



European Securities and
Markets Authority

Reply form for the Technical Discussion Paper on PRIIPs



Responding to this paper

EBA, EIOPA and ESMA (the ESAs) welcome comments on this Technical Discussion Paper on Risk, Performance Scenarios and Cost Disclosures in Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs).

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 so as to allow them to be processed more efficiently. Therefore, the ESAs 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 the ESAs should consider

Naming protocol

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

ESA_TDP_PRIIPs_NAMEOFCOMPANY_NAMEOFDOCUMENT.

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

ESA_TDP_PRIIPs_XXXX_REPLYFORM or

ESA_TDP_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 **17 August 2015**.

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input/Consultations’.



Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with the ESAs' rules on public access to documents.¹ We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Board of Appeal of the ESAs and the European Ombudsman.

Data protection

Information on data protection can be found on the different ESAs' websites under the heading 'Legal notice'.

¹ See <https://eiopa.europa.eu/about-eiopa/legal-framework/public-access-to-documents/index.html>.



General information about respondent

Name of the company / organisation	Securities and Markets Stakeholder Group
Activity	Government, Regulatory and Enforcement
Are you representing an association?	<input type="checkbox"/>
Country/Region	Europe

Introduction

Please make your introductory comments below, if any:

< ESMA_COMMENT_PRIIPs_1 >

Preliminary comment on the method of consulting stakeholders on this critical issue

The SMSG is aware of the time constraints imposed on the ESAs, but it believes that the format of this very important consultation is not optimal as:

- it occurs in a short time frame (less than 2 months) an in the middle of Summer when many SMSG expert members are on holidays;
- it is very technical and very long (127 pages).
- It does not contain user-friendly summaries of the key points of the consultation
- It is available only in English.

The short consultation time is all the more a problem as this consultation is of significant importance for retail investors and consumers of financial products and their representative bodies whose resources are limited. The Group strongly urges that the important consumer testing of the document will be carried out in a significantly more user-friendly way, and use a number of different options so that an effective dataset on the consumer experience is gathered]

A good practice – as done by other Public Authorities – would also be to estimate and disclose the level of expertise and the amount of time (which we believe is considerable - even for industry experts) required to fill this questionnaire.

The Securities and Markets Stakeholder Group (SMSG) advises ESMA on all regulatory and supervision matters. PRIIPs are at the core of the retail investment market. They cover a range of investment products that are marketed to retail investors which, taken together, make up a market in Europe worth up to €10 trillion. As PRIIPs cover a wide range of – per definition – structured products which can take a variety of legal forms that might involve multiple charges and which include different risk profiles, The SMSG stresses the strong need for a simple and short pre-contractual information on objective costs and charges as well as historical real returns that enables retail investors to reach well-informed investment decisions by enabling them

- to understand the product features, including its risks, rewards and the effects of costs/charges
- to easily compare it to other products and
- to assess whether a certain product represents ‘value for money’.

In that respect there is a need to benefit from all the experience accumulated on the work done for the KID for investment funds (UCITS IV Directive), and for its subsequent implementation by the industry.

The SMSG therefore very much welcomes the approach taken by the Joint Committee starting the debate and collecting views on the possible methodologies to determine and display risks, performance and costs in the Key Information Document (KID) for PRIIPs.

Standardization, if appropriately used, is not only a strong and efficient tool to ensure comparability but can also be a strong means for ensuring regulatory consistency. Furthermore, applying consistent and transparent approach towards displaying returns, risks and charges will enable consumers and retail investors not only to compare the products but to determine the real added value of products.

The SMSG therefore calls on the ESAs to ensure that the KID becomes an EU-wide harmonized document which contains meaningful and all necessary information on returns, risks and charges, which is understandable by all retail investors.

To achieve this objective, The SMSG supports using tools and techniques that takes into account as much historical data on performance and costs as possible.

The SMSG is concerned that standardized, easily comparable data on historical performance (of both the product and of its benchmark) would be eliminated under the PRIIPs Regulation. There had been a lot of work done for many years to achieve this major improvement in the KID for investment funds (UCITS). With the PRIIPs Regulation as it stands, we are very concerned that even UCITS funds will have to eliminate this key information from their KID within the next 5 years. Certain organizations (including the ESAs) are already struggling to get clear and comparable data on the past performance of retail investment products. This may be a huge step backward if no solution would be found at level 2. Of course, The SMSG acknowledges that past performance is not a reliable predictor of future performance, and also understands that ESMA must work with the Level 1 text. However, without any information on past performance (including compared to benchmarks), EU citizens will not even know:

- if the product has generated any positive performance in the past or - on the contrary - has destroyed the value of their savings
- if the product has met or exceeded its stated investment objective
- if the product has matched or not the performance of its benchmark

Even worse would be the case that EU citizen would be left only with artificial "scenarios" on future performance which we strongly believe are even more misleading than past performance. And we have the experience of the work on the KID of structured UCITS funds where the use of scenarios (like (pessimistic, median and optimistic) that are not probability weighted is possible. Therefore, the average investor is led to believe that the "median" scenario is the most probable which is not the case.

We therefore consider that an **elimination of information on past performance and especially past performance compared to that of the benchmark(s) chosen by the investment product provider would be a huge step back.**

Taking into account that the need for historic performance information has not been explicitly included in the Regulation The SMSG considers that historical performance data should at least complement forward-looking indicators as this is important to put the latter in perspective. In this respect, the SMSG points at the fact that there is nothing in the Regulation that forbids the use of historic performance as one of the scenarios.

In our opinion this should be done by presenting past performance scenarios in a separate graph. With regard to the highly challenging forward-looking performance scenarios required in Level I, The SMSG considers that they should be probability weighted to the maximum extent possible whereby comparability between the methods used by different manufacturers should be ensured by the ESAs through establishing/prescribing a commonly used methodology. This to enable retail investors to trust in "high", "median" and "low" performance scenarios having the same meaning across manufacturers.

This however will be an extremely challenging task if achievable at all.

Therefore, The SMSG wishes to formally warn the European regulators about the extreme danger of forcing EU individual investors to rely only on shaky, hardly comparable future performance scenarios, while depriving them of the only performance information that does not lie and that is least subject to misleading: the standardised and comparable historical performance of the product and of its objective benchmark (currently required for all UCITS funds).

The will maximize the risk to mislead and confuse individual investors and will certainly not improve their already rock-bottom (see the EU consumer scorecard published every year by the EC) trust level in the investments and savings industry.

We believe Level I should be amended to reintroduce the disclosure of past performance of both the investment products and of their chosen objective benchmark.

Future performance scenarios should be kept only for new structured products and based on probabilities.



< ESMA_COMMENT_PRIIPs_1 >

1. Please state your preference on the general approach how a distribution of returns should be established for the risk indicator and performance scenarios' purposes. Include your considerations and caveats.

<ESMA_QUESTION_PRIIPs_1>

As outlined in our general comments, the SMSG wishes to stress again the necessity for the KIID for PRIIPs to disclose the historical performance of the PRIIP and of its chosen benchmark. At least one of the "future performance scenarios" – if any - should clearly include this past performance disclosure.

If the ESAs still want providers to disclose future performance scenarios, regarding the risk-return profile of PRIIPS, proposed methods for estimating future expected returns seems to be sufficient. When considering proposed methods from the consumer perspective, it should be noted, that ability of consumers to "see the future" is limited. Typical retail investor has a selective memory not able to calculate probabilities and tie them to any future events.

However, our brain is trained to associate numbers with the past events. When we ask a retail investor to associate market developments with the year 2008 or 2009, his/her brain will pop-up red numbers, losses, and crisis. Therefore past events can be associated with our imagination of our reactions to such future events.

