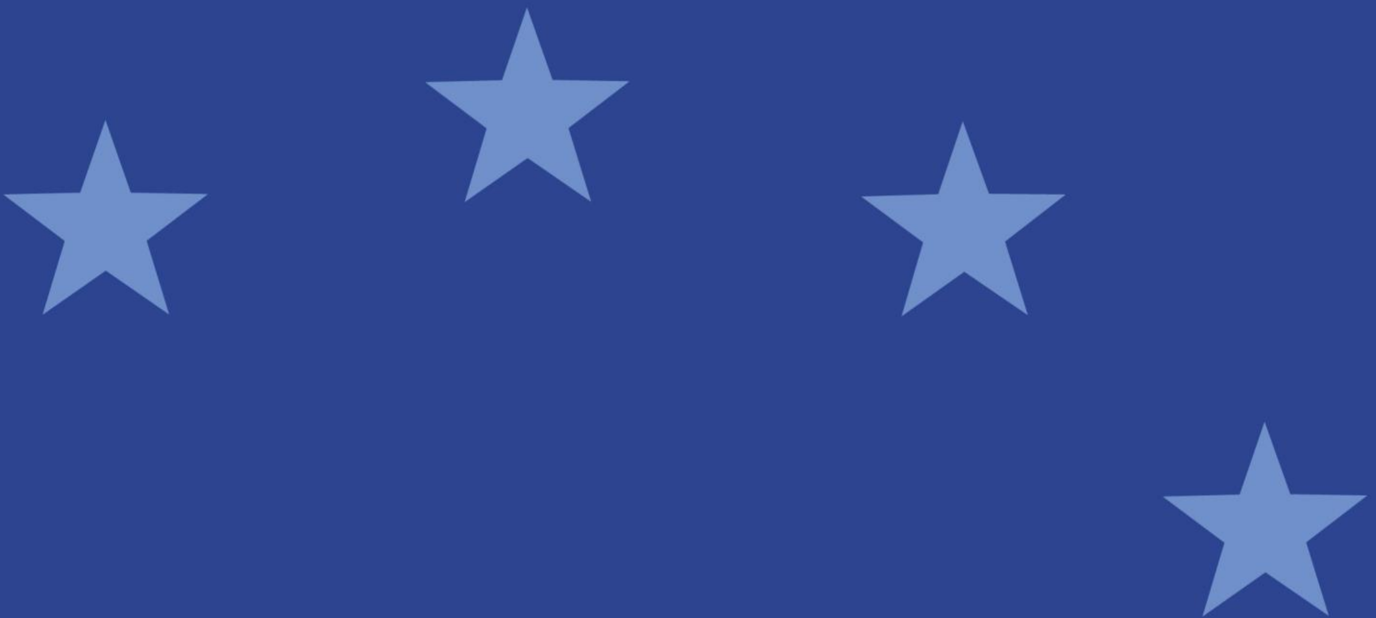
Reply form for the Technical Discussion Paper on PRIIPs



23 June2015

European Securities and Markets Authority

Date: 23 June 2015

Responding to this paper

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

Instructions

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

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type < ESMA_QUESTION_PRIIPs_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

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

Naming protocol

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

ESA_TDP_PRIIPs_NAMEOFCOMPANY_NAMEOFDOCUMENT.

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

ESA_TDP_PRIIPs_XXXX_REPLYFORM or

ESA_TDP_PRIIPs_XXXX_ANNEX1

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

Deadline

Responses must reach us by **17 August 2015.**

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

Publication of responses

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

Data protection

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

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

General information about respondent

Name of the company / organisation	Association of the Luxembourg Fund Industry
Activity	Trade association
Are you representing an association?	☒
Country/Region	Luxembourg

Introduction

Please make your introductory comments below, if any:

< ESMA_COMMENT_PRIIPs_1>

The Association of the Luxembourg Fund Industry (ALFI) is the representative body of the Luxembourg investment fund community. Created in 1988, the Association today represents over 1300 Luxembourg domiciled investment funds, asset management companies and a wide range of service providers such as custodian banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax experts, auditors and accountants, specialist IT providers and communication companies. The Luxembourg Fund Industry is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg-domiciled investment structures are distributed on a global basis in more than 70 countries with a particular focus on Europe, Asia, Latin America and the Middle East.

We thank the ESAs for the opportunity to participate in this technical discussion paper on PRIIPs. However, we regret that the authorities have not granted more time to stakeholders to conduct deeper analyses of the various technical sections and options. Taking account of the general holiday period in July and August, it was more than a challenge for trade associations like us to gather feedback from and channel the expertise of its members into complete answers.

As already stressed in several answers of our response to the first discussion paper on PRIIPs, the outcome of consumer testing is key for the content and design of key information documents (KIDs) to make them user friendly. It would be very helpful also for the industry when preparing responses to consultations to have insight in what consumers prefer. Therefore, in view of the expected two further consultations on PRIIPs we call on the European Commission to officially share the results of consumer testing which we understand is about to end this month.

We support the submission of the European Fund and Asset Management Association (EFAMA) to which we as a member have contributed.

< ESMA_COMMENT_PRIIPs_1>

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

<ESMA_QUESTION_PRIIPs_1>
From our point of view, where available, historical distribution of returns should be used. The true performance of an asset manager and its products can only be demonstrated by means of historical based track records. If historical data were ignored, there would be a risk that arbitrary predefined data led to a uniform illustration of a fund's performance, which might go along with potential disincentive effects to the detriment of the investor's money.

Furthermore, a specific treatment should be defined for structured products or instruments with non-linear pay off (along the lines of the existing UCITS SRRI methodology), provided that a classification procedure to distinguish different asset classes is well defined.

Where historical data are not available or does not cover a sufficient history, the use of forward-looking simulations is the most suitable alternative. In this case, principles for the simulation (models and parameters) will have to be provided from the regulator.

This approach would be tractable, create low implementation costs, easy to standardise and difficult to manipulate. In addition, it would give the consumer comfort that actual data / scenarios were employed when forecasting the probability of distribution and potential outcome, and / or that data are consistent with observable market data.
<ESMA_QUESTION_PRIIPs_1>

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

<ESMA_QUESTION_PRIIPs_2>
Where a modelling approach is used, and on condition that the model has been reviewed and approved by supervisory authorities and/or independent third parties with mandatory periodic (e.g. annual) re-assessments, we believe that manufacturers should be allowed to select a model which is the most appropriate under the given circumstances for a specific product.

Prescribing a simple model for all products may lead to biased comparisons between them when their risk profiles may be sensitive to a specific risk factor or behaviour not appropriately captured by the prescribed model. Leaving the choice to manufacturers with model guidance would ensure that a minimum quality standard is reached and that a more refined modelling could be used when in the best interests of investors.

