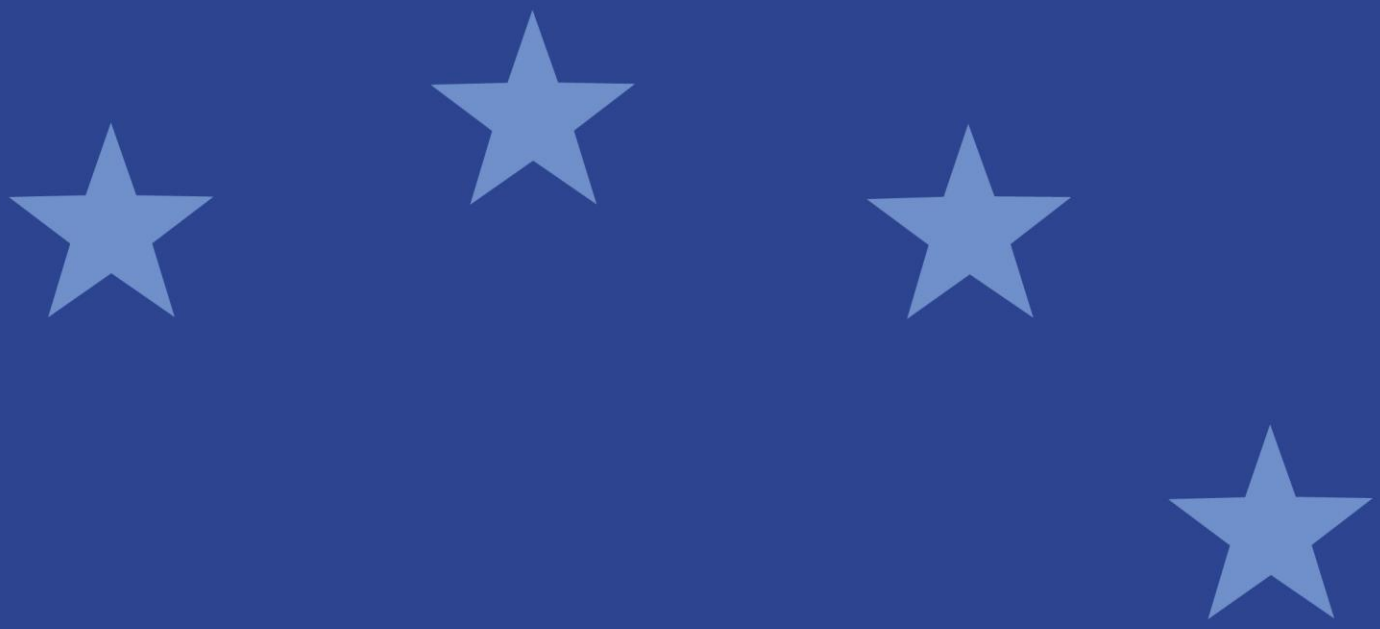
esma European Securities and Markets Authority

EACB Reply form for the Technical Discussion Paper on PRIIPs



23 June2015

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Introduction

Please make your introductory comments below, if any:

The **European Association of Co-operative Banks (EACB)**[1] welcomes the opportunity to contribute to the Joint Technical Discussion Paper on Risk, Performance Scenarios and Cost Disclosures in Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs), as co-operative banks are amongst the major distributors of a large variety of retail investment products.

The EACB is the voice of the cooperative banks in Europe. It represents, promotes and defends the common interests of its 31 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the cooperative banks' business model. With 4,200 locally operating banks and 68,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 205 million customers, mainly consumers, retailers and communities. The cooperative banks in Europe represent 78 million members and 860,000 employees and have a total average market share of about 20%.

Concerning the Discussion Paper, we would like to raise the following key points :

In this Technical Discussion Paper (TDP) the ESAs discuss - in very comprehensive and detailed manner- the different methods of calculation of risks, performance scenarios and costs. However, we fear that – from a retail investor protection perspective- the theoretical analysis of the possibilities ,their practical implementation and the potential benefits are not always well balanced. At various points the ESAs themselves point to the disadvantages of certain approaches. In particular, we oppose a probabilistic representation of different scenarios. Also we want to suggest an overall less complex approach. We doubt that some of the options discussed both in terms of the calculation of risks, as well as scenarios would be understandable for the investor . When it comes to the presentation of costs we would like to point out that - although it is important for the retail investor to include all the costs in the calculation - he/she does not necessarily needs to understand the individual cost elements to the smallest detaill (breakdown). In that regard, consistency with the information required under MiFID II is to be sought (Final Report Annex 2. 14.1 table 2).