One suggestion from SMSG members would be to use combined approach, such as:

1. using historical data for backtesting of the product returns (taking the product's charges into full account of course, including entry and exit fees if any). This would give to retail investors a guideline on how the product would behave under the known past events using the same strategy that is applied for future events. It would also address somehow the major weakness of level I of excluding past performance from the required disclosures (see general comment above).

2. stochastic modelling based on parameters estimated from these historical data, where at least two economic cycles for return distribution should be used. A manufacturer will be restricted from picking-up "favourable" conditions for modelling of returns. But, even assuming these necessary requirements can be implemented industry wide, any modelling of performance scenarios will bear a huge risk of misleading individual investors and of not being comparable from one product KIID to another and even from one provider to another for the same product type.

Complication of combined approach might be overcome by using the approach 1 for displaying past performance (as a first "scenario") and approach 2 for modelling future expected performance. Using graphical tools to see the past and expected future performance will increase the consumer understanding of the product from the performance perspective. Another critical advantage of this approach is to provide EU citizens as savers with at least one "scenario" that is not inaccurate or misleading and is (must be - like for UCITS funds) comparable from one product to another. Otherwise, the risk to confuse and mislead people will be high, and so will be the number of disputes.

Another position in the SMSG expresses a clear preference for option a) ("*Distribution of returns directly obtained from historical data*") for the estimation of the distribution of future returns. At the time of the development of the UCITS KIID, independent academic research showed that past volatility was as good a guide to future performance as any other more complicated (and costly) methodology, especially as the resulting figure is to be compressed into a seven or five figure scale. Furthermore, this approach is simple and could be applied also to PRIIPs that are not investment funds.

Use of distribution of return data would also align with the principles already applicable for the UCITS KIID. Where historical data is not available for the PRIIP, the use of proxy or benchmark data (minus product charges), along the lines of the existing UCITS SRRM methodology, is the most suitable alternative. However, the underlying principles for these simulations will have to be prescribed by supervisory authorities in terms of modelling and choice of parameters, in order to ensure comparability and to guard against cherry-picking by individual product providers.

<ESMA_QUESTION_PRIIPs_1>

2. How should the regulatory technical standards define a model and the method of choosing the model parameters for the purposes of calculating a risk measure and determining performance under a variety of scenarios?

<ESMA_QUESTION_PRIIPs_2>

A prerequisite for the disclosure of risk measures and of future performance scenarios is the consistency with existing investor protection rules, and, in particular those of MiFID I and II. MiFID requires that any information provided to investors must be “fair, clear and not misleading”. In particular, “clear” means by law among other things that it is intelligible by the target audience. We very much doubt that whatever the parameters used, future performance scenarios would ever meet this legal requirement, especially as the KIID must be kept short and comparable. Any standards for risk measure and any future performance scenarios that will not meet this intelligibility requirement will therefore face the risk of being unlawful.

When considering the method of choosing model parameters, wider confidence intervals should be considered. In other words, if the product is really risky and can perform really poorly, than displaying a wider confidence interval (e.g. 5th percentile or even a 1st percentile) is really necessary for retail investor to see the riskiness of the product he/she intends to buy.

When considering parameters that determine the variability to be estimated based on current expectations derived from current market prices (derivatives), one has to think on the usage of a model that uses the derivative contracts (forward looking financial instruments) in this way:

"If a manufacturer or regulator uses the expected returns from forward looking contracts, than the forward looking contracts will be influenced by underlying assets bought under the assumption that the returns are influenced by forward looking contracts built on these underlying assets. This in turn can create a typical self-fulfilling paradigm and a way how to manipulate the market because derivative products are often bought by financial institutions and not by the retail investors via retail products. However, forward looking contracts are often used to "steal" the profit from the future (locking the profit) on expense of holders of underlying assets.

We believe is it crucial to rely on an approach based on historical data instead of prospective models that will generate diverse questions and doubts in addition to the difficulty of understanding them, not only at the level of the individual investor, but also at the level of the retail financial advisers and distributors.

<ESMA_QUESTION_PRIIPs_2>

3. Please state your view on what benchmark should be used and why. Are there specific products or underlying investments for which a specific growth rate would be more or less applicable?

<ESMA_QUESTION_PRIIPs_3>

It seems that this question mixes three concerns: (i) taking into account that historic performance is not used, how will we give the investor a reference with which he can compare the performance of his investment; (ii) how will we give the investor an idea of the time-value of money; (iii) if we give the investor a reference against which to compare his possible return, should that reference also include the risk premium the investor can expect.

In answering this question, we refer to our proposal above (see question 1) to include the historic performance as one of the scenarios, alongside forward-looking scenario based on stochastic modelling of historic returns.

In case of historic performance, the benchmark should be an objective benchmark, so that the investor can compare the performance of the fund with the one of the benchmark to see whether or not there has been excess performance in case of active management or how close the fund has followed the benchmark in case of passive management.

For this historic performance scenario, it is necessary and important to avoid subjective or “peer” benchmarks. Only “objective” benchmarks should be allowed: either macro economic or macro financial indicators that are manufactured by independent parties; in particular capital markets indices for which individual investors can access historical performance. “Peer performance” type of benchmarks must be avoided, as it is not because a given product outperformed 75% of its “peers” that it is actually performing well: its whole “peer” category may well be under water, and/ or under- performing the relevant capital market performance. We made the same remark for the UCITS KIID (UCITS IV Directive)

The questions asked by ESMA are more relevant for the forward-looking scenarios. Here we believe that there should be at least by default an inflation based benchmark used. Inflation is a key parameter every retail investor faces. Retail investor is not concerned by the “risk-free” rate (if any such thing actually exists), rather inflation as he/she has to protect the value of money and thus the wealth and living standard. History shows how much ordinary savers are subject to the “monetary illusion” and how much inflation can wipe out long term and pension savings over the mid and long term. The benchmark could for example be a line showing “this is what the value of your investment should be at x% inflation to maintain at least the purchasing power of your money”. Of course, no one knows the rate of inflation beforehand and history has shown time and time again how difficult long-term forecasts are. For this reason, it could be envisaged to include two or three inflation scenario’s. (“this is what the value of your investment should be at 1% inflation to maintain at least the purchasing power of your money”; “this is what the value of your investment should be at 2% inflation to maintain at least the purchasing power of your money”; “this is what the value of your investment should be at 5% inflation to maintain at least the purchasing power of your money”)

This approach underlines the advantage of our proposal to combine historic performance, as one of the scenarios, with forward-looking scenarios. The use of an objective benchmark in the historic performance scenario would inform the investor of the performance of his investment compared to an objective benchmark while the use of inflation-based benchmarks in the forward-looking scenario’s would inform him of the minimal value needed to maintain purchasing power. At the same time, the concept used are fairly easy to understand.

<ESMA_QUESTION_PRIIPs_3>

4. What would be the most reasonable approach to specify the growth rates? Would any of these approaches not work for a specific type of product or underlying investment?

<ESMA_QUESTION_PRIIPs_4>

Retail investors often make decisions influenced by time varying (time dependent) circumstances and events.

The 2nd option appears to be the most appropriate provided that the “asset specific risk premiums” are determined by the regulator and are not left to the discretion of the PRIIP manufacturer.

The risk premiums should be estimated from historical data using the appropriate holding time of the product not less (see our general comment and reply to question 5 on this issue).

<ESMA_QUESTION_PRIIPs_4>

5. Please state your view on what time frame or frames should the Risk Indicator and Performance Scenarios be based

<ESMA_QUESTION_PRIIPs_5>

In our answer, we distinguish between Performance Scenarios and Risk Indicator.

