

## CONSULTATION PAPER ON PRIIPs KEY INFORMATION DOCUMENTS

### AMAFI's response

### Introduction

***Please make your introductory comments below, if any:***

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI has more than 120 members operating for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives. Nearly one-third of its members are subsidiaries or branches of non-French institutions.

Prior to answering to the specific questions in the Joint Consultation Paper, AMAFI would like to draw the Joint Committee's attention on the following issues:

**1. The methodology for classifying PRIIPs Categories is complex, and the MRM methodology for structured products relies on concepts that are not well established as market practices.**

In AMAFI's view, the proposed methodology for presenting risk in general and market risk in particular is over-complicated because the system for categorising products, especially derivatives (see below), is ill-defined and, in some cases, sketchy. The proposal, which blends a qualitative approach with a quantitative approach depending on the type of product, is anything but a uniform solution for comparing and contrasting products. And yet, such is the aim of the PRIIPS Regulation.

AMAFI also wishes to point out that the risk indicator methodology chosen for structured products (Category III PRIIPs), i.e. bootstrapping of historical data, which was not an option in the previous consultation, does not seem to be widely used by market participants. Moreover, it is not the same as the methodology used for UCITS, which is based on the Black-Scholes model.

With this in mind, AMAFI has identified a number of drawbacks:

- Increasing the number of models according to product categories makes it hard to understand and interpret the PRIIPS system as a whole;
- For market participants dealing multiple products, setting up this kind of mechanism will be an unwieldy process fraught with operational difficulties;
- Using multiple models would frustrate the main aim of the Regulation, which is to facilitate product comparison;
- Reliance on little-used methods would complicate not only the test phase but also the IT developments that are a prerequisite for bringing market participants into compliance with the Regulation. This raises yet again the issue of the planned applicability date for these measures (see point 5).

## **2. Derivatives are hazily defined**

AMAFI points out that the definition of "derivatives qualifying as a PRIIP" is extremely broad, and therefore hazy because these products would automatically be placed in the same category as the riskiest instruments. It also raises the question of the scope of PRIIPS and the fact that non-investment products should be excluded since an option or a future do not imply investment of cash from the "investor" (see point 6 below).

Additionally, AMAFI believes that a specific SRI of "7+" or a "7 complemented by a specific label category should be confined on which investors could lose more than their initial outlay.

## **3. The concepts in the paper need further clarification, particularly the presentation of costs**

Several key concepts in the Consultation Paper need to be clarified if the PRIIPS mechanism is to be uniformly understood. This applies in particular to:

- Reduction in Yield (RIY), which requires further explanations ;
- Fair value (e.g. does this include the cost of hedging the product?). In particular, the Consultation Paper seems to make no link between fair value and RIY. We recommend the RTS should clearly draw a link between fair value and RIY, and explain it through examples and/or formulas;
- Structuring costs, which requires precisions.

In AMAFI's view, if more information on these concepts is to be provided in the final RTS, or Level 3 Guidelines, then they should be published in the near future so that market participants can comply with the Regulation.

## **4. Performance scenarios interim holding period**

The Consultation Paper requires the scenarios to be based on the "*recommended holding period*", as well as two other scenarios are to be displayed for shorter "*interim holding periods*". For structured products or any PRIIP with a fixed maturity date valued using a model, interim scenarios do not make much sense, because the payoff is only valid at the maturity/redemption date. Moreover, the section "*How long should I hold it and can I take my money out early*" already highlights the capital risk in case of an early redemption or a buy back on the secondary market.

Therefore, AMAFI asks that the exemption to display interim actually includes all PRIIP with fixed maturity dates.

Incidentally, further clarification on the methodology that is to be used for selecting the three scenarios in Annex IV for choosing between favourable, moderate and unfavourable scenarios would be welcome.

## **5. Postponing the entry into force of the PRIIPS Regulation should at least be considered**

AMAFI insists that postponing the entry into force of the Regulation should at least be considered, because although potentially far-reaching IT developments will be needed, discussions are ongoing. More-over, there are connections to be made with the MiFID II investor protection measures, such as information on costs and fees and the definition of the target market, which are among the obligations provided for in the product governance arrangements.

