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Discussion Paper

Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs)

Table of Contents

Practical information	3
Glossary.....	3
Executive Summary.....	4
1 Introduction	8
2 'Key Questions' and Criteria for Assessing Options	17
3 What are the risks and what could I get in return?	21
4 What are the costs?	48
5 Other Sections of the KID.....	73
6 Products offering many options	85
7 Review, Revision and Republication	91
8 Timing of delivery.....	95
9 General aspects of the KID.....	97
10 Impact assessment.....	101

Practical information

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

Comments can be sent by clicking on the 'send your comments' button on the consultation page of one of the ESA's websites. Please note that the deadline for the submission of comments is **17 February 2015**. Comments submitted after this deadline, or submitted via other means may not be processed.

It is important to note that although you may not be able to respond to each and every question, the ESAs would encourage partial responses from stakeholders on those questions that they believe are most relevant to them.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise in the consultation form. A confidential response may be requested from us in accordance with the ESA's 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 ESA's and the European Ombudsman.

Data protection

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

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

Glossary

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Directive 2011/61/EU on Alternative Investment Fund Managers
APR	Annual Percentage Rate
CDS	Credit Default Swap
CESR	Committee of European Securities Regulators
CFD	Contract for difference
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EIOPA	European Insurance and Occupational Pensions Authority
ESA	European Supervisory Authority
ESMA	European Securities and Markets Authority
EURIBOR	Euro Interbank Offered Rate
FTT	Financial Transaction Tax
IMD	Insurance Mediation Directive
ISIN	International Securities Identification Number
KID	Key Information Document
KII	Key Investor Information
KIID	Key Investor Information Document
LIBOR	London Interbank Offered Rate
MiFID	EU Directive on Markets in Financial Instruments and Amending Directive
MIFIR	EU Regulation on Markets in Financial Instruments
OTC	Over-the-counter
PRIIP	Packaged Retail and Insurance-based Investment Product
PRIP	Packaged Retail Investment Product
RIY	Reduction in Yield
RTS	Regulatory Technical Standard
SRRRI	Synthetic Risk and Reward Indicator
TER	Total Expense Ratio
UCITS	Undertakings for Collective Investment in Transferable Securities
VAR	Value at risk

Executive Summary

The Regulation on Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs Regulation)² empowers the three European Supervisory Authorities (ESAs)³ to prepare draft Regulatory Technical Standards (RTS) in specific areas. This Discussion Paper is a preparatory step in the preparation of the RTS, setting out early thinking on the part of the ESAs and gathers feedback and reactions from stakeholders.

The PRIIPs Regulation has been introduced to improve the quality and comparability of information provided to retail investors in the European Union (EU) on often complex investment products. The need for EU action reflects the difficulties retail investors have faced in comprehending and comparing investments, hampering the emergence of efficient EU markets.

The RTS will contain detailed rules on the contents and presentation of the Key Information Documents (KIDs), including calculation methodologies and presentation templates necessary for a summary risk indicator, performance scenarios, and cost disclosures. The measures should be designed to be engaging for retail investors, and to help them better comprehend and compare the many different products that fall within the scope of the PRIIPs Regulation.

The RTS will also address measures on the revision, review and republication of the KID, and on the timing of delivery of the KID to the retail investor.

Substance of the Discussion Paper

The Discussion Paper predominantly focuses on the different sections of the KID that need to be covered in the RTS, followed by a number of transversal issues that arise.

Many of the issues raised at this stage are covered in Chapters 3 and 4, which relate to two sections of the KID that the ESAs have identified as raising particular challenges: *'What are the risks and what could I get in return?'* and *'What are the costs?'*

For the *risk and return section* (chapter 3), the Discussion Paper outlines the challenges for and needs of retail investors in understanding and comparing the risks and rewards of PRIIPs. This is essential information about any investment, yet can be very difficult for many retail investors to fully understand. This reflects in part the complexity of the risk profiles of many PRIIPs. The Discussion Paper explores the different dimensions of risk; market, credit and liquidity risks are identified as key risks, and the Discussion Paper explores possible ways of measuring or classifying these and aggregating them. Aggregating different dimensions of risk could be important for aiding retail

² See [http://www.europarl.europa.eu/sed/doc/news/document/2012_0169\(COR01\)_EN.doc](http://www.europarl.europa.eu/sed/doc/news/document/2012_0169(COR01)_EN.doc).

³ European Insurance and Occupational Pensions Authority (EIOPA), European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA).

investors in using the information, yet aggregating risks might also reduce the quality of the information provided.

In relation to *returns*, the Discussion Paper sets out two basic approaches to performance scenarios ('what-if' scenarios and the use of probabilistic scenarios) and raises a number of technical issues that will need to be considered. For such information, providing estimates of the likelihood of future outcomes might be attractive for retail investors, but difficult for the investors to accurately interpret.

The Discussion Paper explores a variety of presentational approaches for the risk and return section, such as the use of simpler or multi-dimensional summary risk indicators and tables or graphs for performance scenarios, and examines some options for how the risk and return section as a whole might work.

For the *costs section* (chapter 4), the Discussion Paper follows a similar structure. It sets out some of the key questions that might be expected from the perspective of retail investors and examines some detailed issues relating to the identification and quantification of individual costs, and the aggregation of these in order to produce a 'total aggregate costs' figure in both percentage and monetary terms. Key challenges for retail investors include comparing different cost structures, and understanding how the costs of a product will apply in practice for the investor. Creating a fair level-playing field between products will be important, and this will involve ensuring a consistent treatment of costs, including costs that are implicit, such as those embedded in prices, for instance for structured products and portfolio transaction costs for funds. Aggregating costs will also require examples of assumptions to be made. Here consistency in these assumptions could help in ensuring comparability between different PRIIPs.

The Discussion Paper then explores different presentational approaches for costs, such as the use of simple indicators or summary figures, the use of benchmarks, the extent of the breakdown of costs that might be needed, and how to show the impact costs could have over the lifecycle of the product. Here there could be link with the information on performance scenarios, which is also looking at the possible cumulative evolution of the product's (net) returns over time.

Chapter 5 examines each of the other sections of the KID, outlining provisional ideas, possible options, and challenges related to each section.

Chapter 6 relates to an important issue, where the KID has to be produced for a PRIIP which offers to the retail investor a choice of different investment options such that these cannot be covered in three pages according to the normal KID requirements. There is a specific derogation in the Regulation related to the content of the KID for such instances, and this chapter explores options for when the derogation could apply, and how the KID might work in these cases.

Chapter 7 addresses the review, revision and republication of the KID, and chapter 8 the timing of delivery of the KID to the retail investor. These are both subject to independent and specific RTS.

Chapter 9 explores some general challenges in relation to the KID, including the possible development of overall templates for the KID, and the importance of plain language requirements so

that the KID can be a truly ‘consumer-friendly’ document that retail investors will actively want to use.

Chapter 10 sets out some initial considerations on impact assessment work that the ESAs will undertake to support the draft RTS.

Who should read this Discussion Paper?

Responses are encouraged from all relevant stakeholders including the firms that manufacture the products in scope, as well as those distributing such products. Feedback is also encouraged from consumer organisations and relevant trade bodies.

Next Steps

The ESAs will use the feedback from stakeholders on the Discussion Paper in preparing the draft RTS. A consultation on the draft RTS, setting out the ESAs conclusions, will follow in the autumn of 2015.

Prior to this there will be a consumer testing exercise organised by the European Commission, to aid the ESAs in developing the draft RTS. The ESAs also plan a more technical Discussion Paper in the spring of 2015.

1 Introduction

1.1 Purpose of this Discussion Paper

This Discussion Paper is preparatory to future Regulatory Technical Standards (RTS) to be developed by the European Supervisory Authorities (ESAs: EBA, EIOPA and ESMA) for the Regulation on Key Information Documents (KIDs) for Packaged Retail and Insurance-based Investment Products (PRIIPs Regulation).⁴

The purpose is to gather initial views from stakeholders to aid the ESAs in preparing the RTS.

For this purpose the Discussion Paper outlines preliminary options and possible approaches, and no approaches or options are ruled in or out at this stage. Proposed conclusions and draft RTS will only be set out later, in a Consultation Paper.

1.2 The PRIIPs Regulation

A political agreement was reached between the European Parliament and the Council on the PRIIPs Regulation in April 2014. The formal proposal from the Commission was published in July 2012.⁵

The Commission used the 'Key Investor Information' (KII) document, required since 1 July 2011 for UCITS funds,⁶ as an inspiration for the KID proposals. However, given the wide range of PRIIPs with differing features, when compared to UCITS, a full replication of the KII for other PRIIPs was ruled out, and there are some differences between the KID and the KII within their respective Regulations.

1.3 Empowerment for Level Two measures

The PRIIPs Regulation seeks to enable investors to better understand and compare the key features, risks, rewards and costs of different PRIIPs through a short and consumer-friendly KID.

The Regulation separates the political decisions on the KID and its content, which are set out in the Regulation itself ('level one'), from certain technical details on how to implement the Regulation ('level two').

This is done through concrete empowerments in the Regulation defining the scope and approach to be taken in the 'level two', in the form of RTS. There are **three empowerments** for developing RTS.

⁴ See [http://www.europarl.europa.eu/sed/doc/news/document/2012_0169\(COR01\)_EN.doc](http://www.europarl.europa.eu/sed/doc/news/document/2012_0169(COR01)_EN.doc).

⁵ For background information, see http://ec.europa.eu/internal_market/finances-retail/docs/investment_products/29042009_communication_en.pdf, http://ec.europa.eu/internal_market/finances-retail/docs/investment_products/29042009_impact_assessment_en.pdf, http://ec.europa.eu/internal_market/finances-retail/docs/investment_products/20120703-proposal_en.pdf, and http://ec.europa.eu/internal_market/finances-retail/docs/investment_products/20120703-impact-assessment_en.pdf.

⁶ See COMMISSION REGULATION (EU) No 583/2010.

Art 8 (5)	<p>Content, Presentation, Calculation of Information in KID</p> <p>In order to ensure consistent application of this Article, the ESAs shall, through the Joint Committee of the European Supervisory Authorities (“Joint Committee”), develop draft regulatory technical standards specifying:</p> <ul style="list-style-type: none"> (a) the details of the presentation and content of each of the elements of information referred to in paragraph 3 [content of KID] (b) the methodology underpinning the presentation of risk and reward as referred to in point (d) (i) and (iii) of paragraph 3 of this Article [risk indicator, performance scenarios]; and (c) the methodology for calculation of costs, including the specification of summary indicators, as referred to in point (f) of paragraph 3. <p>When developing the draft regulatory technical standards the ESAs shall take into account the various types of PRIIPs, the differences between them and the capabilities of retail investors as well as the features of the PRIIPs that allow the retail investor to select between different underlying investments or other options provided for by the product, including where this selection can be undertaken at different points in time, or changed in the future.</p>
Art 10 (2)	<p>Review, Revision and Republication of KID</p> <p>In order to ensure consistent application of this Article, the ESAs shall, through the Joint Committee, develop draft regulatory technical standards specifying:</p> <ul style="list-style-type: none"> (a) the conditions for reviewing the information contained in the key information document; (b) the conditions under which information contained in the key information document must be revised; (c) the specific conditions under which information contained in the key information document must be reviewed or the key information document revised where a PRIIP is made available to retail investors in a non-continuous manner; (d) the circumstances in which retail investors are to be informed about a revised key information document for a PRIIP purchased by them, as well as the means whereby the retail investors are to be informed.
Art 13 (5)	<p>Timing of delivery of KID</p> <p>In order to ensure the consistent application of this Article, the EBA, the EIOPA and the ESMA shall, through the Joint Committee, develop draft regulatory technical standards specifying the conditions for fulfilling the requirement to provide the key information document as laid down in paragraph 1 [‘in good time before [the retail investor is] bound by any contract or offer relating to [the] PRIIP’].</p>

Each of these empowerments sets a timeline for the delivery of the draft Regulatory Technical Standards and then final date of application of the Regulation. The timeline is set out in table 1.

X Publication in the OJ	Foreseen by the end of November 2014 or early December 2014
X + 20 Days (Y) December 2014	Date on which the Regulation comes into force (December 2014)

Y + 12 months December 2015	Date by which draft Regulatory Technical Standards must be provided to the European Commission on Articles 10 and 13.
Y + 15 months February 2016	Date by which draft Regulatory Technical Standards must be provided to the European Commission on Article 8
Y + 24 months December 2016	Date of Application of the Regulation and of the RTS

Table 1: Timeline for PRIIPs Regulation and draft RTS

This Discussion Paper is preparatory for the three empowerments for RTS outlined above only. Please note that the Regulation also contains empowerments to the Commission under Article 8(4), Article 16(8), and Article 17(7). **These are not addressed in this Discussion Paper.** The timeline for the empowerments to the Commission is also to that for the RTS: these empowerments will exist for 36 months from the date the Regulation comes into force.

1.4 Next steps

The ESAs expect to follow this Discussion Paper with a separate technical Discussion Paper in the spring of 2015 on more methodologically complex aspects of the RTS (such as on the methodology for calculation of the summary risk indicator).

This will be followed by a Consultation Paper setting out the draft Regulatory Technical Standards in the autumn of 2015. Prior to this, separate specific Consultation Papers are anticipated for the RTS under Articles 10 and 13, with an estimated timing prior to the summer of 2015.

Given the difficulties retail investors typically face in understanding and comparing disclosure documents related to financial products, consumer testing of different possible ways of presenting information has been identified as an important part of the work to develop level two measures, just as the findings from previous consumer studies were used by the European Commission in developing the PRIIPs Regulation.

To this end, the European Commission has procured the services of a consumer testing contractor to allow different presentational options for the KID to be consumer tested. The testing will seek to assess the relative effectiveness of different options for a sample of consumers that is representative for the EU as a whole, across different Member States and different demographic groups. The testing will begin in the autumn of 2014 and continue until August 2015.

This testing will be carried out in its first phases on the basis of the broad options outlined in this Discussion Paper. These options will be developed into various concrete examples (mock-ups) to explore the effectiveness of different visual and presentational techniques in communicating messages, focused initially on ‘what is this product,’ the risk and reward profile, and costs.

Feedback from this Discussion Paper, alongside results from this first phase of consumer testing, will be used to identify and improve options, to be thoroughly tested in a second phase of testing starting in spring 2015. The consumer testing will therefore strongly inform the final draft RTS.

1.5 Structure of this Discussion Paper

The Discussion Paper focuses in most part on areas related to the RTS for Article 8. Chapters 3 and 4 on the two most challenging parts of the KID – the section on risks and rewards, and the section on costs. Chapter 5 covers all other parts of the KID. Chapter 6 relates to a special case (PRIIPs that offer many options). Chapter 9 addresses some horizontal issues that might impact all KIDs.

Chapters 7 and 8 cover the two specific RTS in Articles 10 and 13.

The remaining chapters are for information purposes. Chapter 2 sets out how certain issues for retail investors are being addressed in this work, while chapter 10 includes some initial thoughts related to impact assessment, on which specific input is sought.

The remainder of chapter 1 sets out a summary of some key provisions in the PRIIPs Regulation to aid readers in using this Discussion Paper, and so as to clarify where parts of the Regulation are being addressed. This summary does not represent guidance on the interpretation of the PRIIPs Regulation on the part of the ESAs, or their considered views on particular points of interpretation. All Article references are to the PRIIPs Regulation.

Readers are encouraged to refer back to the PRIIPs Regulation in its entirety.

1.6 Outline of PRIIPs Regulation

1.6.1 Who does the PRIIPs Regulation apply to?

The Regulation applies to both the manufacturers of PRIIPs and to those who are advising on or selling a PRIIP to retail investors. (*Article 2*).

- The concept of the ‘PRIIP manufacturer’ is defined in the Regulation to include the distributor of a PRIIP where the distributor materially alters the PRIIP.
- Retail investors are defined as retail clients as defined in MiFID, or customers as referred to in the IMD, in so far as these would not qualify as professional clients under MiFID.
- The adviser or the seller may be a member of the staff of the manufacturer, an agent of that manufacturer or acting for or under the control of an entity linked to the manufacturer, or wholly independent of the manufacturer. In the latter case, the seller may or may not have a contractual relationship with the manufacturer.

The Regulation lays down an obligation on manufacturers to prepare a KID for each PRIIP they produce (*Article 5*). They must also publish each KID on their website. This applies where a PRIIP is to be made available to retail investors; a manufacturer would not need to prepare a KID for a PRIIP that is not made available to retail investors.

The Regulation lays down in addition an obligation on those advising on or selling a PRIIP to a retail investor to provide the KID for the PRIIP to the retail investor (*Article 5*). This must be done in sufficient time before the retail investor enters into a commitment, so that they can make an

informed investment decision on the basis of the KID. This could include such time as may be necessary to compare the KIDs for different PRIIPs, as well as time to read and understand each KID.

1.6.2 Products within the scope of the PRIIPs Regulation

The definition of the products for which a KID must be produced occurs in two articles.

The first is Article 4 (*definitions*).

- Article 4 (1) defines non-insurance-based PRIIPs as investments where the amounts repayable to the retail investor are ‘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’;
- Article 4 (2) defines insurance-based PRIIPs (insurance-based investment products). The definition refers to ‘market fluctuations’ impacting surrender or maturity values. All insurance products (Article 2 notwithstanding) are in scope in so far as they allow for fluctuating pay outs on maturity or early exit;
- Article 4 (1) includes a reference in addition to ‘instruments issued by SPVs as referred to in Article 13 (26) of Directive 2009/138/EC⁷ and Article 4 (1) (an) of Directive 2011/61/EU⁸ – these are also included.

The second is Article 2 (*exceptions*).

- The exceptions listed in Article 2 are a combination of true exceptions (products that would be in scope but are excluded solely by the exception), and clarifications (products that might be viewed as out of scope under Article 4, but which are identified for reasons of legal certainty).

For the purposes of this Discussion Paper, it is assumed that the interaction between Article 4 and Article 2 is as set out below in Table 2. This is not proposed however as an exhaustive assessment of all types of products. Please consider this Table when reacting to the questions raised in this Discussion Paper.

Insurance products: non-life	Out of scope	Non-life and pure protection life insurance are excluded. All others that meet the definition in Article 4 (2) would be in scope (so long as they are not ‘pension products’ as defined in the exceptions). In practice this would appear to
Insurance products: pure protection life insurance		
With-profits or ‘traditional’ life	In scope	

⁷ Special purpose vehicle, means any undertaking, whether incorporated or not, other than an existing insurance or reinsurance undertaking, which assumes risks from insurance or reinsurance undertakings and which fully funds its exposure to such risks through the proceeds of a debt issuance or any other financing mechanism where the repayment rights of the providers of such debt or financing mechanism are subordinated to the reinsurance obligations of such an undertaking.

⁸ ‘securitisation special purpose entities’ means entities whose sole purpose is to carry on a securitisation or securitisations within the meaning of Article 1(2) of Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (1) and other activities which are appropriate to accomplish that purpose.

insurance contracts with variable bonuses		mean life insurance other than pure protection is normally in scope.
Hybrid life insurance contracts, which contain both unit-linked and with-profit elements		
Unit-linked and Index-linked life insurance contracts		
Structured securities (Convertible bonds and other securities that embed a derivative), and other 'structured products'	In scope	The definition under Article 4 (1) includes instruments where payouts are linked to an exposure to reference values or the performance of one or more assets 'which are not directly purchased by the investor'. This would include all structured instruments.
Instruments that are assets that are directly purchased by the retail investor, such as corporate shares and sovereign bonds.	Out of scope	The definition under Article 4 (1) excludes instruments that are directly purchased by the retail investor. Recital 7 identifies 'corporate shares or sovereign bonds' as examples of such instruments.
Special cases relating to securities in Art 2	Out of scope	The exception relates to certain specific state and other types of deposit and security, which may be excluded already under Article 4 (1).
Derivatives of all types	In scope	These create exposures to assets or reference values that are not directly purchased by the investor, whether standardised or OTC. The KID is necessary only where these are being sold to retail investors: where there is no distribution to retail there will be no need for a KID. This could include (as a non-exhaustive list): <ul style="list-style-type: none"> - Contract for Difference (CFD) - Binary options (for example on Forex) - Warrants - Options, futures or swaps
Funds: UCITS	In scope	All funds sold to retail investors are in scope. (See however the specific treatment set out in Article 32 where a KII is already used).
Funds: Retail AIFs (whether closed- or open-ended)		
Pensions products recognised in national law	Out of scope	Pension products are out of scope, in so far as national law recognises them as retirement vehicles and there are 'certain benefits' attached to them in respect of this recognition. Occupational pensions are also out of scope, in so far as they are officially recognised falling under the scope of Directive 2003/41/EC, or Directive 2009/138/EC. Annuities that qualify as pension products are out of scope.
Occupational pensions		
Pension products not recognised in national law	In scope	Annuities (other than those that are retirement vehicles) that offer surrender values or maturity values, and where pay-outs are subject to market fluctuations, would be in scope.
Annuities / variable annuities		
Structured deposits	In scope	Under the exceptions, the only deposits that are in scope are those as defined in MiFID II (structured deposits); deposits "solely exposed to interest rates" (Recital 7) are out
Traditional/ 'plain vanilla' deposits	Out of scope	

		<p>of scope.</p> <p>The MiFID II definition excludes variable rate deposits which are ‘directly’ linked to an interest rate index such as the EURIBOR or LIBOR. However, if these deposits exhibit performance caps and/or their return is linked in a non-linear way with the underlying interest rate, then they are in scope.</p> <p>Fixed rate deposits are out of scope under Article 2 and 4.</p>
SPVs (instruments issued by)	In scope	<p>Article 4(1) brings these into scope, as defined in Article 13 (26) of Directive 2009/138/EC (Solvency II) and Article 4 (1) (an) of Directive 2011/61/EU (AIFMD). Article 4 (1)(an) cross refers to article 1(2) of Regulation (EC) No 24/2009 of the ECB.</p>

Table 2: Summary of scope

1.6.3 General principles for production of the KID

The Regulation prescribes that the KID must be no more than three pages (three sides of an A4-sized sheet) long, and written in plain language (avoiding financial jargon). The KID should be available in the language of the retail investor (normally, this would be a language prescribed at national level in the jurisdiction in which the retail investor is located; the situation of *expatriates* is not addressed). (*Articles 6 and 7*).

The Regulation foresees in Article 6 (3) a ‘derogation’ from producing a KID as prescribed in Article 8 for products that offer a range of options (that is, choices for retail investors). A KID will still be necessary for these products, but it will be different in some regards. **See chapter 6 of this Discussion Paper.**

1.6.4 Content of the KID

The Regulation establishes a common sequence of sections to the document, with prescribed headings for these sections. (*Article 8*).

The headings are mostly in the form of questions. Each section of the KID ‘answers’ the question that forms the heading for the section.

The Regulation sets out details on the kind of information that must be covered in each of these sections, but in general does not prescribe in precise detail the specific information to include, or how the information is to be presented (for instance, through the use of graphs or other visual techniques). These matters are left for further specification at level two.

Likewise, the Regulation does not prescribe a specific visual layout in relation to the sections and their headings. The question of specific layout or layouts, visual style or styles to be used is left for further specification, as may be necessary, at level two. Details of calculation methodologies, as may be necessary, are also left for level two.

See chapters 3-6 and chapter 9 of this Discussion Paper.

1.6.5 Revision of the KID and provision of the document to investors

The Regulation requires the KID to be revised in certain circumstances to keep the information updated (*Article 10*). Provision of the KID to investors is also regulated, so that certain obligations for distributors are included in the Regulation (*Article 13*). Specific empowerments for RTS apply in relation to the revision and provision of the KID. **See chapters 7 and 8 of this Discussion Paper.**

1.6.6 Transitional specific treatment for UCITS

In Article 32, the PRIIPs Regulation provides for a transitional specific treatment of UCITS, and of retail Alternative Investment Funds (AIFs) where national rules have extended the UCITS KII requirement to these AIFs. Under this specific treatment these PRIIPs are exempt from the Regulation for a transitional period of five years from the entry into force of the Regulation (i.e. to December 2019). The Review of the Regulation that should be started by the European Commission before December 2018 will need to address any consequential measures in view of the end of this transitional period (i.e. amendments to UCITS, an extension of the transitional arrangement, or a decision to consider the UCITS KII requirements equivalent to the PRIIPs KID requirements).

Given that retail AIFs that do not fall under the extended transition period already fall under the scope of the PRIIPs Regulation, and the fact that UCITS themselves have not been excluded per se from the Regulation, level two proposals under the Regulation will need to be designed with both AIFs and UCITS in mind.

There will be a period of three years during which both a UCITS KID and a PRIIPs KID will co-exist. This shall need to be considered when assessing options and their impact for the level two proposals (notably in terms of comparability and comprehension by investors).

1.7 Interaction with other EU legislation

Regulatory disclosure requirements at the European level on product disclosure already exist in other legal instruments. The most relevant are MiFID II, Solvency II, IMD, the UCITS Directive, the AIFMD and the Distance Marketing Directive for Financial Services.

The PRIIPs Regulation does not amend these other instruments, and does not legally substitute for requirements in these other instruments, the specific treatment of UCITS and AIFs required at the national level to produce a KII notwithstanding.

Changes are currently being finalised by ESMA to advice on level two measures pursuant to MiFID II. This includes in the area of cost disclosures by investment firms subject to MiFID II. As MiFID is not applicable to all PRIIPs, the interaction with other instruments that are still being developed, notably the IMD 2, will be relevant depending the evolution of these instruments.

As regards the interaction with MiFID II, the key aspect would appear to be information on costs. Coordination on the disclosures contained in the KID with requirements on distributors will be

sought, so that the information in the KID on costs might be considered complete and sufficient for the purposes of disclosures required by MiFID II about the costs associated with the PRIIP itself.

A detailed analysis of the interaction with other EU legislation is presented in the Annex 1 of the discussion paper.

Questions

- 1: Do you have any views on how draft RTS for the KID might be integrated in practice with disclosures pursuant to other provisions?

2 Issues for Retail Investors

2.1 Consumer behaviour

Buying PRIIPs is complex for consumers compared to many other consumer goods. For the latter the assessment of quality and whether the goods perform according to the consumers' expectations can often be made right away. By contrast, the quality of financial products can be very hard to assess. For instance, with long-term PRIIP investments investors might not realise how the investment is performing or whether they have been miss-sold a financial product until a considerable number of years have passed. In addition, consumers typically will not be able to learn from experience given the infrequency with which they often buy PRIIPs.

Coupled to this, the retail investment environment has become increasingly complex. The market is characterised by a wide range of products with uncertain returns and costs. Some products might involve multiple charges at the time of purchase and throughout the product life-cycle. Risk profiles can be extremely difficult to understand, making it difficult to assess whether a product is right for the individual investor.

Research into consumer behaviour in investment decision making has also shown the detrimental effects of behavioural biases. For instance, retail investors often tend to focus more on the 'reward' or 'performance scenarios' of an investment product than the effect of costs, or to over-value immediate rewards or risks, over long term rewards or risks.