Furthermore, the TDP clearly shows that the suggested approaches are not suitable for OTC derivatives contracts. Its seems that the ESAs have not yet taken into account the specificities of OTC derivatives.
We would like to once again point out that -in our view- OTC derivative transactions entered into for hedging purposes, especially in the context of interest rate and currency management, in line with normal banking practice (especially with corporate clients), do not fall under the PRIIPs Regulation.
Indeed:

- Derivatives that do not offer an "investment opportunity" but only have a hedging purpose (no speculation at all) should be out of scope.
- Products based on an interest rate exchange, such as an interest rate swap, a forward, an option should be out of scope, these products "do not offer investment opportunities and these products are solely exposed to interest rates" (recital 7 PRIIPs). Furthermore, there is the risk that a bond with floater rate with cap/floor could also fall within this category and thus, be considered as being covered by the PRIIPs requirement.

This is in line with the definition in Art. 4 a) PRIIPs Regulation and the rational of the Regulation as specified in recitals (6), (7) and (9), since there is neither an "investor" nor an "investment" nor an "amount repayable".

Again, the present discussion paper disregards that many small and medium-sized corporate clients, even if classified as "retail clients" under MiFID, are not involved in investment activities, but enter into

[1] For further details, please visit www.eacb.coop

OTC derivatives contracts to secure their business. With this in mind, we consider that the numerous requirements under PRIIPs-regulation are not appropriate for such hedging transactions.

In addition, the standard bank OTC- derivative transactions in interest rate and currency exchange concluded for hedging purposes bear special characteristics. These characteristics do not seem to be taken into account in the relevant discussion paper. This leads to imposing inappropriate PRIIPs requirements on these standard bank OTC- derivative transactions which could not be implemented in practice. For example, when it comes to the representation of risk all basic calculations indicate an actual investment including physical repayment upon customer's demand. How this could be implemented on these OTC derivatives remains completely open.

We therefore strongly urge that it is clarified that standard banking practices in OTC derivative transactions concluded for hedging purposes do not fall within the scope of the PRIIPs Regulation.

But even if OTC derivatives were to be deemed within the scope of application of the PRIIPs Regulation *(quod non)* due to the specifics set out in our comments, ESAs would still need to work out special rules for OTC derivatives that would then require a separate consultation process. The approaches set out in the present Technical Discussion Paper – which do not take the specifics of OTC derivatives into account – cannot (and should not) be simply applied to OTC derivatives. Our concerns with regard to OTC Derivatives are particularly relevant in the context of questions questions 2-7, 9-13, 16, 17, 20-23, 31, 61-64, 66-68, 73, 75, 77 and 79.

This response should be read together with the EACB Response to the Joint Discussion Paper on Key Information Documents (KIDs) (JC/DP/2014/02) dated 17 February 2015.

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.

1. When it comes to the **risk indicator** the members of EACB are divided. There is a large group of members that has a strong preference for the Value at Risk (VaR) approach described under approach C. The consideration of these members is that it is the only way to allow for real and transparent comparison when calculating the risks of individual products according to internal pricing models under uniformly determined parameters [eg risk analysis period (eg 30 days), confidence level, etc.].These members would also recommend to include products subject to UCITS rules by introducing a mechanism, which gives the product manufacturer the opportunity to opt for the risk related rules of the PRIIPS regime instead of the current SRRI disclosure before the end of the transition period. Failure to do so would give rise to the risk of retail investors being induced – due to a lack of such information, and despite identical or even lower risks for investors – to refrain from considering products outside the scope of the PRIIPs Regulation Another group of members expressed a strong preference for option A which is based on historical data as these are the only material evidence available and they could be more easily understood by the investor.

2. When it comes to **performance scenarios**, none of the approaches for the estimation of the distribution of returns (page 10) seem appropriate.
    - Approach a): backtests have very little significance for future developments. Moreover, backtesting is not possible for all products.
    - Approach b): depending on the chosen period results may be artificially inflated.

