



**EFAMA**

European Fund and Asset Management Association

# **EFAMA RESPONSE TO THE ESAS' JOINT CONSULTATION PAPER CONCERNING AMENDMENTS TO THE PRIIPS KID**

**13 January 2020**

## EFAMA response to the ESAs' Joint Consultation Paper concerning amendments to the PRIIPS KID

### Introduction

EFAMA would like to thank the ESAs for their work and continued efforts in putting forward solutions on this targeted and technical Level 2 review of the PRIIPs Regulation.

The review of the Level 2 framework should not only allow for technical changes but address the fundamental issues in the Regulation with regards to performance scenarios, the transaction costs methodologies and the cost disclosures. If they are not addressed within the current Level 2 review, then a Level 1 review becomes absolutely essential. However, such a Level 1 review would have to be concluded and implemented before the end of the UCITS exemption (currently foreseen for the end of 2021) to avoid constantly changing the PRIIP KID – which would be detrimental for retail investors.

Whether Level 1 or 2, the purpose of any review must be to address the inherent conflict stemming from the current PRIIP KID's dual aims to provide clear, fair and not misleading information and to provide comparability between products (of both similar and different types). By focusing too much on providing comparable information between widely different investment products, the information presented to retail investors is, in some cases, irrelevant and, in other cases, even misleading.

Simply put, comparability should not come at the cost of misleading information. It is therefore essential that a review seeks to achieve an optimal balance between these two aims and considers more closely what information is relevant to retail investors for each different type of PRIIP. This move towards more flexibility is fundamental because each type of PRIIP provides a different value proposition and thus necessitates slightly different disclosures on costs and performance. Broad, but not detailed, comparability can still be achieved. A reduction in theoretical comparability will be more than offset by better explaining the fundamentals for each PRIIP and providing investors with more meaningful information while maintaining a degree of standardisation so that retail investors can compare similar PRIIPs.

We also infer from the ESAs' comments that the European Commission has not yet started its review of the Level 1 legislation, as required by Article 33 of the PRIIPs Regulation, which was due to be completed by the end of 2019. This wider review by the Commission was meant to coincide with the ongoing Level 2 discussions to ensure that all issues are addressed in a holistic manner with a well-functioning PRIIP KID "version 2" being the final outcome.

The Commission's inaction, however, creates the risk that the fundamental issues will not be properly and swiftly addressed. We fear this could be the case, as many of the currently proposed solutions remain solely technical in nature, simply masking the inherent flaws while introducing further complexity.

We must also stress our disappointment that the ongoing consumer testing appears to be a "consumer testing" in name only. The fact the current PRIIP KID has not been consumer-tested and used as a baseline for any proposed changes, as well as the narrow focus on performance scenario disclosures without any testing on costs, clearly indicates that the results of this particular testing will not provide any additional insights into investors' understanding.

These concerns weigh heavily on us, as the importance of a revised and well-functioning PRIIP KID cannot be overstated for the European fund industry. First and foremost, it is essential that investors receive clear, fair and not misleading information. Second, the success of the UCITS brand both inside and outside the European Union can, to some extent, be attributed to meaningful disclosures, such as those provided by the UCITS KIID, which is used as a de-facto term sheet for UCITS investors outside

the EU. The upcoming switch to the PRIIP KID (which may still contain misleading disclosures) will require fund managers to reconsider whether other types of information document should be given to potential investors in order to save the UCITS long-standing reputation from harm.

## **Q1: Are there provisions in the PRIIPs Regulation or Delegated Regulation that hinder the use of digital solutions for the KID?**

We support rules that enable digital solutions, in keeping with one of the Commission's top priorities: to encompass the digital age. However, this digital transformation requires more than a "digital" KID as the wider EU distribution framework encompassing MiFID and IDD must all be aligned to provide consistent, meaningful and complimentary disclosures to investors. To do this correctly, one must understand that this requires more profound changes to the current pieces of EU legislations<sup>1</sup> that exceed the scope and intention of the current PRIIPs Regulation, as presenting information digitally will require profound changes and many of the current solutions and compromises will need to be reassessed.