Given this, a traditional approach to disclosures focused solely on information and with little regard to its presentation, is in being superseded in policy making by an approach that is more informed by insights into consumer behaviours. For instance, the framing of information can be considered, so as to counter cognitive biases which may distort perceptions and provide information in a way that is both simple to understand but also salient for the consumer (i.e. capable of drawing the consumers' attention and appearing important for the decision to be made).

The PRIIPs Regulation reflects these considerations already at 'level one'. It introduces specific measures to simplify and standardise the KID, so as to enable consumers to compare products across various providers, make better choices between different investment options and across product classes, while also increasing the salience and comprehension of the key information provided and its use in making an investment decision.

This focus will be continued by the ESAs in developing 'level two' for the KID. Notably, consumer testing (outlined already above in section 1.4) will be used to select options on the basis of how consumers react in terms of comprehension, comparability and 'engagement' (salience).

2.2 Developing a KID that answers consumers' 'Key Questions'

It is very important that consumers choose to read the KID and that it is made easy for them to incorporate the information into their decision making.

In other words, in order for the KID to be easy to use by the retail investor, the KID should have a clear *behavioral purpose* for the retail investor.⁹ In this respect, the PRIIPs Regulation already in Article 8(2) requires the purpose of the KID to be stated within the KID itself:

‘This document provides you with key information about this investment product. It is not marketing material. The information is required by law to help you understand the nature, risks, costs, potential gains and losses of this product and to help you compare it with other products.’

As a next step, it is crucial to engage retail investors by making sure the information included addresses their needs, as can be expressed in terms of their ‘Key Questions’. A KID that clearly answers a retail investors’ Key Questions, not only provides the most important information in a first layer in a way that is personally relevant, it also stimulates the consumer to read further.

At a high level the PRIIPs Regulation has already been structured in the form of a series of sections headed by questions they relate to (a kind of ‘Question and Answer’ document), inspired by a consumers’ perspective on investment products.

Building on this, however, more detailed and specific Key Questions also need to be identified for certain of the more challenging sections of the KID – notably, the sections on its risk and reward profile and on its costs. While these more detailed Key Questions themselves would not be part of the KID, the information in the KID should clearly, from the consumers’ perspective, provide answers to these Key Questions.

Clarifying these Key Questions serves a number of purposes:

- *Attuning the KID’s content to retail investors’ information needs*

Often policy makers require too much information to be provided because they focus on what supervisors believe people ‘should know’ about products (educate consumers on the product). This tendency is often detrimental to document format, structure and contents, reducing the clarity of the document and how readers should ‘use’ the information provided. Readers who cannot quickly pick up the information that is relevant to them and who do not quickly understand how to translate the information into decisions will pay less attention to the document.

Focusing on consumers’ Key Questions is essential for streamlining the information included to only the most essential elements. This would enhance the attention and motivation of

⁹ The behavioural purpose is an important starting point of information provision (Cox, 2011; Sunstein, 2011). If the information does not have a clear behavioural purpose, this will be reflected in the way the information is provided. The information will not be framed in such a way that it is immediately clear for the reader how relevant it is. Generally, if people do not easily recognize how the information is relevant to them, they are likely to stop reading. Therefore, information provision should have a clear and simple behavioural purpose. It should be clear what retail investors should be able to ‘do’ upon and after reading the information in the KID.

consumers and their commitment to understanding the document, also maximizing its 'educational' impact.

- *Conveys a better insight as to what the main messages should be (clear layering)*

Identifying Key Questions can also aid in aligning the priority of information in the KID in view of the importance of questions from the consumer's perspective. An awareness of consumer's typical priorities would also enable a better presentation or framing of messages that are seen as key from a supervisory perspective, even where these might not be a priority for consumers.

- *Needed for consumer testing*

One of the primary goals of the consumer testing is to find out, or get confirmation on, what information retail investors consider important and are able to understand. The expected Key Questions are important input for the consumer testing phase. They will help us understand whether the KID is addressing properly key issues for consumers and also whether consumers interpret the information well with regards to the Key Questions. The testing would also clarify if the identified Key Questions are the right ones.

The identified Key Questions are set out in this Discussion Paper in the chapters related to the risk and reward section (3.3.1) and the costs section (4.3) of the KID.

2.3 Assessing options from the perspective of the consumer

In order to systematically consider consumer perspectives when identifying, developing and assessing possible options or approaches to retain, the ESAs have systematically identified a number of criteria or objectives that might be used.

These criteria will also be useful for the purpose of transparency when balancing different kinds of objectives, including those arising when considering other stakeholders, such as ease of supervision, or proportionality or cost-effectiveness for PRIIPs manufacturers. It will be important that overall the behavioural purpose and effectiveness of the KID for consumers remains at the forefront of these criteria.

Criteria for assessing options for presentation	
Engaging	The presentation of the elements in the KID should be as simple as possible, to be easily understood by retail investors and to engage them more, motivate them to use the KID and increase attention for the KID
Understandable	This criterion refers to the level of <i>complexity</i> of the information as whether consumers can <i>interpret</i> the information. The information in the KID should be understood by the retail investors with the assumption that the consumer may not have an adviser, distributor or seller on hand to explain the information.
Comparable	One of the main purposes of the KID is to enable investors to compare investment opportunities with each other. This can be done by an investor by comparing several KIDs but it is also possible to include reference points within the KID that make the information more comparable, for example through the use of benchmarks.

Compatible	This criterion refers to the compatibility of the proposals for presentation of information with the requirements formulated in the PRIIPs Regulation. All options will need to be strictly compliant with the PRIIPs Regulation.
Balanced presentation	This criterion holds that we should look for a balanced presentation of the different aspects within sections of the KID but also a balanced presentation of the sections of the KID. By this criterion we try to make sure that the upsides and downsides of certain products are balanced in an objective fashion.
Coverage of types of PRIIPs	The goal is to develop presentational forms that are suitable and applicable to all different types of products that fall into the scope of the PRIIPs Regulation. Given the heterogeneity of PRIIPs in scope, this will be an important challenge.
Criteria for assessing underlying methodologies	
Reliable	The information within the KID is reliable where it provides a fair estimate of the actual risks and costs involved.
Robust	The measurement of risk, reward and costs should not be easy to manipulate. It should be an objective representation of the risk, reward and costs that are being measured.
Stable	The output of the measurements needs to be relatively stable. It is important that risk or cost indicators are reliable forecasts, and that they are not overly sensitive to relatively minor changes in conditions.
Applicable	The measurements should be applicable to all types of PRIIPs. Where a measurement (e.g. of historic volatility) is available for some PRIIPs but not available for those without a track record, or might be a misleading measure for some, effective methodologies for combining or synthesizing different measures in an objective way may be necessary.
Comparable	The measurements should lead to values that are comparable amongst different types of PRIIPs.
Discriminatory	If it is not possible to differentiate between PRIIPs, a measure loses its purpose. It needs to be clear that a certain measured output is below or above another measured output. Therefore it is important that the indicator provides discriminatory output.
Feasible/ Proportional	An indicator or measure that is overly sophisticated in relation to the granularity and accuracy of the information included in the KID could be seen as disproportionate. This does not imply that the simplest or least costly option should always be selected.
Supervision	Will it be possible for regulators to assess whether product manufacturers are complying with any proposed prescribed methodology?

3 What are the risks and what could I get in return?

3.1.1 Empowerment

Art 8(3)	The key information document shall contain the following information: ... (d) under a section titled "What are the risks and what could I get in return?", a brief description of the risk-reward profile comprising the following elements: (i) a summary risk indicator, supplemented by a narrative explanation of that indicator, its main limitations and a narrative explanation of the risks which are materially relevant to the PRIIP and which are not adequately captured by the summary indicator; (ii) the possible maximum loss of invested capital, including, information on: - whether the retail investor can lose all invested capital, or - whether the retail investor bears the risk of incurring additional financial commitments or obligations, including contingent liabilities in addition to the capital invested in the PRIIP; and - where applicable, whether the PRIIP includes a capital protection against market risk, and the details of its cover and limitations, in particular with respect to the timing of when it applies; (iii) appropriate performance scenarios, and the assumptions made to produce them; (iv) where applicable, information on conditions for returns to retail investors or built-in performance caps; (v) a statement that the tax legislation of the investor's home Member State may have an impact on the actual payout;
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Article 8(5) of the PRIIPs Regulation reads as follows:

Art 8(5)	In order to ensure consistent application of this Article, the ESAs shall, through the Joint Committee of the European Supervisory Authorities ("Joint Committee"), develop draft regulatory technical standards specifying: ... (b) the methodology underpinning the presentation of risk and reward as referred to in points (d) (i) and (iii) of paragraph 3 [risk indicator, performance scenarios]; and ...
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The purpose of section (d) of Article 8(3) is to provide a description of the risk-reward profile of the investment, so both upside and downside potential of the PRIIP may be shown in a balanced way.

Different elements must be included in the section. The summary risk indicator could give an overall view of the risk of the investment part of the product. More detailed information on risk and reward would be provided in other elements of this section (maximum loss, appropriate performance scenarios, conditions on returns) or in other sections of the KID (notably sections (e) and (f)).

3.2 Definition of risk and reward

The focus of this chapter is in particular on the summary risk indicator and performance scenarios mentioned above:

- Different *methodological options* to elaborate the risk and reward information in the KID

Methodological issues arise both for the risk indicator (methodology to measure different types of risk, options for using these for a summary indicator) and for performance scenarios (selection of appropriate scenarios and options of calculating performance).

This discussion paper addresses methodological issues only on a high level; the ESAs plan a separate discussion paper in 2015 to examine the issues and options in more detail.

- Different risk and reward *presentations*

Different styles or ways to present information on risks and rewards are possible, and to a degree these can be considered separately from questions related to underlying calculation methodologies. The ESA first have looked at options for presentation from an abstract or conceptual perspective, that is, to identify the basic types of options that might be possible, so that the examples presented in this paper are included only to illustrate different abstract approaches, and should not be seen as final options.

More refined examples will be elaborated and tested in the consumer testing. Consumers feedback and technical progress on calculation methodologies will both impact the final draft RTS.

The chapter begins by defining risk and reward, bearing in mind the consumer's perspective on this concept. This is followed by an analysis of the different types of risk that need to be considered when responding to consumer's key questions. These are both under section 3.2 below.

Under section 3.3, different measures that may be used to evaluate each type of risk are explored. Under section 3.4, there is a discussion around what types of risk can and should be integrated in a summary risk indicator and which, if any, may be excluded, in order to present an overall and meaningful summary indicator of the risk of a PRIIP.

This is followed, under section 3.5, by a focus on methodological challenges to select appropriate scenarios and calculate performance.

Options for the presentation for both Risk and Performance Scenarios are outlined under section 3.6.

3.3 Definition of risk and reward

For the purpose of defining risks and rewards, it is vital to examine investors’ perspectives. This can be done by identifying the Key Questions that investors are interested in and want answered.

In order to answer these Key Questions, it is important to identify also the different aspects of risk that should be considered and measured. These will be referred to as Key Types of Risks. The potential measures of these Key Types of Risk will be familiar to those aware of technical academic and market work on financial risk measurement, details on these is included in annex 2.

3.3.1 Identified Key Questions on risk and reward

In chapter 6 we explained the importance of answering consumers’ Key Questions. The answers to the Key Questions on risk and return correspond naturally to the section titled *“What are the risks and what could I get in return?”*.

However, it is important to note that the KID includes two other sections related to risk disclosures, *“What happens if the manufacturer is unable to pay out?”* and *“How long should I hold it and can I take my money out early?”*, that should be coordinated with section *“What are the risks and what could I get in return?”*. There are also links with the section *“What are the costs?”*, given costs are linked to the risk/reward profile of the PRIIP.

For the purpose of developing the details of the content of the KID, section *“What are the risks and what could I get in return?”* should present an overall concept of risk and reward, including, to the extent possible, all aspects of risk, whereas the other sections should present a descriptive information of certain details that complement the information in the former one.

In the table below the Key Questions on risk and reward are listed, bearing in mind that, from a consumer’s perspective, risk has two main dimensions: the possibility of capital loss, on the one hand, and the uncertainty of the returns, on the other.

Basic Questions related to loss	Follow-up Questions related to loss	Required by the Regulation
Can I lose part/all of my money? How much can I lose?	Is there a limit to my loss? Any protection and/or guarantee?	Summary risk indicator The possible maximum loss of invested capital,
Can I lose even more than the initial capital invested?	Is it possible that I have to put additional money to complement the investment? Is there a limit to my loss? Is there any protection or guarantee? What does it cover?	‘Whether the investors bears the risk of incurring additional financial commitments or obligations...’ ‘Whether the PRIIP includes a capital guarantee protecting against market risk,’ “What happens if the manufacturer is unable to pay out?
Basic Questions related to uncertainty (dispersion of	Follow-up Questions related to uncertainty	Required by the Regulation

possible returns)		
How likely is it that I lose my money?	<ul style="list-style-type: none"> • Under which circumstances do I lose my money? • What is a reasonable range of projected returns I can get given market conditions? 	Appropriate performance scenarios, and the assumptions made to produce them;
How much can I win? How much am I likely to win?	<ul style="list-style-type: none"> • What is a reasonable range of projected returns I can get given market conditions? 	Appropriate performance scenarios, and the assumptions made to produce them; Where applicable, information on conditions for returns
Is risk and return balanced?	<ul style="list-style-type: none"> • What is a reasonable range of projected returns I can get given market conditions? • Am I able to get this information of other products and am I able to compare this product with other products? 	'What are the risk and returns?'
Basic Question related to holding periods/ term of the investment	Follow-up Questions related to holding periods/ term of the investment	Required by the Regulation
Can I get my money back at any moment?	<p>How? When? At what cost?</p> <ul style="list-style-type: none"> • Is there any recommended or required holding period? • How would I get my money back? What would be the consequences of cashing in early (additional costs)? 	<p>"What are the risks and ...".</p> <p>"How long should I hold it and can I take money out early?"</p>

Table 3: Key Questions on Risks and Rewards

3.3.2 Types of risks

To be able to provide answers to the consumers' Key Questions one needs to identify aspects or types of risk that are relevant and need to be considered when evaluating the risk of a PRIIP.

In an initial phase the ESAs have examined potential risks related to PRIIPs and their manufacturers. This resulted in a long list of types of risk, expressed in terms common in market and supervisory practice. Amongst these risks were market risk, counterparty and credit risk, fx-risk, legal risk and operational risk. Following analysis, the ESAs consider that these different types of risk factors can be reduced to three main types of risk: market, credit and liquidity risk. All other risk factors or drivers relevant for answering the Key Questions can be expressed, in the ESAs view, through these three main types of risk.

3.3.3 Definition of market, credit and liquidity risk

As indicated, from a consumer's perspective, risk relates to both loss and uncertainty. Uncertainty from a consumer's perspective can be compared with probability from a more methodological point

of view. Both loss and the probability of outcomes are relevant for all three types of risks presented below. The extent to which these types of risks can be aggregated is elaborated on below under section 3.4.

Market Risk

One important characteristic of PRIIPs is that they are by definition indirect investments. Their value is dependent on the value of underlying asset(s) or reference values. There are multiple types of possible underlying assets or reference values, such as equities, commodities, real estate, bonds, interest rates, foreign exchange rates, and so forth. The **market risk of a PRIIP** can therefore be defined as the risk of changes in the value of the PRIIP due to movements in the value of the underlying assets or reference values. Accordingly, when we talk about the PRIIP's market risk, we also mean interest rate risk, FX risk, equity risk and commodity risk, either alone or combined together, depending on the particular PRIIP we are looking at.

Specific attention should be paid to PRIIPs whose value is dependent on underlying investments that are denominated in another currency than the currency the PRIIP is denominated in. In such cases not only the changes in the value of the underlying but also changes in the exchange rate of the currencies impact the value of the PRIIP. This specific type of risk should be considered a part of the market risk of a PRIIP.

Another aspect of market risk that may be considered is the impact of inflation on the value of the PRIIP. The longer the term of the PRIIP the more relevant the impact of inflation may become.

Credit Risk

Credit risk is generally perceived as the risk of loss on a given asset in relation to issuer's credit events – with the extreme case being default. Bearing in mind the extremely wide spectrum of PRIIPs, with very distinctive natures, ranging from derivatives to structured products (including structured deposits), life insurance and funds, it is preferable to define the **PRIIP's credit risk** as the risk of loss on investment arising from the obligor's failure to meet some/all his contractual obligations. The obligor could include the issuer of the PRIIP.

The analysis of credit risk of a product should comprise two interrelated aspects: the first one is the likelihood of each counterparty defaulting and the second the recovery rate upon default.

However, it should be noted that the credit risk of the underlying assets of a PRIIP may end up being reflected in the PRIIP's market risk, limiting the credit risk that needs to be isolated from the risk of failure of the obligor to the consumer.

Liquidity Risk

The PRIIP's liquidity risk relates to factors determining whether an investor can redeem his investment at the moment that the investor wishes to redeem the product, that is for example for a product with a fixed term, before a scheduled maturity date, or a product creating exposures to assets that may be or become illiquid (such as real estate, participations in long term projects).

Liquidity risk can be relevant at the level of both the underlying investment of the PRIIP and the PRIIP itself. A PRIIP may invest in assets for which markets may become illiquid, thereby impacting the liquidity of the PRIIP itself. A symptom of illiquidity for traded assets could be where sales or purchases are significantly moving the market price.

It may be the case that an issuer of a product intends to establish a market but has considerable flexibility in determining how and in which circumstances it would maintain this secondary market. An equivalent arrangement may exist when the counterparty offers liquidity facilities that enable investors to cash in at any moment.

Accordingly, we would define the PRIIP's **liquidity risk** as (i) the absence of a sufficiently active market on which the PRIIP can be traded or (ii) the absence of equivalent arrangements. Absence of these two aspects impacts the uncertainty about whether the PRIIP can be cashed-in during its life in a reasonable time and/or for its fair investment value.

3.3.4 Application of types of risk to answering Key Questions

Market risk is linked to most of the Key Questions identified in section 3.2.1, including those related to loss of capital and to uncertainty about returns, that is, both downward and upward potential. Credit risk is in particular relevant to answering questions about possible loss of capital and downside risks.

Liquidity risk can be relevant for most of the questions, though in ways that can be difficult to quantify (e.g. the difference between a theoretical value and the price achieved). It is also relevant for considering holding periods and the extent to which an investment should be seen as a long term commitment. In addition, the decision of the investor to cash-in earlier than anticipated (changing the intended holding period) may impact the performance and how the return for the investor is calculated in a very significant way. This would be the case, for instance, where a product has been designed with features that are linked to or only available at a particular maturity date.

Questions

- 2: Do you agree with the description of the consumer's perspective on risk expressed in the Key Questions?
- 3: Do you agree that market, credit and liquidity risk are the main risks for PRIIPs? Do you agree with the definitions the ESA's propose for these?

3.4 Measuring risks

The ESAs have explored a variety of ways of measuring risks, broken down by market, credit and liquidity risk. A distinction can be made between quantitative measures, inferred from quantitative market data, and qualitative measures, based on product features or other data.

For certain qualitative measures, a combination of qualitative factors might be envisaged, given that single factor qualitative measures may not be sufficiently effective or indicative.

In addition, for quantitative measures, such as those relating to calculating probability distributions, there may be no fully accepted and already standardized methodology. Options for achieving a consistent approach (either in a normative or a prescriptive way) across manufacturers and PRIIPS are not addressed in this Discussion Paper, but will be considered during a later phase of work. There are clear challenges to address: necessary data may not always be available or may be available but difficult to obtain, while smaller firms may face particular implementation challenges.

See Annex 2 for a detailed outline of these different approaches, and some of their advantages and disadvantages. The selection and/or combination of different measures and factors will be considered at a later stage.

3.4.1 Possible measures of market risk

Quantitative measures		
	<i>Historical (ex post) volatility</i>	Historical volatility is derived from time series of past market prices.
	<i>Volatility of forecast returns</i>	A model is used to calculate the distribution of possible returns.
	<i>Value-at-Risk or Expected Loss for a given Value-at-Risk</i>	Both VaR and ELVaR are statistical measures derived from a probability distribution of expected returns.
	<i>Expected Shortfall for a given Value-at-Risk</i>	Like VaR, Expected Shortfall VaR is a statistical measure derived from a probability distribution of expected returns.
Qualitative measures		
In combination	<i>Type of underlying</i>	Classification of market risk according to qualities of market instruments underlying the product.
	<i>Risk diversification</i>	Classification according to degree of risk concentration or diversification.
	<i>Leverage</i>	Classification according to level of leveraged exposure to underlying assets.
	<i>Other product design features</i>	Classification according to other product features that mitigate or magnify risk exposures.
	<i>Exposure to foreign exchange rates</i>	Classification according to exposure to assets in a different currency.

Table 4: Possible measures of market risk

3.4.2 Possible measures of credit risk

The analysis of the credit risk of a product should be product specific, meaning that it should, as much as possible, consider the product characteristics and not only the general solvency of the manufacturer or of the entity responsible for the payment obligations if different. The following characteristics have been identified as having an impact on the credit risk of a product in addition to the creditworthiness of the manufacturer: risk diversification, level of seniority and secured or unsecured nature (whether by collateral or a third party guarantee).

Next to the product characteristics and the overall creditworthiness of the manufacturer, investors' claims under a PRIIP may sometimes be protected by a deposit or insurance guarantee scheme. All these elements may impact the credit risk attached to a product.

The table hereunder lists credit risk indicators that measure the overall creditworthiness of the manufacturer for a certain type of product. A distinction is made between quantitative indicators, inferred from quantitative market data, and qualitative risk indicators, based on product features or other data.

Quantitative measures		
<i>Credit spread or CDS spread of the manufacturer</i>	The credit spread of the manufacturer refers to the difference in yield between different bonds of same maturity due to different credit quality; the CDS spread being the premium paid by the protection-buyer, reflects the credit risk attached to the underlying reference entity.	
<i>Credit value at risk</i>	The credit risk of a PRIIP can be valued by establishing a loss probability distribution that represents the relationship between a loss level due to a default and its probability of occurrence.	
Qualitative measures		
<i>Credit rating</i>	Counterparties can be distinguished based on their credit rating, taking into account however recent legislative steps to reduce over-reliance on credit ratings.	
<i>Prudential supervision</i>	A distinction could be made between entities subject to prudential supervision (credit institutions, investment firms, insurance undertakings) and other entities.	
<i>In combination</i>	<i>Risk spreading</i>	Other qualitative factors that could be combined for a classification of products.
	<i>Level of seniority</i>	
	<i>Secured/unsecured nature</i>	
	<i>Deposit insurance</i>	

Table 5: Possible measures of credit risk

3.4.3 Possible measures of liquidity risk

Quantitative measures	
<i>The bid-offer spread</i>	These can reflect the difficulty and cost of exit.
<i>The average volume traded</i>	This can reflect possibilities for disinvesting at any moment.
<i>Number of market makers excluding the manufacturer</i>	One or more market makers increase possibility of disinvesting.
Qualitative measures	
<i>Characteristics of the exit arrangements</i>	Classification according to exit arrangements. Aspects to be considered include, whether the products are (i) listed or whether (ii) a secondary market is organized, whether (iii) liquidity facilities are organized under what circumstances or conditions and (iv) how the exit price is determined.

Table 6: Possible measures of liquidity risk

Questions

- 4: Do you have a view on the most appropriate measure(s) or combinations of these to be used to evaluate each type of risk? Do you consider some risk measures not appropriate in the PRIIPs context? Why? Please take into account access to data.

3.5 Aggregation of risk

Financial risk is a multidimensional concept comprising of different types of risk. Market risk, credit risk and liquidity risk have different impacts on the assessment of the risk of the PRIIP. Market risk impacts products on a daily basis, but large losses on a daily basis occur relatively infrequently. Credit risk impacts products on an infrequent basis, but when a credit event occurs it may have a large impact on the payout of a PRIIP.

From the consumer perspective, these different factors are not necessarily considered separately, but risk is considered primarily from the perspective of loss and uncertainty. Loss and uncertainty is not only impacted by market risk but can, for some products, be heavily impacted by the credit and liquidity risk of that product. In general, it might be assumed that disaggregated risks can provide a more nuanced message to the consumer about the risk profile of a PRIIP, yet this would leave the consumer with the task of weighing up the relative importance of the different risk measures or messages, leading perhaps to greater levels of misunderstanding. The consumer testing of options will be designed to provide feedback on this.

This is particularly relevant, as the level one text in the PRIIPs Regulation refers to a summary risk indicator, rather than indicators. However, the PRIIPs Regulation would permit a narrative (textual) explanation of the risks which are materially relevant to the PRIIP and which are not adequately captured by the summary indicator.

As explained above several indicators are being considered, with both qualitative and quantitative possibilities. Methodological challenges can be anticipated in aggregating risk types. No single existing quantitative risk measure has been identified that covers all dimensions of risk with sufficient accuracy. This would imply that a method that draws on a combination of quantitative and/or qualitative methodologies may be needed.

The starting point is likely to be market risk, which is important for all PRIIPs. However, options will need to be examined for incorporating credit and liquidity risk into this approach, whether through narrative or through an objective common methodology. This is important given that both credit and liquidity risks are likely to be materially important for a relevant number of PRIIPs.

The challenges with combining different risks relate to such steps as setting priorities or weightings for each type of risk, which is a complex issue. If quantitative measures are to be used, it would mean assigning a concrete quantified weighing to each type of risk in order to be able to sum the values of each type of risk. Other challenges with aggregating all three risks include the fact they may be correlated (e.g. credit risk may impact the market risk of a product).

The indicator could be accompanied with narrative to explain what it shows and how to use it, including covering the risks not included or aggregated in the indicator.

Another theoretical approach would be to show multiple dimensions of risk, either through a single indicator which shows more than one dimension, or through separate indicators. The latter is however arguably inconsistent with the language in the PRIIPs Regulation. To summarize 5 different options are explored further:

- Three risks aggregated
- Two risks aggregated ; market risk with either liquidity or credit risk
- No aggregation; only market risk is represented within the summary risk indicator, or a multidimensional summary risk indicator.

Presentation options of the summary risk indicator are discussed in section 3.7.

Questions

- 5: How do you think market, credit and liquidity risk could be integrated? If you believe they cannot be integrated, what should be shown on each in the KID?

3.6 Performance scenarios

In addition to the summary risk indicator, the section on risk and reward requires the presentation of performance scenarios, as a way of showing information about possible outcomes. This section will discuss some methodological issues underpinning the selection of scenarios and the calculation of performance.

Presentation alternatives will be discussed in section 3.7 below.

3.6.1 General approach and methodology

Performance scenarios can either be based on descriptions of hypothetical situations or on data (historical or modelled). In the latter case, they could be probabilistic – that is, provide information on the likelihood of outcomes.

In the first option, a performance scenario describes how the product reacts in case of a hypothetical development of the underlying. For example if the underlying goes up by a certain percentage, the payout of the PRIIP will be a certain amount. The hypothetical situations could be selected by the manufacturer, under certain guidelines (for instance they should include a positive, a neutral and a negative situation). This is the approach used for structured UCITS in the KII. The main advantage of this kind of performance scenarios is that they are easy to develop and may be aligned to the description of how the product works. The main disadvantage of this option is that the likelihood of the performance scenarios is not taken into account, and comparability of information would depend on setting a common approach in detail for all PRIIPs.