The postponement issue is especially important for producers, who will have to be up and running several months before the new measures actually come into force. Yet the Consultation Paper does not answer all the practical and theoretical questions about the work that will be needed to comply with the new Regulation (*see also answer to Question 28*).

AMAFI is calling at the very least for a grace period or a transition period in order to make up for the absence of a grandfather clause for products that were designed before the Regulation comes into force and that might be offered to clients or to the general public (in the case of the secondary market) once it has taken effect.

## **6. The scope of PRIIPs is inappropriate in view of the type of products covered**

AMAFI repeats its comments about the very broad scope of products covered by PRIIPS and the difficulties involved in applying the Regulation to instruments that are not investment products. This issue concerns, for instance, a number of foreign exchange or fixed income products sold to corporate clients for the sole purpose of hedging and not investing. The KID template in the proposed RTS is not fit for hedging products. More specifically, the section “*How long should I hold it and can I take my money out early?*” and RIY calculations do not make sense for such hedging products.

Whereas there is no specific indication in the Consultation Paper about the scope of the PRIIPs Regulation, AMAFI wishes to highlight once again that convertible bonds and any OTC derivatives should not be included in the scope.

However, as regards convertible bonds, contrary to the definition of PRIIPs, these products are not designed “*to provide investment opportunities to retail investors*” (*PRIIPs Regulation, Recital 6*); their primary purpose is to meet the financing needs of their issuers, not the investment needs of retail investors. Convertibles are governed by the rules applicable to financing instruments, so there is no reason to distinguish them from corporate shares or bonds, which are outside the scope of the Regulation. For instance, the cost structure for convertible bond is different to the structure for other PRIIPs since it does not include the implicit costs paid by the investors. Indeed, investors buy convertible bond at its market price.

As regards, OTC derivatives, although AMAFI agrees that those intended for mass distribution, e.g. CFDs, are within the scope of the Regulation, those contracted with corporate clients classified as retail clients are not PRIIPs, for the following reasons:

- There is no distribution as such to retail investors, only a bilaterally negotiated contract;
- There is no “investment opportunities” as such;
- There is no repayable amount to the retail investor, as stated in the definition of a PRIIP;
- Some derivatives exposed solely to an interest rate are similar to fixed-rate or variable-rate deposits, which are outside the scope of PRIIPS.

In addition, since contract is different from the others, those OTC derivatives are not standard products ready for mass distribution to retail investors. Applying the requirement to produce a KID for these products would in effect mean that any single derivative contract with a client would require a KID, which seems disproportionate considering the lack of value added for the corporate clients concerned.

For these reasons, AMAFI considers that the Level 2 measures related to the PRIIPs Regulation should explicitly provide that convertible bonds, OTC derivative contracts that do not provide investment opportunities (such as hedging products) are not PRIIPs and that KIDs do not have to be drawn up for them.

## Questions

### Question 1

**Would you see merit in the ESAs clarifying further the criteria set out in Recital 18 mentioned above by way of guidelines?**

AMAFI would support an ESA initiative to develop common complexity criteria, since this could usefully contribute to the harmonisation of product complexity rules and avoid fragmentation of the national regulatory regimes as it has been experienced in the past. However, such an initiative should be conducted in line within MiFID II work on product governance to ensure a consistent approach between both regulations.

### Question 2

**Would you agree with the assumptions used for the proposed default amounts? Are you of the opinion that these prescribed amounts should be amended? If yes, how and why?**

**Would you favour an approach in which the prescribed standardised amount is the default option, unless the PRIIP has a known required investment amount and price which can be used instead?**

AMAFI disagrees that EUR 15,000 should be used for single premium insurance-based investment products. We believe that EUR 1,000 should be used for all types of PRIIPs (all insurance based, regular premium insurance products as well as single premium, UCITS/AIFs, and structured products) since it is standard market practice. It would ensure consistency and comparability between products.

### Question 3

**For PRIIPs that fall into category II and for which the Cornish Fisher expansion is used as a methodology to compute the VaR equivalent Volatility do you think a bootstrapping approach should be used instead? Please explain the reasons for your opinion?**

AMAFI considers that the methodology chosen should produce similar result for a same payoff packaged under different medium, structured product or investment fund.

