After the ESA's draft PRIIPs RTS:
How to make the PRIIP KID fit-for-purpose?

EFAMA[1] strongly supports the objective to provide retail investors with a **key information document (KID) for all packaged retail and insurance-based investment products (PRIIPs)**. It is important that investors and their advisers throughout Europe are given meaningful, comprehensible and comparable information to feel confident about investing and to make sound investment decisions. The PRIIP KID is based on the already existing fund-only Key Investor Information Document (KIID) which gives us invaluable insights into how such a concise document can help investors make better investment decisions.

Nevertheless, after the publication of the European Supervisory Authorities' (ESAs) **final draft Regulatory Technical Standards** (RTS) on 07 April 2016, **EFAMA does not believe that the desired aims will be met. Comparability will not be achieved and there is a danger of investors, at best, being led to focus on the wrong issues and, at worst, being misled.** Thus, it is in the interest of the European Commission, and the European Parliament and Council as co-legislators to carefully scrutinise the usefulness of the PRIIP KID in its current form and correct the mistakes being made.

EFAMA believes that the PRIIPs RTS will ultimately lead to <u>consumer detriment</u> due to the following reasons:

- **Past performance (and benchmark) of a PRIIP is no longer disclosed to investors, even though future scenarios are based on them.**
- **Costs are shown only by their impact on return averaged over the recommended holding period of a PRIIP, making comparisons between products impossible and not showing to investors the actual costs.**
- **The calculation of transaction costs is based on improper assumptions and leads to false outcomes that will surely confuse investors.**
- **Two different disclosure documents will be presented to a retail investor when investing into the same fund through different means.**
- **Retail investors are provided with too much prescriptive narrative that inhibits detailed explanation of the actual product.**
- **The quality of the PRIIP KID will suffer massively as not enough time is given to get the rules right first and then implement them properly.**

Over the following pages we describe the above problems in detail and suggest <u>possible solutions</u> that can make the PRIIP KID fit-for-purpose.

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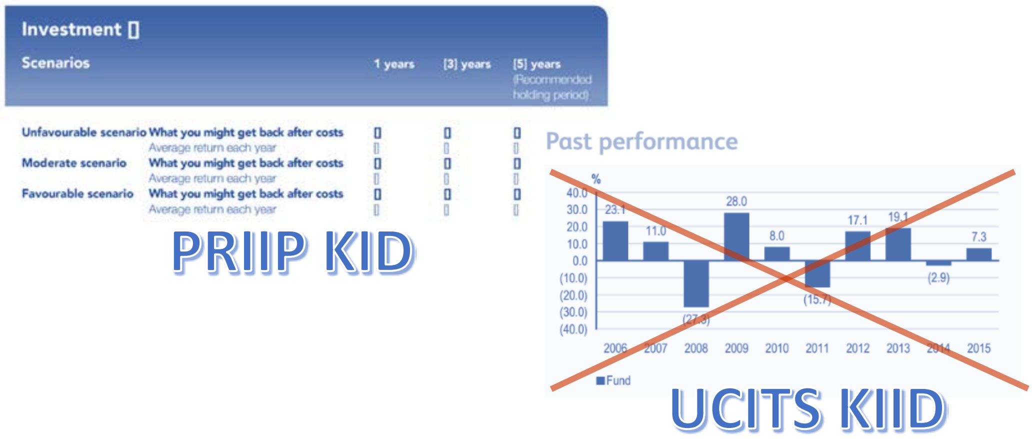
[1] **EFAMA** is the representative association for the European investment management industry. EFAMA represents through its 26 member associations and 61 corporate members EUR 21 trillion in assets under management of which EUR 12.6 trillion managed by 56,000 investment funds at end 2015. Just over 30,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 25,900 funds composed of AIFs (Alternative Investment Funds). For more information about EFAMA, please visit www.efama.org

! Past performance (and benchmark) of a PRIIP is no longer disclosed to investors, even though future scenarios are based on them