In the second option, performance scenarios could be selected on the basis of a probability distribution of expected returns of the product fed by historical data (backward looking – a type of ‘backtesting’) or by data produced by modelling the market instruments which underlie a product’s performance (forward looking – a simulation). This would allow the scenarios to be linked or selected according to their likelihood of occurring according to the assumptions used in establishing probabilities, thereby giving the retail investor an estimate as to what he might reasonably expect to happen.

Looking at the distribution of historical returns may be problematic for several reasons: the history of investment returns may not repeat itself, there may not be enough data to generate a statistical meaningful sample without allowing for overlapping data periods or a particular product or underlying may often not have historical returns at all.

Modelling price data to determine a distribution of possible returns for a particular product requires the specification of a model, the calibration of the model and sufficient number of simulations to produce the required measure. Risk-neutral modelling techniques may have some limitations and might need to be adjusted to adopt a more ‘real world’ perspective, as would be expected by retail investors. The choice of model and model calibration is a difficult task because both the model and its calibration should be chosen so that the distribution of outcomes is the expected distribution of outcomes in the future. Lastly, different models calibrated to the same data set could give different results for the same product. At this point there is neither consensus nor standardisation in the market on the type of model to use and how to calibrate it.

Since in either approach probabilities are ultimately derived from market data, risk mispricing could lead in extreme cases to significantly inaccurate estimates.

Once the probability distribution of returns is estimated, this information can be used in several ways to define the scenarios (and the information communicated about them). Scenarios could be selected on the basis of their probability of occurrence, e.g. a positive, neutral and negative scenario

reflecting the expected return in the 90th percentile, 50th percentile and 10th percentile of the distribution.

Question

- 6: Do you think that performance scenarios should include or be based on probabilistic modelling, or instead show possible outcomes relevant for the payouts feasible under the PRIIP but without any implications as to their likelihood?
- 7: How would you ensure a consistent approach across both firms and products were a modelling approach to be adopted?

3.6.2 Time frame and holding period

Performance scenarios may show performance at a certain moment in time or alternatively present data over a continuous time-frame, depending on the approach taken to presentation.

Performance scenario information therefore requires a time frame to be assumed. The timeframe, that is the holding period used to calculate the returns, could be one fixed period for all PRIIPs or be flexible for different PRIIPs. Flexibility may be useful, given different PRIIPs have different maturity and liquidity profiles; the time frame of the scenarios could therefore be varied according to the maturity of the product or the recommended holding period, requiring only a standardised holding period assumption for open ended products. This more flexible approach could enhance understanding of the product but comparability may be reduced.

Coherence with the approach in the summary risk indicator and in the costs section should be pursued. Both issues are especially relevant with the presentation of costs. For example cumulative cost information could be presented within the performance scenarios. In that case important conditions on the presentation of the performance scenarios would likely be needed.

Another approach would be to use several holding periods, for instance showing the impact of short term holding against long term holding. This option would potentially complicate the presentation, such that consumer testing evidence would be important to establish the degree of complexity possible.

Questions

- 8: What time frames do you think would be appropriate for the performance scenarios?

3.6.3 Other aspects of performance to be considered

Payment and payout structures

Some of the PRIIPs in scope may be sold for periodic investments instead of a lump-sum investment. Taking into account the effect of this periodic investment could complicate calculation and presentation of performance scenarios but may on the other hand contribute to clarify the impact of periodic investments on the performance of the product. Performance information for accumulation products could aid retail investors in not only understanding the impact of market performance on their savings, but also the accumulation over time of their capital given periodic payments.

But products can differ not only in how the initial investment is made (single payment or regular payment) but also on how their pay out phase is structured (lump sum or regular pay out (e.g. annuity)). Here again the choice needs to be made whether a single type of payment and payout is standardised for all PRIIPs, or whether the information varies depending on what is relevant for the type of PRIIP. For consumers it could be confusing when the performance scenarios are calculated based on a single payment and single payout, but the relevant PRIIP does not offer this possibility. On the other hand this does effect the comparability of the KIDs across different PRIIPs. Reflecting in the KID scenarios for period investment given the number of variables (notably, different amounts and payment frequencies) may be practically difficult to achieve.

Percentages and nominal values

Performance scenarios may be displayed in absolute terms (e.g. in euros) or in percentage terms (e.g. average annualised return) or both.

Research shows that people make perceptual mistakes in interpreting percentages (it can be better to presented in terms of frequencies, such as '10 out of 100'). Next to that consumers are prone to a 'small numbers bias' which makes them underestimate the actual impact of small percentages on returns.

Monetary figures could help. However, the KID needs to be produced without knowing personal aspects of the investment. In order to calculate the performance in monetary terms a hypothetical amount invested is necessary, since the exact amount will not be known to the manufacturer at this point.

In order to make these examples as relevant and meaningful as possible from the consumers' perspective, monetary values used in the examples might need to correspond at least to the minimum or average investment amounts for that PRIIP. However, these may vary between different PRIIPs, reducing comparability.

Percentages do not require assumptions related to invesment amounts; performance scenarios in percentages will be directly comparable across products. Also annualized percentages facilitate comparison among products with different time frames or holding periods.

It would be helpful to explore both types of information during the consumer testing, to see whether different presentation options can address the pros and cons of both monetary and percentage information on performance.

Including cost information on the performance presentation

Performance may be shown net of costs (that is, the pay out or cash flow received). We define the 'gross' amount returned to be the sum of the net amount returned and the total costs as reported elsewhere in the KID. With gross here we mean that the pay-out includes costs.

Performance scenarios that take into account costs may help to communicate the effect of costs on performance required by the Regulation, i.e. the key questions about costs on 'How do the costs impact my returns?' and 'How do the costs develop over time?'. In that case, coordination should be ensured with information on costs included in the cost section of the KID. However, if performance scenarios are expressed net of costs, an investor will not be able to distinguish between the 'intrinsic performance' of the PRIIP (ie what a PRIIP would yield in a hypothetical case where no costs are incurred) and the effects of costs incurred throughout the life of the product, as these two aspects will be aggregated in net figures, unless the KID provides for a clear visual presentation of these two components (e.g. through a 'waterfall diagram').

Alternatively, should performance scenarios be expressed in gross terms, the investor will need to refer to the cost section in order to find information on the compounded effect of costs on his actual pay-out(s). He may however gain a better understanding of the functioning of the product in terms of cash-flows received throughout the product life. If this option is chosen, a prominent warning in the KID will be necessary to draw the readers' attention on the fact that the impact of costs is ignored in the performance scenarios presented.

Number of different performance scenarios

The choice of the number of performance scenarios is governed by the following factors: the amount of space needed to display and explain each scenario; the ability to convey the information expected from the scenario to the consumer; and the meaning that the consumer draws from the performance scenarios. Certain products may introduce features that complicate how performance scenarios should be chosen depending on the number of scenarios to be displayed to the consumer. A good example is any derivative product that gives the customer the right, but not the obligation, to convert the product to an equity security (call option, put option, convertible bond). The decision to convert depends on the value of the derivative compared to the value of the equity.

Two scenarios suffice to answer the questions of how much could be earned and how much could be lost: however the information presented by two scenarios could be misinterpreted as there is no comparison to the expected return from the product and there are known behavioural biases that impact understanding when presented with limited options. Three scenarios allow for the comparison of a better and worse outcome to the expected outcome, but still suffer from the behavioural biases mentioned above. Five scenarios, chosen by the probability of the product performing no worse than the level attained at a specific time gives a reasonable idea of the

distribution of outcomes, but may require too much space. Conversion scenarios, if required, will add an additional scenario if a number of fixed scenarios is prescribed for all products. More scenarios are indeed possible, but the space required to display more than five scenarios may exceed the limitations imposed by the requirement to contain the key information in 3 A4 pages.

Questions

- 9: Do you think that performance scenarios should include absolute figures, monetary amounts or percentages or a combination of these?
- 10: Are you aware of any practical issues that might arise with performance scenarios presented net of costs?
- 11: Do you have any preferences in terms of the number or range of scenarios presented? Please explain.

3.7 Options for presentation

This section will examine theoretical high-level possibilities for presenting risk and return: general types or ways of presenting information, considered in abstract rather than specific terms. (These are termed here ‘abstract presentations’ to underline this point). Multiple concrete examples (variants or options) can follow from one abstract model. For instance, a single visual element is an abstract presentation for the summary risk indicator, meaning a style of presentation that may be concretized in very different formats (from a scale similar to UCITS KII SRI to a pyramid, a traffic light, etc.). The methodology underpinning the indicator may also be different (from the aggregation of all risks (credit, market and liquidity) to a model including only market risk).

In order to understand the meaning of the abstract presentation discussed, it may be noticed that these models focus on the general visual or narrative style, but besides the visual elements in all options narrative explanation will always be given (pursuant also to the PRIIPs Regulation), either to give a description about the risk-reward profile and if needed further explanation about the visual aspects of each model. Narrative text is the baseline. Where we refer here to options with a purely narrative representation, this indicates that no visual aspects will be added to this baseline.

Abstract presentation and methodological decisions are highly interrelated, and will be developed ‘hand in hand’. In chapter 2 a number of possible criteria were outlined for assessing different presentational options, which will be used by the ESAs in developing the options outlined here further.¹⁰

¹⁰ When rating the different abstract presentation by the rating criteria a lot of assumptions are made especially with regards to the expected engagement, understanding, comparability and discriminatory characteristics. These assumptions will be tested during the consumer research later in the development process.

3.7.1 Abstract presentations of the summary risk indicator

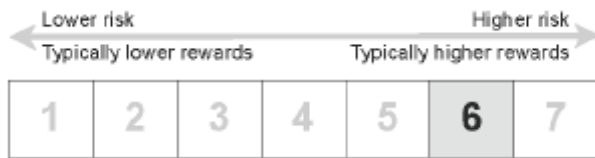
In the table below the different abstract presentation options for the ‘summary risk-indicator’ are displayed by the different numbers (1 to 3). First, we would like to stress that besides the visual aspects of risk more narrative explanation can be given in this section to give a description of the risk-reward profile and if needed further explanation of the visual aspects in this section. So for example, when we discuss a single visual element this does not mean that there would be narrative to accompany the visual element.

Abstract presentation options for the summary risk indicator			Considerations
1	Narrative risk information	This option means that there will be no separate visual aspect of risk; the risk will be explained by a narrative.	A narrative is less engaging than visual elements and difficult to harmonize this might impair comparability between PRIIPs for retail investors. This option is incompatible with the PRIIPs Regulation, as the separate summary risk indicator has to be accompanied with narrative text, which is inconsistent with a purely narrative approach.
2	Single visual element for risk	The risk of the PRIIP is explained in the KID by one single visual element. This option may include any visualization of “buckets” (discrete values in a scale, such as the UCITS model) or a continuous representation (graph). It may include only visual elements or be accompanied by some data. It may represent all or some of the risk types identified in the Key Questions paragraph (market, credit and liquidity risk) depending on technical options for aggregating risks.	This presentation format is expected to be engaging, since it is simple which makes it attractive and accessible for retail investors. It seems easy to understand especially where all types of risks are aggregated, such that the retail investor do not have to worry about weighting different risks or how they are correlated. However there is a concern that retail investors not fully understand what types of risks are represented or that this might oversimplify the risks concerned. This model may ease comparison (of the risks included in the indicator) across different PRIIPs as it may be highly harmonised.
3	Multidimensional indicator ¹¹	The different risks of the PRIIP are shown separately using a multidimensional indicator. This option may include the same alternative as option 2, but applied separately to each type of risk, so that several visual elements are presented (2/3 scales or 2/3 graphs). It may include information on how to integrate the different types of risks (including an aggregated figure) or not.	It may be that multiple elements are too complex for the retail investor and that they reduce engagement. Retail investors may find it hard to combine or rank the different aspects of risk. However it may reduce misinterpretations by some retail investors or mitigate oversimplification. Comparing PRIIPs may become more difficult since more dimensions need to be taken into account. Arguably, multiple indicators may be incompatible with the PRIIPs Regulation, given its reference to a ‘summary risk indicator’, though a multi-dimensional summary risk indicator may instead be compatible.

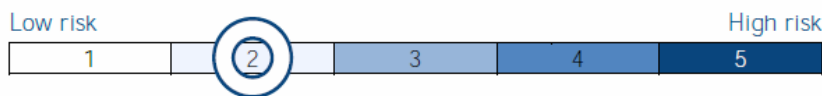
Table 7: Abstract presentations of summary risk indicator

¹¹ For example three visual elements could be displayed, one for each type of risk. Also when the methodology allows for integrating two types of risk, for example credit and market risk these can be integrated, but liquidity risk cannot, the abstract presentation will hold two visual elements.

For the single visual elements for risk (option 2) multiple concrete examples (variants or options) have been identified from market practice, and will be used as inspiration for designing concrete options that will be tested with consumers.



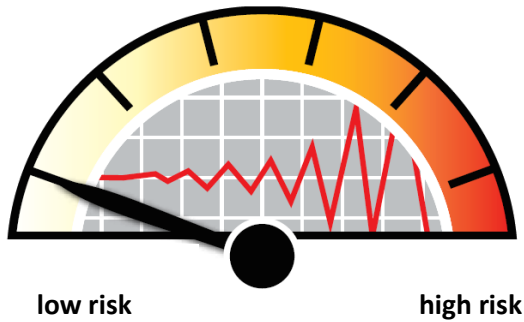
The UCITS KII synthetic risk and reward indicator is a series of categories on a numerical scale with the UCITS assigned to one of the categories. The presentation of the synthetic indicator ranks the funds on a scale from 1 to 7 on the basis of its volatility record.



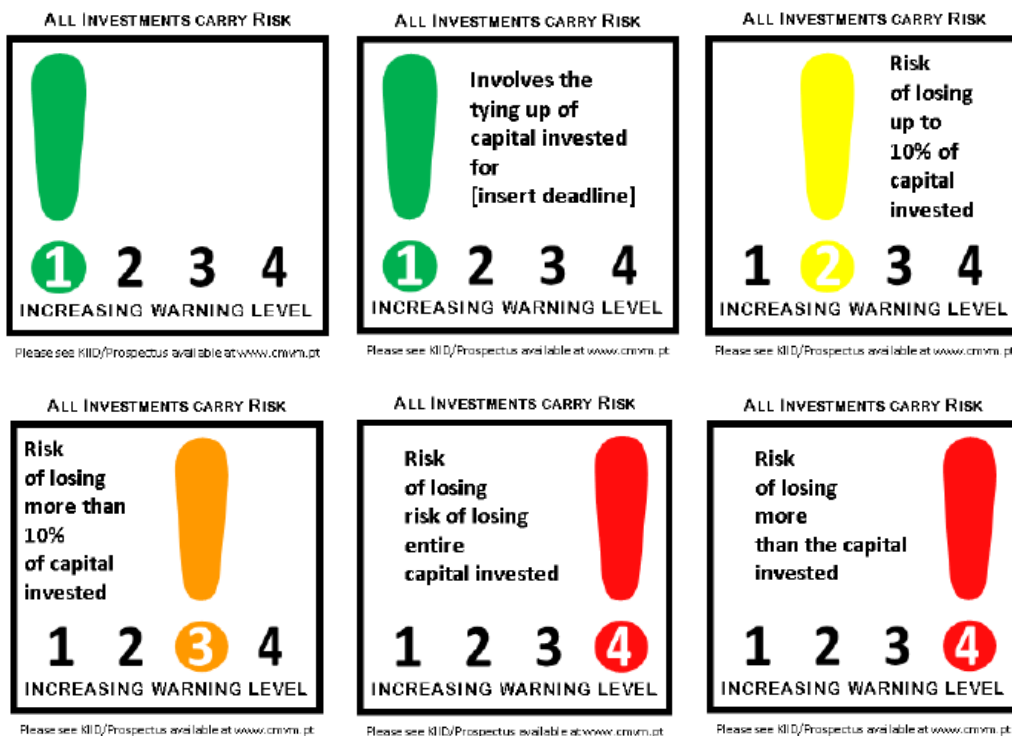
In Italy consumer research was done on the impact of financial information on investment decisions. Different information sheets were used to disclose product characteristics presenting the same content in terms of risk-return and costs. The riskindicator above was designed and tested. The risk indicator ranges from 1 (low risk) to 5 (high risk).



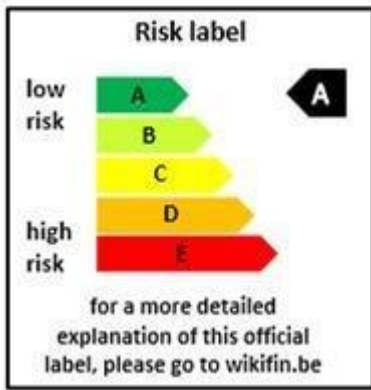
The **Dutch** financial leaflet contains a risk indicator that divides risk over 5 different categories from 'very small' to 'very large'. The indicator provides information on both a guarantee (protection) of the initial investment and the chance of losing (part) of the investment. The risk indicator is graphically presented in a figure that carries more weight as the risk increases. With a very large risk the 'little man' is completely bend over and the meter he is carrying turns almost completely black.



The risk indicator above was introduced as guidance in the **Netherlands** to support financial institutions to improve information disclosure to consumers on risk profiles. The riskiness of the different investments in the different risk categories, the naming of these categories and the number of categories differed significantly. Consumer research showed that consumers had difficulty understanding and comparing risk profiles of funds. To improve the choice context of consumers, the risk meter was introduced which provides information of the risk of the investments within the risk profile. The risk of the profile is indicated by the position of the arrow. The position is determined by calculation of the standard deviation of the standard division of the investment categories within a risk profile (volatility). The bigger the standard deviation, the higher risk is indicated.



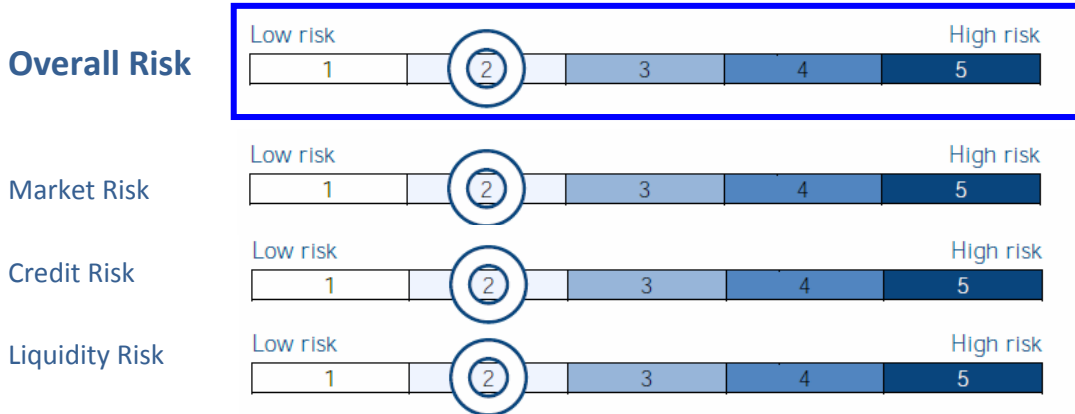
The examples above are different categories of the **Portuguese** risk label (only one will be presented in the KIID) for complex financial products in the securities sectors namely. Four categories of risk are identified, ranging from 1 to 4, with 4 being the highest risk and coloured green to red (green, yellow, orange, red) with red being the highest risk. The Portuguese risk label is meant to inform investors about the possibility of capital loss in a simple and direct manner.



✗ Sale before maturity can lead to loss

Above the national example of the **Belgian** risk indicator is presented as an example to be in effect from June 12, 2015. Financial institutions are required to provide customers with the risk label for all savings or investment products. The label was inspired on the energy labels for electric products. The risk is classified into 5 categories on the basis of market, credit and currency risk and there is a warning for liquidity risk. The five different categories are indicated by coloured arrows on the left and a black arrow on the right to indicate what risk-category is applied to the product.

For the multiple visual elements for risk (option 3) multiple concrete examples (variants or options) were identified from market practice and will be used as inspiration for designing concrete options that will be tested with consumers.



The example above is made up of different single indicators from the Italian research, showing also an overall risk indicator with more prominence. The example below was also tested in the consumer research in Italy. A number of tables are presented rating the product against a benchmark. Different types of risk are adressed.

Market risk

Annual volatility	Product	similar products
Annualised daily average, calculated on data from September 2012 to December 2013.	6.0%	6.1%
Value at Risk (VAR)		
Threshold value such that the probability that the daily loss on the Product exceeds this value is equal to 1%. This measure is calculated on daily yields from September 2012 to December 2013.	1.2%	1.2%

Liquidity risk

Turn-over ratio	Product	similar products
Ratio between the daily average trading volume and the daily average market value from September 2012 to December 2013.	0.3%	1.2%

Credit risk

Annual expected default frequency	Product	similar products
The expected default frequency is based on the book value of the issuers' liabilities and the market value of their assets from September 2012 to December 2013.	0.2%	1.0%
Rating		
Standard Et Poor's equivalent rating.	BB-	B-

Questions

12: Do you have any views, positive or negative, on the different examples for presentation of a summary risk indicator? Please outline advantages and disadvantages, and provide any other examples that you are aware of that you think would be useful.

3.7.2 Abstract presentations of performance

In the table below the different abstract presentation options for the 'performance scenarios' are displayed Letters (A to C). These abstract presentations of the 'performance scenarios' are without prejudice to how the performance scenarios are calculated. Again we would like to stress that besides the visual elements more narrative explanation can be given in this section and if needed further explanation of the visual aspects in this section.

Performance scenario options			Considerations
A.	Narrative presentation of performance scenarios	This option means that there will be no separate visual aspect of performance; the possible outcomes will be explained only by a narrative description.	Narrative is less engaging than visual elements and may be difficult to standardise, and hence this could reduce comparability. It may however be well understood, and reduce potential misunderstandings.
B.	Single visual element for performance	This abstract presentation assumes that the different possible outcomes of the particular PRIIP (scenarios) are shown in one visual	Visual elements provide a clear focal point helping consumers pay attention to the information displayed. It

	scenarios	presentation of possible outcomes. Visual options include a table, scale or a graph. For example when we would like to show three scenarios this abstract presentation assumes that these scenarios are all integrated into one visual presentation of possible outcomes.	reduces the space used to present the information and it may help to understand it and to compare the outcome in different scenarios.
C.	Multiple visual elements for performance scenarios	The performance of the PRIIP is explained in the KID by multiple visual elements to explain possible return scenarios. Several visual elements could be displayed, one for each performance scenario. The number of visual elements could differ depending on the methodology for valuing the different performance scenarios. For example three visual elements could be displayed, one for each performance scenario.	Separated scenarios may allow for more complex representation of each one. However, it may be difficult for consumers to understand the link between different graphs and hence, the relation between risk and reward. Consumers may pay attention only to one scenario. The increased number of elements that needs to be compared also decreases comparability.

Table 8: Abstract presentations of performance scenarios

For the single visual elements for performance (option B) multiple concrete examples (variants or options) were identified from market practice and consumer tests and will be used as inspiration for designing concrete options that will be tested with consumers.

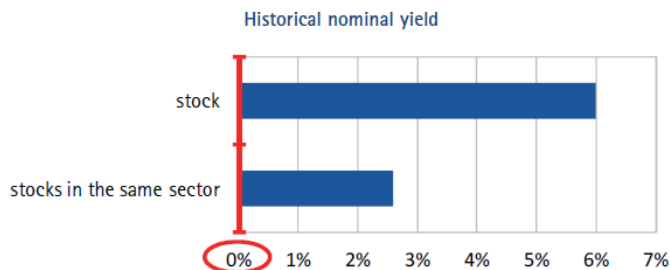
The examples below show the performance within a table. The first example was tested in Italian research. The second example is a market example of a retail fund KID from Spain.

Performance scenarios of the underlying parameters	Annual internal rate of return
At maturity, the inflation rate increases and the price of one of the three securities does not exceed the price on April 18, 2011.	2.2%
At maturity, the inflation rate remains stable and the price of one of the three securities does not exceed the price on April 18, 2011.	3.2%
At maturity, the inflation rate remains stable and the prices of the three securities exceed the price on April 18, 2011.	10.3%

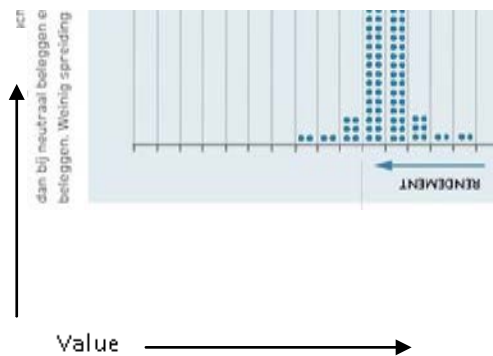
Unfavourable scenario		Average scenario		Favourable scenario	
Index variation	-44,82%	Index variation	-8,14%	Index variation	18,03%
Return=70%* max (0% ; index variation)	0,00%	Return=70%* max (0% ; index variation)	0,00%	Return=70%* max (0% ; index variation)	12,62%
Average Annual	0,00%	Average Annual	0,00%	Average Annual	2,17%

return at maturity	return at maturity	return at maturity
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The performance scenario below was designed and tested in Italian consumer research. It shows the returns in gross percentages without taking into account inflation.

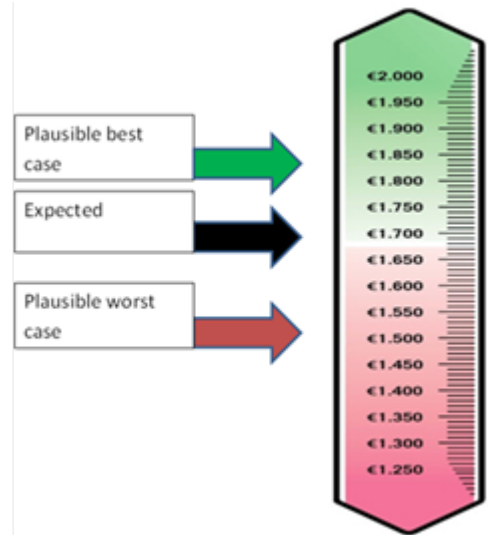
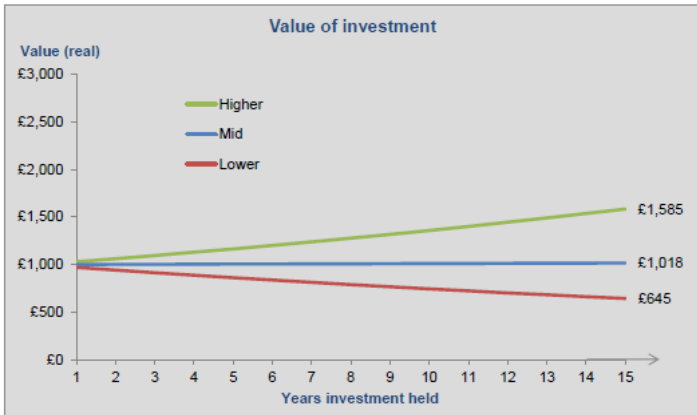


The next example is designed and tested in academic research.¹² The scenario below tries to integrate probability into the performance scenario. Consumers have difficulty in understanding probabilities, which makes it quite hard to interpret the performance scenarios. Research has shown that presenting probability in a number of frequencies increases consumers understanding of risk significantly. The visual element below tries to do so by distributing 100 little dots over the possible range of outcomes.