The SMSG considers that there should be coherence between time frames chosen for disclosure of (past) performance and the recommended holding period/maturity of the product. Next to that, standardized time frames (e.g. 1, 3, 5,10 years and more for long term and pension products) should be used for performance scenarios given the fact, that the KID is not a personalized but a pre-contractual document. The SMSG considers that the inclusion of short time frames are necessary also in cases where the product has a longer recommended holding period as this may help investors understanding the impact of short term holding against long term holding. The SMSG believes that this is also useful to illustrate the relevance of holding period on risk (for example: in plain equity funds, fluctuations may be partly flattened out over the long term).

Time frame for risk indicators as well as performance scenarios should be tied to the recommended holding period as well as half-time of decay, e.g. if the holding period is 5 years, than there should be at least 2,5 year time frame. Additionally, it should be noted that a typical retail investor is able to accommodate in his brain a simple time frames (1 day, 1 month, 1 year), therefore 1 year should be also one of the time frames used for presenting Risk and Return Scenarios (except if forbidden for the product). Understanding the development of the risk in shorter time periods could increase the level of understanding the riskiness of the product.

If the indicator of risk is VaR (Value-at-Risk) or even better CVaR (Conditional VaR or ES - expected shortfall), than a retail investor wants to see the maximum drawdown that happened in a past accompanied with the average or mean value of the indicator).

The rationale behind this is to know when a retail investor puts his/hers savings on stake he/she wants to see, what might happen if it gets really “bad”. Market risk is the most important unit of risk factors. Using volatility as a measure aiming at quantifying the variation of value of an asset for calculating VaR and Expected Shortfall is a good approach. However, simpler method for estimating maximum draw-down that could have emerged in a past can help investors to better understand the risk.

In summary, the SMSG favors options a and c over option b.

<ESMA_QUESTION_PRIIPs_5>

6. Do you have any views on these considerations on the assessment of credit risk, and in particular regarding the use of credit ratings?

<ESMA_QUESTION_PRIIPs_6>

Credit risk – if material - must be taken into account in the overall risk assessment of the product. Whenever a credit rating is available, it should be used, but that is seldom the case for retail packaged products. We would suggest not to look at the rating of the PRIIPS as a whole, but rather to the ratings of the underlying assets.

<ESMA_QUESTION_PRIIPs_6>

7. Do you agree that liquidity issues should be reflected in the risk section, in addition to clarifications provided in other section of the KID?

<ESMA_QUESTION_PRIIPs_7>

Yes, we agree. But there should be a clear distinction between the liquidity profile of the PRIIP and the liquidity risk of the PRIIP. The liquidity profile should be in another section of the KIID than the Risks section (this is particularly relevant for structured funds).

A clear distinction should however be made between the liquidity of the underlying assets (i.e. the time necessary for a PRIIP to dispose of underlying assets at market conditions) and the liquidity profile of a PRIIP (i.e. the time it would take for an investor to get its money back in case of (early) redemption. The

liquidity profile of a PRIIP should be displayed separately and explained in a simple way to determine the potential loss of selling/returning/terminating the product before the recommended holding period.

However, there can be a liquidity risk even if one holds the product for the recommended holding period. In that case liquidity risk should be taken into account in the overall risk assessment but not in a separate section, as this could be complicating the KIID and likely to confuse the reader.

<ESMA_QUESTION_PRIIPs_7>

8. Do you consider that qualitative measures such as the ones proposed are appropriate or that they need to be supplemented with some quantitative measure to some extent?

<ESMA_QUESTION_PRIIPs_8>

The SMSG thinks that cost and exit penalties for early redemptions should be considered as a component of the liquidity profile of a PRIIP and hence, be used to define a product as liquid or not for the KID purpose.

It is quite obvious that the consequences of cost and exit penalties should be quite clear. It would be preferable not to include the penalties for early redemptions under the risk section because it is not a risk, it is a certainty (if you redeem earlier you will have to pay). Hence, it would be more appropriate to include it in the section “how long should I hold it and can I take out my money early?”

The SMSG does not agree that liquidity could be assumed if the product is traded on an MTF. MTFs are less protective and usually less transparent and less accessible for individual investors than regulated markets. For instance, it is usually impossible for an individual investor to access MTFs’ post and pre trade data for free whereas it is the case for regulated markets’ trade data (not in real time).

<ESMA_QUESTION_PRIIPs_8>

9. Please state your views on the most appropriate criteria and risk levels’ definition in case this approach was selected.

<ESMA_QUESTION_PRIIPs_9>

If this approach is selected than Option 2 seems to be more realistic and in terms of using historical data and rolling (compound) volatility as a risk indicator. If the historical data are missing, history is substituted by market indices (minus product charges), peer indices and similar products. As such, it can show the real risk of the product using rolling monthly volatility using 20 years of historical monthly data.

If a quantitative indicator was selected , it should include only the market risk, and the other key risks (credit risk and liquidity risk) should be disclosed in a narrative / qualitative form. Otherwise, individual investors may get confused by the disclosure of several quantified risk indicators.

The SMSG would rather stick to 7 levels of risks instead of 6 as fund investors have already experimented the 7 risk grades scale for UCITS funds, and UCITS funds are in the scope of this PRIIPS KIID: why changing again just a few years after the implementation of the UCITS KIID, and create confusion and additional costs ? As for all issues in the KIID, if one wants to succeed, one must apply the “KISS” principle. Any complexification or change from past disclosures should be highly justified.

<ESMA_QUESTION_PRIIPs_9>

10. Please state your views on the required parameters and possible amendments to this indicator.



<ESMA_QUESTION_PRIIPs_10>

This approach (one quantified market risk indicator similar to the UCITS KIID one plus one qualitative credit risk indicator) has the big advantage of being more understandable and in line with the existing one for UCITS funds, and it still discloses only one quantified risk indicator, which should be less confusing for the average investor (and retail distributor as well). But it should then correct a major weakness of the UCITS risk indicator: using 5 year realised volatilities of the various assets underlying PRIIPs does not make sense if the recommended holding period is different from five years. Typically, for long term retail investment products, risk assessment must be based on much longer term historical volatilities.

<ESMA_QUESTION_PRIIPs_10>

11. Please state your views on the appropriate details to regulate this approach, should it be selected.

<ESMA_QUESTION_PRIIPs_11>

The approach using forward looking simulation models should be avoided as it is likely to vary significantly from manufacturer to manufacturer, to increase complexity and to decrease comparability. It has several drawbacks:

- "forward" looking approach may be a bit misleading as it is based on models using historical data.
- The one used in Germany for structured products uses a very short holding period and only 2 years realized volatilities which are inappropriate for long term investment products.
- The standardisation and comparability issue is very challenging.

<ESMA_QUESTION_PRIIPs_11>

12. Please state your views on the general principles of this approach, should it be selected. How would you like to see the risk measure and parameters, why?

<ESMA_QUESTION_PRIIPs_12>

Using the end of maturity as the default holding period assumes the investment product has indeed a defined maturity, which is not the case for many products: equity funds, most life insurance contracts, etc.

<ESMA_QUESTION_PRIIPs_12>

13. Please state your views on the potential use of a two-level indicator. What kind of differentiators should be set both for the first level and the second level of such an indicator?

<ESMA_QUESTION_PRIIPs_13>

Option 4 leaves too much space for undesirable "financial innovation" and very structured products (complex products with unclear portfolio structure, features and behaviour over time). Plus it is too complex for a retail short KID.

<ESMA_QUESTION_PRIIPs_13>

14. Do you have suggestions or concrete proposals on which risk scale to use and where or how the cut-off points should be determined?

<ESMA_QUESTION_PRIIPs_14>

We refer to our reply to Question 9.

<ESMA_QUESTION_PRIIPs_14>

15. Please express your views on the assessment described above and the relative relevance of the different criteria that may be considered.