For category III, AMAFI members consider that the results achieved by bootstrapping are similar to those from the well-established Black and Scholes methodology. For category II, bootstrapping computation leads to similar results as those from the Cornish Fisher methodology.

In addition, due to its complexity and the fact that it is not standard market practice, AMAFI thinks that not all market participants fully understand bootstrapping methodology. Therefore, we do not see the benefit of implementing this "new" approach. Ultimately, it will imply more resources and time-consuming additional computations.

### Question 4

**Would you favour a different confidence interval to compute the VaR? If so, please explain which confidence interval you would use and state your reasons why.**

If the VaR methodology is to be applied, AMAFI believes the related confidence interval could be wider than currently considered in order to provide differentiating results for the various product characteristics (e.g. soft-capital protection with different barrier levels).

In our opinion, it would be best to set a confidence interval of 5%.

#### **Question 5**

**Are you of the view that the existence of a compensation or guarantee scheme should be taken into account in the credit risk assessment of a PRIIP? And if you agree, how would you propose to do so?**

In AMAFI's view, protection schemes are essentially an external factor which arises only if the counterparty defaults; they are not an element of credit exposure *per se*. This militates against incorporating a compensation scheme cover into the credit risk assessment. To avoid confusion, AMAFI feels that an appropriate disclosure is a better solution, rather than having such schemes wrapped up in the credit risk assessment.

It should be noted that such disclosures should be added to the section "*What happens if [the name of the PRIIP manufacturer] is unable to pay out?*" rather than to the risk section.

#### **Question 6**

**Would you favour PRIIP manufacturers having the option to voluntarily increase the disclosed SRI? In which circumstances? Would such an approach entail unintended consequences?**

Although AMAFI does not have a firm view in favour or against such proposal, we consider it impossible at this stage to anticipate the unintended consequences of such an option. Generally speaking, if PRIIP manufacturers have the option to voluntarily increase the disclosed SRI, and if that option is used widely by manufacturers, the relevancy of the proposed SRI method is questionable. This situation could be detrimental for all the parties involved.

#### **Question 7**

**Do you agree with an adjustment of the credit risk for the tenor, and how would you propose to make such an adjustment?**

AMAFI disagrees with adjusting the CRM class for the tenor since we consider there is no well shared methodology nor standard market practice to justify such adjustment. We do fear that this method would further complicate the calculation of SRI which is enough complex as it is.

Incidentally, AMAFI wish to point out that the CRM methodology as proposed in the Consultation Paper is not completely clear nor precise and will require further guidance to be implemented. For example, AMAFI is not clear as it applies to products such as Credit Linked Notes.

#### **Question 8**

**Do you agree with the scales of the classes MRM, CRM and SRI? If not, please specify your alternative proposal and include your reasoning.**

AMAFI has several and serious concerns on the MRM methodology and scale.

First, as already pointed out, we have doubts about the bootstrapping approach.

Second, the methodology proposed for MRM raises many questions when it comes to be practically implemented. For examples, how to calculate the evolution of the PRIIPs value where the product include a feature like a barrier? Or if it is callable, or depend upon more than one asset? For the purpose of the simulation, curves and PCA steps as described in the Paper (*Annex II, § 30 to 40*) lack of practical guidance.

Finally, we fear that with the current proposal, most of equity investments (regardless of whether highly diversified or single stock) were likely ending up in the highest risk class 7. Therefore, a more balanced way is needed.

The alternative matrix presented in the questions section of the consultation paper does not seem appropriate as it would not be discriminating enough with only 5 credit risk classes”.

#### **Question 9**

**Are you of the opinion that for PRIIPs that offer a capital protection during their whole lifespan and can be redeemed against their initial investment at any time over the life of the PRIIP a qualitatively assessment and automatic allocation to MRM class 1 should be permitted?**

**Are you of the opinion that the criteria of the 5 year tenor is relevant, irrespective of the redemption characteristics?**

AMAFI believes that any product that offers capital protection during the entire lifespan of the product should be allocated to MRM class 1.