The regulatory technical standards could prescribe standard shocks for each asset class or risk factor (equity, credit, interest rate, currency, volatility, etc.) and a correlation matrix to derive a risk level under a "standardized approach", in a way similar to the Standardized Method under Solvency II or the Standardized Approach under CRD IV. Standard shocks would be high to encourage manufacturers to use an internal model.

Parameters should be left to the discretion of the manufacturers, with a few exceptions such as interest rate curves which could be set by the supervisory authority as in the Solvency II framework.

Prescription of model or parameters by the authority could lead to regulatory arbitrage situations where a product could be altered for the purpose of presenting a better risk profile under the prescribed model/parameters of the supervisory authority.

The regulatory technical standards should require manufacturers to perform an independent validation of the model used to generate a distribution of returns and a calculation of a risk measure. Such validation should include amongst other elements the choice of the model, the appropriateness of the assumptions used, the implementation of the model, the calibration of the parameters, predictability of the outputs of the model.

Furthermore, regulatory technical standards should require manufacturers to perform a regularly back-test their models against actual market data and to disclose the results of such back-test to their home state supervisory authority on an annual basis.
<ESMA_QUESTION_PRIIPs_2>

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

<ESMA_QUESTION_PRIIPs_3>
Assuming that the target of the performance section is to compare the performance of all products across all asset classes, only option (a) can be the suitable choice as the other options might not be applicable for all asset classes.

Still, we believe that it might be helpful for the investor, similar to the UCITS KIID, to see within the PRIIPs KID in addition also the performance of a benchmark given that a specific benchmark is mentioned in the prospectus of the product.
<ESMA_QUESTION_PRIIPs_3>

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

<ESMA_QUESTION_PRIIPs_4>
We believe that there is no generally accepted method within the market to estimate risk premiums across or within specific asset classes. Thus, we believe that no risk premium should be considered, which corresponds to option (a).

Still, in case the ESAs would decide to include risk premiums within growth rates calculations, it should be ensured that everybody in the market is obliged to select the exact same assumption.
<ESMA_QUESTION_PRIIPs_4>

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

<ESMA_QUESTION_PRIIPs_5>
Option (a), in order to take into account exit risk at the end of the recommended holding period and risks throughout the life of the product in case of an early exit. In addition, the following specifications should be considered:

- **to ensure consistency through the content of the KID:**

One performance scenario should always correspond to the “Recommended holding period” of the product.

- **to ensure consistency across all PRIIPs products:**
The regulator should specify at least one holding period which allows the investors to compare the scenarios across various products.

<ESMA_QUESTION_PRIIPs_5>

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

<ESMA_QUESTION_PRIIPs_6>
Despite the fact that the whole process of rating the creditworthiness of issuers has undergone severe criticism, in our opinion, the use of credit ratings is an efficient and objective way to measure and control the credit quality of issuers. Credit risk monitoring based on credit ratings has already been tested (e.g. pursuant to the Basel and Solvency regulation) and it is considered an accepted market practice to estimate credit risk. Furthermore some manufacturers may already have implemented infrastructures that are able to retrieve and manipulate such information. Additional disclosures about credit risk mitigating factors could be added such as the seniority of the debt products considered, the level of subordination, type of guarantees if any, credit quality of issuers, domicile, etc.

In case credit ratings are not directly available the use of Peer Company is unavoidable. In order to guarantee comparability, this process should respect specific guidelines in order to reduce the impact of subjectivity and facilitate the supervision.
However, the use of credit default swap spread as a measure of the credit quality may not be suitable as credit default swap spread is usually volatile, can be impacted by other factors than credit risk (e.g. liquidity) and is not available for a consistent number of manufacturers.

Furthermore, it seems appropriate that credit risk should not be reliant on the evolution of the underlying assets. This holds true for investment funds such as UCITS or AIFs. The credit risk of assets linked to these funds is already reflected in the PRIIP’s market risk. Especially from an investor perspective it is important to note that no credit risk materialises given that the invested money is shielded from the manufacturer’s insolvency by means of segregate accounts. The fact that this money is separate from manufacturer’s own funds justifies for a designation of investment funds for the lowest credit risk category.

Specification requested from the ESMA: Considering the fact that the "credit risk" arising from the assets contained in the portfolio of an investment fund is to be considered as market risk, we believe that there is no "credit risk" as by the definition of the guideline applicable for an investment funds. Do you agree? If "no", how would it be defined?
<ESMA_QUESTION_PRIIPs_6>

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

<ESMA_QUESTION_PRIIPs_7>
Yes, we think that liquidity risk, even if measured qualitatively, should also be contained in the risk section. Liquidity risk may vary throughout the life of the product and therefore may be difficult to estimate at the inception of the product.

For certain products, liquidity risk can be as relevant as credit and market risk. The retail investor should know that the lack of market participants willing to enter into a transaction, the issuer having difficulties to redeem or the potential impacts of fire sales can impact the worthiness of the investment.

The liquidity risk should be clustered into five or seven categories and we think the following parameters should be taken into account: “duration of redemption” and “proportion of the redeemable amount in relation to the total investors’ money”. For a differentiation within the respective categories, Annex IV, N° 21 and 22 of the AIFMD delegated regulation EU/231/2013 might serve as a basis. Alternatively, also the following parameters might be taken into account: “available on a daily basis without an exit-fee”, “available on a daily basis with a minor exit-fee”, available on a daily basis with a substantial exit-fee”, “available on an annual basis”, “available at the end of the life-cycle” etc.
<ESMA_QUESTION_PRIIPs_7>

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

<ESMA_QUESTION_PRIIPs_8>
The different quantitative measures of liquidity suggested (i.e. bid-offer spreads, average trading volume, number of market makers excluding the manufacturer) often seem to be inapplicable because for the products in scope a secondary market usually does not exist.

Even though the proposed quantitative measures could be applied to the underlying instruments (at least for a portion of the PRIIPs), we think that the (qualitative) redemption conditions are the key driver to determine the liquidity risk and liquidity profile of the instrument.

Qualitative measures should include a description of the factors or scenarios in which the liquidity profile could vary. Costs and early redemptions fees should reflect potential liquidity risks and costs and should therefore be considered a component of the liquidity risk. They could be used to define a priori a product liquid or not liquid. Narrative should mention that liquidity could vary e.g. according to market conditions.
<ESMA_QUESTION_PRIIPs_8>

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

<ESMA_QUESTION_PRIIPs_9>
General comments:

We think it is pretty difficult to select only one approach that would fit all type of PRIIPs. For instance, in terms of market risk, products with a fixed maturity would have to focus on the return dispersion at maturity while open ended funds could use the basic historical volatility during the life of the product. In that sense, product testing is a key element in assessing those different approaches on a wide range of product type.