<ESMA_QUESTION_PRIIPs_15>

The discussion paper on page 44 claims that:

“...research shows that individuals have difficulties in perceiving the relationship between risk and return and apparently understand returns better than risks. Framing effects and emotional factors may affect both return and risk perception. Therefore, when representing the performances of financial products special attention needs to be paid to the way financial information is represented, to avoid misinterpretations.”

The regulators must realise that for retail investment products, high risk does not unfortunately mean high return in too many cases. Many times for retail products there is a reversed relationship and the widespread selling of « high risk low return » products such as insurance unit linked contracts with equity units and very high consolidated fees. For example in the € 250 billion French Insurance unit-linked market, unit-linked contracts returned minus 11 % after inflation over the last 15 years, despite positive capital markets real returns over the same period. The main reason is their average annual asset-based fees of 2,75% (not taking entry fees into account; source: Better Finance).

We refer to our general comment that performance scenarios will most likely be much more misleading than past performance of the product and of its objective benchmark.

Comment on 2.4.2.1 “What- if: manufacturers choice approach”:

This approach leaves too much space for discretion which would create an uneven level-playing field. Similar products from two competing manufacturers might end up with significantly different “what-if” scenarios. Comparability is a key requisite of the KIID and must not be jeopardised. Specificity for structured funds and the like.

Comment on 2.4.2.1 “What- if: prescribed approach”:

This approach could be a better one, however it would increase the pressure (and costs) on regulator. Nevertheless, some guidelines could be formulated, saying for example that “what-if” scenarios should contain well-know historic periods, which relevant for that particular product and include both upper and lower scenarios. For example: what-if the financial crisis repeats itself.

Comment on 2.4.2.2 “Probabilistic approach”:

This approach could be more realistic, but hard to understand to a typical retail investor. Implementation would require very sensitive way of explaining the results and “numbers” to retail investors.

Note: in formulating this advice, the SMSG did not elaborate on what could be an approach for structured funds, taking into specific needs (for example the need to be also able to explain how a fund functions)

<ESMA_QUESTION_PRIIPs_15>

16. Do you think that these principles are sufficient to avoid the risks of manufacturers presenting a non-realistic performance picture of the product? Do you think that they should be reinforced?

<ESMA_QUESTION_PRIIPs_16>

The UCITS guidelines on performance scenarios for structured funds do not require a probability weighting of the various scenarios. An indication of probability would have a double advantage:

- Individual investors tend to believe the “medium” scenario is the most probable, which is often not the case;
- In case of structured funds where investors buy some kind of protection, it is important that they are able to assess whether they are buying protection against something likely to happen or against an unlikely scenario.

<ESMA_QUESTION_PRIIPs_16>

17. Do you think the options presented would represent appropriate performance scenarios? What other standardized scenarios may be fixed?

<ESMA_QUESTION_PRIIPs_17>

Comment on “historical scenario”:

Even if this scenario is not perfect, it uses longer historical returns that can be attached to past events investors have experienced. It also has the unparalleled advantage of reintroducing a disclosure on past performance: The SMSG therefore strongly supports this approach if level one cannot be amended (as it should to avoid a major investor protection failure) and if the historical performance of the chosen objective benchmark is disclosed together as it is currently the case for UCITS funds.

Comment on “predefined growth rate/performance of underlying investment(s)”:

Using this approach is too unrealistic. It leaves many questions unanswered, for example: How the predefined variables will be set? By whom? Will they adapt to reality? The result might end up with too many questions creating different outcomes in reality caused by different answers from national regulators.

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<ESMA_QUESTION_PRIIPs_17>

18. Which percentiles do you think should be set?

<ESMA_QUESTION_PRIIPs_18>

The 5th and 90th percentiles for outliers. Additional percentile should be the mean (50th percentile). Having lower left-side percentile will present pessimistic view and thus a higher risk (lower returns). Setting the right-side percentile to 90th would at the same time allow for more pessimistic view of the expected reality.

<ESMA_QUESTION_PRIIPs_18>

19. Do you have any views on possible combinations?

<ESMA_QUESTION_PRIIPs_19>

Combined approach presented in point b) seems to be an interesting approach for further consideration, however it is a bit too complex for the average retail investor to understand. It would require a sensitive way of explaining to retail investors. At the same time, having 4 cases that are not probability weighted could be potentially very misleading.

Given the experience of investors wanting to see how a product has actually performed, The SMSG is in favor of offering a scenario that also showcases a historical scenario, as suggested under Option A.

<ESMA_QUESTION_PRIIPs_19>

20. Do you think that credit events should be considered in the performance scenarios?



<ESMA_QUESTION_PRIIPs_20>

This is again showing how challenging it is to build comparable future performance scenarios for the KIID. This being said, if Public Authorities and Regulators still want to pursue this ill-fated route, then yes : for investment products that are sensitive to credit risk (high yield bond fund for example) then it should be taken into account. But this one and simple example shows how unrealistic it would be to decide that *“the negative scenario would be the issuer default”*: the issuer of the packaged product itself (in the fund example, it is irrelevant) or of the underlying assets’ issuers ? In that case should the negative scenario assume 100 % default, which is quite unlikely for diversified funds ? Again, any scenario , “negative” or “positive” must be probability weighted, if not it will be misleading individual investors.

<ESMA_QUESTION_PRIIPs_20>

21. Do you think that such redemption events should be considered in the performance scenarios?

<ESMA_QUESTION_PRIIPs_21>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_PRIIPs_21>

22. Do you think that performance in the case of exit before the recommended holding period should be shown? Do you think that fair value should be the figure shown in the case of structured products, other bonds or AIFs? Do you see any other methodological issues in computing performance in several holding periods?

<ESMA_QUESTION_PRIIPs_22>

The MSGS thinks that adopting this approach would be a resignation on creating a realistic KIID on PRIIPS.

<ESMA_QUESTION_PRIIPs_22>

23. Are the two types of entry costs listed here clear enough? Should the list be further detailed or completed (notably in the case of acquisition costs)? Should some of these costs included in the on-going charges?

<ESMA_QUESTION_PRIIPs_23>

“Acquisition costs” is not clear enough. For example, for an ETF fund acquired on the secondary market (which is the case for individual investors), does it include the brokerage fee, and also the bid/offer spread ?

One should also be able to see to whom these costs are distributed, e.g. who benefits from the existence of these costs.

<ESMA_QUESTION_PRIIPs_23>

24. How should the list be completed? Do you think this list should explicitly mention carried interest in the case of private equity funds?

<ESMA_QUESTION_PRIIPs_24>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_PRIIPs_24>

25. Should these fees be further specified?

<ESMA_QUESTION_PRIIPs_25>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_25>

26. Should these fees be further specified? The “recovering fees” cover the following situation: when an investor receives income from foreign investments, the third-country government may heavily tax it. Investors may be entitled to reclaim the difference but they will still lose money in the recovering process (fee to be paid).

<ESMA_QUESTION_PRIIPs_26>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_26>

27. Should these fees be further specified? The “recovering fees” cover the following situation: when an investor receives income from foreign investments, the third-country government may heavily tax it. Investors may be entitled to reclaim the difference but they will still lose money in the recovering process (fee to be paid).

<ESMA_QUESTION_PRIIPs_27>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_27>

28. This list is taken from the CESR guidelines on cost disclosure for UCITS. What is missing in the case of retail AIFs (real estate funds, private equity funds)?

<ESMA_QUESTION_PRIIPs_28>

It is worth mentioning here that a lot of retail AIFs are general purpose funds like UCITS. The only difference is that they are not passportable and designed only for the local market. For example in France, there are 3500 registered UCITS but 8000 registered AIFs mostly retail AIF funds. Except for special purpose AIFs (as mentioned in the question: real estate, private equity, venture capital, etc.), the CESR guidelines do fully apply to retail AIFs.