In particular, since the PRIIPs framework is based on the concept of a printed document. Even its title contains the word "document", which highlights the intention of a hard copy document being handed over to investors. Providing digital solutions, however, must mean more than simply presenting an investor with a pdf on a website, instead of a printed document.

Looking at this from the perspective of the current PRIIP KID, it brings forward a large number of questions that need to be answered. For example, how should one deal with the current three-page limit if the information is presented only via interactive digital solutions? How could data be made available, aggregated and stored? How can further details be shown if of particular interest to the investor? How interactive can be the information presented (e.g. should investors be allowed to vary the assumptions and see the results)? Would this assume that all underlying disclosure information is available for free online for these digital solutions to function properly?

Given the increasing use of digital tools by investors and the different ways in which information is provided/read digitally, it is important to address these issues.

In this respect, we draw attention to the EBA's recently issued report on digital solutions in relation to providing documents to clients.<sup>2</sup>

## **Q2: Do you agree that it would be helpful if KIDs were published in a form that would allow for the information to be readily extracted using an IT tool?**

In line with our previous response, we believe that a truly 'digital delivery' should go beyond the KID information being readily extracted using an IT tool in order to provide true benefits to retail investors. In the context of this consultation, it is essential to arrive at meaningful disclosures before considering how to best provide this information.

With that in mind, are the ESAs suggesting that product manufacturers would have to upload machine-readable KIDs (e.g. in CSV format) onto their websites alongside their pdf-KIDs?

While fund managers could consider publishing KIDs in a form that would allow for the information to be readily extracted using an "IT tool" (many fund managers and other financial providers indeed already provide such interfaces), we wonder what the ESAs would consider an "IT tool". Also, such digital disclosures would only be indirectly helpful to retail investors, as they are not its prime targets. We assume that the beneficiaries of such information would more likely be financial intermediaries (including robo-advisers), and potentially NCAs, which could more easily consume and digest the

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<sup>1</sup> In some instances, these requirements may even preclude the use of truly digital solutions.

<sup>2</sup> <https://eba.europa.eu/eba-publishes-opinion-disclosure-consumers-buying-financial-services-through-digital-channels>

available information. An example for this could be the “cost and fees aggregator”, the feasibility of which the European Commission was meant to conduct a market survey on by 31 December 2019 (PRIIPs Regulation Art. 33(4)).

In addition, the creation of (digital) data standards is no trivial task and should be fully thought through by the ESAs. EFAMA is well aware how labour-intensive such a process is, as a data standard for PRIIP KIDs had to be developed to ensure that information in relation to multi-option PRIIPs can be transmitted from fund managers to insurance companies (so the latter can produce their own PRIIP KIDs). These standards are called the EPT and CEPT.<sup>3</sup> Discussions on these standards took many months and the standards require regular updates to accommodate changes to the Level 2 framework or newly published guidelines and Q&As. In order to ensure the long-term viability of these particular digital standards (and many others), a dedicated body called “FinDatEx” was created at the start of the year by a number of European financial associations.<sup>4</sup>

**Q3: Do you think that the amendments proposed in the consultation paper should be implemented for existing PRIIPs as soon as possible before the end of 2021, or only at the beginning of 2022?**

We would favour a revised PRIIP KID to become applicable at the beginning of 2022, as this would coincide with the inclusion of UCITS and retail AIFs that currently produce the UCITS KIID.

From a UCITS investor protection viewpoint, it would also be preferable if amendments were implemented at the beginning of January 2022, as it is important to keep the number of changes for retail investors to a bare minimum.

From an operational perspective, one must also consider that the proposed amendments to the Level 2 Regulation will not be approved before the second half of 2020 (at the earliest). Thus, January 2022 may leave market participants with little more than one year to implement all changes. It is essential that they are given enough time for implementation, which will include, among other things, fundamental changes to the underlying IT infrastructures as well as training of financial advisers. Such operational realities should therefore also be considered by the ESAs and the Commission going forward.