The performance visual element below shows three scenarios within one graph. This results in a V-shape indicating uncertainty. This presentation was used by the Association of British Insurers (ABI) in consumer testing. The figure on the right is aimed to do the same and was used in testing by the Netherlands for occupational pension projections.

¹² Donkers, B., Lourenco, C. Goldstein D. & Dellaert, B. Building a distribution builder; Design considerations for financial investment and pension decisions.

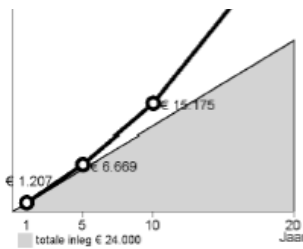


For the multiple visual elements for performance (option C) multiple concrete examples (variants or options) were identified from market practice and will be used as inspiration for designing concrete options that will be tested with consumers.



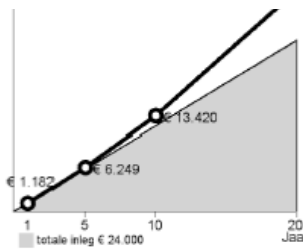
Historical scenario

The outcome predicted based on a value increase of the capital with an average of 6,2% a year



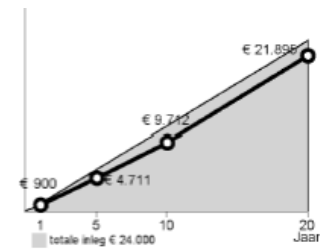
4% scenario

The outcome predicted based on a value increase of the capital with an average of 4% a year



Pessimistic scenario

The outcome predicted based on a value increase of the capital with an average of 0,7% a year



The performance scenarios above are part of the Dutch financial leaflet. The gray area shows the cumulative investments (regular investments). The performance is shown for the duration of the product, on certain intervals a nominal value is shown.

Questions

13: Do you have any views, positive or negative, on the different examples for presentation of performance scenarios? Please outline advantages and disadvantages, and provide any other examples that you are aware of that you think would be useful.

3.7.3 Combinations

Looking at the risk and reward section as a whole, the combination of abstract presentations for the summary risk indicator and for the performance scenarios need to be assessed. The combinations can either strengthen or weaken the overall risk and reward section. The following table shows all possible combinations of the models previously considered. This section on combinations relates strongly to the previous section on aggregation of risk.

			Abstract presentations of the summary Risk indicator		
			1	2	3
			Narrative on risk information	Single visual element for risk	Multiple visual elements for risk
Abstract presentations of Performance scenario	A	Narrative on performance	1A	2A	3A
	B	Single visual element for performance (all scenarios together)	1B	2B	3B
	C	Multiple visual elements for performance (1 per scenario)	1C	2C	3C

Table 9: Combinations of summary risk indicator and performance scenarios

First, combinations that are incompatible with the level one text are eliminated: abstract presentation options of the summary risk indicator 1 (the non-shaded area). While performance scenarios may include risk information, a separate summary risk indicator is required, which could not be purely narrative in form.

The single or multiple risk indicators may be combined with scenarios in narrative form, on as a single or multiple visual elements. As noted before when discussing model 1, the combination of a visual style for the risk indicator and a narrative style for the performance scenario may lead consumers to underestimate the information in the latter, even where it is well understood.

When assessing the remaining six options, options 2A, 2B and 2C were preferred because these options all entail a single visual element for presenting risk. The single visual element would provide a summary of the risk in the product overall so retail investors are not required or expected to combine the different types of risks themselves for a total impression of the risk (see also section 3.4) for this considered to require too great an investment of effort by retail investors and might create confusion, uncertainty, or disengagement from the consumer. Next to that the single visual

element presentation for risk is considered to keep the document as concise as possible we find a preference for presenting a single visual element for the risk indicator.

However as explained in section 3.4, there may be some technical disadvantages to combining different types of risk into one value, particularly in respect of avoiding over-simplification and reducing the potential for misunderstandings. One of the options that might be kept open therefore is to not aggregate the risks into one value and only show this, but present them also separately, as suggested by model 3 where multiple visuals for risk are presented.

However combining multiple visuals of risk together with multiple visual elements for performance would be strongly expected to be overly difficult to compare and understand for consumers, and would increase the amount of information significantly complicating the overall presentation of the risk and reward section. Therefore option 3C is not preferred.

Explaining the performance scenarios by a narrative (3A) is also not preferred. This is due to the expectation that by presenting risk with multiple visual elements and the performance scenarios in a narrative will cause too much focus on the risks. People tend to rely heavily on visual elements and less on the narrative information. By presenting risks with multiple visual elements and no visual elements for performance an imbalance might be caused between the presentation risk and reward.

On this basis, options 2A, 2B, 2C and 3B are considered most fruitful for further exploration during the consumer testing. The testing can be expected to shed additional light on these assumptions, such that the best overall combinations, in view of consumer capabilities, can be identified and developed further.

Single visual risk indicator and narrative performance scenarios (2A)

The presentation of the section seems to be engaging for investors as it includes a simple visual element that has maximum accessibility for its simple presentation. Therefore it improves chances of use during the decision-making process. As the average consumer is not sophisticated, a simple presentation may be the appropriate level of information. However, the combination of the visual option for the risk indicator and the narrative style for the performance scenarios may lead investors to focus on the risk overall assessment, not paying enough attention to the performance scenarios.

The presentation of the summary indicator seems to provide a clear message that is easily understandable for consumers. However, this might become more difficult to understand for consumers, when multiple types of risk are integrated. Consumers might not fully understand what types of risks are represented and possibly oversimplify the risks concerned with the product and therefore the decision to be made about risk. In addition, too little information may incline retail investors to make further assumptions about the product. Given that in this model the visual element refers only to risk, the consumer could perceive this element as the most decisive criteria for his investment decision, disregarding other information on reward and costs.

The harmonised and simple presentation of the summary indicator makes the overall risk easy to compare, though at the cost of some loss of discriminatory power. The performance information may however be more difficult to compare due to the narrative style.

Consumer testing should shed light on how effective a single visual element for risk accompanied by narrative performance scenarios is in practice.

Single visual risk indicator and single visual performance scenarios (2B)

This model seems to fulfil the needs of consumers for a clear, accessible and simple visual element providing a clear focal point within the KID. In addition, both central elements of the risk-reward section are more balanced as they are both presented in a visual style in one single element.

The combination provides retail investor with more information on risk (as the summary risk indicator is complemented with the information on risk and reward in the performance scenarios), which may prevent misleading contextualisations due to 'the ease of retrieval' bias, increasing the chances of correct interpretation of the information and making the information more meaningful. This model may also help consumers to integrate risk and reward information.

On the other hand, some investors may find it difficult to combine two graphics elements and to understand the links between them, reducing the effectiveness of both. The harmonised presentation of both elements fosters the comparability. Consumer testing should look into the understanding of consumer to see the relation between the two visual elements.

Single visual risk indicator and multiple visual performance scenarios (2C)

As in the previous model both elements are visual, but here the scenarios are split, allowing for a more complex presentation of each scenario. The more complete presentation of the scenarios may help (if well designed) to communicate more information. On the other hand it may be even more difficult for consumers to understand the link between the separate graphs, and the indicator and the graphs. Separating the scenarios into more than one might lose the information about the risk and reward trade off. Also retail investors are inclined to focus on rewards. They are expected to remember the best case scenario the best. The increased number of elements that needs to be compared decreases the overall comparability.

Finally, the more complete presentation and the more space devoted to the performance scenarios may diverge attention from the risk indicator. The limited space of the KID pose a challenge to this kind of models as they may need more space that would need to be taken away from other sections.

Multiple visual risk indicator and single visual performance scenario (3B)

This model splits the risk indicator in different visual elements in order to be able to assess different aspects of risk separately. It may or may not include information on how to integrate the different types of risk in making an overall assessment of risk.

This model can be expected to require more effort from consumers to process the multiple different visual elements; it may reduce engagement and attention paid to the information on risk. On the other hand, by communicating the existence of different types or aspects of risk and providing a value for each one, this model may help consumers to better understand financial risks and the

differences between PRIIPs compared to a single indicator accompanied by narrative, whether this single indicator aggregates different risks, or shows one risk type (market risk) only.

However, if this conceptual model leaves the overall conclusion on risk up to the retail investor, for most retail investors it can be expected to be difficult to weigh the different elements into a complete valuation of risk. It is also questionable whether the different types of risk and their impact on the overall product valuation can be explained well enough for retail investors.

Questions

14: Do you have any views on possible combinations of a summary risk indicator with performance scenarios?

4 What are the costs?

4.1 Empowerment

Article 8(5)(a) and (c) empower the ESAs to develop draft RTS specifying ‘the details of the presentation and the content of’ the cost section of the KID as well as ‘the methodology for calculation of costs, including the specification of summary indicators, as referred to in point (f) of paragraph 3’ [of Article 8].

Article 8(3)(f)

Under a section titled “What are the costs?”, the costs associated with an investment in the PRIIP, comprising both direct and indirect costs to be borne by the retail investor, including one-off and recurring costs, presented by means of summary indicators of these costs, and, to ensure comparability, total aggregate costs expressed in monetary and percentage terms, to show the compound effects of the total costs on the investment.

The key information document shall include a clear indication that advisors, distributors or any other person advising on, or selling, the PRIIP will provide information detailing any cost of distribution that is not already included in the costs specified above, so as to enable the retail investor to understand the cumulative effect that these aggregate costs have on the return of the investment.

The empowerment lays down a clear basis for the ESAs to develop comprehensive yet consumer-friendly cost disclosures for the KID.

The empowerment specifically requires RTS to address both methodologies for calculating costs (for instance, identifying what counts as costs for different product types, how to quantify these or estimate them where necessary, and how to aggregate them together as necessary to show costs overall) and the presentation of the costs (for instance, what aggregate figures to show and in what layout, what breakdown of costs is needed, and what narrative text to include explaining the costs shown).

There is a clear interaction between disclosures in the KID of costs and disclosure by the intermediary of costs. It will be important to consider how these two kinds of disclosure work together for consumers so as to avoid inconsistencies, potential for misunderstanding, or ‘too much information’ undermining the consumer’s use of the information overall.

4.2 Discussion

If there were no costs to be paid by investors when investing in PRIIPs, the performance the investor would receive would be identical to the value of the underlying assets of the PRIIP.¹³ However costs are always incurred, and the PRIIPs costs section aims to capture all the costs that subtract from the investment, or impact the performance of the investment.

¹³ The situation is however more complex for PRIIPs that are not backed directly by assets. For structured products, for instance, the PRIIP will typically consist of a promise from the manufacturer to pay the investor a pay-out according to a pre-determined formula. In this case, the formula itself and the pricing of the PRIIP both could be seen as embedding costs.

4.2.1 What are costs?

The Regulation requires cost disclosures in the KID to include costs of all types, whether direct, indirect, one-off or recurring in nature.

Costs and how they are taken can be complex and vary significantly between PRIIPs. Costs can be taken at different points and in different ways. For instance, they can be deducted from:

- the initial amount invested, prior to any investments being made;
- from the investment itself on a periodic basis;
- from the investment itself, when certain conditions arise (such as where investment returns exceed a certain level);
- following a request of the investor to alter the PRIIP, for instance to switch between investment options for a PRIIP that offers different options, or to make changes to a periodic payment plan;
- from the proceeds of the liquidation of the investment, prior to the final payout to the investor.

Direct costs are costs that are explicitly deducted from the investment, whether before investment or during the life of the investment, or from the pay-out. This would include, but not limited to, annual management charges, entry costs, exit costs and performance fees.

Indirect costs are costs that may not be easily identifiable or that are already embedded implicitly in the price of the PRIIP or in underlying assets. Such costs could include costs paid directly from the investment vehicle such as costs related to trading (bid/offer spread, broker commissions, stamp duties, transaction taxes, foreign exchange costs, finance costs). They could also include 'structuring' costs embedded in the up-front price for structured products.

Whether a cost is one-off or recurring relates to the timing of the cost, and can be understood from the perspective of the investor. A one-off cost for instance would be a cost that the investor pays only at one time in the investment period, for example on entry or exit. Recurring costs are costs that the investor pays more than once in the lifecycle of the product such as an annual management fee and other expenses incurred and charged to the product each year.

Costs can occur on different bases – for instance, as fixed monetary amounts, or as an amount that is relative to the investment. The scale of a cost may also vary according to the size of the investment – e.g. lower relative (though not absolute) costs for larger investments.

Costs can be fixed or variable. For instance, the level of certain costs may not be known until they are incurred, for instance in relation to ongoing dealing costs, operating expenses, and so forth. Some costs may apply only under certain circumstances that are not known before hand – for example, a performance fee, where the basis of the fee might be described, but whether the fee applies depends on the future performance of the product.

4.2.2 Summary indicators, total aggregate costs and compound effects of the total cost

The Regulation requires costs to be presented in the KID by ‘means of summary indicators of these costs, and, to ensure comparability, total aggregate costs expressed in monetary and percentage terms, to show the compound effects of the total costs on the investment’.

The Regulation does not prescribe what these requirements should look like and leaves it to the RTS to establish standardisation of the precise content and presentation of the cost section, including supporting methodologies necessary for the cost figures to be shown in the cost section.

In general terms, the cost disclosures can be read as entailing the following specific elements:

- *Summary indicators*

These could include a presentation – in as simple a form as possible – of the basic cost structure of the PRIIP, including historic or estimated values for each of the costs identified. Including a breakdown in the KID of all the different costs, charges and expenses that might be incurred would not be feasible given the complexity and length of such information, so some structuring and aggregation of the cost elements would be necessary. This could be achieved, for instance, through a standardised structured breakdown of the costs, showing, for example, separate figures for entry, ongoing and exit cost, as is the approach taken for the disclosure of costs for authorised funds under UCITS KII, and the approach outlined in ESMA’s MiFID II consultation.

The reference in the Regulation to summary indicators raises the question as to whether it would be feasible to include a cost disclosure that compares the cost of a particular PRIIP against a range of the costs for PRIIPs in general – that is, that offers some form of ‘benchmark’ for considering the costs. This would be similar to a risk indicator that places each PRIIP on a common scale, as discussed in the previous chapter.

While benchmark information of this kind might provide investors with useful information, it is not required by the Regulation. In this context, the issue under discussion is whether this additional information could help to answer the key questions from the perspective of the consumer together with the other cost disclosure requirements as per the Regulation.

- *Total aggregate costs*

These should take the form of both percentage and monetary figure(s), that combine the different costs. To combine the different costs together would require certain assumptions to be made, for instance on the amount invested, holding periods or on the performance of the PRIIP. Estimates of the total aggregate costs would vary according to these assumptions, so that a range of estimates or aggregate figures might be needed.

- *Compound effect*

The total aggregate costs are intended to also show the compound effect of costs on the investment. This could be through a presentation that relates the costs to the performance of the investment (e.g. through a figure showing the ‘reduction in yield’ that might be anticipated due to costs).

Note also however that information related to the compound effect of costs may be very similar to information included in the performance scenario section of the KID, so it might be sensible to present or at least develop these together.

In general terms, the use of estimates for providing the cost information is likely to be necessary, particularly in so far as cost information should cover the future impact of the costs. This also may be necessary in view of the variability of costs, for instance products that do not have a track record (that is, which lack *ex post* data on costs during a previous period) are likely to require cost estimates to be provided.

4.3 Key Questions

In identifying the most effective options for the cost disclosures, it is necessary to consider the consumers’ perspective. This can be captured by identifying ‘Key Questions’. The effectiveness of different options for the cost disclosures in providing answers to these questions will be key for assessing what works best for consumers. This will only be finally established following the consumer testing of options.

In general terms, consumers do not necessarily identify cost information as being of key importance – compared to information on risks or returns, for instance – while from a regulatory standpoint increasing the salience and comprehension of cost information is strongly important, given the impact costs can have on outcomes for the consumer. (Given the importance consumers often place on performance, which is by definition net of costs, it can be argued that costs are of great indirect salience for consumers already).

The ESAs have identified the following ‘key questions’:

Key Questions From a Consumer Perspective on PRIIPs		
	<i>Key Question</i>	<i>Follow-Up Question</i>
The overall cost amount		
1	How much will this investment cost?	<ul style="list-style-type: none"> • Will I be aware of all costs? <ul style="list-style-type: none"> ○ Are all costs included in the overall costs amount? ○ What is included in the overall cost amount? Prior to making an investment, will I know the breakdown of all costs?
Uncertainty of Costs		
2	How accurate is the current estimation of the overall costs?	<ul style="list-style-type: none"> • How much can the actual cost vary from the estimated amount (both for variable and for one-off costs)?
3	How do the costs develop	<ul style="list-style-type: none"> • What costs are fixed or variable?

	over time?	<ul style="list-style-type: none"> ○ How much of what I'm paying in costs is fixed and what costs are variable e.g. how are they distributed? ○ What circumstances or events determine the overall cost amount? ○ Are the costs linked to the performance of the product?
4	What are possible circumstances that trigger additional charges?	<ul style="list-style-type: none"> ● Do I have to pay extra costs if I take my money out early? <ul style="list-style-type: none"> ○ If so, how much extra will I have to pay? ○ Will I pay more the earlier I exit from the investment? ● How does the product manufacturer calculate what I must pay? <ul style="list-style-type: none"> ○ When I am being charged costs on my investment, how or why are these costs being generated? ○ If I have to pay costs other than when I make the investment, what is the frequency or schedule of such payments?
5	How do the costs impact my returns?	<ul style="list-style-type: none"> ● How much of my initial investment remains after cost deduction? E.g. How much of my investment is really invested?
6	What part of the costs will contribute to the level of capital protection provided by the PRIIP?	<ul style="list-style-type: none"> ● How much am I paying for my capital protection in relation to my overall investment?
7	Will I receive updates on my costs?	<ul style="list-style-type: none"> ● After I make the investment, will I receive updates on the costs of my investment and if so, with what frequency will these updates be provided to me? ● In what format will I receive these updates?
Comparing Costs		
8	How do these costs compare to other products?	<ul style="list-style-type: none"> ● Is this product more or less expensive than another product? ● Do I have to pay the same costs (e.g. entry or exit costs) for other products? ● If I pay more in costs for this product will I receive a better return on my investment?

Table 10

Questions

15: Do you agree with the description of the consumer's perspective on costs expressed in the Key Questions?

4.4 Identifying, quantifying and measuring costs

The ESAs have examined potential costs related to PRIIPs and their manufacturers. This resulted in a long list of costs observed in different types of PRIIPs.

It is vital to include all costs in the KID cost section, and to do this in a way that establishes a fair 'level playing field' between different PRIIPs so that this information can be used to compare their costs in a fair fashion. This means that fair techniques for quantifying costs must be used, to enable 'like for like' comparisons without distorting competition or providing misleading information to retail investors. Similar cost elements should be quantified in a consistent way for different PRIIPs, to enable such comparisons to be fair.

What the PRIIPs cost section cannot capture is situations where the customer receives (as part of the investment) investment advice, which is paid for separately, directly by the customer to the distributor. Such costs may not be known by the PRIIP manufacturer, though sometimes the range or maximum for the costs would be known. Loss to the investment as a result of underlying market risk is also not to be viewed as a cost.

The PRIIPs KID costs section also cannot capture so-called 'opportunity costs' (costs of a choice when compared to the best possible alternative which was not chosen). These costs are more closely related to an investment strategy and are specific to each investor's circumstances.

4.4.1 Examples of observed cost structures

There has been considerable work published by the European Commission, CESR and ESMA on the cost structure of funds. Therefore, the ESAs have focused their initial work on the costs structures of other PRIIPs. This section focuses therefore on insurance-based investment products, structured products including structured deposits, CfDs and derivatives. It also includes however some initial thoughts on areas where specific challenges might be anticipated which includes certain items of relevance for all PRIIPs.

4.4.1.1 Insurance-based investment products

This section aims to provide an overview of current cost structures of life insurance PRIIPs. The table gives an overview of costs related to life insurance PRIIPs and gives high level examples of calculation methods used by insurance undertakings.

Cost category for investment and for the insurance cover	Description	investment related	insurance cover related	Consideration in the calculation	unit-linked insurance	capital endowment / with-profit life insurance	hybrid
Entry Costs	All cost connected to contracting a PRIIPs insurance: Up front initial costs such as acquisition costs, structuring costs, marketing, sales and distribution, processing costs, costs for biometrical risks and for medical check-ups) ...	x	x	There is no uniform approach to calculation. Often combinations of the following variants are found where - The entry costs are expressed as mathematical product of estimated costs and a reference value. Often the reference value used is the gross amount of contributions. Possible variations in calculation are that the sum gross contributions of some years is limited or contributions are weighted. - Insurance contracts are charged with acquisition costs are charged one-off or ongoing over the lease term or the contributory period.	x	x	x
Ongoing Costs							
Administrative / Managing costs	Indirect costs for managing the contracts (premium debt collection, IT costs and administration, communication with the policyholder, information of the policyholder, changes in contracts where chargeable)	x	x	There is no uniform approach to calculation. In general, different approaches are combined, in each of which during the entire contributory or non-contributory contract term administrative costs are charged in percentage of gross premiums or the insured sum. Sometimes administrative costs are charged a annual fee (unit cost).	x	x	x
Costs for managing the insurance cover	Costs related to biometric risk	x		Embedded in the product structure, based on risk premium calculation.			
Costs for managing Capital Investments	Personnel costs for the administration of the capital investments; structuring and restructuring costs, costs for new investments, transaction costs, deposit fees ...	x	x	For expenses for the management of investments for separate administration costs will be charged in general. Since these expenses reduce the investment result, the policyholder will contribute towards these costs by reduced profit sharing.		x	x
Fund related costs	Costs born by the by the investment company which influence the performance (Asset based fees, depositary fee, performance fee, ongoing administrative costs, choice of underlying (costs for switching an shifting)	x	x	Often as annual unit-costs, as a percentage of the premium paid, or as a percentage of fund asset.	x		x
Individual Costs	Individual contract changes (changes of the insured sum, changes of the premium, changes in the method of payment, exemption from payment ...)		x	Insofar as relevant transactions will be charged extra, both can be found, absolute values as well as a percentage of the total / sum insured.	x	x	x
Surcharges according to methods of regular payment chosen (annual vs. Monthly; instalment charge)	In general annual premium income is assumed. If the premium is actually paid semi-annually, quarterly basis or monthly, this calculation is not longer correct. Strictly speaking the difference occurring here are not costs, but interest income contribution due to late payment.		x	In general, percentage surcharge of gross contribution in case of periodic premiums and payment of contributions for periods less than a year.		x	x
Exit Costs	Early redemption fees ; penalties	x	x	Reduction of surrender value . The early redemption fee cover administration costs connected to early redemption. Entry costs that have not been settled yet cannot be charged.	x	x	x

Table 11

For insurance PRIIPs, one of the key features differentiating these from other PRIIPs is that they include both insurance cover and an investment. Therefore, the cost of the product relates to both the investment element and the insurance element. An example of costs related to the insurance element could include biometric costs whereas the investment element would have the usual fund-related costs.

Costs typical for the insurance cover can differ strongly between Member States; in some Member States the insurance costs may be very low, in others they may be similar to other non-PRIP life contracts. Early exit costs applicable during the early years of contracts have also often been high, reflecting the timing of costs for the insurance undertaking.

Given that the consumer will be informed on all main benefits and risks inherent in the insurance-based investment product, he would expect the costs section to cover all costs. Therefore, the costs related to the insurance cover should be included there. Apart from the total aggregate cost disclosure for the PRIP as a whole, a breakout showing costs specific to the insurance cover could however be considered. A question may arise however on the practicalities for firms in separating costs related to the insurance element of the product and costs related to the investment element of the product. In particular, there is a challenge in determining and presenting insurance costs in a generic KID in a meaningful way where the insurance costs would vary significantly according to the mortality or other biometric risks of the specific customer.

For with-profits insurance PRIPs, disclosing costs would also require a proportion of costs at the level of the insurance undertaking to be ascribed as costs at the level of the contract, due to the profit participation provided.

4.4.1.2 Structured products, contracts for differences (CFDs) and derivatives

For structured products (which typically combine a bond and a derivative, also known as a structured bond; other instances might combine a deposit and a derivative, known as a structured deposit) certain costs are embedded in the purchase price. These are commonly known as 'implicit costs', or 'indirect costs' as mentioned in the PRIPs Regulation. These may also be termed 'structuring costs'. They are in clear contrast to the situation with PRIPs which have explicit costs (for instance, entry, annual and exit costs for funds), where these directly impact the investment returns for the investor.

The issue of implicit or indirect costs is not limited however to structured products, but can also be relevant for derivatives and CFDs. There can also be implicit or indirect costs for fund-based PRIPs, for instance in relation to portfolio transactions.

The ESAs consider that the KID should enable retail investors to identify, within the issue price of a PRIP, (i) the amount that will be captured by the manufacturer (cost), and (ii) the amount that will be used to provide / generate a return to the customer (investment). Providing such a split will enable a retail investor to compare the cost structure of different PRIPs. The ability of customers to compare PRIPs on the basis of their cost is one of the main objectives of the PRIPs Regulation.

There are two possible approaches to the disclosure of the costs when the cost is fully contained in the purchase price:

- Introduce a distinction between the investment's price and the margin/fees that have been incorporated in the price. Retail investors may not need to know the breakdown of fees and costs, but they should at least know the general amount of margin/fees incorporated in the purchase price of a structured product, derivative or CFD.

For example, if a manufacturer sells a structured Euro Medium Term Note (EMTN) at 1,000€, he should disclose in the KID that 3% (30€) of the purchase price is a sales commission and 2% (20€) of the acquisition price will be absorbed upfront to recompense the manufacturer for the costs the manufacturer incurs when structuring the note. The result is that 95% (950€) of the acquisition price will be invested in the note: there are 5% costs.

- An alternative solution would be to establish cost disclosures on the basis of the 'fair value' or 'intrinsic value' of the product. The 'fair value' is the value of the liability that the manufacturer records on its balance sheet when the product is sold. The difference between the amount received and the 'fair value' is the revenue received by the manufacturer and can be thought of as the cost of the product. For the example listed above, the 'fair value' of the product might be 950€ and the cost might therefore be 50€.

One limitation that applies to both approaches is that there is no guarantee that two manufacturers would agree on the costs of such products. The issue with a fee/cost disclosure framework is that manufacturers could, for similar products and sales channels, account or claim different levels of structuring costs, and indeed sales commissions. The issue with a 'fair value' framework is that sophisticated models, dependent on sophisticated calibration mechanisms, are used to estimate the 'fair value'. Without a standard mechanism for estimating the 'fair value,' there is no guarantee that two manufacturers of the same product would agree as to the 'fair value' of that product.