<ESMA_QUESTION_PRIIPs_28>

29. Which are the specific issues in relation to this type of costs?

<ESMA_QUESTION_PRIIPs_29>

It should be clear that performance-related fee has a high-water mark (HWM) or water mark (WM) related feature. Otherwise, this could be a misleading information and have huge detrimental effect on any investment if the fee is tied to a yearly performance without any HWM or to a performance of different “benchmark”. Typically there are lot of products (absolute performance funds for example) that have a low WM, typically Libor or even zero performance.

The SMSG believes the impact of performance fees should be reflected in the cost indicator, as this impact can be very important. However, some members wish to point out that the application and amount of such fees is dependent on the future return of the fund. Therefore, they believe ex-ante disclosure of the amount of performance fees is most likely to be misleading. They thus believe that such incidental costs should be excluded from the ongoing charges figure and rather be disclosed separately, due to their incidental nature.

<ESMA_QUESTION_PRIIPs_29>

30. Is it relevant to include this type of costs in the costs to be disclosed in the on-going charges? Which are the specific issues in relation to this type of costs? Which definition of Costs for capital guarantee or capital protection would you suggest? (Contribution for deposit insurance or cost of external guarantor?)

<ESMA_QUESTION_PRIIPs_30>

It is relevant if this is not an option, i.e. if it is embedded in the product and the investor has no choice but to take it. Otherwise it should be priced separately.

<ESMA_QUESTION_PRIIPs_30>

31. Which are the specific issues in relation to this type of costs? Should the scope of these costs be narrowed to administrative costs in connection with investments in derivative instruments? In that respect, it could be argued that margin calls itself should not be considered as costs. The possible rationale behind this reasoning would be that margin calls may result in missed revenues, since no return is realized on the cash amount that is deposited, and that:

<ESMA_QUESTION_PRIIPs_31>

<ESMA_QUESTION_PRIIPs_31>

32. Which are the specific issues in relation to this type of costs? Should this type of costs be further detailed/ defined?

<ESMA_QUESTION_PRIIPs_32>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_PRIIPs_32>

33. How to deal with the uncertainty if, how and when the dividend will be paid out to the investors? Do you agree that dividends can be measured ex-post and estimated ex-ante and that estimation of future dividends for main indices are normally available?

<ESMA_QUESTION_PRIIPs_33>

Analysts do publish estimates of future dividends for individual stocks. But, as The SMSG already pointed out in its replies to consultations on benchmarks, experience demonstrates that it is extremely difficult for individual investors to find an estimation of future dividends for main indices. Even to find the annual past performance of such indices has proven to be a major challenge for many heavily used indices (try for example to find the past annual performance of bond indices without paying high fees to providers, which of course an individual cannot – and should not - pay).

<ESMA_QUESTION_PRIIPs_33>

34. Is this description comprehensive?



<ESMA_QUESTION_PRIIPs_34>

There are also depositaries' commissions on transactions (not only broker ones). They are widespread for example in France, where – in addition – they are then typically shared between the depositary and the asset manager.

<ESMA_QUESTION_PRIIPs_34>

35. Can you identify any difficulties with calculating and presenting explicit broker commissions? How can explicit broker commissions best be calculated ex-ante?

<ESMA_QUESTION_PRIIPs_35>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_PRIIPs_35>

36. How can the total of costs related to transaction taxes best be calculated? How should this be done to give the best estimate ex-ante? Are there other explicit costs relating to transactions that should be identified? Do you think that ticket fees (booking fees paid to custody banks that are billed separately from the annual custodian fee paid for depositing the securities) should be added to this list?

<ESMA_QUESTION_PRIIPs_36>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_PRIIPs_36>

37. As regards the abovementioned estimate, can the fair value approach be used?²

<ESMA_QUESTION_PRIIPs_37>

The SMSG could not respond to the previous DP of last Autumn,. Although we would like the cos/charges indicator to encompass all costs including transaction costs and, in particular bid-offer spread costs impact, we believe that it is a very challenging goal to aim at capturing 100 % of variable costs. As rightly mentioned in the DP, bond markets are less transparent than equity ones and do not disclose dealing cost per se. It is even worse for the totally unregulated forex markets. One should try to estimate these transaction costs for the purpose of the KIID if the result is reliable - i.e; coming from or supervised by independent bodies - meaningful and intelligible by the average investor (a MiFID II requirement, see our reply to question 2).

We are quite concerned to read several times in the DP from the ESAs that “*the dealers should know the typical spread in the securities with which they deal*”. We believe it is dangerous to leave it to the dealers to decide and assess what a “typical” spread is.

The best is the (i) option by far: “*The entire market switches to gross pricing, making the broker commissions explicit and possible to identify and report* » but is it realistic ? Otherwise, the cost of supervision may be quite high.

<ESMA_QUESTION_PRIIPs_37>

38. Can you identify any other difficulties with calculating and presenting the bid-ask spread? Do you believe broker commissions included in the spread should be dis-

² One could also argue that all fund managers either have their own dealing desk or sub-contract this to other dealing desks. Since the principle of Best Execution is paramount, the dealers should know the typical spread in the securities with which they deal.

closed? If so, which of the above mentioned approaches do you think would be more suitable for ex-ante calculations or are there alternative methods not explored above?

<ESMA_QUESTION_PRIIPs_38>

The predefined average spread table used by Dutch pension funds (page 62) is interesting, but again is it realistic? For example, the high yield bond “markets” are described by the practitioners themselves as: *“There’s no real exchange trading, it’s all phone calls and Bloomberg messaging”* (quoted by Funds Europe, June 2015 edition, page 54). Also, the table does not mention convertible bonds where spreads can be much higher than 1% on average (i.e; the cost impact is much higher than 0,5%).

<ESMA_QUESTION_PRIIPs_38>

39. Do you believe that market impact costs should be part of the costs presented under the PRIIPs regulation? If so, how can the market impact costs best be calculated? How should this be done to give the best estimate ex-ante?

<ESMA_QUESTION_PRIIPs_39>

To start with, the vast majority of individual investors do not even know what “market impact costs” could be. Second, the DP does not mention the dark pools, OTC trading and exemptions to transparency rules that were included in MiFID I at the request of large participants precisely to avoid market impact. This dark pool and OTC trading issue must be taken into account. We believe we are on too shaky grounds in terms of robustness of estimates to include market impact in the cost indicator. However, the turnover rate should always be disclosed in the KIID and computed properly (all purchases plus all sales of all portfolio assets in the numerator).

<ESMA_QUESTION_PRIIPs_39>

40. How should entry- and exit charges be calculated considering the different ways of charging these charges? How should this be done to give the best estimate ex-ante? Can you identify any other problems related to calculating and presenting entry- and exit fees?

<ESMA_QUESTION_PRIIPs_40>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_PRIIPs_40>

41. Which other technical specifications would you suggest adding to the abovementioned methodology? Which other technical issues do you identify as regards the implementation of the methodology?

<ESMA_QUESTION_PRIIPs_41>

Any KID should have a clear indication of average annual portfolio turnover ratio. Such indicator could show, how actively the portfolio is managed and what can be expected from the portfolio manager when different market situations occur. Not only is this indicator valid for costs calculations but also for understanding a PRIIP as a structured product. Furthermore it should take both purchases AND sales into account.

Regarding the actual calculation methodology, we generally agree with the approach to estimate transaction costs by multiplying a portfolio turnover rate by average transaction costs. The detailed definition and

computation of “portfolio turnover rate” and “average transaction costs” is too technical to be included in the level 2 RTS and should be further discussed and elaborated in the necessary level 3 guidelines.