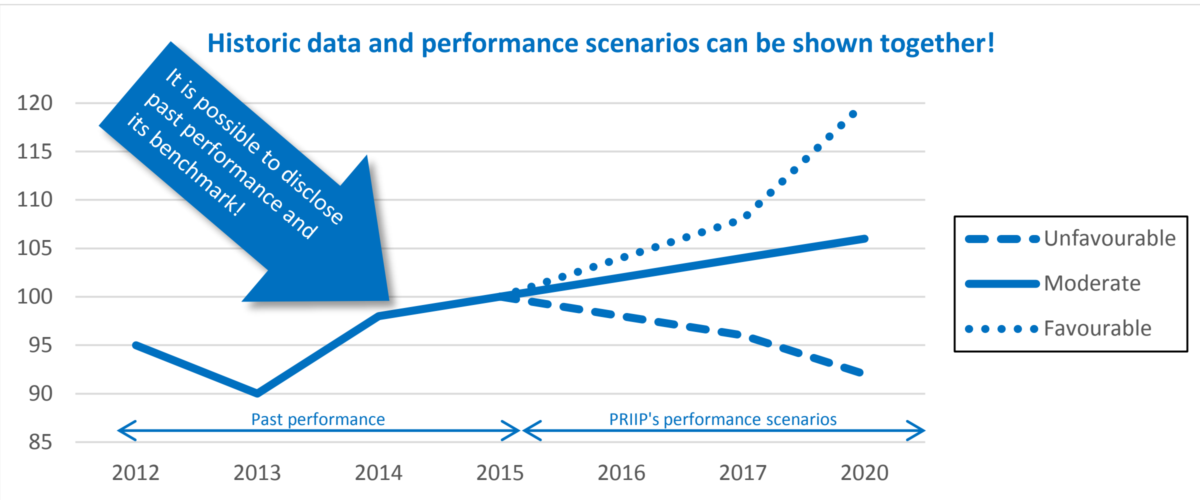
It is important for investors to know how a product has performed in the past. While past performance is not necessarily an indication of future performance, past data is, at least, based on (historical) facts and is presented in a standardised way which shows how the fund is run and allows for easy comparisons. It is contradictory, and gives the wrong message to investors, to acknowledge that it is not a guide to the future but then mandate that elements of past performance should be extrapolated it into an unknown future. This shows that past performance and future outcomes are mutually inclusive, as it allows an investor to know whether the product made money (or not) in the past and to compare (and choose between) similar products.



How to make the KID fit-for-purpose? Our suggested solution.

Past performance of the PRIIPs and of its benchmark chosen by the product manufacturer (where available) should be included alongside the future performance scenarios (see below). This allows retail investors to compare PRIIPs and provides facts about a product's past gains or losses. It would also reduce the risk of misleading investors as the future performance scenarios are not probability weighted and therefore the "moderate" scenario may be confused with the most probable.

PRIIP KID's performance scenarios with past performance



! Costs are shown only by their impact on return averaged over the recommended holding period of a PRIIP, making comparisons between products impossible and not showing to investors the actual costs

The PRIIP KID is meant to allow retail investors to make an informed investment decision by comparing different types of products. Costs are crucial to understanding its overall functioning. The Regulation [Art. 8(f)] therefore requires the KID to contain "the costs [...] presented by means of summary indicators [...] and [...] total aggregate costs [...] to show the compound effect". The draft RTS meets the second requirement by showing the aggregate compound effect over a number of holding periods.

However, it fails to deliver the first requirement because instead of showing the costs in the form of summary indicators, it shows only the compound effect of each cost component. It will be impossible for clients to see the costs they will actually be charged at each stage as they enter, hold and exit their investment. For example, according to the draft RTS, a 3% entry charge will be shown as approximately 0.62% for a product with a 5-year recommended holding period. An exit charge of up to 2% for the first five years will not even show up at all. In addition, the results are of little to no use to distributers when disclosing the overall costs to retail clients[2].

Example how differently costs are disclosed between a UCITS KIID and a PRIIP KID

Cost item	Actual fund costs	UCITS KIID	PRIIP KID's draft RTS
Entry charge	*3.0%*	**3.00%**	**0.62%**
Exit charge	*2.0% in the 1st year* *1.5% in the 2nd year* *1.0% in the 3rd year* *0.5% in the 4th year* *0.0% 5th year onwards*	**2.00%**	**0.00%**
Transaction costs	0.25% (3 year avg.)	*[excluded from UCITS KIID]*	**0.25%**
Ongoing charges	0.85% per year	**0.85%**	**0.87%**
Performance fee	*0.00% in the last year* *0.15% (5 year avg.)*	**0.00%**	**0.15%**

versus

How to make the KID fit-for-purpose? Our suggested solution.