- Approach d): for the range of products covered by PRIIPs Regulation this is not a viable option, because the products are too diverse; This approach could not lead to realistic results.
- Approach e): the desired comparability is not feasible with this approach

Performance scenarios based on probabilities are to be seen very critical because they are heavily depended on individual assumptions, simulations and forecasts, which do not only need further explanation, but are also difficult to verify to the extend that these are not solely based on historical data. At the same time, they do not offer a reliable indicator of future performance. In addition, the financial crisis has shown that probabilistic models could lead to retail investors building up expectations that are too optimistic and even misleading. In addition, the illustration of a negative development of the product might be missing, in case such a negative development was calculated as minor or not likely to occur when developing the relevant product. In addition, probabilistic representations lead to a continuous need for change and thus to higher costs, which would ultimately be borne by the investor. In particular:

Historical data should not be the basis for a decision which is related to unpredictable future developments since it may be misunderstood by retail investors as a realistic estimate of risk or return. Decisions based on historical data may only work in a deterministic environment which is not the case in the financial markets. Stochastic data requires, for a proper understanding, a comprehensive knowledge of sophisticated statistical concepts which, in general, cannot be assumed for retail investors. In more detail:

In conclusion , we consider that it would be better to present three scenarios (positive, neutral, negative) without providing any likelihood.

The risk indicator itself should be indicated in a qualitative (graphical and possibly textual) representation.

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?

1. When it comes to the **risk factor**, the calculation should, in general, be based on current market data. Historical data could also be used if current market data are not available. The models must be defined in such a way that the market price of the product is represented as accurately as possible.

2. When it comes to performance scenarios the members of EACB oppose any probabilistic modelling. In our view, the presentation of performance – especially for packaged products – should enhance retail investors' understanding of how a product works (the 'product mechanics'), i.e. the development of the assets invested in various scenarios. In this context, the presentation of performance also serves to illustrate the risks involved in a given product. That is why provisions, such as the mandatory inclusion of a negative scenario, are important supplements to the risk indicator and its descriptive explanation. Taking all this on board, a probabilities-based presentation needs to be seen very critically indeed: such a presentation may primarily induce return expectations with retail investors, which cannot be fulfilled in all cases and are thus misleading. Moreover, this approach would fail to address a negative product performance if such a development was assigned a low probability (or no probability at all) when creating the product. A probabilities-based presentation would also require constant adjustments and consequently higher costs, ultimately borne by retail investors.

   From a retail investor perspective it is essential to clearly describe the various pay-off options of a PRIIP. In principle, scenarios should not based on models, but follow a neutral representation. We would propose the introduction of a table of three performance scenarios

(positive, neutral, negative) to be as simple as possible to make the presentation. The additional narrative presentation of performance scenarios (in tabular form) has the advantage that the product dynamics is well illustrated.

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?

Given that this information is indented for retail investors we would support the approach that is based on option a. Gross return is the most effective way to compare different products and the easiest one for investors to understand as it expresses the reality of the cash they have invested. We consider that the other options (growth rates) would simply add complexity as it would only lead to variable results, because it is necessary to work with assumptions.

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?

Please refer to our response to Q 3 above. We are sceptical towards growth rates because we fear that this approach would simply add complexity.

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

1. When it comes to the **Risk Indicator**, we consider that all values should be annualised in order to ensure that products are comparable on a comprehensive scale. Thus, the risk indicator should be calculated for a standardized holding period of e.g. 1 year in order to provide comparability. In case maturity < 1 year then option c) would come in.
2. When it comes to **Performance Scenarios** calculations should be made with reference to the recommended holding period (or final maturity): this means that (potential) returns are stated for the recommended holding period (or final maturity), with returns or losses additionally converted to an annual basis. .

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

The EACB would take a retail investor perspective. Retail investors know ratings since they are part of our daily news. In addition, credit ratings are the only operational transparent measure available for credit risk. However, where the credit rating is not available it doesn't mean that the credit risk is higher than a rated issuer.

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?

Liquidity risk may be part of this section but should only be described at one place in the KID. However, it should be part of the narrative explaining this particular risk in a way that everybody understands. In particular, we consider that it is better to outline the respective financial instrument's tradeability as well as

the factors influencing market prices together with a note that retail investors are exposed to the risk of value fluctuations during the product's lifetime. Whilst this is a description of the risks arising from the financial instrument's liquidity profile, using "Liquidity Risk" as a heading would at least be imprecise, if not misleading.

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?

In our view, these factors are not appropriate because they do not fit for all products and only have a limited significance. The important is to enlighten small investors about the possibilities and consequences of early exit ways.

A narrative description of liquidity profile is much more transparent than a single figure on liquidity risk which nobody would understand (see also our response to Q7).