<ESMA_QUESTION_PRIIPs_41>

42. Do you think that an explicit definition of performance fees should be included? Do you think the definition by IOSCO is relevant in the specific context of the cost disclosure of the PRIIPs Regulation?

<ESMA_QUESTION_PRIIPs_42>

We agree that that an explicit definition of performance fees should be included.

<ESMA_QUESTION_PRIIPs_42>

43. What would be the appropriate assumption for the rate of returns, in general and in the specific case of the calculation of performance fees?

<ESMA_QUESTION_PRIIPs_43>

We agree that any use of performance assumptions to estimate the ex ante performance fee must be consistent with the performance scenarios, especially with the historical returns one if it is long enough to be meaningful. So option 1 and 2 seems preferable.

<ESMA_QUESTION_PRIIPs_43>

44. Which option do you favor? Do you identify another possible approach to the disclosure and calculation of performance fees in the context of the KID?

<ESMA_QUESTION_PRIIPs_44>

Options 1 and 2 - performance fees shown in performance scenarios AND in the cost indicator should be considered as a preferred option. However some SMSG members believe performance fees should be disclosed separately: we refer to our reply to question 29.

<ESMA_QUESTION_PRIIPs_44>

45. Which of the above mentioned options 1 and 2 for the calculation of aggregate costs would you prefer? Do you agree with above mentioned assumptions on the specificities of the costs of life-insurance products? How should the breakdown of costs showing costs specific to the insurance cover be specified? Do you think that risk-type riders (e.g. term or disability or accident insurances) have to be disregarded in the calculation of the aggregated cost indicator? How shall risk-type rider be defined in this context? (one possible approach might be: A risk-type rider in this context is an additional insurance cover without a savings element, which has separate contractual terms and separate premiums and that the customer is not obliged to buy as a compulsory part of the product).

<ESMA_QUESTION_PRIIPs_45>

We believe that one should water down the following assertion from the DP that “*For insurance PRIIPs, one of the key features is that the computation of the amount of the insurance premium is based upon*

numerous factors such as biometric risks". It is sometimes a feature, but not often a key one. For example the € 1500 billion life insurance market in France (number one retail investment product there) is not impacted – or very marginally – by the biometric risk, especially in terms of fees and charges. That is because, a typical French insurance contract does not basically provide any protection against death or against long life (except for annuities, but these are very little used in favor of capital redemptions).

Therefore, as long as biometric risks are offered and only as non mandatory options, they should be priced separately.

<ESMA_QUESTION_PRIIPs_45>

46. Do you think this list is comprehensive? Should these different types of costs be further defined?

<ESMA_QUESTION_PRIIPs_46>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_46>

47. Do you agree that guaranteed interest rate and surrender options should be handled in the above mentioned way? Do you know other contractual options, which have to be considered? If yes how?

<ESMA_QUESTION_PRIIPs_47>

We believe the guaranteed interest rate has nothing to do with the cost indicator: it is a key feature of the insurance product in that case. The essential question is what kind of a guarantee is it and who is guaranteeing, as we experienced many cases where providers renege on their interest rate "guarantee" after some time.

We agree on the way to handle surrender life options.

<ESMA_QUESTION_PRIIPs_47>

48. Should the methodology for the calculation of these costs be further specified?

<ESMA_QUESTION_PRIIPs_48>
<ESMA_QUESTION_PRIIPs_48>

49. Do you think this list and breakdown is comprehensive?

<ESMA_QUESTION_PRIIPs_49>

The MSG congratulates the ESAs for having identified "profit sharing" as a key fee/charge item in life insurance products, and one that is largely undisclosed to investors to this day. For example in the French € 1250 billion with profit policy market ("fonds en euros"), insurers will typically retain 15% of the performance of the underlying portfolio without quantifying and disclosing this in the fees / charges. This is quite inconsistent with the cost disclosure rules for funds.

Another big ongoing cost that is not currently disclosed in the overall cost indicator is the ongoing asset-based fees on the underlying portfolio of assets such as funds (in with profit policies) and "units" in unit-linked contracts. Whereas funds of funds must currently disclose the sum of the commissions charged at the fund of funds (wrapper) level but also at the underlying funds level, unit-linked insurance contracts typically only disclose the contract's commission, not adding the commissions paid on the underlying units. So, we recommend to make crystal clear that the cost indicator MUST include the commissions charged at the underlying levels, especially the commissions charged at the "units" level.



<ESMA_QUESTION_PRIIPs_49>

**50. Should the methodology for the calculation of these costs be further specified?
How?**

<ESMA_QUESTION_PRIIPs_50>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_50>

**51. Should the methodology for the calculation of these costs be further specified?
How?**

<ESMA_QUESTION_PRIIPs_51>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_51>

52. Should the methodology for the calculation of these costs be further specified?

<ESMA_QUESTION_PRIIPs_52>

Like for all entry and exit fees, their impact should be disclosed in numbered examples over specified holding periods, like it is being done in the US for mutual funds: it has two advantages:

- first, it is more intelligible for the average investor than percentages;
- second, it is an effective way to combine the impact of ongoing charges and of entry/exit fees on the performance of the product for the investor.
-

-<ESMA_QUESTION_PRIIPs_52>

**53. Should the methodology for the calculation of these costs be further specified?
How? Do fund related costs also exist for with profit life insurance products?**

<ESMA_QUESTION_PRIIPs_53>

As mentioned in our reply to question 49 it is necessary that fund related costs are added to the contract related costs in the overall cost indicator. Typically in a unit-linked contract, the fund related costs constitute the immersed part of the cost iceberg: i.e; bigger than the contract costs per se but up to now undisclosed in the overall cost indicator.

And yes, fund related costs do exist in with profit life insurance policies as their insurer provider often invests into funds for these policies. The SMSG can provide examples if needed. THE ESAs should take time to precisely define “with profit policies” as this is a very UK centric term that is not used or even understood even by insurance practitioners in pother Member States, with the risk of misunderstandings on the nature of life insurance contracts in the EU.

<ESMA_QUESTION_PRIIPs_53>

54. How to ensure that the look-through approach is consistent with what is applied in the case of funds of funds?

<ESMA_QUESTION_PRIIPs_54>

By applying the same disclosure rules to unit-linked contracts as to funds of funds. For information FAID-ER, a French member organisation of The SMSG obtained this disclosure rule in France in 2005, but the



government abrogated it after one year. But it had been in force for one year and policy holders could access the real total cost of their unit-linked contracts at that time.

If a unit-linked contract offers too many “units “(typically funds), then it should disclose the minimum and the maximum charge, with a link to the specific total cost according to the unit(s) chosen.

<ESMA_QUESTION_PRIIPs_54>

55. Should the methodology for the calculation of these costs be further specified?

<ESMA_QUESTION_PRIIPs_55>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_PRIIPs_55>

56. Which above mentioned or further options do you support, and why? More generally, how to measure costs that are passed to policy holders via profit participation mechanisms? Would you say that they are known to the insurance company? Do you think an estimate based on the previous historical data is the most appropriate methodology for the calculation of these costs?

<ESMA_QUESTION_PRIIPs_56>

We fully agree that the part of the profit that is not distributed to policy holders is a cost for them. As mentioned above , typically French insurers keep up to 15% of the investment returns for them. We agree an estimate based on the previous historical data is appropriate for the ex ante cost, but insurance companies are of course fully knowledgeable about this cost and should disclose the real amount in the ex post cost indicator.

TYPE YOUR TEXT HERE

<ESMA_QUESTION_PRIIPs_56>

57. Is this type of costs really specific to with-profit life-insurance products? Do you agree that these costs should be accounted for as on-going costs?