Detailed (itemised) costs need to be disclosed for all investment scenarios and not just the recommended holding period (please see our example below). This ensures that investors know how different costs impact on their overall return at any given point in time.

Example of PRIIP KID's detailed costs per holding period[3]

		If you cash in after 1 year	If you cash in after 3 years	If you cash in after 5 years
One-off costs	**Entry charge**	**3.06%**	**1.04%**	**0.62%**
	Exit charge	**1.98%**	**0.34%**	**0.00%**
Ongoing costs	**Portfolio transaction costs**	**0.25%**	**0.25%**	**0.25%**
	Other ongoing costs	**0.88%**	**0.86%**	**0.87%**
Incidental Costs	**Performance fee**	**0.15%**	**0.15%**	**0.15%**

[2] Furthermore, these cost figures will be of little use to distributors who are required to produce aggregated cost figures under MiFID II. In this case, distributors need summary indicators of the actual fund costs in order to account for them in the aggregated calculations. If the PRIIP KID fails to deliver cost indicators fulfilling the disclosure requirements at the point of sale, we run the risk of turning it into a legal document without any added value in the distribution process.

[3] The example is based on a 5-year recommended holding period with a 2% per annum performance.

! The calculation of transaction costs is based on improper assumptions and leads to false outcomes that will surely confuse investors

A key element of the PRIIP KID compared to the UCITS KIID is that it will include transaction costs in the overall cost disclosure. The PRIIPs RTS are meant to provide a common methodology for the calculation of those transaction costs. Unfortunately, the current proposal is not workable for two reasons: firstly, the methodology is based on market data that cannot be obtained before MiFID II/R comes into force. Secondly, and more importantly, the proposed method of calculation means that the costs disclosed include not just the actual costs, but also market movements. This is because transaction costs are deemed to include changes in the market price from the moment the decision is made to deal ("the observed market price") and the price at which the transaction actually takes place. This incorporates a spurious accuracy and does not provide useful information by which to hold the manager to account since market fluctuations are outside his/her control. It could also lead in certain circumstances to negative transactions costs (as illustrated in the examples below), which does not reflect reality and would therefore be misleading to investors.

Example of negative costs (i.e. a profit) for a single transaction

A buy order is placed on a liquid share; the observed market price is €100.00; the market goes slightly down and the buy order is executed at €99.50; the brokerage fee (i.e. the cost paid to the broker for executing the transaction) is €0.04.
The transaction cost would be shown as - €0.46 per share (i.e. market movement (-0.50€) + brokerage fee (+0.04€)), according to ESAs' method, while under the current long-standing method reflected in the fund accounting transaction cost should be €0.04 per share.

Outcome: If you buy 100,000 shares the transaction cost under the ESAs' PRIIPs methodology will make the investor believe that he/she has made a profit of €46,000, which is inaccurate and misleading. Actual transaction costs are more likely to be around €4,000.

Example of negative costs (i.e. a profit) for a fund over a whole calendar year

An asset manager simulated the transaction costs according to the ESA's methodology for a popular multi-asset fund. This fund has assets under management of over €400 million. Due to the lack of arrival price data, this simulation is based on the previous closing price of the bonds which can be used instead. Due to the complexity of the analysis, only euro-denominated bonds and stocks have been taken into account in this computation.

	2012	2013	2014	2015
Transaction costs	0.04%	-0.05% *(i.e. profit)*	-0.05% *(i.e. profit)*	-0.01% *(i.e. profit)*

Outcome: The calculations presented to the investor suggest that a fund gained 0.05% in 2013 and 2014 through "negative" trading costs. Only in 2012 the result of the computation gives a "cost" for the investor. Over a three-year period the investor appears to have gained on average 0.04% per year in transaction costs.

How to make the KID fit-for-purpose? Our suggested solution.

The ESAs have already suggested a different (and much simpler) method to estimate transaction costs in the final draft RTS solely for new PRIIPs. This methodology [Annex VI, Part 1, paras 21-23] should be extended to be used for existing and new PRIIPs and should fully replace the erroneous methodology.

This methodology uses 50% of the most recent bid-ask spread. The bid-ask spread is the difference between the sell and the purchase price of an instrument. This methodology has already been used successfully in some Member States.