We recognise, though, that retail investors in other types of PRIIPs, including retail AIFs that do not produce the UCITS KIID and MOPs with UCITS as the underlying investments, are currently being presented with misleading information.

Finally, the ESAs must ensure that a revision of the PRIIP KID does not trigger an obligation to provide retail investors with a revised KID for prior investment decisions.

**Q4: Do you think that a graduated approach should be considered, whereby some of the requirements would be applied in a first step, followed by a second step at the beginning of 2022?**

A gradual approach to introducing amendments is not helpful due to the number of issues arising with two different PRIIPs regime being applied by stakeholders. As replied to Q3, our preference is that all changes should be implemented at the beginning of 2022.

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<sup>3</sup> European PRIIPs Template and “Comfort” European PRIIPs template.

<sup>4</sup> More information on FinDatEx can be found here: <https://findatex.eu/>

However, this answer depends on the timely publication of the revised Level 2 framework in the EU Official Journal. Should Delegated Regulation be published later than the first half of 2020, then a sufficiently long implementation period (not less than 18 months) is required to ensure proper implementation of the new rules.

**Q5: Are there material issues that are not addressed in this consultation paper that you think should be part of this review of the PRIIPs Delegated Regulation? If so, please explain the issue and how it should be addressed.**

#### Consistency with the PRIIPs Regulation

Certain proposals made by the ESAs may require targeted amendments of the PRIIPs Regulation to ensure legal clarity and consistency:

- Most importantly, the current length of the PRIIP KID (Art. 6(4)) is being tested in view of the ESAs' final advice on the presentation of past performance in addition to performance scenarios and the new requirements for cost tables. In addition, we also expect further disclosures in relation to the fast progressing sustainable finance framework exacerbating the current situation.
- The manufacturer's obligation to publish PRIIP KIDs on its website (Article 5(1)) should relate to products made publicly available or at least launched for public distribution, but should not affect customised products set up according to the preferences of selected investors.
- The obligation to provide PRIIP KIDs in the context of regular saving plans (Art. 13(4)) should be aligned with the current supervisory practice under the UCITS framework (cf. our reply to Q45 below).

#### Interpretation of "appropriate performance scenarios"

If the ESAs conclude to not recommend changes to Level 1 Regulation, we ask the ESAs to revisit their interpretation as regards the objectives of and suppositions for the "appropriate performance scenarios" under Article 8(3)(d)(iii). The term "performance scenario" has been interpreted as meaning "future performance scenario". The outcome is misleading for the following reasons:

- It is impossible to predict or estimate the future performance of investment products
- All methods proposed to calculate such performance scenarios are based on past performance, and therefore reflect the past performance of the product

The term "performance scenarios" should, therefore, be interpreted as "certain possible outcomes", an interpretation which is supported by the second part of Article 8(3)(d)(iii) which requires "*the assumptions made to produce [performance scenarios]*". This leads us to believe that a more accurate meaning of Article 8(3)(d)(iii) is "Given certain assumptions about the future behaviour of markets and of the product, what are the possible outcomes of your investment?".

For such scenarios to be useful to guide the investor to make an informed investment decision, the set of assumptions made to define the scenarios should be described in a way which is understandable by the retail investor. If such a clarification of the interpretation of Article 8(3)(d)(iii) is not possible with the current wording of the Level 1 legislation, then an amendment should be considered to clarify that future

performance scenarios are not relevant for investment funds and only past performance should be shown.

Please see our response to Q18 for more information.