<ESMA_QUESTION_PRIIPs_57>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_PRIIPs_57>

58. Do you think the list of costs of life-insurance products presented above is comprehensive? Which types of costs should be added?

<ESMA_QUESTION_PRIIPs_58>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_PRIIPs_58>

59. To what extent are those two approaches similar and should lead to the same results?

<ESMA_QUESTION_PRIIPs_59>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_PRIIPs_59>

60. In comparison to structured products, do you see any specificity of costs of structured deposits? Do you think that the potential external guarantees of structured deposits might just have to be taken into account in the estimation of the fair value of these products?

<ESMA_QUESTION_PRIIPs_60>
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<ESMA_QUESTION_PRIIPs_60>

61. Do you agree with the above mentioned list of entry costs? Which of these costs are embedded in the price? Should we differentiate between “delta 1” and “option based” structured products? In which cases do you think that some of these costs might not be known to the manufacturer? Which of these types of costs should be further defined?

<ESMA_QUESTION_PRIIPs_61>
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<ESMA_QUESTION_PRIIPs_61>

62. To what extent do you think these types of costs should be further defined and detailed?

<ESMA_QUESTION_PRIIPs_62>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_62>

63. How would you estimate ex ante the spread referred to above in (b), in the case the product is listed as in the case it is not? Should maximum spreads, when available, be considered? Should the term “proportional fees” be further defined? Which definition would you suggest?

<ESMA_QUESTION_PRIIPs_63>
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<ESMA_QUESTION_PRIIPs_63>

64. Do you agree with the list of costs outlined above? Which types of costs would require more precise definitions? To what extent should the methodology be prescriptive in the definition and calculation methodologies of the different types of costs?

<ESMA_QUESTION_PRIIPs_64>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_64>

65. Would you include other cost components?

<ESMA_QUESTION_PRIIPs_65>
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<ESMA_QUESTION_PRIIPs_65>

66. Under which hypothesis should the costs of the underlying be included?

<ESMA_QUESTION_PRIIPs_66>
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<ESMA_QUESTION_PRIIPs_66>

67. How would you deal with the issue of the amortization of the entry costs during the life of the product? For derivatives it will be notably important to define what the invested capital is, in order to calculate percentages. The possibilities include: the amount paid (i.e. option premium price or initial margin/collateral) or the exposure (to be defined for optional derivatives). Do you see other possible approaches on this specific point?

<ESMA_QUESTION_PRIIPs_67>
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<ESMA_QUESTION_PRIIPs_67>

68. Do you think that there are products with ongoing hedging costs (to ensure that the manufacturer is able to replicate the performance of the derivative component of the structured product)?

<ESMA_QUESTION_PRIIPs_68>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_68>

69. Do you agree with the general framework outlined above?

<ESMA_QUESTION_PRIIPs_69>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_69>

70. Which criteria should be chosen to update the values in the KID when input data change significantly?

<ESMA_QUESTION_PRIIPs_70>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_70>

71. As the evolution of underlying asset/s should be taken into account, are there specific issues to be tackled with in relation to specific types of underlying? To what extent should the RTS be prescriptive on the risk premium?

<ESMA_QUESTION_PRIIPs_71>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_71>

72. Are you aware of any other assumptions to be set?

<ESMA_QUESTION_PRIIPs_72>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_72>

73. Having in mind that most of the applied models in banking are forward looking (e.g. using implied volatility instead of historical volatility) which are the pros and cons of backward looking approach and forward looking approach?

<ESMA_QUESTION_PRIIPs_73>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_73>

74. Do you think that there are other risk free curves that could be considered?

<ESMA_QUESTION_PRIIPs_74>
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<ESMA_QUESTION_PRIIPs_74>

75. Do you think that there are other market data that could be used to determine the credit risk? Do you think that implied credit spreads from other issuer bonds (other than structured products) could be used?

<ESMA_QUESTION_PRIIPs_75>
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<ESMA_QUESTION_PRIIPs_75>

76. How would you determine the credit risk in the absence of market data and which are the criteria to identify the comparable?

<ESMA_QUESTION_PRIIPs_76>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_76>

77. How would you include the counterparty risk in the valuation? Would you include specific models to include counterparty risk in valuation (CVA models)? How would you consider the counterparty risk for pure derivatives?

<ESMA_QUESTION_PRIIPs_77>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_77>

78. In which circumstances do you think parameters cannot be computed/estimated using market data? What would you suggest to deal with this issue?

<ESMA_QUESTION_PRIIPs_78>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PRIIPs_78>

79. Would it be meaningful to prescribe specific pricing models for structured products, derivatives and CFDs? If yes which are the pros and cons of parametric and non-parametric models?

<ESMA_QUESTION_PRIIPs_79>
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<ESMA_QUESTION_PRIIPs_79>

80. What should be the value of x ? (in the case of UCITS, $x=5$, but the extent to which this is appropriate for other types of PRIIPs, notably life-insurance products, is unclear).

<ESMA_QUESTION_PRIIPs_80>

5 years is a minimum.

<ESMA_QUESTION_PRIIPs_80>

81. Should this principle be further explained / detailed? Should the terms “rank pari passu” be adapted to fit the different types of PRIIPs?

<ESMA_QUESTION_PRIIPs_81>

Yes this principle should be further explained in plain English, in particular to average individual investors.

<ESMA_QUESTION_PRIIPs_81>

82. What should be the relevant figure for the initial invested amount to be taken into account for the calculation of cost figures? Should a higher initial investment amount be taken into account not to overestimate the impact of fixed costs? How should the situation of products with regular payments be taken into account for that specific purpose? (Would an invested amount of 1 000 euros per period of time be a relevant figure?)

<ESMA_QUESTION_PRIIPs_82>

The numbered example for the US mutual funds is based on a \$ 10,000 investment, but € 1000 seems rather appropriate, both for unique investment and for recurring ones.

However, one should bear in mind that other currencies beside the Euro exist in the EU and an investment amount “hard wired” into the legal framework would lead to conversion to local currencies that would leave non-Euro investors with (numerically speaking) arbitrary investment amounts. Furthermore, some of the charges levied are determined by the distributor and are, thus, outside the scope of the PRIIP’s manufacturer. Overall distribution costs can therefore be highly dependent on the total amount to be invested and might vary significantly.

<ESMA_QUESTION_PRIIPs_82>

83. For some life-insurance products, the costs will differ on the age of the customer and other parameters. How to take into account this specific type of PRIIPs for the purpose of aggregating the costs? Should several KIDs for several ages be considered?

<ESMA_QUESTION_PRIIPs_83>

As mentioned before this is marginal in certain MS markets such as France for example. As much as possible, charges/costs related to biometric risks should be identified separately.

<ESMA_QUESTION_PRIIPs_83>

84. Do you agree with the abovementioned considerations? Which difficulties do you identify in the annualisation of costs?

<ESMA_QUESTION_PRIIPs_84>

We agree with these considerations, but would add another one: any TCR must be intelligible by the average individual investor. Therefore, as we asked for the UCITS KID before, and as it has been done successfully in the USA for decades, the TCR disclosure should be complemented by an example in numbers (not percentages) like for a € 1000 investment. See our reply to question 52. This is the best and most intelligible way to integrate entry and exit costs. Otherwise, the annualisation of such costs can only be done using the recommended holding period if any.

<ESMA_QUESTION_PRIIPs_84>

85. Which other assumptions would be needed there? In the case of life-insurance products, to what extent should the amortization methodology related to the amortization methodology of the premium calculation? To what extent should the chosen holding period be related to the recommended holding period?