We do not think that the 5-year tenor criterion is very relevant in this categorisation.

We would like to point out that many life insurance products offer a capital protection but need to be held for more than 5 years to be eligible (e.g. in France, the tenor is usually 8 years). Setting the maximum tenor at 5 years for MRM1 would lead to a bias for many insurance products.

Incidentally, AMAFI would like to raise questions about the “*risk free rate*” as ESA explained that another reason for the criteria of the 5 years is that some PRIIPS are compared against the risk free rate. We understand that in the general principles for Market Risk assessment, the risk free rate is to take into account. But what reference should be taken for the risk free rate: Eonia, OAT? How should this rate apply to variable maturity products?

#### **Question 10**

**Are you aware of other circumstances in which the credit risk assessment should be assumed to be mitigated? If so, please explain why and to what degree it should be assumed to be mitigated?**

AMAFI considers that Annex II paragraph 65(a) cross-refers only to AIFMD/UCITS.

However, we believe there could be other circumstances in which credit risk is mitigated. This is notably the case when there is over-collateralization, i.e. where the face amount of the pledged assets is greater than the assets they back. As the over-collateralization process is investor-protective, we believe it should be acknowledged in the credit assessment. One way of acknowledging this effective mitigation of the credit risk could be to change the credit risk rating by one to several notches depending on the level of over collateralization.

#### **Question 11**

**Do you think that the look through approach to the assessment of credit risk for a PRIIP packaged into another PRIIP is appropriate?**

Yes, AMAFI believes that the look-through approach to the assessment of credit risk for a PRIIP packaged into another PRIIP is appropriate.

#### **Question 12**

**Do you think the risk indicator should take into account currency risk when there is a difference between the currency of the PRIIP and the national currency of the investor targeted by the PRIIP manufacturer, even though this risk is not intrinsic to the PRIIP itself, but relates to the typical situation of the targeted investor?**

No, AMAFI does not think that the risk indicator should take into account currency risk. This would prevent investors from comparing very similar products with or without currency risk. To include further risk elements will make the indicator even harder to understand and apply. In our view, the risk indicator is already too complex and potentially misleading, and it would be a mistake to complicate it further by including further risk elements. Rather, these risks should be disclosed in text form, for the sake of clarity.

#### **Question 13**

**Are you of the opinion that the current Consultation Paper sufficiently addresses this issue? Do you it is made sufficiently clear that the value of a PRIIP could be significantly less compared to the guaranteed value during the life of the PRIIP? Several alternatives are analysed in the Impact Assessment under policy option 5: do you see any additional analysis for these assessment?**

Yes, AMAFI believes that the current Consultation Paper sufficiently addresses this issue.

#### **Question 14**

**Do you agree to use the performance fee, as prescribed in the cost section, as a basis for the calculations in the performance section (i.e. calculate the return of the benchmark for the moderate scenario in such a way that the return generates the performance fee as prescribed in the cost section)? Do you agree the same benchmark return should be used for calculating performance fees for the unfavourable and favourable scenarios, or would you propose another approach, for instance automatically setting the performance fees to zero for the unfavourable scenario? Please justify your proposal.**

Yes, AMAFI agrees with using performance fee as a basis for the calculations in the performance section and with the fact that the same benchmark return should be used for calculating performance fees for the unfavourable and favourable scenarios.

#### **Question 15**

**Given the number of tables displayed in the KID and the to a degree mixed consumer testing results on whether presentation of performance scenarios as a table or a graph would be most effective, do you think a presentation of the performance scenarios in the form of a graph should be preferred, or both a table and a graph?**

AMAFI prefers a table presentation because a presentation with graphs will require heavy IT developments. Also, we consider that the difficulties linked to the presentation of interim performance scenarios should be further analysed. As explained in introductory comment (*see point 4*), we would suggest that only one performance analysis should be required for products with fixed maturity dates.



**Question 16**

**Do you agree with the scope of the assets mentioned in paragraph 25 of Annex VI on transaction costs for which this methodology is prescribed? If not, what alternative scope would you recommend?**

Paragraph 25 of Annex VI applies to investment funds (AIFs and UCITS), so AMAFI has no comments on this question.