The existence of exit penalties should be mentioned here, while the amount should be included in the cost part. However, cost and exit penalties for early redemption should not be considered a component of the liquidity risk, as these factors do not really reflect the liquidity of a product. The investor knows the recommended holding period and exit fees before investing into the product. If the investor decides to sell the product this decision does not reflect the liquidity risk of the product but the investor's investment decision. i.e. this reflects more the "investors risk" based on its investment decision but a product risk. In general, we consider that a statement on whether the product is liquid or not is not appropriate.

Quantitative measures depend on the product type and its common the market situation. The quantitative measures would have to be adapted to single products types and as such would not accommodate comparability and transparency for investors. They would have to reflect the typical characteristics of the product for which qualitative measures would be more appropriate.

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

The below comment represents the answer of the EACB to question 9, 10,11 and 12.

The EACB does not support option 1. As for option 2 and 3, the EACB community is divided. There is a large group of members that supports option 3 arguing that option 2 is too limited and simplified. They also indicate that the two dimensional indicator might confuse retail consumers. The members supporting option 2 believe that market risk could be explained with a quantitative measure, credit- and liquidity risk should be explained in qualitative format. They criticise the high implementation complexity of option 3 and find that it cannot be used for all product classes. This divide continues to transpire when analysing the views of different members to question 13. Those in favour of option 3 radically oppose option 4 from the perspective that a well developed option 3 can encompass all product classes and all kinds of risk. Those that prefer option 2 (and believe that option three is not suitable for all product classes), have an open mind towards option 4 as it would allow giving a more easily understandable indication of the risk to retail investor. They also believe that it would sit well with the target market approach introduced by MIFID 2.

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

See under question 9.

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

See under question 9..

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?

See under question 9.

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?

See under question 9.

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?

We would support the classification system used in various structured products markets across Europe and mentioned as an example in the TDP. If other classification schemes are considered, we prefer at least a five-class scale since this is in-line with the majority of distribution units classifying investors.

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

The members of EACB prefer a scenario-based presentation where the product's development in the event of market fluctuations is shown as at the product's final maturity – without using probabilities. Issuers should be able to choose the specification and number of scenarios themselves, within the framework prescribed (positive/neutral/negative), given the respective product architecture. We also refer to ESMA's Working Paper No 1/2015, where ESMA itself acknowledges that, whilst the risk-free probability model may be acceptable for pricing purposes, it is inadequate for forecasting a product's future value since it is impossible to calculate 'real-world' probabilities.
The concern, voiced in the discussion paper, that investors might perceive all scenarios as equally probable (or assign the highest probability to the middle scenario) could be addressed by a corresponding clarification in the KID.
Since the main purpose of these scenarios is to allow investors to understand the products, issuers must be permitted to correctly present their products. The required flexibility cannot be achieved through rigid requirements. In this context what-if scenarios should clearly be selected by manufacturers since they are helpful to explain the behaviour of the product to the customer. It would allow to present investment returns together with the speculative market development and it would be easier to assign probabilities to those scenarios. Otherwise a meaningful comparison between the products would very difficult to achieve.

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?

Please refer to our answer to Q15. We do not think that a probability-based scenario analysis – which itself is based on certain assumptions – can be made transparent and understandable to retail investors..

In any case the regulator should publish guidelines for performance scenario. These should be similar to those for structured UCTIS (CESR-1-1318).

Due to the very different payout profiles it has to be the manufacturer who has to decide on the most suitable performance picture. HOWEVER, IT Should be made clear that a balanced set of scenarios should be chosen.

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

In general, we do not support the idea of historical scenarios. For instance, product characteristics of PRIIPs (structured products) are dependent on the actual market environment (e.g. current yield and their moneyness (e.g. cap), so a historical scenario would be misleading. Regarding growth rates, we also believe that they would produce misleading results.

Regarding prescriptions, we prefer an approach similar to the UCITS structured funds where general guidelines are given. The manufacturers then should compile these guidelines to suitable performance scenarios at a per structure level.

- To item a) on page 49: backtests cannot be performed for all products and therefore should not be used as a basis.
- To item b) on page 49: This approach is not appropriate for all cases. For example, if an equity linked-bond (reverse convertible) with an exercise price of 80% of the reference value increases by 10%, remains unchanged or falls by 10%, there would be no negative example to display. Since all three scenarios would lead to the same income, the investor could make even the false interpretation that the repayment is always the same amount regardless of the performance of the underlying. The situation is similar for OTC derivatives, whereno fixed thresholds should be set.