A second limitation that applies to the 'fair value' approach is that some costs are not included in the 'fair value.' Firstly, most approaches to derivative valuation assume that there are no trading costs incurred in hedging operations (the basic concept of a derivative valuation model is that the derivative can be replaced by dynamic positions in market securities – equities and/or bonds – for no cost). As this is not the case, the parameters used to value the derivative are adjusted to account for the cost of hedging and the 'fair value' includes an estimate of the transaction costs borne by the manufacturer. Secondly, the manufacturer may actually receive revenue as the money received for a structured product may represent cheaper funding than alternate means (e.g. equity and/or alternate forms of debt). This difference in funding results in revenue, which is not generally disclosed to the purchaser as part of the cost. Thirdly, the 'fair value' can vary over time so that if the 'fair value' is disclosed at the time of purchase, different purchasers of the same product may see different costs depending on the 'fair value' at the time of purchase.

Some countries have self-regulation in place; in these markets a 'fair value' approach is used to calculate the structuring costs. In these models usually a certain 'valuation day' is set and the structuring costs are calculated based on valuations performed on that day. However, there are many challenges on how to calculate the structuring costs properly.

An example is an approach developed in Germany for structured products where 'issuer estimated values' (IEVs) are calculated by issuers. The IEV is a single amount reflecting what might be seen as the price of the product for professional market counterparts, or, in other words, its intrinsic or 'fair value'. The price paid by the retail investor minus the IEV gives an overall cost figure for such products as at the valuation day, which would address also sales commissions. The approach

ultimately uses the issuer's own internal pricing models, so there may be some challenges achieving consistency in pricing assumptions for comparisons between providers.

From a more general perspective, the implicit or structuring costs discussed above are not the only costs relevant for structured products. Other costs can include

- *Upfront costs*: sales commissions.
- *Ongoing costs*: hedging costs to ensure that the manufacturer is able to replicate the performance of the derivative component of the structured product.
- *Exit costs*: bid-mid spread paid by the purchaser to sell the product back to the manufacturer and any penalties for early exit.
- *Other factors*: loss of interest on the amount invested between the purchase date of the product and the strike date (or commencement date) of the product.

Likewise, for derivatives, the issue price includes the following items:

- the intrinsic value of the derivative;
- a front-end load fee;
- a sales commission; and
- the issuer margin.

The issuer margin covers, inter alia, the operational costs incurred by the issuer for structuring the derivative, market-making costs (spread), settlement costs and the profit of the issuer (including any possible margin uplift that the broker may decide in the event stocks become less liquid or more volatile).

In the case of a contract-for-difference (CFD), the cost structure for a derivative would be applicable as well, but additional types of costs will usually exist and impact the effective return. These costs will include:

- commissions charged by CFD providers (general commission or a commission on each trade (i.e. on opening and closing a contract));
- costs related to CFD trading such as bid-offer spreads, daily and overnight financing costs, account management fees and taxes.

Transaction costs are needed to replicate the derivative's performance, yet these are not readily available, as they are included in the intrinsic value of the derivative.

4.4.1.3 Cost categories with specific difficulties

The ESAs have identified certain more detailed technical issues around identifying and quantifying certain types of costs on which they would like to seek views from stakeholders. In the table below a number of costs are mentioned including their difficulties to assess the amount of costs. The list below is not a complete list of costs, but these are the costs where the ESA's perceive specific difficulties with regards to discriminating and calculating these costs. A future technical consultation paper will discuss these issues in more detail.

Costs categories related to PRIIPs		
<i>Portfolio management techniques</i>	A PRIIP manufacturer can use the securities contained in a portfolio to earn additional income through, for example, stock lending, repo, collateral swaps and reverse repo. To ensure a level playing field across funds, the costs of these techniques should be taken into account. This raises that question whether earnings should be reported as a cost to the investor if they are not paid into the portfolio as they reduce the potential return earned by the investor. Or if only the costs of the actual technique should be taken into account and whether any additional risk should be reported in the risk section.	
<i>Implicit Costs</i>	When looking at specific examples of PRIIP cost structures, for categories of PRIIPs such as structured products, derivatives and CFDs, all costs are embedded in the purchase price (more commonly known as "implicit costs") should be included. The design of the KID's cost disclosure section should take into account different cost structures so as to create a level playing field amongst the various categories of PRIIPs.	
<i>Dividends</i>	Whether dividends can be considered costs depends on the type of product and the eventual beneficial owner of the shares in a PRIIP. A case-by-case analysis of the extent to which dividends fall within an investor's beneficial ownership as per the terms of the PRIIP, is required to determine whether any costs are incurred as a result of missing dividend or not.	
<i>Performance fees</i>	A performance fee is a fee that an investor's investment may be charged by the investment manager that manages the assets. This fee is normally based on a percentage of the increase in the funds' value and is in addition to the annual management charges. The challenge that arises for a pre-contractual document such as the KID is that while the performance fee formula might be known in advance of the purchase of the investment, the likelihood and scale of any such fees will not be. However, where costs are presented against relevant performance scenarios these costs might be disclosed.	
<i>Early redemption costs</i>	The PRIIPs Regulation requires a product manufacturer to set out the consequences of early redemption in a separate section of the KID (see section 9.6 below). Retail investors can be charged a fee where they choose to withdraw their investment before the contractual holding period, or in other words 'early termination'. This raises the question as to whether such fees should be shown in the costs section of the KID for PRIIPs.	
<i>Look-through costs</i>	Where a PRIIP invests in another PRIIP, for example a fund-of-funds investing in underlying funds, the question arises as to how these costs should be accounted for in the KID. For the purposes of this DP, this is referred to as look-through costs.	
<i>Costs Embedded in Pricing Parameters</i>	The valuation of Derivatives, CFDs and Structured Products rely on pricing parameters such as implied volatility of the underlying security or securities and the correlation between price movements of the underlying securities. Implied volatility and implied correlation often include adjustments in the level to account for uncertainty in hedging costs,	
<i>Portfolio Transaction Costs</i>	<i>Broker Commissions</i>	<i>Excluded from the spread:</i> Broker commissions are the fees paid to brokers to execute a trade in a financial instrument. For trades in equities and several other financial instruments (for example mutual funds, ETF's and options), the fund or portfolio manager receives an invoice on which the broker commissions are specified. <i>Included in the spread:</i> For instruments such as bonds, derivatives, swaps and transactions on foreign exchange markets, broker commissions are embedded within the bid-ask spread rather than being charged separately. A method would have to be agreed upon to make these commissions explicit.
	<i>Entry- and exit charges paid by the fund</i>	If a fund trades units or shares of another fund, they will be charged entry- and exit charges. Entry- and exit charges are payments to open-ended funds to compensate for the effect of transaction costs incurred when rebalancing the fund portfolio, in order not to

		disadvantage existing shareholders' interests in that fund. These charges are calculated charged in several different ways depending on the fund.
	<i>Transaction Tax and Stamp Duty</i>	A financial transaction tax (FTT) is a levy placed on a specific financial transaction. These taxes exist in several different countries and are not uniform. Stamp duty is a specific form of transaction tax on the purchase of securities in the UK. Stamp duty is settled by the broker and invoiced separately to the fund manager in the same way as broker commissions excluded from the spread.
	<i>Bid-Ask spread</i>	The bid-ask spread is the difference between the price that is offered and the price that is asked for a financial instrument. The actual difference between the bid price and ask price can be considered the spread and can be regarded as separate from commissions paid to brokers incorporated in for example the spread of bonds or currency. The spread depends largely on the liquidity of the particular security. The spread is hard to quantify as it changes frequently due to changing market conditions.
	<i>Market impact Costs</i>	Market impact cost is a measure of market liquidity that reflects the cost faced by a trader of an index or security. The market impact is how much additionally a trader must pay over the initial price when buying, or under the initial price when selling, due to market slippage, in other words the cost incurred because the transaction itself changed the price of the asset.

Table 12

Questions

- 16: What are the main challenges you see in achieving a level-playing field in cost disclosures, and how would you address them?
- 17: Do you agree with the outline of the main features of the cost structures for insurance-based investment products, structured products, CfDs and derivatives? Please describe any other costs or charges that should be included.
- 18: Do you have any views on how implicit costs, for instance costs embedded within the price of a structured product, might be best estimated or calculated?
- 19: Do you agree with the costs and charges to be disclosed to investors as listed in table 12? If not please state your reasons, including describing any other cost or charges that should be included and the method of calculation.

4.4.2 Aggregating Costs

In addition to the issues outlined above with identifying and quantifying costs, there are certain issues that arise when aggregating different costs together, as may be required for providing both summary indicators of these costs, and monetary and percentage figures for the total aggregate costs.

Three basic methodologies have been identified by the ESAs so far that may be relevant for 'aggregating' costs.

Fair Value

An approach using fair values to establish and aggregate implicit costs was outlined above in the discussion of structured products.

In principle, such an approach might be used more broadly, though its practical relevance would appear to be limited to establishing the scale of certain implicit costs.

Ongoing Charges / Total Expense Ratio (TER)

This methodology is common for cost disclosures related to open-ended funds.

The total expense ratio means that the expenses of operating a fund on an ongoing basis are aggregated and presented as an annual percentage rate. This can be on an *ex ante* or *ex post* basis, though is normally *ex post*. The method for calculation a TER standardises what is included in the TER, and the basis for allocating certain expenses.

The TER does not include entry or exit costs, performance fees, or portfolio transaction costs, and so does not provide a 'total aggregate' figure. For this reason, it was renamed in the KII to 'ongoing charges'.

Specific measures might be necessary to include portfolio transaction costs within the ongoing charges figure.

In principle, an ongoing charges figure might be adjusted to also include other costs (upfront costs, for instance), for instance by using an assumption to 'annualise' these other costs (amortise them). In this case a 'total aggregate' figure might be derived. The final figure would be sensitive to the scenarios or assumptions chosen, but might be able then to be used to illustrate total aggregate costs and compare between products (in so far as the assumptions used are standardised across all PRIIPs).

Reduction in Yield (RIY) Type Approach

RIY is a method for expressing the overall impact of costs in terms of their negative impact on a notional 'gross' yield for a product.

A RIY figure for a product can combine different cost elements (up front and exit costs, ongoing costs, performance fees) for comparison purposes. Different assumed scenarios would give different RIY figures, as RIY takes into account such factors as the amount invested (where fees might vary by investment size), the length of the investment (where penalty fees might vary according to the investment term, and where the overall relative impact of different fees varies according to the investment term), and the rate of investment return (some fees will vary in their impact depending on performance).

A RIY may be expressed in various ways – as a percentage figure, as monetary figures, in a table showing different RIYs for different terms. This presentation allows also the compound impact of the costs on investment returns to be shown.

A variant, which expresses the RIY without reference to a growth rate or yield, could be a ‘Total Cost Ratio’.

RIY type calculation methods are relevant where a figure is required to aggregate all costs, including costs that are charged on different bases.¹⁴

Questions

20: Do you agree that a RIY or similar calculation method might be used for preparing ‘total aggregate cost’ figures?

21: Are you aware of any other calculation methodologies for costs that should be considered by the ESAs?

22: Do you agree that implicit or explicit growth rates should be assumed for the purpose of estimating ‘total aggregate costs’? How might these be set, and should these assumptions be adjusted so as to be consistent with information included on the performance scenarios?

23: How do you think implicit portfolio transaction costs should be taken into account, bearing in mind also possible methods for assessing implicit costs for structured products?

4.4.3 Parameters and assumptions

In developing technical standards on the methodology for calculation of costs, the ESAs will have to consider establishing common parameters and assumptions, notably in view of the methodologies outlined above for calculating and aggregating costs.

The ESAs have already identified a number of key areas for further work.

Ex-post vs ex-ante

Costs can be calculated on an ex-post or ex-ante basis. Under section 3 of the KII implementing Regulation, the ongoing charges figure for UCITS has to be calculated at least once a year, on an ex-post basis. Where it is considered unsuitable to use the ex-post figure because of a material change (e.g. an increase in management fees) or where the fund is new to the market, an estimate may be used instead until reliable ex-post figures becomes available. However, whilst ex-post figures give a true reflection of past costs they are not necessarily relevant to what might happen in the future.

¹⁴ In Sweden an approach (the ‘Norman Key Figure’) has been developed where a standardised scenario is applied (a regular premium of 1000 SEK is assumed each month for 10 years, and a cost figure in monetary terms is then provided for the 10 year period).

This may be particularly important when providing details of the cumulative impact of costs over time, where it may be misleading in some cases to use *ex-post* data even where it is available.

Holding period

A PRIIP manufacturer will already be required to disclose in the KID, as per the Regulation, a recommended holding period. In respect of the cost section, providing information on total aggregate costs to illustrate their cumulative impact implies estimating costs over a future time period, which should be consistent with any recommended holding period otherwise disclosed. The aggregation of costs into a percentage figure for the purposes of comparison could also depend on holding period assumptions, so as to allow an appropriate amortisation of one-off costs or other similar technique for combining costs.

A holding period is also necessary for estimating risks and rewards (performance scenarios). The ESAs consider that it is important that these different sections of the KID are aligned to reduce potential confusion for consumers when reading the KID as a whole.

Not all PRIIPs will have the same holding period, which may reduce comparability. One way of addressing this issue might be to show costs to certain standardised time horizons, e.g. year 1, year 3, year 5, etc.

Rates of return / growth rates

The KID must include cost disclosures to show the compound impact of costs on the capital investment. This implies that an assumption on rates of return on the investment needs to be set. This may be important also where different elements of the cost structure vary differently according to the performance of the investment. One approach would be to assume 0% growth – in effect to disregard this factor. Otherwise, a common rate for purposes of comparison could be established, or rates used that reflect viable outcomes for each PRIIP (reflecting also growth rates illustrated in the performance scenario section of the KID). Making a non-zero assumption for rates of return could be more accurate for consumers when consider the impact the costs will have on their investment. However, the use of rates of return for the costs section may be problematic if no such rates are assumed in the performance scenario section. The use of rate of return assumptions therefore needs to be considered jointly in connection with the selection of options for showing performance scenarios.

Assumed amount invested

The Regulation does not require the KID to be a personalized document. On that basis the KID needs to be produced without knowing how much is being invested. In order to aid comparability, a standardized amount invested for the purposes of monetary disclosure of costs might be explored for all KIDs. Part of the information on costs would thereby in the form of an 'example' or 'scenario'. However the ESAs acknowledge that a standardized amount may not be appropriate for all products in scope. For example a standardized amount may not be appropriate for investment products with regular contributions compared to a product with a single contribution, while some products may have limits on investment amounts.

Rebates

Some manufacturers provide a rebate to the distributor, a portion of which may be passed to the customer at the distributor's discretion. The manufacturer would not know the amount of such rebates.

Questions

24: Do you have any views on possible assumptions that should be made, and how these might be calibrated or set?

4.5 Presentation of cost disclosure in the KID

4.5.1 Options for presenting costs

Consumer research suggests a trade-off between the level of detail provided on costs, and the extent to which consumers engage with and use this information or find it important to their investment decision.

Some customers may have higher levels of financial capability and seek additional information and consumer research also suggests many consumers will find almost all information on costs difficult to use. European Commission research shows that a key way of improving the salience of costs for retail investors is a highly structured approach to the presentation of costs. This can aid both comprehension of the information and comparisons. This implies also a certain standardisation also in the assumptions being used (investment amounts, for instance, for information in monetary amounts) as discussed also above in section 4.4.3.

The PRIIPs Regulation commits to just such a structured approach, leaving details to be prescribed through the RTS. The Regulation also leaves a degree of flexibility as to the level of breakdowns presented. It requires, as already noted, 'total aggregate' costs as well as summary indicators of the costs.

There are many challenges in presenting cost information in a way that answers consumers' key questions on costs. In particular, to summarise, consumers can face difficulties:

- combining different parts of the cost structure of a PRIIP together to understand their overall impact;
- comparing the overall cost of different PRIIPs where these have different cost structures;
- applying cost structures to their own personal circumstances; and
- effectively understanding the compound impact of costs over time, notably where the costs are expressed in percentage terms.

The ESAs have attempted to show the options in the next section for presenting costs based on what is required by the Regulation, i.e. into examples of how to show costs using summary cost indicators, showing total aggregate costs, and options for highlighting or demonstrating the cumulative impact of the costs. The options in some cases combine these different elements (i.e. summary indicators that are also providing a total aggregate cost figure).

While the Regulation is clear on the different elements to be included, the precise details will need to be calibrated carefully in view of the results from the upcoming consumer testing. The selection of final options will depend in large part on finding the right balance between simplified summary information and details of the cost structure. As noted above, aggregating costs requires assumptions to be made, and this can reduce the accuracy of the information for some consumers, depending on how close the consumer's personal situation is to the assumptions made, and how well the consumer understands the limitations (uncertainty) of the information shown.

In the following section we describe options for a summary indicator (options 1-5) where options 1-3 offer some form of benchmarking. Options 6-10 disclose the aggregated cost figures and their compound effect on returns.

A combination from options 1-3, 4-5 and from options 6-10 would potentially meet the requirements of the Regulation. The options do not always meet the full requirements in the Regulation on their own. Naturally any final presentation option will have to meet all the requirements in the Regulation.

Summary cost indicator showing total aggregate costs

The following three options show illustrations for presenting a summary cost indicator which focuses on the total aggregate costs in percentage terms. All three examples present this value in a way that shows how the product compares (benchmarking) to other products in terms of the level of costs (option 1 also shows the variability of its cost).

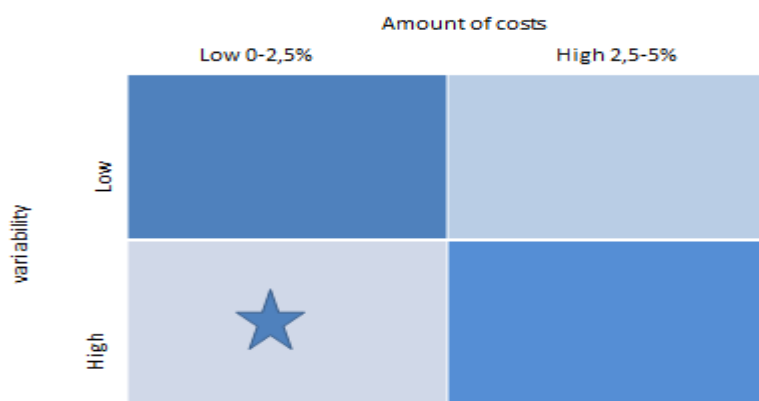
These options are simple and not loaded with information. However, the more simplistic the categories of cost, e.g. option 1, the more difficult it will be for investors to compare products with costs that fall within the same category. Therefore options 2 or 3 may be preferred as they allow for a greater number of categories. By benchmarking costs, e.g. high/low, challenges will arise as to how to determine what is high cost, especially for option 3 which has an average best cost to be determined. This approach would seem to require a pan-European or a national basis for collecting data on ranges of costs. By focusing on aggregated costs, these options also require assumptions to be made that may not always fit the specific needs of each retail investor.

Option 1

This example is a simple illustration of how a product compares to other products based on the amount of costs in percentages and the variability of these costs. This example is quite simplistic but it could be expanded to fit more categories of variability and more differentiation in the amount of costs. Nonetheless, even if expanded, this example does not show the exact amount of costs either in percentage or monetary terms. It also doesn't show the breakdown of the different kinds of costs

included in the amount of costs nor does it explain the reason behind the variability. The variability of costs is clearly visible but the range between which the costs can range is not clear. A part of this problem is illustrated by the fact that it is not possible to distinguish between entry- and exit costs, on-going costs or early redemption fees. It is also not possible to see how the investors own choices might influence the amount or variability or the amount of costs.

This example may be easy to understand and engaging because of its simplicity. Its simplicity also may make it easy to compare one product with another, due to the small amount of different categories. However, it also only makes possible basic 'high/low' comparisons on cost variability and magnitude. The detail is lost between products and such that this particular example on its own would be incompatible with the PRIIPs regulation.



Option 2

This example has two visual elements that work together to give a cost summary indicator for the PRIIP. The total cost per annum would fall into a specific bucket numbered one to five depending on which classification the cost falls in to. The percentage figures below are for illustrative purposes only. This example also provides an aggregated figure by having the total cost per annum in a particular category and the second visual accompanying element could be adapted to show both monetary as well as percentage terms. Costs other than annual ongoing costs would need to be combined into the figure used for the assignment to a bucket. This example also does not show the compound effect that the costs would have on the investment.

This example has the advantage of having a simple and clear layout that would help investors understand the cost in comparison to other PRIIPs. It would improve comparability and comprehensibility and would suit all products in scope of the Regulation. A difficult task with this approach is establishing the appropriate ranges for the five cost classifications as they would have to be standardised in order to be used in any PRIIPs KID.

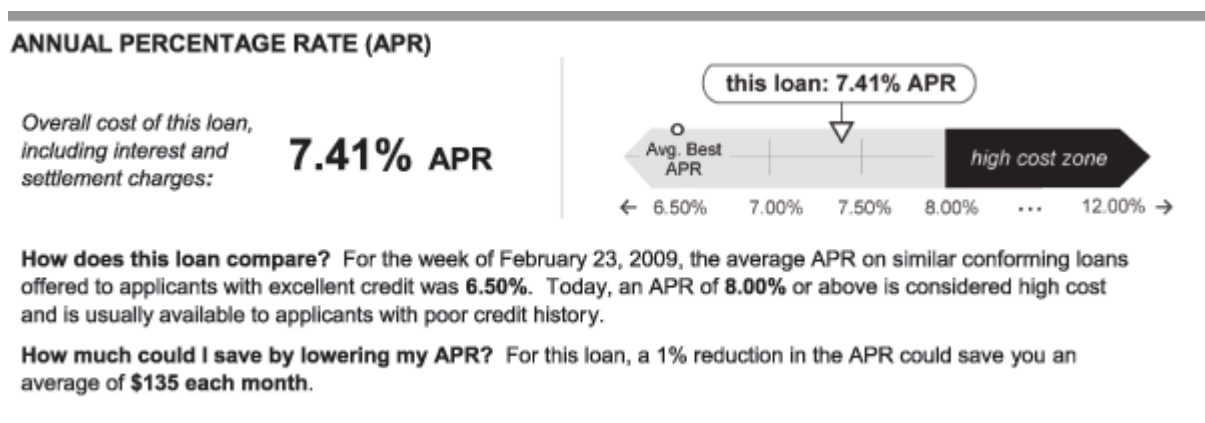
Total costs p.a.	1	2	3	4	5
------------------	---	---	---	---	---

Cost class	cost intervals p.a.	
	Equal or above	Less than
1	0	0.25%
2	0.25%	1.00%
3	1.00%	2.50%
4	2.50%	4.50%
5	4.50%	

Option 3

The US Federal Reserve Board's home-secure credit disclosure graphic was adopted to help establish a context for consumers to better understand the Annual Percentage Rate (APR) revised mortgage disclosure forms. It shows the APR in relation to APRs on similar loans offered to borrowers with excellent credit. Similar to option 2 it provides total aggregated figure of cost per annum in percentage terms but instead of having cost classification in buckets, it provides a visual 'sliding scale'. A narrative accompanies the total figure in order to aid the investor understand and compare the total cost figure. As in options one and two, this example does not give show entry or exit costs separately, so these figures would need to be combined into this figure or handled separately. Furthermore, including the cost in monetary term could clutter the presentation thus making it less engaging for the consumer to look at. It also does not show the investor the compound effect of costs on the investment.

This example may be engaging for retail investors, as it has a simple sliding scale without too much information. By including a narrative it helps the investor understand the context and enables them to compare with other products in the relevant market.



Summary indicator showing breakdown of costs

When presenting costs, one option is to separate entry, exit and ongoing costs, even where examples might be used for how they have a combined impact. Products will differ in that some will

have high upfront / entry costs and low ongoing costs and vice versa. Separating the costs allows the investor to have a good idea whether they are paying low upfront but high ongoing and therefore need to hold the product for longer or shorter periods. (Such presentations can also include cumulative figures to show the costs over an assumed or prescribed holding period, so as to also provide aggregated figures).

Option 4

This option shows a table setting out initial costs, ongoing costs and exit costs as both percent and monetary figures. The example below shows the costs for an investment of €1000. At the time of subscription the investment can be broken down into three quantities: invested capital – that equals the fair value of the product – costs and gross investment. The difference between the gross investment (A+B+C) and the fair value of the Product (A) is due to the costs of the product (B) and the cost of the investment services (C) paid by the investor where they are known by the product manufacturer. In order to make this approach applicable to all PRIIPs, a proper representation of costs (on going and exit costs) applied after the subscription date is needed. The entry and exit charges shown are maximum figures. In some cases you might pay less – you can find this out from your financial advisor. The ongoing charges figure is based on expenses for the year ending.

The costs of the product include any kinds of third party payments paid or received by the manufacturer in connection with the provision of services by firms to the client. The percentage of such payments of total costs is disclosed separately.

A separate line is provided for costs and charges related to the provision of investment services known by the manufacturer that are not included in the costs of the product as they are paid directly by clients to the investment service provider. A short narrative would also be necessary in the KID in order to include a definition of the different figures and details of the calculation methodology of performance fees and transaction costs. This disclosure format is consistent with the PRIIPs Regulation requirements on summary indicators and could be designed to cover all products in scope.

Value of investment components	Upfront costs (%)	Upfront costs (monetary terms)	On-going yearly costs (%)	Ongoing yearly costs (monetary terms)	Exit costs (%)	Exit costs (monetary terms)
Gross investment (A)	100%	1.000				
Costs* (B)	2.7%	27	0.4%	4	0.8%	8
Investment Service Costs** (C)	0.3%	3	0.2%	2	0.2%	2
Fair value/invested capital (A-B-C)	97%	970				

* % Third party payments

** Costs linked to the provision of investment services known by the manufacturer

Option 5

This option is relatively simple and contains precise information. It is consistent with the PRIIPs Regulation requirements, since it contains summary indicators, and also cumulative and aggregate cost figures. It could also be designed to be applicable for all different PRIIPs.

With this presentation option a short narrative would also be included in the KID. This narrative would very briefly explain what information these different costs figures present. It would also provide information (if needed) regarding some special features, e.g. performance fees, early redemption fees etc. What is not clear is how much the investor would have at the end of the twenty year holding period in return for these costs.

The approach in Sweden (the 'Norman Key Figure') is similar in that a standardised scenario is applied in order to show monetary cost figures over the longer term (a regular premium of 1000 SEK is assumed each month for 10 years, and a cost figure in monetary terms is then provided for the 10 year period).

This is an example for illustrative investment of 1.000€, investment period of 20 years					
		Ongoing costs			
	Upfront costs	(p.a.)	Exit costs		
%	1,00 %	1,50 %	2,00 %		
€	10 €	15 €	20 €	Total cost	Annual percentage rate
Cumulative cost	10 €	300 €	20 €	330 €	1,65 %

Presenting cumulative effect of costs

Option 6

In the **UK** firms selling insurance-based investments are required to show cumulative effect of charges in two ways; in cash terms using an 'effect of charges' table and in percentage terms using the Reduction in Yield summary statistic which shows how the charges effectively reduce the investment growth. The effect of charges table shows the effect of charges over the lifetime of the contract on the value of the fund and the reduction in yield figure shows the effect of all product charges on performance, expressed a single percentage reduction in annual yield:

Year	Investment to date	Effect of deductions to date	What might you get back at 5%	Reduction in Yield
1	£5000	£328	£4,750	
3	£5000	£494	£5,070	
5	£5000	£671	£5,410	
10	£5000	£1,160	£6,380	2.74%

This option meets all of the PRIIPs Regulation requirements. It sets out the cumulative costs of the investment over a periodic time basis in both percentage and monetary terms to enable the investor obtain an appreciation of the overall costs of the investment over a specified period of time. It could be used as a summary cost indicator with the 'effect of deductions to date' column and the reduction in yield columns showing the total aggregated figures in percentage and monetary terms.