About the integration of the three main risks in a single indicator, we are sceptical about the added value and transparency it is supposed to bring to the investor.

If we would have to retain one of the main approaches, we would rather support a UCITS

KIID-like approach, where the historical volatility is a key driver of the rating process.

Comments on the option 1:

The risk classes definition and criteria suggested are appropriate under this option, however this option may not be the most appropriate as it is only qualitative and may be subject to interpretation.

A maximum tenor for the portfolio of unsubordinated bonds should be added to risk class 1 and set at the investment length (i.e. bonds in the portfolio cannot have a residual maturity longer than the residual length of the product).

Regarding alternative ways to define and measure levels of loss (for non-structured PRIIPs), we think the use of volatility (2nd alternative) would be the best alternative. This is actually the basis of the current SRRI methodology under UCITS. One concern about that 2nd alternative however is the requirement to use ten years of monthly returns for the assets in market / peer indices. This can be hard to achieve.
<ESMA_QUESTION_PRIIPs_9>

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

<ESMA_QUESTION_PRIIPs_10>
Separating the two main risk areas which are market and credit risk is a good idea, provided the legal terms of the regulation are respected. It appears simpler to implement because market risk would be directly rated based on the volatility, similarly to what is currently done for UCITS products and the credit risk dimension could be easily implemented by mapping the credit ratings to the A-G scale.

This being said, option 2 is not very clear in terms of methodology and lacks some testing too. It is essential to test it on a wide range of product in order to better assess its applicability.

It is worth noting that the delta adjusted approach suggested would be a shortcut not appropriate to all products, and the approach proposed would overlook potential significant risk factors. The approach would also not be relevant for some structured products or funds such as private equity / real estate.
<ESMA_QUESTION_PRIIPs_10>

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

<ESMA_QUESTION_PRIIPs_11>
In our opinion, from a theoretical / scientifically point of view, this approach would be the most reliable, robust and accurate. If this approach was selected, a standardized procedure (concerning the models to be used and the calibration procedures) should be prescribed by the regulator in order to guarantee comparability of the risk figures produced by different manufacturers. However, this option would bring a high level of complexity, significant costs of implementation and also make the supervision process a difficult task.

More generally, we think discretion should be left to manufacturers regarding the choice of models and parameters, within certain guidelines and principles. The risk measure could cover different horizons, such as 20 days, 1 year, 3 years, until the recommended investment period. A VaR set at a 95% or 99% confidence level could be used, in line with practices for UCITS and alternative investment funds. It could be complemented by the expected shortfall at 5% or 1% and the expected return of the distribution.

Choice for the integration of credit risk should also be left to manufacturers, with certain guidelines and principles:

- One approach could be through the incorporation of credit spread volatilities into the products' return distribution, which reflect the changes in the perception of credit risk by market participants. The model used for simulation of credit spread volatility should be calibrated on historical market data but should be granular enough to allow for occurrence of high credit spread levels to simulate significant credit depreciation or defaults.
- Another could be through the simulation of issuer credit rating migration and default scenarios and their incorporation into the distribution of returns, according to default probabilities derived either from credit ratings or from credit spreads.
- A combination of the two approaches could be used, where the first one would focus on changes in credit risk perceptions only (market component), including credit migration, while the second one would focus on default risk only.

<ESMA_QUESTION_PRIIPs_11>

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

<ESMA_QUESTION_PRIIPs_12>
With regards to the proposed "extensions" of this approach, proportionality should be applied, as option 3 would already be very difficult to implement. The proposed "extensions" of this approach would further increase the costs of implementation, in what could be considered an excessive manner.

As an alternative, to achieve a higher level of standardization among market participants within option 3, a possible modification could be to prescribe default standard shocks per risk factor (equity, credit, currency, interest rates, liquidity, etc.) and a standard correlation matrix to derive a Standard Risk Level for manufacturers not willing to use an internal model. Such approach could allow for comparison between products.
<ESMA_QUESTION_PRIIPs_12>

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

<ESMA_QUESTION_PRIIPs_13>
After recognising different interpretations of this option, we believe that practical examples would be needed to avoid confusion of investors on the risk level of the product. In addition, compliance with the level one text would be questionable and should be ensured upfront. Also, some feedback from the consumer testing exercise on this would be helpful.
<ESMA_QUESTION_PRIIPs_13>

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

<ESMA_QUESTION_PRIIPs_14>
We believe that this question comes too early and should be raised again at a later stage as there is not yet a decision on the various options or risk metrics selected.

At this point in time, we think a scale based on the VaR level could be useful:

VaR 1 year 99%	Risk class
< 5%	1
< 10%	2
< 20%	3
< 35%	4
< 50%	5
< 75%	6
> 75%	7

A translation of the volatility table used in the SRRI derivation process for UCITS would be:

Annual volatility	VaR 1 year 99%	Risk class
<0,50%	< 2%	1
< 2,00%	< 5%	2
< 5,00%	< 12,50%	3
< 10,00%	< 25%	4
< 15,00%	< 40%	5
< 25,00%	< 65%	6
> 25,00%	> 65%	7

<ESMA_QUESTION_PRIIPs_14>

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

<ESMA_QUESTION_PRIIPs_15>

Experience shows that investors wish to know the historic performance of a product, where it is available. Therefore, we believe it is very important for a PRIIP to be able to show performance histories, where available, in the same graphical presentation as the future performance scenarios. We appreciate that Article 8 para. 3 (d) (iii) refers specifically to performance scenarios, but Recital 15 contains a general reference to "relevant performance information", thus clearly allowing past performance to be shown where available.

Generally, we think that what-if scenarios selected by the manufacturer seem the best alternative to demonstrate the product characteristics under different severe, adverse but plausible scenarios. This only requires regulatory guidelines and principles and is easy to supervise. Leverage from other regulatory framework (e.g. UCITS) could be performed. Such stress testing policy could be subject to an independent annual review, for instance as regards the appropriateness and adequacy of scenarios retained in relation to the specific risk profile of the product. Such an approach has the advantage of being model-free and parameters-free.

The manufacturer's choice approach:

This approach would be easy to implement and one could leverage on the UCITS method. It would leave the manufacturer with the possibility to select the most appropriate scenarios applicable to their products.
However, it would give manufacturers too many choices which would impair the comparability between products and between firms.

The prescribed approach:

Products could be easily compared, which would be important from the perspective of the end consumers. But no prescribed approach is going to be suitable to all possible strategies.