**Question 17**

**Do you agree with the values of the figures included in this table? If not, which values would you suggest? (please note that this table could as well be included in guidelines, to allow for more flexibility in the revision of the figures)**

This question is relevant only for investment funds (AIFs and UCITS), so AMAFI has no comment.

**Question 18**

**Do you agree that the monetary values indicated in the first table are a sum of costs over the respective holding periods? Or should the values reflect annualized amounts? If you prefer annualized amounts, which method for annualisation should be used (e.g. arithmetic average or methods that consider discounting effects)?**

AMAFI prefers annualized amounts since this appears to be the most frequently used format in the financial industry for disclosing costs to retail investors. AMAFI prefers an arithmetic average, which can be computed easily by retail investors.

**Question 19**

**Do you think that estimating the fair value of biometric risk premiums as stated in paragraph 55(b) of Annex VI would raise any technical or practical difficulties?**

This question is relevant for insurance-based investment products only, so AMAFI has no comment.

**Question 20**

**Knowing that the cost element of the biometric risk premium is included in the total costs calculation, how do you think the investor might be most efficiently informed about the other part of the biometric risk premium (i.e. the fair value), and/or the size of biometric risk premium overall? Do you consider it useful to include the fair value in a separate line in the first table, potentially below the RIY? Or should information on the fair value be disclosed in another part of the KID (for instance, the “What is this product?” section, where the draft RTS currently disclose biometric risk premiums in total, and/or in the performance section)? What accompanying narrative text do you think is needed, and where should this be placed, including specifically narrative text in the cost section?**

This question is only for insurance-based investment products relevant, so AMAFI has no comment.



#### **Question 21**

**Given evidence as to the difficulties consumers may have using percentage figures, would you prefer an alternative presentation of the second table, solely using monetary values instead? As with the first table, please also explain what difficulties you think might arise from calculating monetary values, and whether this should be on an annualized basis, and if so, how?**

AMAFI prefers the use of percentage figures since this appears to be the most frequently used format in the financial industry for disclosing costs to retail investors. For consistency reason, the total cost divided by the invested amount and per year must equals to the RIY (which AMAFI understands as an annualized measure of cost, taking arithmetic average). The ESA should nevertheless provide clear examples detailing how Table 1 should be filled for a structured product, based on its fair value.

Also we suggest to add that all costs in % in the second table are expressed per year so that their sum add up to the RIY.

#### **Question 22**

**Given the number of tables shown in the KID, do you think a more graphic presentation of the breakout table should be preferred?**

No, we do not recommend a graph; the tables are clear enough. To make it even shorter, both tables could be merged where possible.

AMAFI is also concerned about the fact that required information, disclosures, graphic presentations and tables do not fit into the maximum length of three KID pages, as specified in the PRIIPS Regulation.

#### **Question 23**

**The example presented above includes a possible way of showing the variability of performance fees, by showing the level for all three performance scenarios in the KID, highlighting the 'moderate' scenario, which would be used for the calculation of the total costs. Do you believe that this additional information should be included in the KID?**

AMAFI believes that the KID is already a voluminous and complex document. Including further information will be detrimental to the overall understanding of the key information it supposed to provide to investors. Unless it proves highly useful (which is not really the case here), additional information should not be included.

#### **Question 24**

**To reduce the volume of information, should the first and the second table of Annex VII be combined in one table? Should this be supplemented with a breakdown of costs as suggested in the graphic above?**

Yes, given the length restriction that will apply to KIDs, AMAFI thinks that the presentation of the requisite cost items should be restricted to a single table. Again, AMAFI expresses concern about the fact that all required information, disclosures, graphic presentations and tables do not fit into the maximum length of three KID pages, as specified in the PRIIPS Regulation.

#### **Question 25**

**In relation to paragraph 68 a) of Annex VI: Shall the RTS specify that for structured products calculations for the cost free scenario have always to be based on an adjustment of the payments by the investor?**

AMAFI thinks that the wording of the RTS could be made clearer on this issue and that there is a lack of practical examples applied to structured products. As explained in our introductory comments, the Reduction in Yield (RIY) requires further explanations because at present, the draft RTS does not make any link between the fair value and RIY.