18. Which percentiles do you think should be set?

In general, the EACB would propose providing relative values with the possibility to use absolute figures in brackets. Absolute figures can be presented on basis of a hypothetical investment amount, which equals the typical volume invested by customers.

19. In addition, please refer to question 16.Do you have any views on possible combinations?

We have a strong preference for the what-if approach and see no need for combinations with a probabilistic approach. In general, we fear that combinations of different approaches usually lead to more complexity and reduces the ability of the investor to understand. Indeed, in case of a combination, retail investors would have to understand two approaches / facts and understand the difference. The added value is too small compared with the confusion that would be created for the retail investor.

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

No, they are already part of the risk disclosure. “Double counting” of risks should be avoided in the PRIIPs KID. However, it should be pointed out that these scenarios do not include credit risk.

An exception would be, if the product itself is based on a credit event occurring with respect to the underlying instrument (CreditLinkedNote). Scenario analyses should serve the purpose of enhancing understanding of the product architecture. Including issuer risk into the scenario analysis does not further that purpose, but will in fact make the presentation more complex.

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

Yes, they are an important feature of a PRIIP which has to be explained through the performance scenarios. Redemption events (such as early repayment triggered by the issuer's termination rights) should be pointed out in a general manner. However, performance scenarios should always refer to the final maturity, as opposed to various holding periods.

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?

Presenting scenarios for different holding periods is not appropriate, since this is too complex and even confusing. Generally, it should be assumed that investments are held to maturity. If too many versions are shown retail investors could be confused. Therefore, a decision of consumer to exit earlier should not be considered If anything it could be better to provide a general warning on the consequence of the early exit.

Having said that, for open ended products this information could be relevant for investors For products with path dependent allocations it is necessary to calculate the performance at each point on each single path.

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?

The description regarding the first question is sufficient. We consider that the list does not need to be further detailed or completed. Moreover, the costs do not need to be included into the "on-going charges" concerning funds.

As a general remark it might be questioned if the proposed granularity really makes sense. Assuming that the implementation of the identification and aggregation of the different cost components will be extremely costly, the result will always be based on too many assumptions have to be made. So it might be questioned as to whether the proposed granularity justifies the accompanying implementation costs for the industry or if the existing cost disclosures are not already sufficient (e.g. TER for UCITS).

Additionally we would highly recommend to ensure that the cost disclosure requirements are aligned with those cost disclosure requirements under MiFID II (Final Report Annex 2. 14.1 table 2). If there would be no alignment, the burden for the industry would be unnecessarily high and even unintended by the legislator.

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

As stated above (see answer 23), the costs do not need to be included into the "on-going charges". As to the list itself, the list is clear enough, but there must be a differentiation between the costs of the purchase of the product and the regular costs of the product itself. Only the regular costs of the product can be part of the on-going charges. Initial upfront fees, such as constitution costs should not form part of entry fees as they are caused by the product itself and not the investment into the product. As these appear only at launch these costs should not be part of the ongoing charges.

In addition, entry costs should not be included in the on-going charges. The entry fee can be different for each single investor (e.g. rebate on subscription fee or charged over a longer period), so there can't be an on-going charge that is identical to every investor.

25. Should these fees be further specified?

No, as long as it is clear that the list is not exhaustive.

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).

All fees should be clearly specified to avoid any misunderstandings and misinterpretations.

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).

This situation seems to be too specific for being part of PRIIPs cost disclosure. In addition, we would not recommend including recovering fees as these might be different for each the investors depending on their tax status.

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)?

We do not think that anything is missing. Moreover, as this list is not exhaustive further costs can be added.

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

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?)

A guarantee comes at a price (balance sheet costs) which should be taken into account as cost, i.e. this type of costs should be included if those costs are charged separately to the fund and deducted from the fund NAV on the basis of a fee. In this case it should be part of the on-going charges.

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:

If at all, it should be narrowed to administrative costs. The question is whether there are missed revenues. Margin calls are an essential and necessary requirement when investing in derivatives so as to mitigate counterparty risk. From a theoretical point of view, it could indeed be seen as an opportunity cost because of the retention of a resource that could be invested somewhere else. However, this analysis will erroneously lead to the inclusion of all opportunity costs in the KID which is practically impossible. All investments involve an opportunity cost of not investing in other assets.

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

It should only be ensured that there will be no inconsistency with MiFID 2.