This presentation option should aid investors in comparing costs between products and time-horizons, as investor can quite simply compare the cumulative cost of a product in year 1 or year 5 by comparing the tables for each product as set out under this option. This option could well meet the criteria of being 'engaging,' as when retail investors see this type of information it immediately catches their attention as it is a simple indication to them of what costs are involved in the investment.

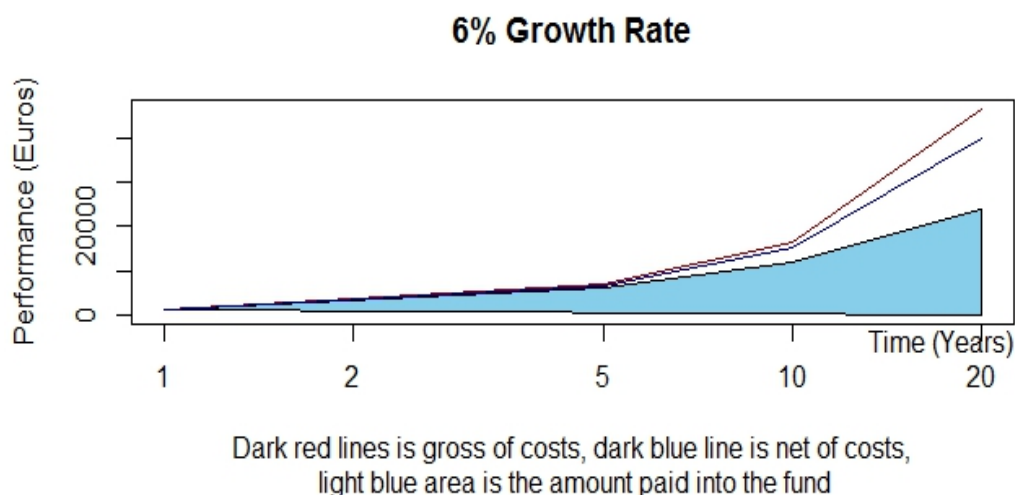
The presentation may be easy to process by the investor as it sets out clearly the effect that the relevant costs have on their investment, and combines different parts of a product's costs into single figures for comparison purposes. The level of complexity in this presentation option is relatively low, though many figures are shown and the purpose of some of the columns may not be immediately clear for all retail investors.

It can be argued that this presentation option is somewhat neutral in managing investor expectations in that the cumulative effect of costs is offset by a positive performance scenario ('what might you get back?') thereby permitting the consumer to make a reasoned judgement as to the suitability of this investment to their needs.

Option 7

A graph is an elegant way of showing the relation between costs, return and the amount paid into the fund or portfolio. The graph below shows the cumulative effect of costs in relation to the return on top of the amount paid. This gives a clear indication of the cumulative effect of costs on the eventual return; however, it doesn't show the aggregated amount of costs, nor does it show figures in percentage terms. A breakdown of the costs is also not made in a graph, which will make it hard for an investor to understand how his or her choices relate to the costs incurred.

A graph is engaging but not necessarily easy to understand at first sight. Due to the long timeframe it might not be very clear what the actual cost might be if an investor were to exit before the recommended holding period. Different recommended holding periods in a single graph might make it more difficult to compare products, especially when aggregated cost amounts are not added. When applied to different kinds of PRIIPs they might not always be as clear and understandable as this particular example, because the graphs might become more complex. The graph shown here assumes a regular payment is being made.



Option 8

This option shows the cumulative effect of costs on returns. It is based on performance scenarios calculated according to hypothetical developments of the underlying, without considering their likelihood of occurrence.

This example differs from option 6 because it includes three different performance scenarios as opposed to one. This option may confuse retail investors from the density and amount of information, yet be helpful in order to disclose the effect of the reference market trends of the PRIIP on variable costs (performance fees). In order to simplify the presentation as much as possible, the table focuses only on the average annual cost on investment and on its effect on returns. It is designed to effectively convey cost information in a clear and understandable manner.

Investment = 1000 €, recommended holding period= 5 years				
Scenarios		1 years	3 years	recommended holding period / maturity
Worst (-4%)	Gross of costs (€)	960	885	815
	Net of costs (€)	915	829	759
	Cumulative cost (€)	-45	-55	-57
	Average annual cost on investment (%)	-4,5%	-1,8%	-1,1%
Neutral (0%)	Gross of costs (€)	1.000	1.000	1.000
	Net of costs (€)	954	942	940

	Cumulative cost (€)	-46	-58	-60
	Average annual cost on investment (%)	-4,6%	-1,9%	-1,2%
Best (+4%)	Gross of costs (€)	1.040	1.125	1.217
	Net of costs (€)	993	1.064	1.153
	Cumulative cost (€)	-47	-61	-64
	Average annual cost on investment (%)	-4,7%	-2,0%	-1,3%

The proposed presentation assumes three different fixed periods to show the cumulative effect of costs; therefore it is independent of the duration of the PRIIP. The chosen time frame allows for the disclosure of the impact of the fixed components such as the entry fees or the exit fees in case of redemptions before the recommended holding period (short term holding versus recommended holding period/maturity). The use of fixed horizons could enhance comparability among different products.

Option 9

This example, similar to option 8, shows the cumulative effect of costs on returns. It is based on performance scenarios calculated taking into account their likelihood of occurrence and has been included in order to be consistent with the options set out in the performance scenario section.

Investment = 1000 € recommended holding period= 5 years				
Scenarios		1 years	5 years	Recommended holding period
Prob (10%)	Gross of costs (€)	960	885	815
	Net of costs (€)	915	829	759
	Cumulative cost (€)	-45	-55	-57
	Average annual cost on investment (%)	-4,5%	-1,8%	-1,1%
Prob (50%)	Gross of costs (€)	1.000	1.000	1.000
	Net of costs (€)	954	942	940
	Cumulative cost (€)	-46	-58	-60
	Average annual cost on investment (%)	-4,6%	-1,9%	-1,2%
Prob (90%)	Gross of costs (€)	1.040	1.125	1.217
	Net of costs (€)	993	1.064	1.153
	Cumulative cost (€)	-47	-61	-64
	Average annual cost on investment (%)	-4,7%	-2,0%	-1,3%

Option 10

The **Dutch** financial leaflet contains a costs section which was designed for insurance products, mortgage loans and investment products. In the financial leaflet, this costs section is combined with the performance scenarios shown in section 3.6 of this DP. It shows the costs incurred in relation to the return as both a monetary figure and as a percentage terms for different holding periods. The

cost section is based on a single performance scenario of a 4% increase in value of the investment. The costs are partially broken down and it is possible to distinguish between insurance premiums and exit fees.

A table is not as engaging as a single indicator or figure. However, this option is very compatible with the PRIIPs regulation as it shows both a monetary figure and the cumulative effect of costs as a percentage. This option is fairly understandable and it clearly shows the relation between both cost and return. In the financial leaflet the holding periods are adjusted depending on the product - this would make comparison between similar products easy but comparison between very different products more difficult.

Wat are the costs?

The resulting costs based on a forecast of a 4% increase in the value of the investment



	Value	-	Insurance premium	-	Costs	+	Return	-	If terminated prematurely	=	What you retain	Return after costs (%)
After 1 year	€ 4.836	-	€ 0	-	€ 1.390	+	€ 76	-	€ 0	=	€ 3.522 upon life € 3.522 upon death	-50,9% a year
After 10 years	€ 39.365	-	€ 0	-	€ 4.900	+	€ 7.967	-	€ 0	=	€ 42.432 upon life € 42.432 upon death	+1,4% a year
After 30 years	€ 116.094	-	€ 0	-	€ 12.700	+	€ 96.606	-	€ 0	=	€ 200.000	+3,3% a year

Questions

- 25: What do you think are the key challenges in standardising the format of cost information across different PRIIPs, e.g. funds, derivatives, life insurance contracts?
- 26: Do you have a marked preference or any objection for any of the presentational examples? If so, why? Please provide any alternative examples which you believe could be useful.
- 27: In terms of a possible breakdown of costs, are you aware of cost structures for which a split between entry or exit costs, ongoing costs, and costs only paid in specific situations or under specific conditions, would not work?
- 28: How do you think contingent costs should be addressed when showing total aggregated costs?
- 29: How do you think should cumulative costs be shown?

5 Other Sections of the KID

5.1 Title – Article 8(1) and Explanatory Statement – Article 8(2)

Article 8

- (1) The title 'Key Information Document' shall appear prominently at the top of the first page of the key information document.

The key information document shall be presented in the sequence laid down in paragraphs 2 and 3.

- (2) An explanatory statement shall appear directly underneath the title of the key information document. It shall read:

"This document provides you with key information about this investment product. It is not marketing material. The information is required by law to help you understand the nature, risks, costs, potential gains and losses of this product and to help you compare it with other products."

The title and explanatory statement are prescribed and should appear in every KID. The draft RTS do not relate to Article 8(1) and (2).

5.2 Identity – Article 8(3)(a)

5.2.1 Empowerment

Article 8(3)(a)

at the beginning of the document, the name of the PRIIP, the identity and contact details of the PRIIP manufacturer, information about the competent authority of the manufacturer and the date of the document;

The first section under Article 8(3) contains information about the identity of the PRIIP, and does not have a heading.

However, there are two areas where further specification within RTS might be considered:

- the information to include as 'contact details' for the PRIIP manufacturer; and
- what would be relevant as 'information about the competent authority of the manufacturer'.

A further question arises as to whether universal identifiers (such as International Securities Identification Numbers (ISINs)) might be included where available.

5.2.2 Discussion

The extent of information included on 'contact details' could, unless standardised, vary significantly between different PRIIPs – for instance, this could be a contact telephone number, a web site, or a postal address. Different approaches might confuse consumers comparing different KIDs.

In principle, in keeping with the overall objectives of the KID, this information should be kept as brief as possible, and made as relevant as possible for the consumer. For instance, since the Regulation requires a website for each PRIIPs Manufacturer on which each KID would be published, this website might be the most appropriate contact information to include. To ensure relevance, a link to a specific 'contacts and further information' page of the website might be considered. However, a focus on using a website may exclude some consumers who do not use the internet. A telephone number or even postal address might be considered an alternative.

In relation to the information about the competent authority, this could be expected to be the identity (name) of the competent authority of the manufacturer, or a web link.

In regards the inclusion of ISIN references or similar identifiers, these could be particularly useful when searching for further information, so could be permitted as a part of the information. Standardising what identifiers might be included at this stage would appear premature, given the range of possible PRIIPs. For some PRIIPs there will be no such identifiers at all.

Questions

30: Do you have any views on the identity information that should be included?

5.3 Comprehension Alert

5.3.1 Empowerment

Recital (18)

As some of the investment products within the scope of this Regulation are not simple and may be difficult for retail investors to understand, the key information document should, where applicable, include a comprehension alert to the retail investor. A product should be regarded as not being simple and as being difficult to understand in particular if it invests in underlying assets in which retail investors do not commonly invest, if it uses a number of different mechanisms to calculate the final return of the investment, creating a greater risk of misunderstanding on the part of the retail investor or if the investment's pay-off takes advantage of retail investor's behavioural biases, such as a teaser rate followed by a much higher floating conditional rate, or an iterative formula.

Article 8(3)(b)

where applicable, a comprehension alert which shall read: "You are about to purchase a product that is not simple and may be difficult to understand.";

Under this item, a question arises as to the circumstances in which the alert is applicable (that is, when the alert needs to be included). Recital 12a includes criteria that can be used for assessing whether to include the alert or not.

5.3.2 Discussion

Article 8(3)(b) prescribes that, where applicable, the KID shall contain a comprehension alert reading: “You are about to purchase a product that is not simple and may be difficult to understand”.

Recital 18 enumerates three types of product where the comprehension alert should especially be applied:

- it invests in underlying assets that are not commonly invested in by retail investors;
- it uses a number of different mechanisms to calculate the final return of the investment, creating a greater risk of misunderstanding on the part of the retail investor;
- the investment’s pay-off takes advantage of retail investor’s behavioural biases, such as a teaser rate followed by a much higher floating conditional rate, or an iterative formula.

Article 33 prescribes that four years after the entry into force, the European Commission shall, on the basis of the information received by ESAs, elaborate a general survey of the operation of the comprehension alert taking into account any guidance developed by competent authorities in this respect. There might be a need for the ESAs to develop a common approach on the use of the comprehension alert. Indeed, in the absence of such an approach, there is a risk of divergence in national practice, leading to problems in the cross-border distribution of PRIIPs and a lack of comparability.

Any material developed by the ESAs on this topic should take as a basis the three elements set out in recital 18. These are considered in turn below.

[the PRIIP] invests in underlying assets that are not commonly invested in by retail investors

A number of different approaches can be envisaged here. One possibility would be to take inspiration from the UCITS framework since it already provides for a harmonised set of product rules and detailed rules on eligible assets. In particular, Article 50 of the UCITS Directive includes a list of assets in which a UCITS may or may not invest. Given that UCITS are a popular product among retail investors that are already distributed extensively across the EU on the basis of a passporting regime, it might be appropriate to take the list of assets in Article 50 as a proxy for assets in which retail investors commonly invest.

[the PRIIP] uses a number of different mechanisms to calculate the final return of the investment, creating a greater risk of misunderstanding on the part of the retail investor

This part of the recital appears to focus on the way the product is constructed and how that construction impacts on the calculation of the final return or pay-off. In a different context, ESMA developed an [opinion](#) on MiFID practices for firms selling complex products, which looked at risks for

retail investors arising from their inability to understand the risks, costs and expected returns of certain products and/or the drivers of risks and returns. However, the criteria mentioned in the ESMA opinion would have to be tailored to fit the specific context of the PRIIPs Regulation.

the investment's pay-off takes advantage of retail investor's behavioural biases, such as a teaser rate followed by a much higher floating conditional rate, or an iterative formula

This element of the recital is the most specific of the three in that it gives an example of a product which offers a teaser rate followed by a much higher floating conditional rate. However, it is understood that this is merely an example and that a potentially broader range of products might be considered to have a pay-off which takes advantage of retail investor's behavioural biases. Further work by the ESAs could potentially involve i) developing a common understanding of the behavioural biases referred to in the recital; and ii) identifying other mechanisms that should be considered as taking advantage of such biases.

Questions

31: Do you consider that the criteria set out in recital 18 are sufficiently clear, or would you see some merit in ESAs clarifying them further?

5.4 What is this product?

5.4.1 Empowerment

Recital (14)

When developing the technical standards for the content of the key information document so as to reflect accurately the product's investment policies and its objectives in accordance with this Regulation, the ESAs should ensure that the PRIIP manufacturer uses clear and understandable language which is accessible to retail investors and that the description of how the investment targets are achieved, including the description of the financial instruments used, avoids financial jargon and terminology which is not immediately clear to retail investors.

Article 8(3)(c)

under a section titled "What is this product?", the nature and main features of the PRIIP, including :

- (i) the type of the PRIIP;
- (ii) its objectives and the means for achieving them, in particular whether the objectives are achieved by means of direct or indirect exposure to the underlying investment assets, including a description of the underlying instruments or reference values, including a specification of the markets the PRIIP invests in, including, where applicable, specific environmental or social objectives targeted by the product, as well as how the return is determined;
- (iii) 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;
- (v) where the PRIIP offers insurance benefits, details of those insurance benefits, including the circumstances that would trigger them;
- (vi) the term of the PRIIP, if known;

The section of the document titled ‘What is this product?’ contains key information about the PRIIP. This should cover the nature and main features of the product, which are also elaborated in the Article through a list of areas to be covered. As with the KID as a whole, this information should be provided in a way that avoids the use of financial jargon.

5.4.2 Discussion

5.4.2.1 Type of PRIIP

Information on the type of the PRIIP gives the retail investor a basic message as to where a particular PRIIP sits in the universe of other PRIIPs.

In theory, there are a variety of ways of classifying or organising PRIIPs according to types. The most obvious starting point, common with existing disclosures, is to classify according to the legal form of the contract or instrument (e.g. security, structured deposit, UCITS or retail AIF, life insurance contract). However, the classification could also include a differentiation according to other aspects of the PRIIP (economic exposures, or product features). For parts of the PRIIPs markets classifications already exist and could probably be used as starting point: for example the fund classification used by the European Central Bank (ECB), classifications of AIFs related to the reporting requirements under AIFMD, or the structured products classification developed by the European Structured Investments Products Association (EUSIPA).

Options could vary as to the extent to which a common classification of types is established through the RTS. The classification of products could be left to individual PRIIP manufacturers, or standardised, for example by establishing common principles to be followed and/or indicative categories. Given the variety of PRIIPs and markets for PRIIPs, it may be very difficult to establish a fully detailed typology at the outset. Guidance (‘level three’) might be used to address issues in practice as they arise.

The more flexibility that is allowed on the description of the ‘type’ of PRIIP, the increased potential for confusion amongst retail investors comparing different KIDs, if PRIIPs of a similar type are described differently in their KIDs.

Possible principles for assigning a type could, for instance, include reference to the legal form of the PRIIP.

Questions

32: Do you agree that principles on how a PRIIP might be assigned a 'type' will be needed, and do you have views on how these might be set?

33: Are you aware of classifications other than by legal type that you think should be considered?

5.4.2.2 Objectives and means of achieving them

This information is crucial, as it provides the description of what the product aims to achieve, and how it will do this. This aids in comparing different types of PRIIP.

The PRIIP Regulation establishes certain elements that must be addressed:

- The description must describe the underlying instruments, or reference values, and the markets the PRIIPs invests in.
- The description must make reference to whether the PRIIP provides for direct or indirect exposure to underlying assets. This would appear to be aimed at making a distinction between PRIIPs where the exposure is gained by direct purchase of securities, and PRIIPs where the exposure to underlying assets is via an intermediary instrument (e.g. derivatives such as total return swaps).
- The description must include reference to specific environmental or social objectives targeted.
- The description must describe how the return is determined. This should not be read as a description of the engineering of the product, so much as a description of the pay-off structure, as relevant for a structured product.

In general, such areas would normally be addressed when describing an investment proposition, though the distinction between indirect and direct investment in assets is a new requirement. While in principle it might be relatively straightforward for PRIIP manufacturers to prepare this section of a KID without additional guidance or measures, the overarching obligation set out in Recital 14 to avoid financial jargon means that completing this section may in practice be particularly challenging for a PRIIP manufacturer.

In addition, describing how the return is determined in a short and easy to understand format may be very difficult for some particularly complex structured instruments, where multiple conditions apply to determine the pay-off.

Given this, guidance on language might be necessary, though this might better be developed in supporting level three material rather than within the draft RTS, in addition to the setting of certain prescribed statements in the draft RTS themselves as may be necessary.

Certain common principles however might be developed and included already in the draft RTS.

These could include keeping descriptions very brief (including some indications or examples of how to do so); describing the pay-off structure of the product (where relevant) in a summary format, highlighting only the key elements of importance for the retail investor; and some examples clarifying the circumstances in which a PRIIP is considered 'direct' or 'indirect' in its investments.

- Examples of indirect investment might include the use of financial instruments such as derivatives that create exposures without there being a holding in the underlying asset, or synthetic ETFs or structured products. It could be clarified that although all PRIIPs are indirect investments by definition, a principle of look-through could be followed in assessing whether the PRIIP is indirect or direct in the meaning of this provision.
- For the summary information on the pay-off structure, this might be supported by a cross-reference to where more detailed information is provided, including to the performance scenario section of the KID; the KID would still need to be understandable by a retail investor who does not consult other more detailed documents.

Questions

34: Do you agree that general principles and as necessary prescribed statements might be needed for completing this section of the KID?

35: Are you aware of other measures that might be taken to improve the quality of the section from the perspective of the retail investor?

5.4.2.3 Consumer types

Information should include a generic description of the consumer type at whom the PRIIP is aimed at. This should include reference to the ability of the targeted type of consumer to bear investment loss and the investment horizon they should have.

A key aim of providing this information – given the reference in the text to investment loss and investment horizons - is to summarise the overall risk/reward profile of the PRIIP in terms the consumer can relate to. Article 8(3)(c)(iii) is open with regards to other aspects that might be covered – other than in relation to investment losses and horizons. These could include the kind of purpose the investment might have (for instance, products that are aimed solely at accumulation, or where some income distributions are made). However this information should not overlap with the information under Article 8(3)(c)(ii). Information could also be included on the experience or knowledge expected of the consumer.

The reference to types of consumer also implies a link to the target market of the PRIIP, a concept that has been explored in separate joint and individual work by the ESAs on product oversight and governance.¹⁵ In general, it could be required that information included in the KID should be

¹⁵

https://eiopa.europa.eu/fixed-width/joint-committee/index.html?no_cache=1&cid=4301&did=37230&sechash=6e906d6e

consistent with the PRIIP manufacturers' identified target market for the PRIIP. The question of the target market is dealt also within MiFID II level two work. Consistency in approach will need to be considered carefully, to avoid legal uncertainty and to reduce potential confusion for retail investors.

Another possible type of information that might be included, is where PRIIPs target narrow or very specific developments of certain underlying assets, indices or indicators, or baskets of these, where arguably very specific linked expectations for these assets, indices or indicators would need to be adopted by an investor for the PRIIP to be relevant to him.

The reference to investment horizon links to information on 'recommended holding periods', as foreseen also under Article 8(3)(g). The PRIIP manufacturer shall have to indicate for each PRIIP the kind of investment horizon that it suits, however Article 8(3)(g) will go into more specific detail on recommended holding periods, whereas the information in this section could, for this reason, be higher level in nature.

For PRIIPs that are relatively neutral in relation to investment horizons and/or ability to bear loss, the information included might make reference to this.

In order to aid PRIIP manufacturers, and ensure useful and comparable information is provided to retail investors, the draft RTS might outline principles for what should and should not be included in this section. The avoidance of unnecessary duplication of information under the different headings of the KID and in this section of the KID in particular should however be a guiding principle, as should keeping the information as short as is possible.

Questions

36: Do you have views on the information PRIIPs manufacturers should provide on consumer types?

5.4.2.4 Insurance benefits

For insurance PRIIPs the KID covers products with a primarily investment purpose complemented by life insurance cover. The insurance cover needs to be explained clearly in the KID, so as to achieve a level playing field between PRIIPs and ensure retail investors understand all of the features of the insurance PRIIP. Whereas the other sections of the KID are focused on the investment profile of the PRIIP, the information on "insurance benefits" provides the place where insurance cover can be disclosed.

Key information could include information on what happens if the insured person dies, and brief or summary information on the key terms and conditions of the insurance cover.

Questions

37: What is the key information that needs to be given to the retail investor on insurance benefits, and how should this be presented?

5.4.2.5 Term

The KID should include a simple statement of the term (fixed length or open ended) of the PRIIP. Difficulties are therefore not anticipated, and so draft RTS on this are not expected.

Questions

38: Are you aware of PRIIPs where the term may not be readily described, or where there are other issues?

5.5 What happens if [the name of the PRIIP manufacturer] is unable to pay out?

5.5.1 Empowerment

Article 8(3)(e)

under a section titled "What happens if [the name of the PRIIP manufacturer] is unable to pay out?", a brief description of whether the related loss is covered by an investor compensation or guarantee scheme and if so, which scheme it is, the name of the guarantor and which risks are covered by the scheme and which are not;

This section is designed to include factual information on possible investor or customer compensation or deposit guarantee scheme coverage.

5.5.2 Discussion

It would appear that the information to include in this section of the KID would be straightforward. In general, given that at national level most PRIIP manufacturers may be subject to the same schemes in the same ways, consistency in the description included between the different KIDs they produce should be the aim, though given the variety of possible schemes, this might be done through level three measures, or through self-regulatory steps.

The reference to which risks are covered by the scheme can be read broadly, as covering the limits of what might be paid back to the customer.

Please note that this section can overlap with what can be described as the credit risk associated to the PRIIP, which is also considered in this Discussion Paper in the context of in 8(3)(d) and in the risk-reward section. However, it could be noted also that the information in this section – which is not a

summary indicator – will have a different and complimentary impact for the consumer compared to the information in the risk-reward section.

A description of the time scale of any pay outs may be relevant, and a link provided to the website of the scheme for further information, where relevant or available. However, any such information should be brief, in view of the length of the KID.

Questions

39: Are you aware of specific challenges arising for specific PRIIPs in completing this section?

5.6 How long should I hold it and can I take money out early?

5.6.1 Empowerment

Article 8(3)(g)

under a section titled "How long should I hold it and can I take money out early?"

- (i) where applicable, whether there is a cooling off period or cancellation period for the PRIIP;
- (ii) an indication of the recommended and where applicable required minimum holding period;
- (iii) the ability to make, and conditions for, any disinvestments before maturity, including all applicable fees and penalties, having regard to the risk and reward profile of the PRIIP and the market evolution it targets;
- (iv) information about the potential consequences of cashing in before the end of the term or recommended holding period, such as the loss of a capital protection or additional contingent fees;

This section notably includes information on possibilities for redeeming or cashing-in a PRIIP – on demand or under restrictions. It also includes information on the extent to which – irrespective of rights to redeem or cash-in – investors in a PRIIP should be encouraged, as a guide, to viewing an investment in the PRIIP as entailing a certain holding period.

5.6.2 Discussion

The section places a strong emphasis on communicating financial penalties or other consequences of early exit. This reflects the perceived importance of consumer detriment arising from early lapses or exits, where consumers commit to longer term products yet find that they need access to their investment earlier than anticipated.

This section links to the information on the consumer types (Article 8(3)(b)) above), in that it includes information also on recommended holding periods. It also links to the section on risks (notably, in relation to liquidity risk) and on costs (in relation to exit penalties).

In the interests of keeping the KID as simple and as short as possible, the presentation of information under this section should, as far as possible, combine together the information required, rather than including a mechanical list of each item listed in the Regulation separately.

Some principles and examples might be included in the draft RTS to aid in this, for instance, showing possible information to include for open-ended funds versus closed-ended funds, for typical tranche

products such as structured products, or other products where penalties apply on early exit such as may be the case with some insurance products. Penalties may take an explicit form – such as an early exit fee or cost – or an implicit form – such as where early exit means a guarantee does not apply, or means that the investor receives market value of components of the product. This information might be supplemented by level three guidance.

Some products may be exchanged through a secondary market. This section could include an indication of the risks attached, such that it might become very expensive or difficult to sell where counterparties willing to buy cannot be easily found. This might be particularly relevant for PRIIPs where there is a material risk that a secondary market could become illiquid.

Questions

40: Are you aware of specific challenges arising for specific PRIIPs in completing this section?

5.7 How can I complain?

5.7.1 Empowerment

Article 8(3)(h)

under a section titled "How can I complain?", information about how and to whom a retail investor can make a complaint about the product or the conduct of the manufacturer or a person advising on, or selling, the product;

This section contains practical information on how to complain.