#### Further technical clarity

On a technical level, further clarity must also be provided with regards to the following:

- MRM update (Delegated Regulation, Annex II, para. 53): The provisions in relation to the MRM “risk bucket” updates are different between the UCITS KIID and the PRIIP KID. In the UCITS KIID, the update has to be carried out when the MRM falls outside its bucket on each weekly or monthly data reference point over the preceding four months. In the PRIIP KID, the update is driven by the majority of evidence of the last four months, regardless of the time pattern of the series. This could lead to a more frequent risk class update for funds that fall in between two MRM class. We believe that RTS should be updated in line with UCITS rules.
- Cost of acquiring or disposing of units in UCITS or AIF (Delegated Regulation, Annex VI, para. 5, lit. l and m): The provisions should exclude the reference of the summary cost indicator to avoid an overestimation of the costs to be presented to investors, in particular in relation to entry and exit fees being shown as their maximum values.

#### **Q6: Do you have comments on the modifications to the presentation of future performance scenarios being considered? Should other factors or changes be considered?**

In general, consumer testing is a cornerstone for “Better Regulation”. Regulatory changes should be based on thorough and in-depth consumer testing processes.

With that in mind, would question how much value this consumer testing exercise will add. The ESAs themselves explain that “within the timeframe of the current review of the PRIIPs Delegated Regulation, it will not be possible to test all aspects of the KID”.<sup>5</sup> A proper full-scale consumer testing exercise by the European Commission would have allowed insight into the functioning of the current PRIIP KID and would have provided important understandings for both this technical review and the more fundamental Level 1 review.

We understand that only (certain) performance scenarios are being consumer tested. Unfortunately, none of the substantial changes to the presentation of costs is subject to any consumer testing.

Even when focusing on the performance scenarios, it is peculiar that only certain options are being tested with some of them (e.g. assigning probabilities to performance scenarios) having been tested previously. They relate only to technical changes to the existing quantitative approaches. The European Commission should be testing other alternatives, such as narratives or what-if scenarios (which are being tested only for structured products) to gain further insights into possible alternatives.

Please also consider our remarks in our response to Q7.

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<sup>5</sup> ESAs consultation paper, page 12

**Q7: If intermediate scenarios are to be included, how should they be calculated for Category 3 PRIIPs (e.g. structured products)? If intermediate scenarios are not shown in the performance section, which performance assumption should be used for the ‘What are the costs?’ section?**

We would like to provide more general comments with regards to the “appropriate performance scenarios” (as required by the Level 1 Regulation) before providing our reply to Q7.

General remarks on future performance scenarios

EFAMA supports the two aims of clear, fair and not misleading information and of comparability between products (of both similar and different types). In practice, though, these two aims can be in conflict, as we have seen with the current iteration of the PRIIP KID. By focusing too much on providing comparable information between widely different investment products, the information presented to retail investors is, in some cases, irrelevant and, in other cases, even misleading. Simply put, comparability should not come at the cost of misleading information.

**Therefore, we believe it is essential to revisit the theoretical concept behind the current methodology and go beyond the technical modifications now proposed by the ESAs.**

Any review should seek to achieve an optimal balance between these two aims and considers more closely what information is relevant to retail investors for each different type of PRIIP. This is fundamental because each type of PRIIP provides a different value proposition and thus necessitates slightly different disclosures on performance.

This view is already present in the current UCITS KIID, which distinguishes between non-structured UCITS that provide only past performance information and structured UCITS that provide ‘what if’ scenarios. Additionally, the current PRIIP KID RTS already provide different methodologies depending on the Category of the PRIIP. **This already existing flexibility needs to be extended further to ensure that relevant performance scenarios for each type of PRIIP are presented to investors.** In particular, different approaches should be used for non-structured funds and structured products.

For non-structured funds, we must again stress that “appropriate performance scenarios” do not necessarily have to be limited to future scenarios as maintained by the ESAs. This is important as we have seen that any type of future projections will always remain educated guesses – no matter how complex the underlying methodology. **With regards to linear funds, we, therefore, believe that showing a range of outcomes based on what has been experienced by investors in addition to past performance disclosure will be more helpful compared for investors.** This approach could provide more meaningful information to retail investors that is not biased or misleading as is currently the case with the existing scenarios. It would also fulfil the Level 1 requirement to provide “performance scenarios, and the assumption made to produce them”. Please find more information in our response to Q18 below.