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?

The estimation of future dividends is only available for short time period. For long term periods there are no reliable estimates.
Nevertheless, the non-accrual of dividends can only be regarded as costs if the investment management company has an influence on the accrual of the dividends. In case of tax (no repayment, governmental action) or any other conditions which cannot be influenced by the investment management company the non-accrual cannot be considered as cost.

34. Is this description comprehensive?

Yes, we believe that this description is comprehensive.

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

Due to the fact that prices do not include broker commissions entirely, the calculation ex ante would be misleading if at all possible. Any ex-ante calculation will depend on assumptions, e.g. on turn over ratios and commission schedules. As the commissions might change over time and turn over ratios might also change, the reliability of such an estimate would be questionable. For future estimations the average broker commissions from the previous year may be used.

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?

To estimate transaction taxes ex-ante, an assumption regarding the respective turn over ratios has to be made.

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

No, we strongly believe it is not possible to use the fair value approach since it is an unrealistic assumption to calculate broker commissions. Capturing all bid-ask spreads and possibly independent "fair value" mid price on all transactions for this reporting purpose will cause disproportionate implementation efforts. Furthermore in the bid-ask spread there might be a component for providing liquidity, which is not really a type of cost but a payment for the risk taken by the broker. Therefore, we would recommend a standardized table of typical transaction costs.

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?

No, the members of EACB do not believe it is appropriate to disclose broker commissions which are included in the spread to avoid any misinterpretation. Please refer to our response to question 37.We would actually doubt that it will be possible to separate broker commission from brokerage fee.

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?

No, the members of EACB strongly oppose the idea to include market impact costs as part of the costs. They are the result of market movements and market participants behavior and their inclusion would confuse investors and possibly lead to false decisions and misinterpretation. In addition, this is not part of the costs that have to be disclosed under MiFID 2. Disclosure might, therefore, even be confusing.

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?

The different calculation methodologies can lead to fundamental different cost levels. Even distributing entry and exit fees over the recommended holding period could be difficult as it might incentivise manufacturers to extend the recommended holding period.

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?

Independent from the methodology to be used to calculate turn over ratios, the ratio may change significantly depending on market conditions. If any, a hybrid model might be preferable in order to avoid that one mutual fund is preferred by one or the other method.

[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.

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?

Yes, we believe that a uniform definition of performance fees would be very useful. We would recommend in this context, that the definition by IOSCO should be applied.
However, we would not recommend to report it in aggregated cost figure. For instance, if the fund has a performance fee for outperformance over a benchmark, the fund still yields at least the benchmark performance. If one compares this with a benchmark replicating fund one should not add performance fees to the costs, but deduct the performance fee from the assumed outperformance above benchmark.
Performance Fee should therefore be mentioned explicitly and not reported in one aggregated cost figure, e.g. total cost 3% thereof 0.5% performance fee.

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?

Please refer to questions 16 and 17.

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?

The performance fee should be included in the performance scenarios. Please refer to questions 16 and 17. Version 2 is inapplicable since there is no possibility to calculate the performance fee in advance. Therefore, we recommend version 3.

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).

Insurance premiums should not be regarded as costs. Premiums are paid for the insurance risk cover offered and it is not a cost for the investment. Including the risk premium as a cost would make it more difficult to compare actual costs for different investment products.

The KID for the wrapper product should only include information of the wrapper product, not of the underlying investment objects. Information on the wrapper should make it clear that there is a multilayer design in the product and all information on the final investment is not available in the wrapper KID. The wrapper should provide for links to information on the underlying investments, when possible.

Utmost it might be possible to disclose the different kind of investment object classes the investor may choose from (in the form of examples or a summary). Using ranges of risk and costs for certain investment classes would result in too wide ranges and this information will not bring added value to the customer. Limited space in the KID needs to be taken into account when deciding on what information on underlying investments can be shown in the wrapper KID. The customer cannot normally grasp and understand the

information contained in several graphs or indicators in the same limited document. We also have to take into account that after concluding the contract, the customer may at any time change the underlying investments in the wrapper.

It seems the proposed RIY model for calculating costs might be the most suitable for insurance savings products. For other products like structured products, it might not be a workable model.