#### **Question 26**

**Regarding the first table of the cost section presented in Annex VII, would you favour a detailed presentation of the different types of costs, as suggested in the Annex, including a split between one-off, recurring and incidental costs? Alternatively, would you favour a shorter presentation of costs showing only the total costs and the RIY?**

If ESA wishes to keep the two tables, then given that the length is restricted three pages, we would favour a shorter presentation of Table 2 showing only the total cost and the RIY.

#### **Question 27**

**Regarding the second table of the cost section presented in Annex VII, would you favour a presentation of the different types of costs showing RIY figures, as suggested in the Annex, or would you favour a presentation of costs under which each type of costs line would be expressed differently, and not as a RIY figure -expressed as a percentage of the initial invested amount, NAV, etc.?**

AMAFI favours a presentation of the different types of costs in Table showing percentage figures, as suggested in the Annex VII. Yet, for consistency and clarity the sum of all percentages in table 2 should add up to the RIY.

#### **Question 28**

**Do you have any comments on the problem definition provided in the Impact Assessment?  
Are the policy issues that have been highlighted, in your view, the correct ones? If not, what issues would you highlight?  
Do you have any views on the identified benefits and costs associated with each policy option?  
Is there data or evidence on the highlighted impacts that you believe needs to be taken into account?  
Do you have any views on the possible impacts for providers of underlying investments for multi-option products, and in particular indirect impacts for manufacturers of underlying investments used by these products, including where these manufacturers benefit from the arrangements foreseen until the end of 2019 under Article 32 of the PRIIPs Regulation?  
Are there significant impacts you are aware of that have not been addressed in the Impact Assessment? Please provide data on their scale and extent as far as possible.**

As pointed out in the introductory comments, AMAFI wishes to draw attention to the following impacts and issues that ought to be addressed:

- The **proposed methodology for presenting risks is already highly complex**; it should not be made more cumbersome or complex unnecessarily.

- The different product categories on which the methodology is based should be enhanced and defined in greater detail, especially as regards **derivatives**.
- By and large, the **risk indicator methodology chosen for structured products, i.e. bootstrapping of historical data, seems impractical**. This choice would complicate not only the test phases but also the IT developments that are a prerequisite for bringing market participants into compliance with the Regulation.
- Several **key concepts in the Consultation Paper** (notably linkage between RIY and fair value and structuring costs) **need to be clarified** if the PRIIPS mechanism is to be uniformly understood.
- AMAFI expresses concerns about the fact that all required information, disclosure, graphic presentations and tables as currently presented in the CP already **do not fit within the maximum length of three pages of the KID** defined by PRIIPS Regulation. Did ESA test on a wide range of products to draft KIDs that are compliant with PRIIPS and draft RTS and that fit into the three-page format?
- There are **territoriality issues** that are not solved yet: For example, does the Regulation apply to products issued by an issuer located in the EEA but distributed solely outside of the EEA?
- **Further guidance is expected on the target market even though it will have strong interconnections with forthcoming MIFID II provisions.**
- **Interactions with Prospectus Directive** will need to be clarified as well. In case of differences between the KID and the Final Terms drafted within Prospectus framework, which one will prevail? In addition, it would make sense for requirements in relation to updating a Prospectus and supplementing a Prospectus to be broadly aligned with the requirement to review and revise the KID. Generally speaking, it would be useful if ESA could confirm that each document has its own purposes and objectives and therefore their differences could be explained and justified.

AMAFI wishes to insist that postponing the **entry into force** of the Regulation should at least be considered, in view of the fact that although potentially **far-reaching IT developments will be needed, discussions are still ongoing. Moreover, there are connections to be made with the MiFID II investor protection measures.** More specifically, PRIIPS will have strong links with **Product Governance and the definition of target market.** At the very least, AMAFI requests a grace period or a transition period in order to make up for the absence of a grandfather clause for products that were designed before the Regulation comes into force and that might be offered to clients or to the general public (in the case of the secondary market) once it has taken effect.

