BE
BETTER
INFORMED

Open letter (sent by email) to

Steven Maijoor, Chairman of ESMA
Gabriel Bernardino, Chairman of EIOPA
Andrea Enria, Chairman of EBA
(together the European Supervisory Authorities (ESAs))

23 November 2016

Dear Mr Maijoor, Mr Bernardino and Mr Enria,

Revised Regulatory Technical Standards (RTS) for Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs KIDs)

FE Kii Hub is a leading outsourced provider of UCITS KIIDs and was among the first to commit to providing a similar solution for PRIIPs KIDs when Regulation EU 1286/2014 was published. The FE Kii Hub service is provided by FE, the multiple award-winning, independent provider of data solutions to asset managers, institutions, financial advisers and retail investors.

Along with the asset management and life assurance industries and consumers' representatives, FE Kii Hub was pleased with the European Commission's announcement of a delay of one year to the launch date of PRIIPs KIDs and request to the ESAs to consider amendments to the RTS.

PRIIPs KIDs are expected to play an important part in improving consumer protection across Europe by providing a simple, clear and comparable pre-sale document for all retail investment products. It is extremely important that the final documents contain appropriate information and the tables show meaningful and useful numbers. It is better to take whatever time is necessary to get the requirements right than to risk delivering something that is rejected by consumers.

We have seen what we believe to be a draft of the proposed changes to the RTS and we agree with them in principle, but we have concerns over the details when putting those proposals into practice.

FE London / 2nd Floor / Golden House
30 Great Pulteney Street
London / W1F 9NN / UK
T/ +44 (0)20 7534 7600

There has been no mention of a public consultation about the revised RTS and the timetable for adoption of the RTS by the Commission in February does not allow for one, so we feel it is important to make you aware of our concerns over the impact of what we understand the revisions to be.

FE Kii Hub believes that consumer protection would be improved further by additional amendments to the RTS, but we understand the desire to restrict revisions primarily to those areas cited by the European Parliament in its rejection of the RTS. The four areas the Commission asked the ESAs to modify are:

- The treatment of Multi Option PRIIPs (MOPs), with reference to investments in UCITS;
- The performance scenario calculations, as the unfavourable scenario may be over-optimistic;
- The application of the comprehension alert; and
- The disclosure of insurance costs and benefits, where applicable.

As a data-driven company, we have restricted our comments to the first two areas above.

<u>Multi Option PRIIPs (MOPs)</u>

We note that the exemption originally offered in the Regulation to UCITS has been restored, allowing MOPs investing directly into these funds to rely on the information in the UCITS KIID. This is how we interpreted the original RTS and Regulation before Lord Hill said otherwise in his letter earlier this year. To follow Lord Hill's instruction and issue PRIIPs-type fund guides when linking UCITS to a MOP would have imposed a disproportionate burden on both asset managers and life assurance companies and would have removed any benefit of the exemption.

However, without further changes to the RTS, consumers will be presented with UCITS KIIDs and PRIIPs KIDs with what appear to be similar risk indicators, but which have very different scales. For example, a UCITS with historical annualised price volatility of 15% has a risk class of 6 ("very high"), while a PRIIP with forward-looking VaR-equivalent volatility of 15% has a risk class of 4 ("medium"). On the face of it, the UCITS will appear to be much "riskier" than the PRIIP.

With costs, the problem is the other way around. The costs information on a UCITS KIID takes no account of transaction costs, so the range of charges shown in the 'Costs over time' table will be skewed downwards by UCITS and the 'Composition of costs' table will only show the range of transaction costs for the PRIIPs, which will appear to have additional costs and charges.

The question also arises as to how a MOP can show the range of risk classes and costs of the underlying fund options if those funds include different elements, use different calculations and different scales.

The solution lies in two minor changes:

1. **Given the range of products classed as PRIIPs, including those with over 100% of capital at risk, the PRIIPs KID SRI scale should go beyond the highest current level of 7, with the thresholds between 1 and 7 being the same as for the UCITS SRRI. This will have the added benefit of making the transition from UCITS KIID to PRIIPs KID in 2019 less confusing for consumers.**

2. **We don't believe there is any consumer protection benefit from showing the range of risk classes and costs in the MOP KID. Instead, the MOP KID should show the product-level costs and charges and any product-specific risks, summarising their effects on the returns shown in the fund-level document. Both the risk and costs sections should include a statement, similar to that in the returns section, that the risks and costs faced by the consumer will depend on the choice of fund(s).**

<u>Performance scenarios</u>

The current RTS uses historical fund prices going back up to five years, which is shorter than the average market cycle, resulting in potentially distorted indications of possible future returns. For example, the performance of many equity markets since their lows in 2008 could give retail consumers the misleading impression that returns are almost always positive, even in "unfavourable" conditions.

But the proposal in the revised RTS is not the solution. Applying the revised formula to the FE database of funds shows that over 90% produce a return for the moderate scenario of between +0.1% and -0.1%, regardless of asset class or charges, which is no more "accurate, clear, fair and not misleading" than the over-optimistic scenarios rejected by the European Parliament.

Whatever the intention of the KID, the moderate scenario will be viewed by many retail consumers as indicative of what they could receive in "normal" circumstances, that is in the

FE London / 2nd Floor / Golden House
30 Great Pulteney Street
London / W1F 9NN / UK
T/ +44 (0)20 7534 7600

absence of any extreme positive or negative market event. The implication of the revised moderate scenario is that consumers can expect almost identical returns from funds investing in equities (regardless of market), bonds, property, money market or any combination of these.

Annex IV, paragraph 25 of the RTS states that the return scenarios are to be shown “net of all applicable costs”, so we would expect to see a difference between the moderate return scenarios of funds investing in the same asset class with different charging structures, but this is not the case with the revised formula.

This formula even shows that money market funds whose charges exceed their gross returns appear to offer a good prospect for capital preservation, which is dangerously misleading for low-risk and financially illiterate retail consumers.

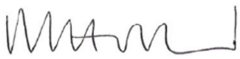
What the moderate scenario now indicates to retail consumers is unclear, but it is not the expected net return from the fund in the event of moderate returns from the underlying assets. If the ESAs and the European Commission wish to show a zero return, it should be clear that is what it shows and not risk misleading retail investors by labelling it a “moderate” return scenario.

As five years’ historical data has been shown to deliver potentially distorted forward-looking scenarios, we suggest reverting to the formulae in the existing RTS, but using up to ten years’ historical data. This time period is consistent with the UCITS KIID and generally covers at least one full market cycle. A suitable benchmark or proxy could be used for those PRIIPs with a shorter price history, with actual costs and charges applied to gross benchmarks, where necessary.

In addition, we propose following the suggestion made in the joint letter of 13 October from EFAMA and Better Finance to include past performance, ideally alongside a suitable benchmark, to show the fund’s historical performance against its objective. While this would not be an indicator of future returns and would not be displayed as such, it would be, as stated in that letter, “an extremely valuable piece of factual information for investors in their investment decision”.

FE Kii Hub has always strongly supported the principles behind the PRIIPs KID. For the laudable goals outlined by Commissioner Barnier as he presented Regulation 1286/2014 to be achieved, consumers must have a “basic information document to help [them] make the right choice” and the document must show “in simple language what they are investing in, and what the risks are”. We believe our recommendations bring those goals nearer and we strongly urge you to consider them as part of your submission of a revised set of regulatory technical standards.

Yours sincerely



Michael Holland
Managing Director

FE London / 2nd Floor / Golden House
30 Great Pulteney Street
London / W1F 9NN / UK
T/ +44 (0)20 7534 7600