The probabilistic approach:

This option would ensure consistency with the VaR approach, which basically looks at confidence levels (i.e. probabilities). However, it might be difficult to understand for final investors.
<ESMA_QUESTION_PRIIPs_15>

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

<ESMA_QUESTION_PRIIPs_16>
These principles are sufficient for unit linked products. However, they do not cover other types of products such as insurance or banking products. They could be reinforced in this sense, and also by the requirement of an independent review or validation.
<ESMA_QUESTION_PRIIPs_16>

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

<ESMA_QUESTION_PRIIPs_17>
We prefer option (a) – historical scenario – as it is the most appropriate scenario for unit-linked products. In case of missing historical data, benchmarks can be used. The objective is to be in line with the logic applied to UCITS.

Option (b) – set a predefined growth rate / performance of the underlying – gives a reasonable framework but would be more costly to implement and maintain from a regulatory standpoint. Different percentages (or ranges) have to be defined and maintained per types of products to allow efficient comparison.
<ESMA_QUESTION_PRIIPs_17>

18. Which percentiles do you think should be set?

<ESMA_QUESTION_PRIIPs_18>
We propose to set the following percentiles:

- Negative outcome: 25th percentile
- Neutral outcome: 50th percentile
- Positive outcome: 75th percentile

These percentiles have been selected to represent meaningful scenarios, to represent the most likely scenarios and to properly differentiate the cases. However, a too broad range should be avoided. Otherwise the recipient would not have the necessary point of reference which puts him into the position to make a meaningful decision. The problem of a too broad range might hold true in the course of long extrapolations of 5 years or more.

However, it is worth noting that probabilistic scenarios are already taken into account in the calculation of the risk measure. They would rely too heavily on the risk model chosen and could therefore lead the manufacturer to use a risk model underestimating the losses suffered under these scenarios.
<ESMA_QUESTION_PRIIPs_18>

19. Do you have any views on possible combinations?

<ESMA_QUESTION_PRIIPs_19>
We did not identify ideal possible combinations of performance scenarios.
<ESMA_QUESTION_PRIIPs_19>

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

<ESMA_QUESTION_PRIIPs_20>
Credit events should not be included in the performance scenarios, as these are tail events. The impact on the performance of a credit event of the issuer / guarantor should be mentioned separately. The risk section already covers the credit risks. To avoid considering twice this risk, we suggest to cover it exclusively in the risk section which is, from our point of view, the most appropriate.

Should an option for the risk section be chosen under which credit risks would not be covered, credit events should be considered in the performance scenarios, more precisely in what-if scenarios selected by the manufacturer. Regulatory guidelines should mention the inclusion of credit events in what-if scenarios.
<ESMA_QUESTION_PRIIPs_20>

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

<ESMA_QUESTION_PRIIPs_21>
From a manufacturer's standpoint, redemptions decided 100% by the investors will be difficult to incorporate in the performance scenarios. However, from an investor perspective, it is interesting to show the impacts on the yield of such events in the performance scenario. If possible, such events should then be considered.

The redemption events that could be more reasonably incorporated in a performance scenario are events that are not in control of the investors, i.e. issuer-driven / market-driven / triggered redemption events. Such events should then be considered.

Redemptions should in any case be considered in the course of ordinary events, as it is common for endowment life insurances. In this context, it has to be born in mind that the business model of endowment life insurances is exposed to a high frequency of redemptions which require transparency.

The other possibility (to avoid double consideration) is to cover the redemption events in the sections "How long should I hold it and can I take money out early?" (Which details the recommended holding periods, and early encashment consequences can cover early voluntary redemption events) and / or the section on risks (liquidity risk part).
<ESMA_QUESTION_PRIIPs_21>

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

<ESMA_QUESTION_PRIIPs_22>
Answer to the first question:

To avoid double consideration, we suggest to cover the performance in the case of exit before the recommended holding period in sections "How long should I hold it and can I take money out early?" (which details the recommended holding periods, and early encashment consequences might cover the case of exit before the recommended holding period) and / or the section on risks (liquidity risk part).

The risk metric could be disclosed at intermediate times before the recommended holding period, with disclosures about liquidity risk, but performance scenarios at intermediate times should be avoided.

Answer to the second question:

Fair value is best practice and generally required for any investment product, so any scenario presented should reflect the fair value of underlying investments. However, a fair value method has to be detailed for comparison purposes (please refer to question 69 of the Technical Discussion Paper, validation of the methodology for the calculation of the fair value).

Answer to the third question:

Performance scenarios can be presented graphically at varying confidence levels and varying time periods. VaRs can be calculated for any time period and there is a mathematical relationship between VaR and time. Therefore, we don't see methodological issues with presenting varying time periods for probabilistic approach.
<ESMA_QUESTION_PRIIPs_22>

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

<ESMA_QUESTION_PRIIPs_23>
General comment on charges:

We believe it is important for the understanding of retail investors to provide transparency of the charges which are applied to their funds while not overloading them with detail that can be confusing and does not add to their ability to make an informed decision and to compare equivalent charges across different products. It is also important that specific guidance be given as to the calculation and disclosure of each type of cost / charge in order to ensure a standardised methodology is used across different products and to allow for comparability of products by an investor. On the UCITS KIID there was very clear guidance given by CESR for the disclosure of entry / exit charges, on-going charges and other charges such as performance fees. A similar approach is needed for the PRIIPs KID and particularly with regard to the methodology for the calculation of transaction costs and the other additional disclosure being proposed.

Answer to question 23:

If entry / exit charges are specified in the fund prospectus or other offering documents they should be included in the PRIIPs KID as they currently are in the UCITS KIID. These charges are often discounted by the distributor and therefore need to be annotated as being the 'maximum charge that may be applied'. There are also situations where the distributor will charge a commission on the sale of a fund. Such commissions will vary between distributors and the fund manufacturer is not party to these charges and is unable to include them in the PRIIPs KID. Typically, 'distribution fees' and 'marketing costs' are included as part of the 'on-going charge' on the UCITS KIID and care should be taken to ensure fee disclosure does not result in double counting.
<ESMA_QUESTION_PRIIPs_23>

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

<ESMA_QUESTION_PRIIPs_24>
The charges listed under (a) would typically be included in the on-going charges figure on the UCITS KIID. They do not need to be separately disclosed and care must be taken to avoid double counting.