<ESMA_QUESTION_PRIIPs_85>

It would seem that this computation of the TCR is too complex: why not doing it like in the USA for mutual funds, and consider only one investment, not (in the example given) an investment, then a redemption then another investment of a different amount). Again a key success factor of the future KIID will be simplicity/intelligibility. The summary prospectus for US mutual funds has been time-tested.

<ESMA_QUESTION_PRIIPs_85>

86. This definition of the ratio is taken from the CESR guidelines on cost disclosure for UCITS. Is it appropriate also in the case of retail AIFs? Should it be amended? Another approach to calculate these costs is to calculate the ratio of the total of these amortized costs to the invested amount in the fund. However in that case the question remains as to how to aggregate this ratio with the on-going charges ratio. Another possible approach could be to use the ratio between the total amount of costs over the holding period and the average net investment (assumed during the whole period, in order to take into account future additional investments, partial withdrawals, payments (i.e. programmed investments or disinvestments)). Do you think this approach would be appropriate?

<ESMA_QUESTION_PRIIPs_86>

The CESR guideline is appropriate and of course it should also apply to retail AIFs (which are more numerous than retail UCITS).

<ESMA_QUESTION_PRIIPs_86>

87. What would be other options to define the TCR ratio in the case of life-insurance products? What about the case of regular payments or regular increasing? Which definition would you favour? How to ensure a level playing field and a common definition with the other types of PRIIPs in this regard? Another possible approach could be to use the ratio between the total amount of costs over the holding period and the average net investment (assumed during the whole period, in order to take into account future additional investments, partial withdrawals, payments (i.e. programmed investments or disinvestments)). Do you think this approach would be

appropriate? To what extent do these possible calculation methodologies fit the case of insurance products with regular payments?

<ESMA_QUESTION_PRIIPs_87>

The option for insurance products should be consistent with that for funds. In case of regular payments, it should apply to one payment not to a series. The more important question is the estimate of the holding period, as insurers do not typically issue any recommended holding period for life insurance contracts.

<ESMA_QUESTION_PRIIPs_87>

88. What would be other options to define the TCR ratio in the case of structured products? Do you identify other specific issues in relation to the TCR if applied to structured products? Another possible approach could be to use the ratio between the total amount of costs over the holding period and the average net investment (assumed during the whole period, in order to take into account future additional investments, partial withdrawals, payments (i.e. programmed investments or disinvestments)). Do you think this approach would be appropriate? For derivatives, it might be the case that it is necessary to further define the concept of investment to be used as denominator of the ratio. Possibilities include the use of the actual sums paid and received (i.e. initial margins, variation margins, collateral postings, various payoffs, etc.) or the use of the exposure (i.e. market value of the derivative underlying). Do you think these approaches would be appropriate?

<ESMA_QUESTION_PRIIPs_88>

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<ESMA_QUESTION_PRIIPs_88>

89. This definition of the ratio is taken from the CESR guidelines on cost disclosure for UCITS. Is it appropriate also in the case of retail AIFs? Should it be amended? Another possible approach could be to use the ratio between the total amount of costs over the holding period and the average net investment (assumed during the whole period, in order to take into account future additional investments, partial withdrawals, payments (i.e. programmed investments or disinvestments)). Do you think this approach would be appropriate?

<ESMA_QUESTION_PRIIPs_89>

Yes, to our knowledge, it is applicable - and should apply - to retail AIFs

<ESMA_QUESTION_PRIIPs_89>

90. These different aforementioned principles are taken from the CESR guidelines on cost disclosure for UCITS. Is it also appropriate in the PRIIPs context?

<ESMA_QUESTION_PRIIPs_90>

Yes, we think so.

<ESMA_QUESTION_PRIIPs_90>

91. To what extent do the principles and methodologies presented for funds in the case of on-going charges apply to life-insurance products?

<ESMA_QUESTION_PRIIPs_91>

As long as there are no embedded (i.e. the investor cannot exclude them) risk (biometric or other) protection features, we believe the principles and methodologies for funds do apply - and should apply - to life insurance products.

<ESMA_QUESTION_PRIIPs_91>

92. Do you think this methodology should be further detailed? To what extent do you think this methodology is appropriate and feasible (notably in terms of calibration of the model)? It might indeed be considered that valuation models for Solvency II usually are not likely to be designed for per contract calculations. Life insurers may restrict the calculation of technical provisions in the Solvency II-Balance-Sheet to homogenous risk groups. Furthermore they are allowed to use simplified calculation methods if the error is immaterial at the portfolio level. As profit sharing mechanisms in many countries are applied on the company level and not on a per contract level, projected cash flows from future discretionary benefits will not easily be broken down on a per product or even a per contract basis with the existing Solvency II-Valuation-Models.

<ESMA_QUESTION_PRIIPs_92>

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<ESMA_QUESTION_PRIIPs_92>

93. Do you identify any specific issue in relation to the implementation of the RIY approach to funds?

<ESMA_QUESTION_PRIIPs_93>

Yes:

- First it is a totally new approach to cost disclosure for retail funds: it would imply a lot of communication / education to retail intermediaries and to citizens.
- we fear it is more difficult to understand than the TCR: it should be tested on a sample of average investors/savers.
- It implies more critical assumptions than for computing the TCR, in particular it requires return assumptions which can be very misleading. Although it may not be always possible, one should avoid having to rely on future performance assumptions.

However some members point out that the TCR does not actually include all costs (at least this seems to be currently the case in the UK). Also some members favour the RIY over the TCR approach because it better reflects the compound effect of costs and see no specific issues in relation to the RIY approach to funds or for any other type of PRIIPs. Another argument in favour of the RIY approach is that it clearly distinguishes the cost impact for different holding periods.

The SMSG recommends that these two cost indicator approaches (TCR and RIY) be subject to a thorough consumer testing before any choice is made between the two.

<ESMA_QUESTION_PRIIPs_93>

94. In addition to the abovementioned issues and the issues raised in relation to TCR when applied to structured products, do you identify any other specific issue in relation to the implementation of the RIY approach to structured products?

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<ESMA_QUESTION_PRIIPs_94>

95. Do you agree with the above-mentioned assessment? Should the calculation basis for returns be the net investment amount (i.e. costs deducted)? Do you identify specific issues in relation to the calculation per se of the cumulative effect of costs?

<ESMA_QUESTION_PRIIPs_95>

The RIY approach could be more appropriate for insurance contracts with embedded biometric risk protection. For example, in Belgium, typical life insurance contracts will charge a commission for the embedded death coverage (that guarantees a minimum capital amount at death under some conditions and ceilings) that increases with age every year. It would also indeed be useful for life contracts with a very high entry fee. Again the issue there would be to assess the holding period (and even more so for annuity products as mentioned in the DP).

The calculation basis for returns should not be the net investment amount but the gross: again for simplicity / intelligibility reasons: what counts for the individual investor is what he puts in (invests/saves) and what he gets out.

Again the most sensitive issue is the assumptions on the future performances / returns. If such assumptions have to be used they should follow very strict and common rules:

- all providers of the same types of products would have to use the same maximum one
- they must be cautious and not exceeding past performance
- they must be supervised by an independent party.

Otherwise these assumptions will be a major source of confusion and of disputes.

Another issue that we would like to raise is ex ante versus ex post cost indicator: we believe both should be disclosed as currently for UCITS funds: not only for the retail client, but also for supervisors and as a “sanity check” for everyone else to ensure the “ex ante” one makes sense.

<ESMA_QUESTION_PRIIPs_95>

96. Is this the structure of a typical transaction? What costs impact the return available to purchasers of the product?

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97. What costs impact the return paid on the products?

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98. What are the potential difficulties in calculating costs of an SPV investment using a TCR approach?

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99. What are the potential difficulties in calculating costs of an SPV investment using a RIY approach?

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