Overall, we feel there is a risk that the cost calculation model ends up being too detailed and too complicated. We should aim for a clear and comparable cost model, which brings added value for the customer. This means simplification is needed and every detail cannot be displayed

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

Costs of embedded options might not exist – due to applicable national legislation- although the insurance product contains and even markets the inherent guarantee feature. Eg. the manufacturer is not allowed to collect any fees for statutory guarantees. A product might contain an option to guarantee a minimum price or return, but the manufacturer would not be allowed to demand the premium or to include this in the price of the product.

Nevertheless, guarantees reduce in general the performance of the respective products. This has to be properly disclosed in the PRIIPs-KID. Especially as high guarantees will result in limited performance. This correlation should be disclosed properly.

The exit costs should be added to the list. Any costs in case of (early) termination, redemption, may be depending on the term of contract or any penalty fees/ fines in case of premium exemptions or change of provider should be disclosed.

Some insurers demand additional fees in special events/ cases. This could be a direct debit return, issue an substitute police, several cases of contract amendments, divorce, termination, written information/ disclosures, etc.. These fees can be a fixed amount, a (capped) percentage of the investment amount, a percentage of the premium, etc.. As these events are not predictable, the investor cannot calculate the relevant costs of the product

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?

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

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

We do not believe that the list and breakdown is comprehensive .

The EACB would propose a set of clusters of costs and to assign each costs. These Clusters could be:

- Signing and Distribution
- Administration
- Capital Investment
- Miscellaneous

Costs would have to be allocated to one of these clusters and ideally the regulator would specify the categories.

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

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

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

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?**

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

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

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?**

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?**

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

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

60. The two approaches should lead to the same results as long as costs are consistently considered. Issuer Estimated value is already well established in Germany, based upon fair value, and allows disclosure of costs for the investor, including commissions, inducements and expected issuer margin.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?

Yes.

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?

The EACB believes that the product-related costs should be shown in the KID as a total and there is no need to further split each cost beyond what is required by MiFID II. No further breakdown of costs should be imposed as such information is too detail, extends to too many elements and is complex for retail investors. For a retail investor, it is important to know the level of product-related costs. How these costs are further split in detail is secondary – if anything- for a retail investor.

As far as certificates are concerned, for example, this means that all of the costs charged by the issuer are reflected in a fair value concept, and that the product does not contain any other issuer costs. Fair value is the certificate's value, as estimated by the issuer. The difference between the certificate's issue amount and the fair value covers the issuer's expected margin as well as a sales commission (if applicable). The issuer's expected margin covers items such as the costs for structuring the certificate, market-making (the continuous quoting of bid and ask prices) and settlement, as well as the issuer's expected profit.

The KID requires the product- related costs but not distribution costs: These are not be known to the issuer, and therefore can only be based on approximations. The KID is – by nature- an issuer document and not a sales document. That means that the parallel to MIFID II only concerns product costs.

In this context it is essential that the understanding of costs under MiFID II and the understanding of costs under PRIIPs is as identical as possible in order to avoid misunderstandings and confusion for the investor and problems in the implementation. Meaningful and understandable information on the processing chain during the lifetime of the (issuance, distribution and custody) is only possible if all service providers in the chain have the same understanding of costs and can build on each others contribution.

We would also like to propose the following (page 86):
Concerning item a) Sales commission: This may be split between

- issuance surcharge (on top of nominal)
- placement fee (embedded in nominal)

Concerning item e) The funding aspect may be included here

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

For entry costs no further specification is necessary. Please refer to our response above to Q61.

There are certain ongoing costs not listed which may be disclosed or published as on-going costs. In particular some structured products contain a license or management fee which is continuously calculated

on the basis of underlying index levels and has the effect of reducing the PRIIP performance in comparison to the underlying/index. Otherwise, costs relating to coupon payments and costs of the underlying may also be difficult to express as they are (as above) normally incurred at an aggregate and not product-by-product level. They may also be already embedded in the entry costs.

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?

The price setting is a matter of liquidity and not of cost.
In case MiFID II requires ex-ante cost disclosure regarding spreads this very component should be part of the PRIIPs KID as well.

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?

See our response to Q 61.

Guidelines on the definition and calculation of costs should be sufficiently precise to ensure standardisation, but also flexible enough to accommodate the different pricing models and approaches of manufacturers and also across different product types.

Regarding early redemption costs, even though early redemption may happen when retail investors do not longer want the product (or need to liquidate) this is not to be counted as a cost (opportunity costs is too broad a concept to be included here) unless there is a real fee part of this transaction.

The same applies for the loss of interest which is an opportunity cost. However, it should be mentioned in the narrative that the product does not pay interests.