In view of remuneration structures prevailing in the private equity sector, we deem it reasonable that carried interest not be explicitly mentioned in the list of relevant payments because carried interest does generally not qualify as a remuneration for services provided. Carried interest cannot be qualified as a charge per se. The reason is that carried interest is a mere profit sharing arrangement which kicks in when the fund has reached a certain performance. Carried interest does equally not qualify as a remuneration for services provided under Luxembourg tax law, it is

neither charged to the fund nor to the investor. Instead, carried interest is an allocation of (capital) gains that is generally realised towards the end of a fund's life when investors have recouped their original investment plus a minimum pre-set return.
<ESMA_QUESTION_PRIIPs_24>

25. Should these fees be further specified?

<ESMA_QUESTION_PRIIPs_25>
The charges listed under (b) would typically be included in the on-going charges figure on the UCITS KIID. They do not need to be separately disclosed and care must be taken to avoid double counting.
<ESMA_QUESTION_PRIIPs_25>

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

<ESMA_QUESTION_PRIIPs_26>
The charges listed under (c) would typically be included in the on-going charges figure on the UCITS KIID. They do not need to be separately disclosed and care must be taken to avoid double counting.
<ESMA_QUESTION_PRIIPs_26>

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

<ESMA_QUESTION_PRIIPs_27>
The fund manufacturer is not party to the tax treatment that may be applicable to investors in a third country and is therefore unable to include the impact in a charges disclosure in the PRIIPs KID. Any relevant disclosures must be the responsibility of the MiFID firm providing investor services to the investor in the third country when considering appropriateness or suitability.
<ESMA_QUESTION_PRIIPs_27>

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

<ESMA_QUESTION_PRIIPs_28>
The charges listed under (e), (f), (g) would typically be included in the on-going charges figure on the UCITS KIID. They do not need to be separately disclosed and care must be taken to avoid double counting. As the fees paid to a distributor for the distribution of a UCITS will vary between distributors and distribution markets / countries it is only the distributor who is in a position to ensure that these are appropriately disclosed to the end investor.
<ESMA_QUESTION_PRIIPs_28>

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

<ESMA_QUESTION_PRIIPs_29>

The current disclosure requirement for performance fees in the UCITS KIID is appropriate and provides the investor with both ex-ante disclosure, as a percentage, and ex-post as the actual fee paid for the previous twelve months.

For UCITS any financing costs, including overdraft interest charges, are part of the investment strategy or due to the late receipt of sale proceeds from a broker or subscription monies from an investor. Funds may also receive credit interest on balances held on bank accounts. It is difficult to see how a disclosure could be made that would provide meaningful information to an investor.
<ESMA_QUESTION_PRIIPs_29>

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

<ESMA_QUESTION_PRIIPs_30>
We think there would need to be a distinction between the costs associated with the provision of an explicit guarantee or capital protection and the costs that may be incurred in hedging exposure within a fund.
<ESMA_QUESTION_PRIIPs_30>

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

<ESMA_QUESTION_PRIIPs_31>
As we have previously argued the disclosure of portfolio transaction costs will be difficult to achieve in a manner that will provide meaningful information to an investor. However if this is to be done, it will be important that guidance be given to the industry on exactly how these should be calculated for each asset type to ensure a standardised disclosure methodology. It should also be made clear on the KID that the impact of these costs is already included in the performance of the fund.
<ESMA_QUESTION_PRIIPs_31>

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

<ESMA_QUESTION_PRIIPs_32>
We would concur with the industry approach / argument being put forward by EFAMA and in earlier responses to consultations. In particular in relation to investment research this is a cost within the transaction costs that are also to be disclosed. It must be ensured that an approach is taken that does not lead to double counting of the costs.
<ESMA_QUESTION_PRIIPs_32>

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

<ESMA_QUESTION_PRIIPs_33>
We support the arguments being put forward by EFAMA and the requirement for greater clarification.

In relation to securities lending fees there is ambiguity currently on the UCITS KIID where some product manufacturers disclose the cost within the on-going charges figure while others do not disclose it. A consistent approach across the finance industry would be welcomed.
<ESMA_QUESTION_PRIIPs_33>

34. Is this description comprehensive?

<ESMA_QUESTION_PRIIPs_34>
We welcome recognition of consistency with MiFID II with regard to the disclosure of transaction costs. Both the implementation of MiFID II and PRIIPs will involve significant system development, and cost, by market participants and consistency in the requirements of the regulations is important.

As previously stated it is essential that guidance be given to the industry on exactly how these should be calculated for each asset type to ensure a standardised disclosure methodology. It should also be made clear on the KID that the impact of these costs is already included in the performance of the fund.

It is difficult to see how market impact cost can be quantified as part of the on-going charges. By definition a market works and establishes a pricing level based on supply and demand. The ability to trade in a market to minimise price impact and to achieve the best outcome for investors is the role of the investment manager. Market impact on the price achieved is a very subjective view where it is difficult to determine what exactly has caused the impact. Any attempt to predict this effect on an ex-ante basis would be unachievable.
The description is comprehensive but we would not recommend to include market impact costs and to provide that guidance be given to the industry on exactly how these should be calculated for each asset type.
<ESMA_QUESTION_PRIIPs_34>

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

<ESMA_QUESTION_PRIIPs_35>
As previously stated we believe it is important for the understanding of retail investors to provide transparency of the charges which are applied to their funds while not overloading them with detail that can be confusing and does not add to their ability to make an informed decision and to compare equivalent charges across different products.

Explicit costs such as broker commissions can be in principle be identified and reported separately to the investors in a fund. However, the price paid for an asset, and recorded in the accounting records of the fund, is typically gross of the price and any commissions paid. Therefore, if broker commissions are to be separately reported it must be in a way that the investor understands that these charges are already accounted for in the performance of the fund and this is not an additional charge.

In considering the reporting of broker commissions it is necessary to take into account other measures that may be in place to protect shareholders from the impact of trading costs. For example, the use of swing pricing will, by adjusting the NAV of the fund applied to the pricing of large subscriptions or redemptions, significantly reduce the dilution impact of the trading costs (including broker commissions) on the portfolio transactions executed in response to the shareholder flows. If the broker commissions are reported without any offsetting effect of the swing pricing the costs to the fund will be overstated. The same will apply where entry and exit charges are paid by shareholders and those charges are applied to the fund to offset the trading costs of the entering o exiting shareholders.

With regard to funds that invest in other UCITS or UCIs, it is very unusual for the fund to deal at a bid or offer price and they will typically deal at NAV, therefore no commissions are paid.

The calculation of explicit costs on an ex-ante basis is likely to be quite inaccurate given the many variables that drive the volume of portfolio transactions. These being primarily subscription and redemptions by investors and trading in response to market events, neither of which can be anticipated ex-ante.
<ESMA_QUESTION_PRIIPs_35>

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

<ESMA_QUESTION_PRIIPs_36>
Custodian transaction charges ('booking fees') are already included in the disclosed on-going charge in the UCITS KIID. Typically, a custodian will invoice for two costs: safekeeping which is based on the AUM, and transaction costs that are a charge based on the market / country of the underlying security. UCITS regulation defines those charges that are to be included in the on-going charges figure, an itemised disclosure of the constituent costs would be confusing to retail investors and not add to their understanding of the charges paid by the fund.