Deletion of intermediate performance scenarios

We agree with removing the intermediate performance scenarios from the future performance scenarios. However, based on the ongoing Commission’s consumer testing, we can understand that the removal of both the 1-year and intermediate holding period are being considered as well. If this is the case, then we would argue that the recommended holding period (RHP) provides sufficient information to retail investors. In any case, it is imperative that the removal of the 1-year holding period must not affect the disclosure of the 1-year holding period in the cost section to ensure that retail investors are aware of potential costs of an early exit for certain PRIIPs.



With that in mind, the ESAs should clarify that these one-year and intermediate performance scenarios should be removed for all types of PRIIPs and not just Category 3 PRIIPs.

#### Disclosing probabilities in the performance scenarios

As the consultation does not contain a specific question on the new performance scenario example proposed on page 57, we would like to raise our concerns on the suggested addition of a new column entitled “estimated chance the scenario occurs”. We are very concerned that such information will mislead investors.

Most importantly though, these probabilities may again provide investors with unrealistic expectations about the future outcome of their investments. In any case, the KID should clearly state that future scenarios are for illustrative purposes only (since they are based on past performance), so that potential investors have a better understanding of the expected return and risk profile of the PRIIP. **We, therefore, ask that the probabilities be deleted.**

#### Performance assumptions for the cost section

We are confused by the ESAs’ last question in Q7, i.e. “If intermediate scenarios are not shown in the performance section, which performance assumption should be used for the ‘What are the costs?’ section?”. We understand that the ESAs have in mind the ½ RHP when talking about “intermediate scenarios” and not the “moderate performance scenarios”. Confirmation of our reading would be welcome.

#### Scenario and cost presentations for closed-ended fund only at RHP

There may also be a need for a derogation for closed-ended AIFs not traded on secondary markets and that cannot be redeemed before the contractual end date. The investment activity, trading behaviour and cost structures in these funds differ very substantially from a UCITS. These funds are by definition aimed at illiquid investments attracting long-term capital and where the valuation may vary considerably over time, so the impact of costs will vary considerably. The raising of capital, especially when there are retail investors, usually takes some time and the drawn commitment is driven by the target investment; the base of calculation of costs differ over time (usually through total commitment over the investment period and the NAV afterwards).

The information presented in the PRIIP KID should reflect the PRIIP’s lifetime and be based on the business forecast given for these highly individualised funds (e.g. ELTIF, EUVECA, EUSEF, real estate and other private equity or debt funds). This would facilitate retail investors’ understanding of the financial characteristic of these PRIIPs and incentivise long-term investments in line with the CMU objectives. To achieve this, the one-year (and the hopefully to-be-deleted half RHP) disclosures regarding performance scenarios and costs should simply state “not applicable” for these types of funds.

#### **Q8: If a stress scenario is included in the presentation of future performance scenarios, should the methodology be modified? If so, how?**

We are not in favour of including a stress scenario and believe the unfavourable, moderate and favourable scenarios are sufficient.

Its original inclusion stemmed from the current scenarios being considered as providing too positive outcomes. With changes to the underlying methodologies, its inclusion should not be necessary

anymore. Also, its deletion should help to avoid investor confusion between the unfavourable and stress scenario.

In addition, we agree with a short disclaimer (as proposed by the ESAs on page 67, i.e. “There is no minimum guaranteed return. You could lose some or all of your investment”) that the unfavourable scenario does not reflect the worst possible outcome.

### **Q9: Do you agree with how the reference rate is specified? If not, how should it be specified?**

#### General comments on performance scenarios

We are aware of the existing time pressures being levied on the ESAs. However, to ensure proper rule-making, we would have expected the ESAs to have conducted extensive and thorough back-testing of their proposals before presenting them as suggested “solutions”. While EFAMA and its members have, in the very limited time available, undertaken best efforts to test the ESAs’ assumptions and to provide counterproposals, such actions cannot and should not replicate a thorough testing process before decisions are made or presented. Also, the process should allow adequate time for industry testing to take place and for feedback to be fully considered and taken on board.