! Two different disclosure documents will be presented to a retail investor when investing into the same fund through different means

The PRIIP KID's predecessor, the UCITS KIID, is only a few years old. It was the first key information document to be presented to investors. Its basic and successful idea has now been extended to more investment products through the PRIIPs Regulation. As funds already provided this disclosure document, the Regulation decided to exempt these funds (PRIIPs Regulation Articles 32 & 33) from producing a PRIIP KID until 2019. The final draft RTS make it obligatory that insurance-based investment products present the information of the underlying investment options (i.e. funds) in the PRIIPs format, thus making the UCITS KIID's disclosures null and void. This will only add to the investor's confusion, as the very same underlying fund, when purchased directly and not through an insurance wrapper, will present a UCITS KIID with fundamentally different information on the essential elements of a fund, such as risks, costs and performance.

How to make the KID fit-for-purpose? Our suggested solution.

The draft RTS should acknowledge the UCITS KIID's nature as a disclosure document until the review of its exemption until at least 2019, as decided by the European co-legislators. Manufacturers of multi-option products should thus be allowed to present the UCITS KIID as an equivalent disclosure document for its underlying investments and use its inherent data until that time.

! Retail investors are provided with too much prescriptive narrative that inhibits detailed explanation of the actual product

Designing a KID must strike the right balance between providing the right information and standardisation that allows retail investors to compare PRIIP KIDs. For this very reason the co-legislator decided to cap the KID at three A4 pages (which is one page more than the current UCITS KIID).

Unfortunately, the final draft RTS are very prescriptive with the type of standardised information that needs to be included. All in all, there are up to nine A4 pages of narrative that have to be included if applicable. It will be a massive challenge to include all this narrative while still providing information about the actual PRIIPs (investment objective, etc.) in less than 3 pages. Evidence has shown that even for simpler products it will be impossible to include all this information on 3 A4 pages.

Furthermore, in some instances individual narratives by the product manufacturer are capped at 300 characters for the classification of product and 200 characters to describe other risks. This is clearly insufficient, even more so when the text is translated into other European languages that are less concise than English.

How to make the KID fit-for-purpose? Our suggested solution.

Less prescriptive narrative and more flexibility for the product manufacturer is needed to ensure that the 3-page limit is met.

! The quality of the PRIIP KID will suffer massively as not enough time is given to get the rules right first and then implement them properly

It is clear that more work is required on the proposed RTS, yet there are immense timing challenges to successfully implement the KID by the 31 December 2016. Given the potential benefits for investors and the broader EU economy (i.e. encouraging investors to have confidence in channelling their savings to support growth), and the costs to the industry, it is important to get this right the first time around.

We are extremely concerned that, in the best case scenario, the final Regulatory Technical Standards (RTS) – which are essential for the development of the KID – will only be officially published in the third quarter of 2016, leaving only three to four months for product manufacturers and distributors to meet the 31 December 2016 deadline[4]. This timeline is simply unrealistic and will result in many KIDs not being ready on time. Not meeting this deadline will mean that those products cannot be bought by retail investors from 1 January 2017.