With regard to transaction taxes, we would make the same points as for broker commissions. Taxes are included in the cost of the asset, are part of the NAV / performance of the fund and should not form part of the charges disclosure.
<ESMA_QUESTION_PRIIPs_36>

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

<ESMA_QUESTION_PRIIPs_37>
We refer to the response given by EFAMA:

It is not clear how the fair value approach could be used to estimate the commission-equivalent element in the spread. We understand fair value in the accounting context to be the price that would be received when selling an asset (i.e. the bid price) and the transaction price is the price paid to buy an asset (i.e. the ask price). An estimate of spread for a particular asset could be

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

made by deducting the fair value from the transaction price, provided that the fair value is determined on a bid basis at a time reasonably close to the time of the trade (for example, at the next market close or at the next calculation of a fund's net asset value). However, this approach does not facilitate an estimation of the commission-equivalent element of the spread.

In relation to this question we also do not agree with the assertion made in footnote 23, which suggests that dealers should know the spread of a security in order to fulfil their best execution obligations. According to MiFID II, best execution is about ensuring dealers secure "the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order." If the objective is to purchase a bond, best execution is about ensuring it is done at the lowest possible ask price within a reasonable timeframe. The lowest ask price could be associated with a wider spread than the spread on a higher ask price. The bid price at the time, and hence the spread, is entirely irrelevant.
<ESMA_QUESTION_PRIIPs_37>

38. Can you identify any other difficulties with calculating and presenting the bid-ask spread? Do you believe broker commissions included in the spread should be disclosed? If so, which of the above mentioned approaches do you think would be more suitable for ex-ante calculations or are there alternative methods not explored above?

<ESMA_QUESTION_PRIIPs_38>
We believe that the calculation of implicit costs at a transaction level would probably be very difficult. If these are to be disclosed we would support the answer prepared by EFAMA.
<ESMA_QUESTION_PRIIPs_38>

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

<ESMA_QUESTION_PRIIPs_39>
We support the answer submitted by EFAMA and repeat the comment made in question 35 above. In addition, we do not believe that market impact costs should be part of the cost disclosure.

It is difficult to see how market impact cost can be quantified as part of the on-going charges. By definition a market works and establishes a pricing level based on supply and demand. The ability to trade in a market to minimise price impact and to achieve the best outcome for investors is the role of the investment manager. Market impact on the price achieved is a very subjective view where it is difficult to determine what exactly has caused the impact. Any attempt to predict this effect on an ex-ante basis would be unachievable.
<ESMA_QUESTION_PRIIPs_39>

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

<ESMA_QUESTION_PRIIPs_40>

We support the answer submitted by EFAMA and repeat our comments made in question 36 above.

Swing pricing should be viewed as reducer of transaction costs to the fund by ensuring that subscribers and redeemers specifically pay the costs of the transactions that have been generated by their transactions.

Trading in a fund is as result of the subscriptions or redemption trades received from investors. In considering the reporting of transaction costs it is necessary to take into account other measures that may be in place to protect shareholders from the impact of trading costs. For example, the use of swing pricing will, by adjusting the NAV of the fund applied to the pricing of large subscriptions or redemptions, significantly reduce the dilution impact of the trading costs on the portfolio transactions executed in response to the shareholder flows. If the transaction costs are reported without any offsetting effect of the swing pricing the costs to the fund will be overstated. The same will apply where entry and exit charges are paid by shareholders and those charges are applied to the fund to offset the trading costs of the entering of exiting shareholders.

With regard to funds that invest in other UCITS or UCIs, it is very unusual for the fund to deal at a bid or offer price and thy will typically deal at NAV, therefore no commissions are paid.
<ESMA_QUESTION_PRIIPs_40>

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

<ESMA_QUESTION_PRIIPs_41>
We support the EFAMA comments and are in favour of a hybrid approach – where actual figures and numbers are available they should be used and where not, in case of implicit cost, a standardised methodology should be used. As previously stated, it is important that all methodologies are provided by the ESA and consistently applied for all product and asset types.
<ESMA_QUESTION_PRIIPs_41>

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

<ESMA_QUESTION_PRIIPs_42>
We agree with the EFAMA comments and the IOSCO definition.

The disclosure of performance fees in the UCITS KIID provides for an ex-ante basis of calculation and an ex-post disclosure of the actual fee paid in the previous year. This combined with a more detailed description in the fund's constitutional documents (prospectus) of how the fee is calculated provides a clear disclosure to an investor.

As the performance fee is normally paid on the basis of investment performance that exceeds that of a pre-determined benchmark it is difficult to see how using assumed rates of return will work. For example, if the assumed rate of return is 4% and the benchmark also grows by 4%, no performance fee will be payable. However, if the fund had performed at 4% and the benchmark at only 2%, a performance fee may be payable.
<ESMA_QUESTION_PRIIPs_42>

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

<ESMA_QUESTION_PRIIPs_43>
We would not support to take any assumptions.
<ESMA_QUESTION_PRIIPs_43>

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

<ESMA_QUESTION_PRIIPs_44>
We support the EFAMA comments and agree that option 3 is probably the most appropriate.
<ESMA_QUESTION_PRIIPs_44>

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

<ESMA_QUESTION_PRIIPs_45>
We think biometric risk premium should be considered as cost with a clear indication that this cost is related to both insurance and investment element. The comparability is still possible due to the fact this treatment is applied by all insurers.

Yes, we agree with the specificities of the cost of life-insurance products.

The cost section should be separated between investment cost and insurance-related costs.

The risk type riders costs need to be disclosed.

