.markit.com/Product/File?CMSID=a1f8dc911f4c4663925353e9c0fb40fc> for more details on Markit TCA for the buy-side.

- Markit provides participants in global financial markets with state of the art analytical services that help them in assessing the market risks they are exposed to. Our market risk service⁵ provides, for example, a VaR calculator and a stress testing framework across a broad range of asset classes.
- Markit offers a variety of pricing and valuation services that are widely used throughout the financial industry. For example, we provide independent pricing and risk metrics for various asset classes and instruments including fixed income cash products, vanilla and exotic derivatives, private equity instruments and structured notes.⁶ We further offer a variety of services that help market participants validate their price and valuation adjustments for OTC derivatives across asset classes.⁷

Comments

We welcome the publication of the Consultation Report and we appreciate the opportunity to provide the ESAs with our comments. Specifically we believe that the ESAs should:

- Clarify a market risk methodology for Category III PRIIPs that have path dependent features;
- Require updates to performance scenarios for path dependent products following changes in market data and
- Persist with the requirements on transaction cost analysis as they are sensible given market realities.

i) Risk Methodology for Category III PRIIPs

The ESAs have set out categories of PRIIPs for the purpose of outlining a market risk assessment methodology.⁸ Specifically, the ESAs state that “the VaR shall be calculated from a simulation of the evolution of the Category III PRIIPs value up to the end of the recommended holding period” and that “the minimum number of simulations is 10,000”.⁹ We understand this to mean that 10,000 asset price simulations are generated at the recommended holding period (RHP) of the product which is then used to evaluate the payoff of the PRIIP in each scenario. Since the payoff of a PRIIP is defined at maturity, the requirements imply that the RHP is equal to the PRIIP’s maturity.

Our experience has shown that many structured products contain path-dependent features¹⁰ and the route that the referenced asset price takes until maturity would hence be required to define the payoff at maturity. However, the risk methodology proposed by ESAs would only consider the asset value at maturity. It is therefore unclear how firms should treat PRIIPs with embedded path-dependent features. We recommend that the ESAs clarify the market risk measurement approach for such path-dependent products.

ii) Performance scenarios

The ESAs have made provisions for the review and ad hoc revision of Summary Risk Indicators (SRI)¹¹. However, the Consultation Paper does not provide any such clarification regarding the update of performance scenarios following changes in market data. We believe this aspect will be particularly relevant for products with path-dependent features¹² where the payoff may change in response to a market event, thereby influencing its value under the performance scenarios.

⁵ See <https://www.markit.com/product/Analytics-Market-Risk> for further details.

⁶ See <http://www.markit.com/product/portfolio-valuations> for more details.

⁷ See <https://www.markit.com/Product/Totem> for more details.

⁸ Pg.34 Annex II Methodology underpinning the presentation of risk

⁹ Pg.38 Details on MRM for Category III PRIIPs

¹⁰ See Section 22.5 of *Paul Wilmott on Quantitative Finance 2nd Edition* for a definition of path dependent products (options):

“Many options have payoffs that depend on the path taken by the underlying asset, and not just the asset’s value at expiration. These options are called path dependent.”

¹¹ Article 5(4) states that “The summary risk indicator shall be reviewed and revised regularly and always revised in case of a material change”

¹² Such as structured products that contain barrier options.

To address this issue we recommend that the ESAs recommend how firms should review the criteria for performance scenarios following a change in market data.

iii) Transaction costs

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?

The ESAs propose a methodology for the computation of transaction costs for outstanding PRIIPS. As part of the proposed approach firms would use the mid-market price as the arrival price while it would also allow for the use of opening price or previous closing price as arrival price.¹³

We believe that using an arrival price / implementation shortfall measure would be appropriate for all asset classes and the methodology being used is the most logical and sensible in this instance. We also believe that the ESAs' proposal provides firms with sufficient flexibility provided to allow transaction costs to be calculated on less liquid instruments and instruments where there is not an abundance of trade / executable data to measure against, for example many OTC derivatives, FX and fixed income products. This methodology even account for lack of quality time-stamped data allowing the measurement to be performed from prices collected from the previous close or the opening price of the trade date.

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)

The ESAs set out requirements for transaction costs in a table "using the standardised percentages" for new PRIIPS.¹⁴ Based on our experience we believe that the figures that are provided by the ESAs in this table is feasible and in line with the current market rates.

We hope that our above comments are helpful to the ESAs. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. In the event you may have any questions, please do not hesitate to contact us.

Yours sincerely,



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¹³ Annex VI, Paragraph 16, 17

¹⁴ Annex VI, Paragraph 25