5.7.2 Discussion

This section should be straightforward to complete. It should include information both about the manufacturer and distributor.

However, the manufacturer may not always be aware of who the distributor is and so may not be able to include specific information for the handling of complaints related to the distributor. A possible solution might be to include generic information, or a reference to where further information can be found related to complaining about a distributor.

For the manufacturer, the information implies providing a contact at the manufacturer. This may be a link to a specific page on the manufacturer's website set up for handling complaints. For unit-linked contracts, where other manufacturer's PRIIPs might be used to provide the units that are being offered, issues may relate to the underlying PRIIP rather than the unit-linked contract itself.

Questions

41: Are you aware of specific challenges arising for specific PRIIPs in completing this section?

5.8 Other relevant information

5.8.1 Empowerment

Article 8(3)(i)

under a section titled "Other relevant information", a brief indication of any additional information documents to be provided to the retail investor at the pre-contractual and/or the post-contractual stage, excluding any marketing material.

This section contains information on other official documents.

5.8.2 Discussion

This section should only refer to official documents, such as offer documents, the full prospectus for a fund, or other contractual documents related to a life insurance contract. A reference to the periodic disclosure documents the investor can expect should be also included. The indication can include a link to a website where documents can be found. No marketing information should be included.

Questions

42: Do you agree that this section should link to a webpage of the manufacturer?

6 Products offering many options

6.1 Empowerment

Article 6(3)

By way of derogation from paragraph 2 where a PRIIP offers the retail investor a range of options for investments, such that all information required in Article 8(3) with regard to each underlying investment option cannot be provided within a single, concise stand-alone document, the key information document shall provide at least a generic description of the underlying investment options and state where and how more detailed pre-contractual information documentation relating to the investment products backing the underlying investment options can be found.

Article 6(3) establishes that the KID can be different in a specific way for certain PRIIPs.

This is linked also to the general empowerment under Article 8(5) to specify in RTS the details of the KID for different PRIIPs.

In addressing this Article and its implications, it is important to determine which PRIIPs might be concerned, what the reference to ‘investment options’ relates to, and what will need to be considered for the presentation and content of the KID for these PRIIPs.

6.2 Scope of article 6(3)

The ESAs have identified the following criteria as relevant for determining what products may be concerned by article 6(3):

- Choices offered to retail investors do not affect the legal form of the PRIIP: choosing an investment option or another does not affect the legal form of the product. A change in legal form would in practice mean a choice between different PRIIPs.
- Retail investors are offered choices between at least two investment options, in so far as a single stand-alone KID cannot be provided to retail investors that complies with the three page limit on length. This determines what ‘a range of investment options’ is.
- Manufacturer must be able to justify, on demand of the competent authority, that a single stand-alone KID cannot be provided to retail investors.
- Choices can be offered at subscription and after subscription.

In some cases it may be that a product that offers different options could be also viewed as in effect a series of different products. In such a case separate KIDs for each variant of the product might be most effective for the consumer, and these would not be produced subject to article 6(3), but in the normal way as for any other PRIIP. For instance, where a contract is offered in three or four variants each with different investment profiles, these variants might be perceived as in effect separate PRIIPs. This could include where each different option offers a predefined asset allocation or where a portfolio management service is wrapped in a PRIIP.

Questions

43: Do you agree with the assessment of when PRIIPs might be concerned by article 6(3)?

6.3 Scale of market

Taking into account the list of criteria proposed above, the Joint Committee expects that products concerned by article 6(3) are mainly unit-linked life insurance contracts and hybrid life-insurance contracts (combining a with-profit fund and several units of accounts).

Questions

44: In your market, taking into account the list of criteria in the above section, what products would be concerned by article 6(2a)? What market share do these represent?

45: Please provide sufficient information about these products to illustrate why they would be concerned?

6.4 Impact of article 6(3)

The level one text provides in Article 6(3) that manufacturer shall give a “generic description of the underlying investment options and state where and how more detailed pre-contractual information documentation relating to the investment products backing the underlying investment options can be found”.

The ESAs are considering what this generic information might contain, and how it might be presented, including which sections of the KID set out in Article 8(3) it would cover, and how manufacturers should indicate where more detailed pre-contractual information can be found.

The ESAs seek broad views at this stage to aid in identifying different options.

Article 6(3) clearly draws a distinction between what might be termed the ‘product KID’ and ‘pre-contractual information documentation’ on underlying investment options. The ‘product KID’ should address the options in general, but separate ‘pre-contractual information’ is also to be available (information stipulated otherwise in EU or national legislation).

This ‘pre-contractual information’ could be information prepared by a third party, or by the PRIIP manufacturer themselves to provide detail the specific investment options offered. A number of specific ‘fund KIDs’, designed to complement the ‘product KID’, can be envisaged. The information might be provided in different forms, for instance in a ‘fund’ or ‘option’ booklet, or in a layered and hyper-linked format on a website (in so far as electronic communication is appropriate to the sale).

The focus under Article 6(3) however is on the ‘product KID’ and its content, rather than the specification of the content and nature of the ‘fund KIDs’.

Given the 'product KID' will need to be adapted to include 'a generic description of the underlying investment options', the ESAs have identified the following sections of the KID as particularly relevant, where adaptations would be needed. This is because the information in these sections would vary materially for the different investment options being offered in the PRIIP:

- *Comprehension alert*
This may apply for some investment options, but not for others. Moreover, the comprehension alert may also not be applicable to the PRIIP itself, or could be different for the PRIIP compared to the different underlying investments.
One possible option would be to adjust the statement to state that 'Some of the investment options you can choose for this product are not simple and may be difficult to understand.'
- *Objectives and Means of achieving them*
While it would be possible to provide general information about the objectives of the PRIIP, the investment objectives and the means for achieving them would also vary according to the investment options selected.
- *Identification of the target market*
The target market may vary according to different investment options offered with the PRIIP.
- *Risk-reward section*
Each of the investment options will normally have a different risk and reward profile. The investment options may be organised for some PRIIPs to offer a relatively small range of different profiles (ranging for instance across different risk appetites from very conservative to very adventurous), or the PRIIP may offer a very wide range of options across the full universe of investment possibilities. These of course may be arranged under a range of investment profiles.
Performance scenario information would vary along the same lines.
- *Cost section*
As with the risk-reward section, the costs for the PRIIP could be different depending on which investment options or combination of investment options are selected. The costs of the PRIIP reflect both the costs of the PRIIP itself, the costs for the underlyings and the acquisition of these. This would include costs on a 'look through' basis.

A variety of options have been identified for considering how these sections might be adapted for a 'product KID'. These include:

- *Broad narrative descriptions (including for both risk and cost sections)*

General information might be included in the KID in a narrative form, indicating the range of options available, and that the selection of these options will alter the risks, rewards and costs of the PRIIP, as relevant. This could include specific statements or warnings where the range of the options is very broad or wide, or where the options include both those with a broad target market, and those which have a much narrower target market.

This broad narrative description may however have the disadvantage of diminishing the comprehension of consumers as regards costs, risks and performances, and in particular the

comparability of this information between different KIDs, particularly where other KIDs include graphical information on risks, rewards and costs. On the other hand, narrative descriptions may be more flexible for taking into account a large range of products with different features.

- *Use of examples for costs and/or risks*

For cost information a purely narrative approach would not be feasible.

While the costs could be prepared to exclude costs that vary according to the underlying options selected, this could mislead investors, so the inclusion of examples or representative investment options might be considered.

This may be particularly relevant where the costs of different options are the same or very similar. However, where options exist that carry significantly higher costs, for instance, this could be misleading for the investor. It may be that a narrative warning could be included in such instances to mitigate this risk.

The same approach could be followed for the risk section.

Using examples on costs, risks and performance may help the consumer to understand what type of product it is and also enhance the comparability between PRIIPs. This presentation could particularly be useful for products offering a wide range of investment options which are not grouped in predetermined investment profiles. A number of examples might be included to illustrate the range of options.

There are a number of challenges. For instance:

- Examples may overly emphasise a particular option, misleading investors; including a range of examples may be difficult given the short nature of the KID;
- Setting rules for which examples to use to aid comparability may raise challenges with matching the different products prevalent in different markets. However, standardised the examples used might enhance comparability between products (these might be segmented according to the options they offer, with different examples applying);
- Using a principle-based approach, where manufacturers establish different examples based on the features of the products they offer, may improve accuracy but reduce comparability with different manufactures taking different approaches.

It would be crucial for such an option to be effective that consumers are practically able to recognise that the indicators shown are only examples which may not reflect their individual choices. For this reason, this would be a key area to assess through consumer testing.

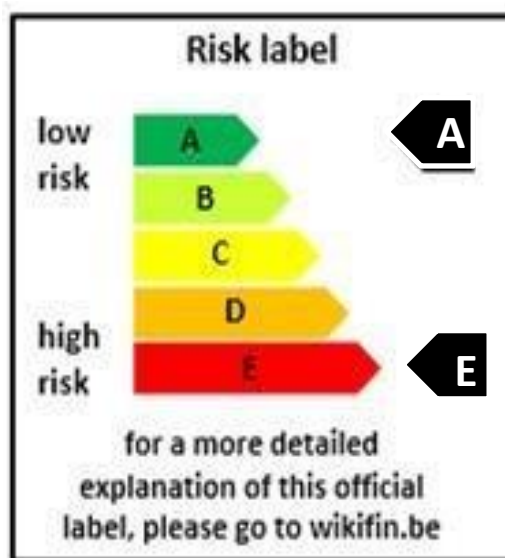
- *Use of ranges*

A further possibility would be to show ranges. This could be done both for the risk reward information and the cost the information. This might also be combined with indicative example(s) too.

Ranges mean in this specific case establishing a presentation of risks and costs indicators that would show consumers what maximum and minimum rates they could be exposed to when investing in the PRIIP. This would mean that the risk or cost indicators would not present each investment option but they would give different possible rates. Examples are presented below based on some indicators proposed in the discussion paper:



1	2	3	4	5	6	7
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This may reduce the risk that the retail investor underestimates costs where they choose higher cost investment options. However, the inclusion of additional information on costs may reduce the overall comprehension of the cost information for the consumer. Moreover, such information may not reflect the probability of having higher or lower costs.

Similarly, information on the range of risk profiles might be included.

The KID is intended as a generic document, such that it cannot take into account the specifics of the investment choices that an individual retail investor might make. However, it may be that an effective way that PRIIP manufacturers can communicate specific costs and risks would be to supplement that KID with 'personalised' information, once the retail investor has made a provisional

selection of possible investment options. This provide costs and risks information that takes into account these selections. However, this would fall outside the scope of the 'product KID' being examined here.

The analysis of detailed options for how to adapt these sections will be possible following analysis of feedback to this Discussion Paper.

Given the overall aims of the KID to aid consumers in understanding and comparing PRIIPs, it will be important to consider all options in terms of how they best communicate the features of the PRIIP overall, while at the same time communicating the risks, rewards and costs of the different underlying options. The combination of information provided in different documents will be a crucial factor to consider.

Questions

- 46: Do you have views on how you think the KID should be adapted for article 6(3) products, taking into account the options outlined by the ESAs?
- 47: How do you consider that the product manufacturer should meet the requirements to describe and detail the investment options available?
- 48: Are you aware of further challenges that should be taken into account?

7 Review, Revision and Republication

7.1 Empowerment

Article 10

1. The PRIIP manufacturer shall review the information contained in the key information document regularly and shall revise the document where the review indicates that changes need to be made. The revised version shall be made available promptly.
2. In order to ensure consistent application of this Article, the ESAs shall, through the Joint Committee, develop draft regulatory technical standards specifying:
 - a) the conditions for reviewing the information contained in the key information document;
 - b) the conditions under which the key information document must be revised;
 - c) the specific conditions under which information contained in the key information document must be reviewed or the key information document revised where an PRIIP is made available to retail investors in a non-continuous manner;
 - d) the circumstances in which retail investors are to be informed about a revised key information document for a PRIIP purchased by them, as well as the means whereby the retail investors are to be informed.

The European Supervisory Authorities shall submit those draft regulatory technical standards to the Commission by [...].

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010, Articles 10 to 14 of Regulation 1094/2010 and Articles 10 to 14 of Regulation (EU) No 1095/2010.

The conditions for reviewing the information contained in the KID relate to both the frequency by which a regular assessment of the information (risk rating, cost information, other information) for its continued accuracy should be undertaken, and the situations in which a review might be needed outside of this regular process, for instance where there is a change to the product or the market conditions to which the product is sensitive. This could include expectations on the steps that a manufacturer should take (such as organisational measures and monitoring facilities) to ensure that they are aware of relevant changes.

The conditions under which the KID should be revised relate to the circumstances under which a change is materially important enough to require a revision (change and republication) to a KID.

The specific conditions related to PRIIPs offered in a non-continuous manner concerns PRIIPs such as retail structured products that might be offered only for a short period of time, and would typically have a fixed maturity. For these products that are not on offer throughout their life, the continued updating of all sections of the KID may not be relevant. Similar questions may arise for products that were open but become closed or are otherwise no longer offered. Any consideration of these questions would also entail examining situations in which a product is traded on a secondary market. For instance, for many non-continuous structured products sold to retail investors, the issuer may facilitate a 'secondary market' on which the products can be bought from and sold to the issuer. For these secondary market sales, an update of the KID from the issuer would seem appropriate (for

instance, due to price fluctuations for a structured product during its life, and therefore the likely impact of this on performance scenario information included in the KID).

The circumstances in which investors are to be informed of a revision, and how this will be done, concerns both the ways in which republication might be done, and circumstances in which a notification of investors of a changed KID might be necessary. The means by which a notification is done will need to consider PRIIPs where the manufacturer does not know the identity of investors in the PRIIP (e.g. where intermediaries net together transactions and appear as the investor for the manufacturer).

7.2 Discussion

The KII Regulation addresses similar issues for UCITS, and might operate as a good starting point:

Article 22

Review of key investor information

1. A management company or investment company shall ensure that a review of key investor information is carried out at least every twelve months.
2. A review shall be carried out prior to any proposed change to the prospectus, the fund rules or the instrument of incorporation of the investment company where these changes were not subject to review as referred to in paragraph 1.
3. A review shall be carried out prior to or following any changes regarded as material to the information contained in the key investor information document.

Article 23

Publication of the revised version

1. Where a review referred to in Article 22 indicates that changes need to be made to the key investor information document, its revised version shall be made available promptly.
2. Where a change to the key investor information document was the expected result of a decision by the management company, including changes to the prospectus, fund rules or the instrument of incorporation of the investment company, the revised version of the key investor information document shall be made available before the change comes into effect.
3. A key investor information document with duly revised presentation of past performance of the UCITS shall be made available no later than 35 business days after 31 December each year.

Article 24

Material changes to the charging structure

1. The information on charges shall properly reflect any change to the charging structure that results in an increase in the maximum permitted amount of any one-off charge payable directly by the investor.
2. Where the 'ongoing charges' calculated in accordance with Article 10(2)(b) are no longer reliable, the management company shall instead estimate a figure for 'ongoing charges' that it believes on reasonable grounds to be indicative of the amount likely to be charged to the UCITS in future.

This change of basis shall be disclosed through the following statement:

'The ongoing charges figure shown here is an estimate of the charges. [Insert short description of why an estimate is being used rather than an ex-post figure.] The UCITS' annual report for each financial year will include detail on the exact charges made.'

In general terms, it would seem feasible to apply these measures to other PRIIPs. However, some changes would be necessary to address the features of PRIIPs that are different from UCITS.

The key areas that have emerged from initial assessments include:

- PRIIPs offering a large range of investment options, where a change in those investment options do not alter the legal form of the product.
- PRIIPs that are not closed-ended or not offered on a continuous basis (this is foreseen in the PRIIPs Regulation under Article 10 (2) (c) already);
- Tailoring to reflect the risks, reward and costs information in the KID: the measures under an equivalent for PRIIPs of Article 24 would need to take into account the risk, reward and cost figures included in the KID and reflect the sensitivity of these to change over time.
- The republication of the KII foreseen in Article 23 (3) is less relevant for the KID as there is no past performance included in the KID (although there are performance scenarios).
- The language would need to be adjusted to reflect a reference to PRIIPs manufacturers, rather than investment companies or management companies.
- The reference to changes to fund rules leading to a prior revision and republication of the KII might be broadened for the KID to cover any change materially impacting the investment objectives of the PRIIP.

In addition, the KII rules do not cover the circumstances in which retail investors are to be informed about a revised key information document for a PRIIP purchased by them, as well as the means whereby the retail investors are to be informed.

Situations in which an investor might be informed of a changed KID could include where there is a significant change – such as a reclassification of the risk of the product, or a major change in its likely costs, or in its objectives and how they are to be achieved.

However, in certain of these cases, other disclosures may be necessary, as may be dictated by contract law or post-contractual or ongoing disclosure requirements in sectoral or national law. The KID has been designed as pre-contractual information, so the extent to which it might be used to inform investors of such changes may be questioned.

In general terms a key question that arises is the choice between an ‘active’ communication model and a more ‘broadcast’ or passive model. In the former manufacturers and distributors would alert retail investors to the new KID or send it to them (e.g. by email). In the latter, manufacturers might make public the new KID on their website, or have a section of that website for highlighting such republished KIDs. Other possibilities might include notifications of the public at large using mass media (for instance, publications in newspapers). Such ‘passive’ measures have the downside that many investors may not be aware.

An active approach however would be costly for the manufacturer and the manufacturer may not know the identity of the end-investors.

Questions

- 49: Do you agree with the measures outlined for periodic review, revision and republication of the KID where 'material' changes are found?
- 50: Where a PRIIP is being sold or traded on a secondary market, do you foresee particular challenges in keeping the KID up-to-date?
- 51: Where a PRIIP is offering a wide range of investment options, do you foresee any particular challenges in keeping the KID up-to-date?
- 52: Are there circumstances where an active communication model should be provided?

8 Timing of delivery

8.1 Empowerment

Article 13

1. A person advising on, or selling, a PRIIP shall provide retail investors with the key information document in good time before those retail investors are bound by any contract or offer relating to that PRIIP.

...

5. In order to ensure consistent application of this Article, the ESAs shall, through the Joint Committee, develop draft regulatory technical standards specifying the conditions for fulfilling the requirement to provide the key information document as laid down in paragraph 1.

The European Supervisory Authorities shall submit those draft regulatory technical standards to the Commission by [...].

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010, Articles 10 to 14 of Regulation 1094/2010 and Articles 10 to 14 of Regulation (EU) No 1095/2010.

The ESAs are empowered in article 13 to specify the conditions for fulfilling the requirement to provide a KID 'in good time' before a retail investor is 'bound' by a contract or offer related to the PRIIP.

The KID is a document that is designed to aid the retail investor in making an informed decision in relation to a PRIIP, including aiding the retail investor in comparing between different PRIIPs. It is a condition for this that the document is provided to the retail investor sufficiently early in the decision-making process for the retail investor to read and consider the KID and its contents, including such time as is necessary for the retail investor to ask further questions of their advisor (where there is one), or to search for more detailed additional information.

Different retail investors may have different needs in this regard, and also the needs of the retail investor may vary according to the PRIIP involved.

In general terms, it is vital that retail investors receive the KID early in the investment process, some time before making any decision. There should be no pressure on the retail investor in this regard, should they wish to take a few days, for instance, before making a decision.

8.2 Discussion

Recital 83 of MiFID II already outlines some possible criteria that could be taken into account when assessing what might count as provision of information 'in good time' before the conclusion of a contract of commitment to a transaction.

Recital 83

In determining what constitutes the provision of information in good time before a time specified in this Directive, an investment firm should take into account, having regard to the urgency of the situation, the client's need for sufficient time to read and understand it before taking an investment decision. A client is likely to require more time to review information given on a complex or unfamiliar product or service, or a product or service a client has no experience with than a client considering a simpler or more familiar product or service, or where the client has relevant prior experience.

It would appear feasible to apply the same criteria to the determination of 'in good time' in the context of the provision of the KID, whereby persons advising on or selling a PRIIP should have regard to:

- The urgency of the situation, from the perspective of the retail investor;
- The time necessary for the specific retail investor to read and understand the KID;
- The complexity of the investment;
- The familiarity of the investment for the retail investor.

Questions

53: Do you agree that Recital 83 of the MiFID II might be used as a model for technical standards on the timing of the delivery of the KID?

54: Are you aware of any other criteria or details that might be taken into account?

9 General aspects of the KID

9.1 Plain language

Article 6(1) requires the KID to be ‘accurate, fair, clear and not misleading’. Article 6 (3) requires the KID to be clearly expressed and written in language and a style that communicate in a way that facilitates the understanding of the information. This can be understood as a requirement to use ‘plain language’.

It would be difficult – except where RTS contain prescribed statements, which should themselves be written using plain language – to establish within the RTS themselves useful guidelines on plain language. However, it can be expected that guidance or ‘best practice’ guides might support the implementation of the RTS by PRIIPs manufacturers. Such supporting work might be undertaken by the ESAs, by national competent authorities, or, indeed, by industry associations.

9.2 Use of templates to establish consistent ‘look and feel’ or visual style

The use of prescribed templates (that is, documents that manufacturers may ‘complete’, but with standardised visual layout and statements already included) has benefits:

- Ease of implementation for manufacturers
- Legal certainty for manufacturers
- Strong standardisation of the KID across the EU
- Ease of supervision by competent authorities

However, prescribing templates could also reduce the extent to which manufacturers take responsibility for developing the KID, and reduce innovation and development of the KID.

In addition, fixed templates could reduce flexibility for adapting the KID to the precise features of different PRIIPs, potentially reducing the effectiveness of the KID for retail investors for some PRIIPs.

Such problems might be addressed by preparing certain templates which could operate as *defacto* ‘safe harbours’ for manufacturers, but leaving it open for manufacturers to use other formats compliant with the RTS and the PRIIPs Regulation. However, manufacturers may still feel bound to treat the templates as binding, given the legal risks that might arise when adapting the templates for specific PRIIPs.

A further issue that would need to be addressed in using prescribed templates would be selection of the types and number of templates to prepare (matching, for instance, different types of PRIIP), and the level of detail (prescribed text) included in these.

- The decision on the later – the extent of prescription used – will be determined in large part by the policy choices on the specific parts of the document, where more or less prescription of the content or statements to be included might be chosen.

Questions

55: Do you think that the ESAs should aim to develop one or more overall templates for the KID?

9.3 Single payment and regular payment products

9.3.1 Background

Products can be designed to allow for single investment, or periodic payments over a period, or indeed a mixture of the two. Together with different options for the pay-off, makes for four basic options for accumulation and decumulation:

- Single payment in – single pay-out
- Regular payment in – single pay-out
- Single payment in – regular pay-outs
- Regular payments in – regular pay-outs

Annuities may be a special case. These could be characterised as a single payment in, regular pay-out product. They may be exempt by virtue of being retirement vehicles. In addition, they may not offer either a surrender nor a maturity value (the pay-outs would not necessarily qualify as either).

The same product may have different risk profiles depending on whether a single lump sum investment is made, or periodic (e.g. monthly) payments. Typically, in the latter case a product that has short term volatility would have lower overall volatility when investments are made on a monthly basis compared to investments as single lump sums.

Costs can also be different: the same product may have different overall costs depending on whether investments are made on a single or regular basis.

Other differences are more obvious: possibility and timing of disinvestments, minimum investment amounts, and timing and procedure for making regulator investments.

The UCITS KII requirements do not seek to address circumstances in which a UCITS is bought under a regular payment. The PRIIPs Regulation also does not make any specific references to regular payment products (whether these are payments in or payments out).

For insurance further to the question single payment and regular payment there is the question of the frequency of regular payment (example annual base, monthly base). Since insurances are usually calculated on the assumption that regular payment has an annual frequency and the benefits are also calculated on an annual basis, of course the premiums for monthly payment which are the individual choice of the policy-holder are higher. Offering monthly payment is seen as some sort of giving the consumer a loan in order to allow him a different payment scheme. In case these options

shall be included in the KID regarding performance it needs to be considered the benefit, in particular benefits from the insurance cover) he is getting and also the costs he is saving for not taking bank loan in order to finance the premiums.

9.3.2 Discussion

- KID(s) should reflect the product contractually offered: there could be a separate KID for a product offered with regular payments (e.g. endowment, savings plan) and for the same product offered on a single payment basis.

A principle might be established, but the choice left to the firm, whether these might be both explained in the same KID (e.g. the general principle of 'not misleading').

- Another possibility would be to not address regular payment structures in the KID itself. This would also be consistent with the PRIIPs Regulation and follow the UCITS approach. The regular payment arrangement could be addressed separately, e.g. in a pre-contractual document specifically and solely about the arrangement. The KID would be designed to represent single lump sum investments only.
- Alternatively, the contractual form of the product might be considered: where a product is contractually designed as regular payment product, than the KID might be prepared on this basis.

The choice on this relates also to the final form of the summary risk indicator, performance scenarios and cost information. Where this information would be materially different for regular payment versus single payment arrangements, a separate KID might be considered.

More accurate information on regular payment products may aid investors in making informed comparisons, yet differences in the information could also make comparisons between single and regular payment products more difficult to make.

Where a specific KID is prepared for a regular payment product, this could include specific information, such as:

- an outline of the nature of the payment plan (the commitment this entails) – when payments are made, for how long;
- cost information that reflects the cost structure under the plan, e.g. using an example payment amount and period;
- the risk profile, e.g. using an example payment amount and period.

Given the product may offer different options for the payment periods and amounts, the personalisation of information for the specific options an investor is considering, may be most effective in some cases. However, given the KID is intended to be a generic document, only examples might be included.

Questions

56: Do you think the KID should be adjusted to reflect the impact of regular payment options (on costs, performance, risk) where these are offered? If so, how?

10 Impact assessment

10.1 General discussion

The ESAs will prepare an impact assessment to accompany the draft RTS they will submit to the European Commission. This will examine the costs and benefits of different policy options identified during the work of the ESAs. It will outline the definition of the problem that is being addressed through the draft RTS, and the objectives that are being targeted and the criteria for assessing options. It will identify the policy options identified and assessed, and provide estimates (qualitative and quantitative) of the costs and benefits of these different options.

The impact assessment will build on that prepared by the European Commission in support of the original legislative proposal.¹⁶ The key problem drivers identified by that impact assessment were the emergence of retail investment products of similar economic nature but with different legal forms, a patchwork of regulation to address these products, and unmitigated asymmetries of information. These have led in the context of product information, the impact assessment argued, to insufficient or difficult to comprehend and compare disclosures, and an unlevel playing field between product manufacturers. These in turn have caused individual consumer detriment through mis-sales, a decline in confidence in the investment markets, and reduced capital-market efficiency.