We agree with the separate terms approach.
<ESMA_QUESTION_PRIIPs_45>

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

<ESMA_QUESTION_PRIIPs_46>
We agree on the list of entry cost with a more detailed definition.
<ESMA_QUESTION_PRIIPs_46>

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

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<ESMA_QUESTION_PRIIPs_47>
We agree with the option to disclose the guaranteed interest rate costs due to an unfavourable scenario. For surrender options, we think that the cost related to the disinvestment should only be disclosed in the section “How long should I hold it and can I take my money out early?”.
<ESMA_QUESTION_PRIIPs_47>

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

<ESMA_QUESTION_PRIIPs_48>
The methodology should be further specified with bad scenario examples (for interest rate guaranteed products) in order to have a consistent view on cost between several PRIIPs of the same nature.
<ESMA_QUESTION_PRIIPs_48>

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

<ESMA_QUESTION_PRIIPs_49>
In our view, the list is comprehensive. The cost of the underlying investment should be further disclosed (see question 53).
<ESMA_QUESTION_PRIIPs_49>

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

<ESMA_QUESTION_PRIIPs_50>
We think each type of calculation should be further specified to ensure a uniform implementation of the PRIIPs regulation.
<ESMA_QUESTION_PRIIPs_50>

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

<ESMA_QUESTION_PRIIPs_51>
Yes, the insurance cover cost calculation should be further specified to ensure a consistent implementation of the PRIIPs regulation.
<ESMA_QUESTION_PRIIPs_51>

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

<ESMA_QUESTION_PRIIPs_52>
We are of the view that further specification should be disclosed.
<ESMA_QUESTION_PRIIPs_52>

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

<ESMA_QUESTION_PRIIPs_53>
Our members await further specification in order to determine the level of look through that is required for this cost section.
<ESMA_QUESTION_PRIIPs_53>

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

<ESMA_QUESTION_PRIIPs_54>
We think the level of look through should be further specified in order to have a consistent approach.
<ESMA_QUESTION_PRIIPs_54>

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

<ESMA_QUESTION_PRIIPs_55>
Yes, specifications are in our view needed.
<ESMA_QUESTION_PRIIPs_55>

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

<ESMA_QUESTION_PRIIPs_56>
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<ESMA_QUESTION_PRIIPs_56>

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

<ESMA_QUESTION_PRIIPs_57>
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<ESMA_QUESTION_PRIIPs_57>

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

<ESMA_QUESTION_PRIIPs_58>
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<ESMA_QUESTION_PRIIPs_58>

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

<ESMA_QUESTION_PRIIPs_59>
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<ESMA_QUESTION_PRIIPs_59>

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

<ESMA_QUESTION_PRIIPs_60>

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<ESMA_QUESTION_PRIIPs_60>

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

<ESMA_QUESTION_PRIIPs_61>
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<ESMA_QUESTION_PRIIPs_61>

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

<ESMA_QUESTION_PRIIPs_62>
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<ESMA_QUESTION_PRIIPs_62>

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

<ESMA_QUESTION_PRIIPs_63>
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<ESMA_QUESTION_PRIIPs_63>

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

<ESMA_QUESTION_PRIIPs_64>
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<ESMA_QUESTION_PRIIPs_64>

65. Would you include other cost components?

<ESMA_QUESTION_PRIIPs_65>
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<ESMA_QUESTION_PRIIPs_65>

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

<ESMA_QUESTION_PRIIPs_66>
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<ESMA_QUESTION_PRIIPs_66>

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

<ESMA_QUESTION_PRIIPs_67>
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<ESMA_QUESTION_PRIIPs_67>

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

<ESMA_QUESTION_PRIIPs_68>
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<ESMA_QUESTION_PRIIPs_68>

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

<ESMA_QUESTION_PRIIPs_69>
Yes. The general framework outlined covering general principles of governance and a proposal of a methodology for the calculation of the fair value is consistent with the framework established by the CRD IV / CRR package and by the UCITS and AIFM Directive.
<ESMA_QUESTION_PRIIPs_69>

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

<ESMA_QUESTION_PRIIPs_70>
In the case of subscription products, the KID should disclose a preliminary fair value based on the preliminary terms of the product and should disclose the main assumptions used (such as the date at which the preliminary fair value has been performed) and the associated risks if market conditions should differ significantly before the end of the offering period.
<ESMA_QUESTION_PRIIPs_70>

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

<ESMA_QUESTION_PRIIPs_71>
The main issues have been listed on page 92. In case of asset-backed securities and securitisations products the correlation of defaults and the modelling of tranches could be added to the list. The RTS should not be prescriptive on the risk premium which should be the responsibility of each manufacturer in accordance with the valuation methodology used to value the product in their financial statements. Prescription of risk premium by the supervisory authority could lead to a distortion between the fair value disclosed to investors in the KID and the fair value disclosed to regulators and investors in the financial statements of the manufacturer, or to regulatory gaming. See our answer to question 4.

<ESMA_QUESTION_PRIIPs_71>

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

<ESMA_QUESTION_PRIIPs_72>
In case of securitised products, guidelines with regards to default correlation modelling could be provided by the supervisory authority, i.e. the use of a non-Gaussian copula model for instance.
<ESMA_QUESTION_PRIIPs_72>

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

<ESMA_QUESTION_PRIIPs_73>
The forward looking models are consistent with risk neutral pricing and fair valuation techniques and therefore with fair value accounting principles. They ensure a "non arbitrage" price and reflect hedging conditions and costs. On the other end, retail investors may not be familiar with risk neutral probabilities but more familiar with historical probabilities, which reflect the actual past behaviour of financial markets.
<ESMA_QUESTION_PRIIPs_73>

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

<ESMA_QUESTION_PRIIPs_74>
Risk free curves should be set by the supervisory authority to set a common level playing field.
<ESMA_QUESTION_PRIIPs_74>

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

<ESMA_QUESTION_PRIIPs_75>
We think the assessment of credit risk should be left to the discretion of the manufacturer of the product but principles and guidelines should be issued by the supervisory authority, such as the use of CDS spreads, implied credit spreads from debt securities issued by the manufacturer / guarantor of the product.
<ESMA_QUESTION_PRIIPs_75>

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

<ESMA_QUESTION_PRIIPs_76>
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<ESMA_QUESTION_PRIIPs_76>

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

<ESMA_QUESTION_PRIIPs_77>

The issuer counterparty risk should be disclosed to investors in the KID in order to allow investors to understand the credit risk taken when subscribing the product. Counterparty risk linked to derivatives transactions included in the product should be taken into account in the fair valuation of the product.
<ESMA_QUESTION_PRIIPs_77>

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

<ESMA_QUESTION_PRIIPs_78>
Such circumstances, i.e. lack of market data to estimate / compute parameters may reflect a lack of liquidity which should be reflected in the "risk and reward section" with specific disclosures.
<ESMA_QUESTION_PRIIPs_78>

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

<ESMA_QUESTION_PRIIPs_79>
In our view, the supervisory authority should not be prescriptive with pricing models but should issue guidance and principles to ensure consistency across the organisation of the manufacturer, i.e. a given product or derivative should be valued with the same model irrespectively of the purpose. Valuation models and marked to model valuations should be subject to regular independent validation. The supervisory authority could require manufacturers to regularly (e.g. annually) disclose the valuation models used for each type of the product, the last independent validation performed and the entity who performed it.
<ESMA_QUESTION_PRIIPs_79>

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

<ESMA_QUESTION_PRIIPs_80>
We would agree with retaining the current UCITS period of five years. But for insurance products, ideally, the calculation should be trackable during the their lifetime.
<ESMA_QUESTION_PRIIPs_80>

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

<ESMA_QUESTION_PRIIPs_81>
Guidance would have to be given on how different types PRIIPs could be ranked 'pari passu' given the very different nature and features of different investment types. However, within a UCITS where different share classes are considered to rank 'pari passu' the use of a single calculation would seem to be appropriate, in the same way that a UCITS KIID may be prepared on a representative share class to cover several different share classes.
<ESMA_QUESTION_PRIIPs_81>

82. What should be the relevant figure for the initial invested amount to be taken into account for the calculation of cost figures? Should a higher initial investment amount

be taken into account not to overestimate the impact of fixed costs? How should the situation of products with regular payments be taken into account for that specific purpose? (Would an invested amount of 1 000 euros per period of time be a relevant figure?)