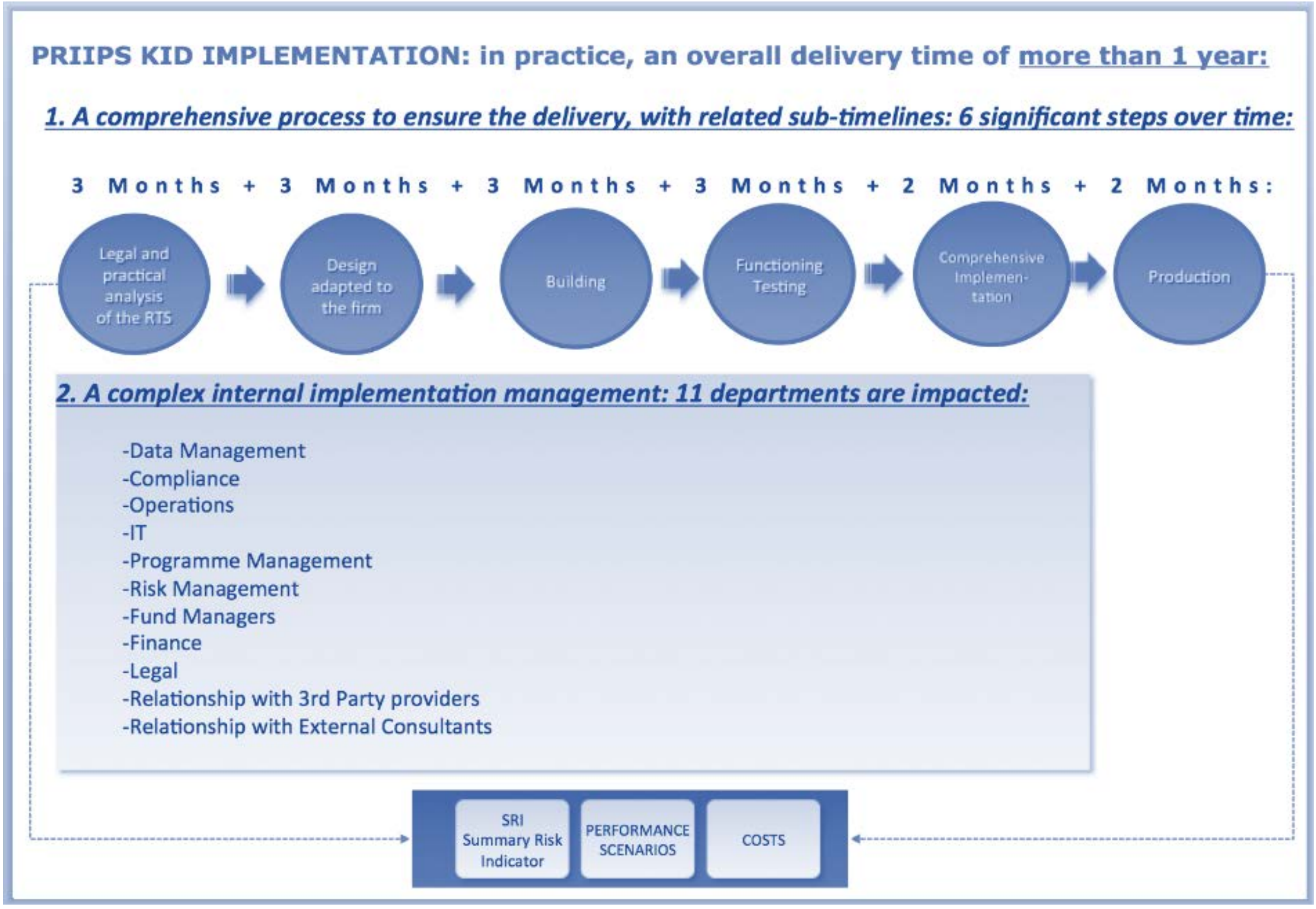
It is important not to underestimate the operational challenges that PRIIPs manufacturers need to overcome in order to provide the PRIIP KID to retail investors. More specifically, the launch of a KID requires the development of all necessary processes to ensure that the data are accurate, to build and test the relevant IT systems, to program and test the KID itself, and to ensure that the actual provision of the new KIDs via distributors is working. All of these steps need to be executed properly, if the ultimate aim is to provide consumers with a useful tool that allows them to better understand and compare PRIIPs.

How to make the KID fit-for-purpose? Our suggested solution.

The application date of the PRIIPs Regulation regarding PRIIP KID should be postponed by at least one calendar year. This will give the European Supervisory Authorities and PRIIPs manufacturers enough time to address these fundamental & unresolved issues and present retail investors with a fit-for-purpose KID.

This additional year will not only provide sufficient time fix the current problems with the RTS, but will also provide the ESAs with sufficient time to develop Level-3 guidelines and/or Level-4 Q&As that are essential to answer still open questions before creating high-quality KIDs for retail investors.

[4] We would also stress that the industry cannot rely on the final draft RTS as proposed by the ESAs, or on the RTS as approved by the European Commission, to start implementing the PRIIP KID, as both the European Parliament and Council can still object to the RTS endorsed by the European Commission.


PRIIPS KID IMPLEMENTATION: in practice, an overall delivery time of more than 1 year:
1. A comprehensive process to ensure the delivery, with related sub-timelines: 6 significant steps over time:
3 Months + 3 Months + 3 Months + 3 Months + 2 Months + 2 Months:
Legal and practical analysis of the RTS
Design adapted to the firm
Building
Functioning Testing
Comprehensive Implementation
Production
2. A complex internal implementation management: 11 departments are impacted:
-Data Management
-Compliance
-Operations
-IT
-Programme Management
-Risk Management
-Fund Managers
-Finance
-Legal
-Relationship with 3rd Party providers
-Relationship with External Consultants
SRI Summary Risk Indicator
PERFORMANCE SCENARIOS
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