The main objectives identified were to improve the comprehensibility of disclosures, improve the comparability of products using disclosures, ensure disclosures are provided at the right time in sales processes, and improve regulatory consistency. Following an assessment of a range of options, the retained policy option was:

“... to use a new regime (delivered through a separate legal instrument) to introduce a new PRIPs product disclosure with a common 'look and feel', and to establish comparability between PRIPs through the development of detailed prescriptive implementing measures at level 2 on the layout, content and presentation of the new document, tailored as necessary for different types of PRIP. The prescriptive measures at level 2 on the new documents would be set (in the light of testing of options on consumers) so as to allow for objective and balanced comparisons of the investment features of different PRIPs, notably in regards areas open to the use of objective indicators or 'metrics' (risks, costs and potential benefits).”¹⁷

The main purpose of the impact assessment to accompany the draft RTS will be to address the costs and benefits of policy choices arising at level 2.

¹⁶ See http://ec.europa.eu/internal_market/finservices-retail/docs/investment_products/20120703-impact-assessment_en.pdf.

¹⁷ See *ibid.*, p. 42-43.

10.1.1 Differences between Level 2 and Level 1 Impact Assessment

Though the problem definition and policy objectives for the draft RTS are derived from those at level 1, the context is different. The options selected and agreed at level 1 are not subject to impact assessment as such at level 2. Rather, the focus of impact assessment at level 2 is on assessing and selecting the best options at the technical level for achieving objectives that are laid down in the level 1 text.

Notably, the costs and benefits of introducing a new KID, including the one-off and ongoing costs associated with this, are in large part costs and benefits subsequent to the level 1 text. This would include most of the generic costs of drawing up and putting new documents into circulation, keeping them up-to-date, and so forth, and the generic benefits of introducing common documents in this manner.

By contrast, the costs and benefits related to the level 2 text are specific to the details of the implementation of the KID: the type of risk indicator or cost disclosures used, the extent to which the KID is effectively adapted for specific products, and so forth.

10.1.2 Drivers of costs and benefits at level 2

It can be anticipated that – irrespective of the costs and benefits borne in general consequent to the level 1 – options for the detailed implementation of the KID, as set out in this Discussion Paper, will carry significantly different costs and benefits.

In respect of costs for the industry, different ways of approaching a risk indicator could for instance trigger very different one-off and ongoing costs related to data acquisition and aggregation. Some options might trigger specific IT and publication costs, for instance for turning data into graphical forms. Other cost factors that might vary between options could include those linked to revision and review provisions, for instance for establishing systems for monitoring data related to the ongoing accuracy of the risk, performance and cost information in the KID.

More generally, the degree of standardisation of the presentation of the information may increase costs for firms, though also may drive some efficiencies. For instance, the legal and administrative costs associated with completing a strongly standardised template may be lower than where there is flexibility provided to manufacturers.

Indirect costs may vary between options, for instance, in relation to market impacts where options create new points of comparison between PRIIPs. This could increase competition on these points of comparisons, possibly leading also to changes in the range and nature of the PRIIPs offered on the market. This may be most obvious in relation to cost disclosures, where clearly and more comparable cost figures might be expected to increase price competition amongst some manufacturers.

Costs for providers – including indirect costs – would likely correlate with benefits for retail investors. The use of consumer testing to fine-tune the options offered in view of their effectiveness in achieving defined objectives should provide a strong basis for assessing and demonstrating the

benefits of retained options against rejected options. Quantifying these benefits will likely however be difficult, since the benefits relate ultimately to reduced levels of mis-selling, and the factors determining mis-selling extend beyond those factors impacted by the provision of a KID.

10.1.3 Assessing costs and benefits

It is premature in this Discussion Paper to outline detailed views on the costs and benefits of different options. However, views and data are sought at this stage from stakeholders on the broad drivers of costs and benefits, outlined at a high level above, and how these might vary for the different options being explored in this Discussion Paper. Views on the major drivers of costs are in particular sought.

10.1.4 Proportionality

It can be expected that different options could have different impacts for different sectors or groups of manufacturers. A key factor would be extent to which requirements diverge from existing measures for the manufacturer, e.g. at the national or sectoral level.

In general, the KID is likely to impact certain sectors more than others – e.g., impacting the insurance and structured product sectors greater than the funds sector – both in absolute and proportionate terms. However, much of these costs are driven by the level 1 Regulation and its introduction of a cross-sectoral KID, and would not in general terms be material for assessing options at level 2.

Questions

- 57: Are there other cost or benefit drivers that you are aware of that have not been mentioned? Please consider both one-off and ongoing costs.
- 58: Do you have any evidence on the specific costs or benefits that might be linked to the options already explored earlier in this Discussion Paper? Please provide specific information or references broken down by the specific options on which you wish to comment.
- 59: Are you aware of situations in which costs might be disproportionate for particular options, for instance borne by a specific group of manufacturers to a far greater degree in terms relative to the turnover of that group of manufacturers, compared to other manufacturers?

Annex 1

Interaction between the PRIIPs Regulation and MiFID II

MiFID II includes requirements on cost disclosures by investment firms

These following paragraphs investigate interactions between these and the requirements on cost disclosures by PRIIP manufacturers under the PRIIP Regulation.

Article 24(4) of MiFID II clarified the MiFID I provisions relating to the information that should be disclosed to clients on costs and charges of products falling in the scope of the directive. This provision implies that all costs and associated charges related to investment/ancillary services and financial instruments should be disclosed to clients. A number of key points emerge from the section 2.14 of the MiFID2 / MIFIR Consultation Paper of ESMA (2014/549) (“the MiFID CP”) in relation to the possible interaction between MiFID2 requirements and the PRIIPs Regulation:

Reliance on the PRIIPs Regulation to comply with MiFID requirements

In order for investment firms to fulfil their MiFID obligations in relation to the disclosure of costs, investment firms should be provided with reliable information about the costs and charges related to financial instruments by the product manufacturer. Recital 78 of MiFID2 clarifies that for costs relating to the financial instrument, investment firms may rely on the information that the product manufacturer or issuer of the financial instrument is obliged to publish under existing Union law. This means that investment firms may rely on information on costs of the relevant financial instrument as disclosed in the prospectus and the UCITS key investor information document (KIID) or PRIIPs key information document (KID). However, the recital also makes clear that reliance on such disclosure documents is subject to the assumption that all costs relating to the financial instrument are disclosed in that document.

Aggregation of costs and charges

The MiFID CP considers that, in accordance with the obligation to disclose costs and charges, investment firms should aggregate information about the costs related to the financial instrument and costs related to investment or ancillary services. The MiFID CP identified various cost items that are related to investment and ancillary services and the different types of financial instruments falling under the scope of MiFID II. It considers that these identified costs should form part of the costs to be disclosed to the clients. These cost items are listed in the Annex 2.14.1 of the aforementioned Consultation Paper.

The MiFID CP states that an investment firm should aggregate: i) all costs and associated charges charged by the investment firm or other parties where the client has been directed to such other parties for the investment services(s) and/or ancillary services provided to the client; and ii) all costs and associated charges associated with the manufacturing and managing of the financial instruments.

To the extent that investment firms under MiFID II may rely on information on costs of the relevant financial instrument as disclosed in the PRIIPs KID, the costs that are included in the cost section of the PRIIPs KID for products subject to MiFID II should therefore include (at least) the costs that are required for cost disclosures under MiFID II, and notably the aforementioned Annex 2.14.1 of the MiFID CP. This aggregation methodology is consistent with the second paragraph of Article 8(3)(e) of the PRIIPs Regulation.

Transaction costs

The MiFID CP notes that the UCITS KIID does not currently include an obligation to provide information about transaction costs. This could mean that the information currently provided in conformity with the UCITS KIID would be different in scope compared to MiFID II requirements, in which case the firms recommending or marketing UCITS should additionally provide their clients with information about the transaction costs. The MiFID CP notes, however, that the PRIIPs KID would have to disclose costs associated with the investment comprising both direct and indirect costs, one-off and recurring costs. The investment firm providing disclosure in the context of MiFID should therefore be able to rely on the costs and charges disclosed in the PRIIPs KID when aggregating the costs and charges according to MiFID II¹⁸.

Distribution fees

In the aforementioned Annex 2.14.1 one-off charges related to the financial instrument notably include distribution fees. This means that the investment firm under MiFID II could rely on the PRIIPs KID to assess the amount of these distribution fees, which, in turn, implies that the cost section of the PRIIPs KID should include such information. This raises the question whether the PRIIPs manufacturer is able to assess the amount of distribution fees for all types of PRIIPs and in all circumstances (e.g. depending on the distribution channels to be used). Such distribution fees should be included in the PRIIPs KID if they are known.

Cumulative effect of costs on return

The MiFID CP considers that an investment firm should provide its clients both ex-ante and ex-post with an illustration showing the cumulative effect of costs on return when providing investment services, such as portfolio management and investment advice. The MiFID CP does not prescribe the format of the cumulative effect of charges on return.

¹⁸ The costs related to the transactions as stated in the Annex 2.14.1 of the MiFID CP are “Costs and charges that are related to transactions that are performed by the manager of the financial instrument”. It includes Broker commissions, entry- and exit charges paid by the fund, mark-ups embedded in the transaction price, stamp duty, transactions tax and foreign exchange costs.

MiFID II includes also requirements on the disclosure of information on the risk of financial instruments.

These following paragraphs investigate interactions between these and requirements on risk under the PRIIP Regulation.

Article 24(4)(b) of the MiFID II states that the information to be provided to client shall include guidance on and warnings of the risks associated with investments in financial instruments or in respect of particular investment strategies. Section 2.13 of the MiFID CP specifies that Article 31(2) of the MiFID Implementing Directive, relating to the description of risks, should specifically address the risk of financial instruments involving impediments or restrictions for the disinvestment.

This information seems to be covered by the different requirements of the PRIIPs Regulation, which means that under certain circumstances the investment firm could rely on the PRIIPs KID to provide this information.

Interaction between the PRIIPs Regulation and the UCITS Directive

The UCITS Directive includes requirements on cost disclosure

These following paragraphs investigate interactions between these and the requirements on cost disclosures under the PRIIP Regulation.

Article 78(3)(d) of the UCITS Directive states that key investor information shall provide information on “costs and associated charges”. Articles 10 to 12 of Implementing Regulation 583/2010 outlines that “The ‘Charges’ section of the key investor information document shall contain a presentation of charges in the form of a table as laid down in Annex II” of this Regulation. The categories of charges listed in this table are: i) one-off charges (entry and exit charges expressed as the maximum percentage which might be deducted from the investor’s capital commitment to the UCITS); ii) charges taken from the fund over a year (ongoing charge, expressed as a single figure representing all annual charges and other payments taken from the assets of the UCITS over the defined period, and based on the figures for the preceding year); iii) charges taken from the fund under certain specific conditions (e.g. performance fees).

The CESR guidelines on the methodology for the calculation of the ongoing charges figure in the Key Investor Information Document (hereafter the CESR guidelines)¹⁹ provide a number of details on the calculation of the ongoing charges figure, including a definition of ongoing charges to be disclosed and the details of the calculation methodology.

A non-exhaustive list of the types of ongoing charge that, if they are deducted from the assets of a UCITS, shall be taken into account in the amount to be disclosed, is also provided. A list of charges and payments that shall not form part of the amount to be disclosed as ongoing charges in the KIID is also included in the guidelines. These charges and payments are: i) entry / exit charges or

¹⁹ http://www.esma.europa.eu/system/files/10_674.pdf.

commissions, or any other amount paid directly by the investor or deducted from a payment received from or due to the investor; ii) a performance-related fee payable to the management company or any investment adviser; iii) interest on borrowing; iv) payments to third parties to meet costs necessarily incurred in connection with the acquisition or disposal of any asset for the UCITS' portfolio, whether those costs are explicit (e.g. brokerage charges, taxes and linked charges) or implicit (e.g. costs of dealing in fixed-interest securities, market impact costs); v) payments incurred for the holding of financial derivative instruments (e.g. margin calls); vi) the value of goods or services received by the management company or any connected person in exchange for placing of dealing orders (soft commissions or any similar arrangement).

When comparing the provisions of the PRIIPs Regulation and the CESR guidelines, it is to be noted that the categories of charges and payments listed in the points iii) to vi) above, which are excluded from the disclosure of costs under the UCITS KIID requirements, should in principle be included in the costs to be disclosed under the PRIIPs Regulation.

The UCITS Directive also includes requirements on the disclosure of information on the risk of financial instruments

These following paragraphs investigate interactions between these and the requirements on risk under the PRIIP Regulation

Article 78(3)(e) of the UCITS Directive states that key investor information shall provide information on “the risk/reward profile of the investment, including appropriate guidance and warnings in relation to the risks associated with investments in the relevant UCITS”.

Articles 8 and 9 of Implementing Regulation 583/2010 (hereafter the KII Regulation) outline that “*the ‘Risk and reward profile’ section of the key investor information document shall contain a synthetic indicator*” and provides a number of features of this indicator.

The synthetic indicator shall take the form of a series of categories on a numerical scale with the UCITS assigned to one of the categories (Article 8(2)). The presentation of the synthetic indicator shall comply with the requirements laid down in Annex I of the KII Regulation, which states, inter alia, that the indicator shall rank the fund on a scale from 1 to 7 on the basis of its volatility record; however, for structured UCITS, the calculations are based on the volatility corresponding to the 99% VaR at maturity.

A narrative explanation of the risks which are materially relevant to the UCITS and which are not adequately captured by the synthetic indicator shall supplement the indicator (Article 8(1)(b)); These risks shall notably include credit risk, liquidity risk, counterparty risk, operational risks, risks related to the safekeeping of assets;

CESR's guidelines on the methodology for the calculation of the synthetic risk and reward indicator (hereafter SRRRI) in the Key Investor Information Document provide a number of details on the calculation of the SRRRI of UCITS in general and of specific UCITS structures in particular. These details include the precise elements of the methodology that shall be used for each type of fund and the values of the different parameters to be used to implement these methodologies.

While the requirements of the UCITS Directive and the PRIIPs Regulation are remarkably consistent, this does not imply that the Risk and Reward indicator of the PRIIPs KID should be the same as the SRRI, notably due to the variety of PRIIPs, and their differences compared to UCITS funds.

Interaction between the PRIIPs Regulation and the AIFMD

The AIFMD includes requirements on cost disclosure which are to be articulated with the provisions of the PRIIPs Regulation on the cost section of the KID.

Under Article 23(1) of the AIFMD, AIFMs shall, for each of the EU AIFs that they manage and for each of the AIFs that they market in the Union, make available to AIF investors some detailed information before they invest in the AIF²⁰. Under Article 23(4) of the AIFMD, AIFMs shall also, for these same AIFs, periodically disclose to investors, the current risk profile of the AIF and the risk management systems employed by the AIFM to manage those risks (Art. 23(4)(c)).²¹

There is no provision concerning the interaction between the PRIIPs KID and the information mentioned in the Art. 23 of the AIFMD in the case of AIF marketed to retail investors. However, the information provided under AIFMD should be consistent with the information provided in the PRIIPs KID. This information includes notably the points referred to in Art. 23(1)(a), Art. 23(1)(d), Art. 23(1)(i), Art. 23(1)(d), and Art. 23(4)(c) of the AIFMD.

Interaction between the PRIIPs Regulation and the IMD and Solvency II

The Insurance Mediation Directive (IMD),²² requires those distributing PRIIPs to provide various disclosures to the customer under Article 12. However, these disclosures do not relate to the PRIIP itself, but to the intermediary. The proposed revision of the IMD (IMD 2) that was proposed by the European Commission²³ included measures similar to those in MiFID for the sale of PRIIPs by insurance intermediaries or in the case of direct sales by insurance undertakings. This proposal is still under negotiation, so it is not possible to assess the interaction at this stage.

Solvency II includes measures on pre-contractual disclosure of information about insurance contracts.²⁴ This information varies depending on whether the contract is a life or non-life contract. All PRIIPs would be life contracts. The key provision is therefore Article 185. The PRIIPs Regulation

²⁰ A description of the investment strategy and objectives of the AIF, a description of the types of assets in which the AIF may invest, the techniques it may employ and all associated risks (Art. 23(1)(a)); the identity of the AIFM, the AIF's depositary, auditor and any other service providers and a description of their duties and the investors' rights (Art. 23(1)(d)); a description of all fees, charges and expenses and of the maximum amounts thereof which are directly or indirectly borne by investors (Art. 23(1)(i)); where available, the historical performance of the AIF (Art. 23(1)(n)).

²¹ Article 108(4) of the Commission Delegated Regulation (EU) No 231/2013 supplementing the AIFMD states that the disclosure of the risk profile of the AIF in accordance with point (c) of Article 23(4) of the AIFMD shall outline: (a) measures to assess the sensitivity of the AIF's portfolio to the most relevant risks to which the AIF is or could be exposed; (b) if risk limits set by the AIFM have been or are likely to be exceeded and where these risk limits have been exceeded a description of the circumstances and, the remedial measures taken.

²² Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation.

²³ See http://ec.europa.eu/internal_market/insurance/docs/consumers/mediation/20120703-directive_en.pdf.

²⁴ Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (Text with EEA relevance).

makes it clear that for insurance-based investment products, both Solvency II and the PRIIPs Regulation will apply. Certain of the items outlined in Article 185 may be satisfied by a KID, however the KID may not satisfy all information items outlined in Article 185.

Annex 2

Possible measures of market risk

Quantitative indicators

For all the quantitative measures outlined here there is no fully accepted and already standardized method for calculating probability distributions and statistical measures. Options for achieving a consistent approach (either in a normative or a prescriptive way) across manufacturers and PRIIPS are not addressed in this Discussion Paper, but will be considered during a later phase of work. There are clear challenges to address: necessary data may not always be readily available, and some methodologies may be difficult for smaller firms to implement.

Historical (ex post) volatility

Description	Consideration
Historical volatility is derived from time series of past market prices; this would follow the UCITS SRRI approach (except for structured UCITS) of calculating the variance of the distribution of the log of the product's returns over a suitable period of time.	Historical volatility gives a measure of the range of returns achieved in the past. It does not give a measure of loss or the probability of a loss occurring in other words history may not be a good predictor of the future.

Volatility of forecast returns

Description	Consideration
A model is used to calculate the distribution of possible returns. The volatility is a measure of the width of the distribution of possible returns.	As with historical volatility, the volatility of forecast returns measures the range of possible returns, but does not give a measure of possible loss or the probability of a particular loss occurring. The use of a model to forecast returns introduces the complication of how to specify the model to ensure comparability of all products across all manufacturers (normative versus prescriptive).

Value-at-Risk or Expected Loss for a given Value-at-Risk

Description	Consideration
Both VaR and ELVaR are statistical measures derived from a probability distribution of expected returns. VaR is a measure of the minimum return (or loss) that would be expected over a period of time for a predefined small probability. VaR is used to calculate the SRRI for structured UCITS. ²⁵	VAR gives a measure of the loss or potential loss for a particular probability. These measures focus on the downside potential, with no indication of the range of returns accessible with a particular product

Expected Shortfall for a given Value-at-Risk

²⁵ See http://www.esma.europa.eu/system/files/10_673.pdf.

Description	Consideration
<p>Like VAR, Expected Shortfall VAR is a statistical measure derived from a probability distribution of expected returns.</p> <p>Expected shortfall VAR measures the average of the returns that are expected within that predefined small probability. It presents an average of the expected loss for a chosen probability.</p>	<p>Expected Shortfall VAR gives a measure of loss for a particular probability. Since the measure indicates an average for a selected probability, this measure can be valuable for products with discontinuous return probabilities.</p>

Qualitative indicators

To measure market risk in a qualitative way would combine several aspects. Taken together, these indicators could provide a good understanding of the uncertainty in the distribution of returns. The reason why a combination of measures is needed is because a single indicator below would not provide sufficient specific value of the market risk associated with the product. As they are based on product features, they are not limited by data availability or by the difficulties to estimate future returns. On the other hand they do not benefit from the input of market data.

Description	Consideration
<p><i>Type of underlying</i>; Determination of market risk on the basis of the qualities of the market instruments underlying the product.</p>	<p>All PRIIPs have underlying investments which can be ranked according to perceived riskiness. This indicator is not specific per underlying and therefore might impact the comparability between products</p>
<p><i>Risk diversification</i>; Determination of market risk on the basis of the degree to which the risk is concentrated on a single underlying or multiple underlings and the degree of risk diversification achieved</p>	<p>This relates to the indicator above, but now relates to the number of underlyings and the correlation among the underlyings.</p>
<p><i>Leverage</i>; Determination of market risk on the basis of the amount of leverage (i.e. the change in value of the product for a given change in value of the security underlying the product).</p>	<p>Leverage is very relevant as measure for risk since the impact of leverage on the value of a PRIIP can be substantial. One could decide to separate between 'levels of leverage'.</p>
<p><i>Impact of characteristics of the product on the return or initial investment of the PRIIP</i>; Determination of market risk on the basis of the degree to which market risk is offset by the presence of mitigating factors (i.e. the presence of a minimum return or a promise to return the initial amount invested) or could lead to a loss exceeding the initial investment.</p>	<p>This indicator refers to specific characteristics a product could have that may impact the return on a PRIIP. One could think on caps, knock-out levels and capital protection levels.</p>
<p><i>Exposure to foreign exchange rates</i>; Determination of market risk on the basis of the question whether the return of the product depends on a foreign exchange rate</p>	<p>In case the underlying investment is made in another valuta than the PRIIP this may impact the value of the PRIIP not only by changes in value of the underlying investment but also by changes in the exchange rate. It therefore reflects another kind of risk that impacts the market risk of a product.</p>

Possible measures of credit risk

The analysis of the credit risk of a product should be product specific, meaning that it should, as much as possible, consider the product characteristics and not only the general solvency of the manufacturer or of the entity responsible for the payment obligations to the investors if different

from the manufacturer. The following characteristics have been identified as having an impact on the credit risk of a product in addition to the creditworthiness of the manufacturer: risk diversification, level of seniority and secured or unsecured nature (whether by collateral or a via a third party guarantee).

Next to the product characteristics and the overall creditworthiness of the manufacturer, investors' claims under a PRIIP may sometimes be protected by a deposit or insurance guarantee scheme. All these elements may impact the credit risk attached to a product.

The table hereunder lists credit risk indicators that measure the overall creditworthiness of the manufacturer for a certain type of product. A distinction is made between quantitative indicators, inferred from quantitative market data, and qualitative risk indicators, based on product features or other data.

Quantitative measures

Credit spread or CDS spread of the manufacturer

Description	Consideration
The credit spread of the manufacturer refers to the difference in yield between different bonds of same maturity due to different credit quality. As a CDS insures against a loss due to a credit event, the CDS spread or premium paid by the protection buyer reflects the credit risk attached to the underlying reference entity.	To measure the credit or CDS spread, liquid bonds or CDS should be available in the market. If not, the spread may be obtained on the basis of the spread of issuers or products with a similar risk profile. Estimations may be difficult for some PRIIPS due to lack of market data, that may only be accessible via specialized databases. Furthermore, agreement is needed on a reference rate. The spread may not be exclusively representing the credit risk as it may be impacted by other factors such as liquidity; moreover, the spread may not be representative for the credit risk attached to a product due to some specific product characteristics such as collateral).

Credit value at risk

Description	Consideration
The credit risk of a PRIIP can be valued by establishing a loss probability distribution that represents the relationship between a loss level due to a default and its probability of occurrence. This indicator can be compared with the VaR indicator	See comments on VaR indicator for market risk.

Qualitative measures

Credit rating

Description	Consideration
Counterparties can be distinguished based on their credit rating.	Although a credit rating is an indicator of credit risk that is used very often, not all manufacturers may have a credit rating. Furthermore, there are multiple credit rating agencies in the market and comparability of the ratings amongst agencies should be assured. The reliability of credit ratings has been questioned

	in the last years, that may advise not to over rely on them. However, they are still a possible input to assist investors to get a general or first impression of the risk of a product
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Prudential supervision

Description	Consideration
A distinction could be made between entities subject to prudential supervision (credit institutions, investment firms, insurance undertakings) and other entities.	Prudential supervision frameworks cannot prevent all failures, as evidenced by the debates on bail-in.

The tables hereunder lists other qualitative credit risk indicators that measure a specific element or feature of credit risk; these specific qualitative credit risk indicators could be additional criteria to the overall qualitative credit risk indicators and could allow, if combined, to distinguish PRIIPS on the basis of credit risk attached. These measures are considered not to be able to provide sufficient information on credit risk by their selves but could be, when combined.

Description	Consideration
<i>Risk spreading</i> ; A distinction could be made between PRIIPS where the counterparty risk is diversified and other PRIIPS. Criterion for risk spreading could be based on UCITS risk spreading regime.	Risk spreading lowers counterparty risk. Additional protection may be limited in case of distress if underlyings are correlated.
<i>Level of seniority</i> ; The level of seniority may impact the credit risk attached to a PRIIP. A distinction can be made between super-senior, senior and subordinated debt.	The level of seniority determines the hierarchy of creditors in case of default. Level of seniority does not impact the expected amount of loss in case a default occurs.
<i>Secured/unsecured nature</i> ; A distinction can be made between PRIIPS where the undertaking of the counterparty is secured and PRIIPS where the undertaking is unsecured. Further distinction amongst secured PRIIPS can be made between PRIIPS where the protection consists of a third party guarantee or PRIIPS where the protection is provided via a claim on assets (collateral).	In case a PRIIP is secured by underlying assets the credit risk is perceived less than when such underlying investments are not present. For a third party guarantee the level of credit risk also depends on the credit risk that is related to the third party that provides the guarantee. And whether specific collateral is identified for such guarantee.
<i>Deposit insurance</i> ; As well EU harmonized banking deposit protection as equivalent national insurance protection schemes could be considered.	Protection by deposit insurance depends not only upon the type of PRIIP but also on some investor-specific elements. Strength of deposit insurance depends on financial strength of the responsible country.

Possible measures of liquidity risk

Analysis and presentation of liquidity risk should highlight the possibility that a client may not receive the value of the investment (possibly extremely less) on exit, especially if the time of exit is at the discretion of the investor. The quantitative and qualitative measures in the following table could be a means for comparing the risk of illiquidity across different products.

Quantitative measures

The bid-offer spread

Description	Consideration
The bid-offer spread could be used as a measure of the difficulty and cost of exit. Transaction costs based liquidity measure	Bid-offer data are based on orders and may not be easily available.

The average volume traded

Description	Consideration
Volume based liquidity measure (e.g. turnover ratio, frequency of trading). High volumes are usually associated to small bid-offer spreads.	Data on volumes traded are easily available if the product is admitted to trading on a regulated market. Other trading venues and OTC data may be more difficult to collect, though disclosure requirements are increasing.

The average volume traded over a given period or the average number of operations or days with tradings may all serve as indicators of the possibility of disinvesting at any moment.

Number of market makers excluding the manufacturer

Description	Consideration
If there at least one market maker providing liquidity independent of a product's manufacturer, the client has a better chance of receiving fair value under any market condition.	This measure gives no indication of the impact of low liquidity on the value accessible to the client (no measure of potential loss). It does indicate where the client faces lower risk.

Qualitative measures

Characteristics of the exit arrangements

Description	Consideration
Products can be distinguished on the basis of differences in exit arrangements. Aspects to be considered include, whether the products are (i) listed or whether (ii) a secondary market is organized, whether (iii) liquidity facilities are organized under what circumstances or conditions and (iv) how the exit price is determined.	Nominal listing in similar venues may hide significant differences in the real possibilities of selling the product for the fair value.