<ESMA_QUESTION_PRIIPs_82>
In many ways using as an initial amount the minimum investment that is required for a specific PRIIPs makes sense. This may however be problematic for a UCITS where a fund may have a higher initial subscription requirement in its prospectus to the level at which a retail investor may subscribe through a platform or other distributor.

As UCITS are marketed widely into non-Euro Member States, and countries outside of the EU may have base or share class currencies other than the Euro, it should be permissible to state the initial invested amount in a currency other than the Euro. This figure should not be linked to the initial investment amount, free of any reference currency and expressed in an absolute number (100). Therefore, we believe that such an “initial invested amount” can only be an illustrative number that can diverge from the minimum subscription amount foreseen for such a product.

For life insurance products, we consider the invested premium as a relevant figure for calculating the cost figures.
<ESMA_QUESTION_PRIIPs_82>

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

<ESMA_QUESTION_PRIIPs_83>
Several KID updates are needed during the lifetime of the contract if cost structure is changing.
<ESMA_QUESTION_PRIIPs_83>

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

<ESMA_QUESTION_PRIIPs_84>
We think the table showing simulations (bottom of page 99) is unclear: i.e. on which basis would we simulate subscriptions or redemptions over the recommended holding period? Models would have to be defined more precisely to avoid diverging results amongst the various providers.

For insurance products, showing a TCR is appropriate but adjustments are needed for non-recurrent cost of both insurance and underlying movements (in case of unit-linked products).
<ESMA_QUESTION_PRIIPs_84>

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

<ESMA_QUESTION_PRIIPs_85>
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86. This definition of the ratio is taken from the CESR guidelines on cost disclosure for UCITS. Is it appropriate also in the case of retail AIFs? Should it be amended? Another approach to calculate these costs is to calculate the ratio of the total of these amortized costs to the invested amount in the fund. However in that case the question remains as to how to aggregate this ratio with the on-going charges ratio. Another possible approach could be to use the ratio between the total amount of costs over the holding period and the average net investment (assumed during the whole period, in order to take into account future additional investments, partial withdrawals, payments (i.e. programmed investments or disinvestments)). Do you think this approach would be appropriate?

<ESMA_QUESTION_PRIIPs_86>
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<ESMA_QUESTION_PRIIPs_86>

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

<ESMA_QUESTION_PRIIPs_87>
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88. What would be other options to define the TCR ratio in the case of structured products? Do you identify other specific issues in relation to the TCR if applied to structured products? Another possible approach could be to use the ratio between the total amount of costs over the holding period and the average net investment (assumed during the whole period, in order to take into account future additional investments, partial withdrawals, payments (i.e. programmed investments or disinvestments)). Do you think this approach would be appropriate? For derivatives, it might be the case that it is necessary to further define the concept of investment to be used as denominator of the ratio. Possibilities include the use of the actual sums paid and received (i.e. initial margins, variation margins, collateral postings, various payoffs, etc.) or the use of the exposure (i.e. market value of the derivative underlying). Do you think these approaches would be appropriate?

<ESMA_QUESTION_PRIIPs_88>
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89. This definition of the ratio is taken from the CESR guidelines on cost disclosure for UCITS. Is it appropriate also in the case of retail AIFs? Should it be amended? Another possible approach could be to use the ratio between the total amount of costs over the holding period and the average net investment (assumed during the whole period, in order to take into account future additional investments, partial withdrawals, payments (i.e. programmed investments or disinvestments)). Do you think this approach would be appropriate?

<ESMA_QUESTION_PRIIPs_89>
Although the disclosed amounts should be sufficient to comply with all the MiFID II (and IMD) disclosures, we think the aggregation of contingent costs (such as transaction costs or performance fees) with costs that are known in advance (such as management fees or audit fees), would lead to disclosure of misleading information. Therefore, we urge for the presentation of two total cost figures: on the one hand, all costs fully known ex-ante and, on the other hand, all contingent costs that need to be estimated. The latter could then be accompanied by appropriate disclaimers so that clients are informed that this figure is only an estimate.
After those two amounts of costs are calculated, they can indeed be divided by the average net assets of the costs to produce the TCR (or the RIY), as currently prescribed by the CESR guidelines.
<ESMA_QUESTION_PRIIPs_89>

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

<ESMA_QUESTION_PRIIPs_90>
We consider it appropriate to use principles from the CESR guidelines on cost disclosure for UCITS in the PRIIPs context.
<ESMA_QUESTION_PRIIPs_90>

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

<ESMA_QUESTION_PRIIPs_91>
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<ESMA_QUESTION_PRIIPs_91>

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

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

<ESMA_QUESTION_PRIIPs_93>
The concern that we have with a RIY, or similar calculation method, is that a number of assumptions (e.g. growth rates, turnover/transaction volumes, FX rates, holding periods, etc.) must be made in order to arrive at the published figure. Such assumptions, particularly with regard to investment return, can be taken by retail consumers as an 'expectation' of future performance (re. Endowment Policies in the UK).

A RIY will not be able to include any advisory or point of sale costs that a consumer may also be charged. Generally, it would be impossible to have one single figure capturing all different kinds of costs. It is not clear how a RIY method can incorporate any 'early redemption' costs or other individual aspects.

Performance fees will often be based on the investment performance compared to a benchmark. It will be difficult to determine for the RIY calculation whether a performance fee needs to be included or not unless only ex-post figures are used. Consideration will need to be given in defining the specific calculation methodologies as to how this should be estimated for new products.

If this route is taken the ESAs will need to provide very specific calculation methodologies that will need to be mandatory across all markets and products, if a level playing field is to be achieved and a consumer able to make direct comparisons."
<ESMA_QUESTION_PRIIPs_93>

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

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<ESMA_QUESTION_PRIIPs_94>

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

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

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

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

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

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