65. Would you include other cost components?

See our response to Q 61.
It depends whether this is consistent with MiFID II. If so, this should be sufficient.

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

Cost of the underlying (e.g. index license cost) is a cost borne by the manufacturer, implicitly included in the Direct Costs and priced upfront. It should not be included in on-going costs.

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?

With certificates, costs are usually levied in the form of a one-off charge upon purchase together with all costs applied to a fair value meaning that costs are included in the issue price.
Again, we highlight that it is essential that the understanding of costs under MiFID II and the understanding of costs under PRIIPs is as identical as possible in order to avoid misunderstandings and confusion for the investor and problems in the implementation. Meaningful and understandable information on the processing chain during the lifetime of the (issuance, distribution and custody) is only possible if all service providers in the chain have the same understanding of costs and can build on each others contribution.

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)?

These costs are not born by the retail investor. That is the risk of the issuer alone.

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

Concerning investment service only the sales commission embedded in the nominal should be disclosed in the PRIIPs KID as investment service. All cost components on top of the nominal (i.e. the issuance surcharge) are subject to price models of the distributors which may vary significantly. This is relevant for mutual funds as well.
When it comes to for fair value measurement it is not clear why complexity should be part of fair value measurement; complexity is just a characteristic of a product, internal pricing models (compare with b)) have to be able to handle them. Moreover, issuer risk (i.e. the credit spread) and the risk of the underlying(i.e. volatility) are both part of the internal pricing model and do not have to be mentioned separately.

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

We believe that the obligation of update the KID should be applied only in the presence of a significant raise in the reported risk levels.

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?

Please refer to our response to Q69.

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

Yes, internal funding curves of the manufacturer.

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?

Back-tests do not yield prices in line with prevailing market conditions; they contradict the aim of the rukes as described on page 90 (items b. and e.).Therefore we have a strong preference to use forward-looking models due to their wide-spread usage in banking and our experience with a forward-looking approach for a risk indicator. We do not see any advantage of a plain backward looking besides simplicity. It should be borne in mind that that forward-looking models also use historical data.

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

No.

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?

Ratings and Credit spreads even if not perfect are the only available measures.
Deriving credit spreads from other issuer bonds is a valid alternative for getting up-to-date spread information especially for issuers with illiquid CDS-contracts, providing that the “benchmark” bond is listed in a trading venue. Besides we even have the internal funding curves of the manufacturer.

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

In the absence of market data appropriate peers have to be defined in order to determine the credit risk. In case peers are not available, fixed values (worst-case) for credit risk can be determined .

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?

Ratings, even if not perfect are the only available measures. A credit analysis, along the lines if a bank is giving a loan or a rating agency is giving a rating would be required.

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

In many circumstances parameters cannot be computed/estimated using market data, if not enough data is available for counterparties (ie no rated entities) or even in times of extreme uncertainty like political or extreme economic events.

(Partially) unobservable market data is not a rarity in financial modelling, e.g. for exotic underlyings or options observable market data is often missing. In these cases valid assumptions or approximations in-line with industry as well as theoretical standards have to be applied. As these approximations will be reflected in the purchase price of a PRIIP and therefore in the corresponding cost disclosures in the KID, it will be transparent to investors that potentially higher costs will occur in such a PRIIP.

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?

No, but it is important to ensure that the models reflect the market prices of products as accurate as possible.

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).

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

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?)

In general the average amount invested depends on the specific PRIIP.

For certificates the invested amount is "cost-independent" with respect to the issuer's cost so that the definition of a certain investment amount does not matter here. Decisive this is only if transaction costs must be taken into account.

For OTC derivatives, the acquisition costs are calculated as a percentage on the notional amount agreed with the customer and thus, the comparison can be made on the basis of percentages. In this regard is should be noted that according to Article 5 para. 1 of PRIIPs regulation the PRIIP manufacturer shall draw up for that product a KID before the PRIIP is offered to retail investors. However, in OTC derivative contracts the terms are agreed between the parties individually. This means that the KID for the specific PRIIP can be created only after appropriate discussions with the customer. Before only a a kind of " Fill in the Blank" or a kind of pattern-key information document with fictitious / assumed values (including the notional amount) is only possible.

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?

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

Yes. although an annualisation of costs has its difficulties especially for products expiring within 1 year, annualized values are well-known by investors due to the similarities to interest rates.

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?**

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?**

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?**

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?**

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?**

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

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

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.**

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

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?**

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?**

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

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

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

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