We welcome that the ESAs are trying to put forward solutions to the currently misleading performance scenario disclosures. However (as stated in our introductory comments to Q7), it is a fact that any type of future projections will always remain educated guesses – no matter how complex the underlying methodologies and each will have its distinct advantages and disadvantages. Therefore, the approach chosen should strike a balance between simplicity and meaningfulness for retail investors (to allow for a better understanding of how each product functions, but not to predict the future).

Our guiding principles can be described as follows:

- The information provided must be meaningful to consumers and the methodology should not produce results that may be misleading.
- Comparability between products should be an aim but should not be more important than providing meaningful information to investors.
- The approach taken should be proportionate and as simple as possible to calculate (without producing misleading results) and be easy to explain to investors.
- Firms that have fewer resources or are less able to incur additional data costs should not be put at a disadvantage by the imposed methodology.
- The benefit of the approach to investors must outweigh the costs incurred to deliver the new methodology, as ultimately costs are borne by the end investor.

#### Severe shortcomings of the dividend yield methodology

With these essential comments in mind, we share the ESAs’ concerns that the current methodology is pro-cyclical in nature. The newly proposed ‘dividend yield methodology’ in essence tries to tackle the issue of pro-cyclicality by smoothing results, thus the scenarios remain more constant over time. This decrease in pro-cyclicality is, unfortunately, achieved by creating a methodology that is much more complex and resource-intensive than the current one.

The proposed methodology has a large number of shortcomings. In short, they are:

- The formula is too complex, which could lead to mistakes
- The necessary data are difficult to extract
- It still presents misleading information to the investor
- It will give rise to significant market data costs
- It requires a look-through analysis of the portfolios, which is overly burdensome in terms of IT tools and cost of data. Ultimately, this cost will be borne by the investors
- It is based on a snapshot of the positions (investments in underlying assets), which is not at all relevant, as the fund's allocation can vary significantly over the RHP.
- It is not applicable to funds investing in other funds, as the composition of the latter is not necessarily known.
- It is not applicable to positions in the currency different from the fund's currency.
- It is not applicable to funds using leverage or derivatives.
- Please allow us to provide further details on some of the points mentioned above.

### Complexity

Broadly speaking, the methodology is way too complex and some of the data inputs are open to interpretation. This will inevitably lead to either unforeseen calculations and/or significant variations in results (even for similar types of funds). The following and telling issues were raised by EFAMA members:

- The reference rate has to be calculated on an **asset-weighted basis**. The consultation paper, however, does not go into detail on the maturity of the sovereign bond being used. This could result in a number of interpretations, such as their maturity being fixed (e.g. using sovereign bonds with a five-year maturity) or it being connected to the PRIIP's recommended holding period.
- In addition, the reference rate is based on the currency and country of the assets. This could cause issues for funds with certain geographical and/or credit exposures, such as funds investing in emerging markets or for funds that use currency hedging strategies. In some cases, the reference rate could consequently be overly optimistic and not reflect the actual sovereign credit risk.
- The requirement for calculating the dividend yield of the equity is very granular: firms are expected to use the average dividend yield **for each country and sector** represented in the fund, weighted by its representation in the fund. A globally diversified fund, with a reasonable spread of shares by sector, would end up requiring a complex calculation on an asset, country and sector weighted basis.

- There is no clarity in the CP on how to determine the country of origin of the asset (i.e. primary listing, country of incorporation, country of headquarters etc) and how the sector of the asset should be determined.
- **Extracting the yield data** weighted by asset and by country is extremely challenging. No firm has been able to provide data that are also weighted by sector for our testing, narrowing the range of funds available for us to test. Also, share buyback data is not readily available in Europe and there is little clarity on the availability of such data.

Given the increased complexity of the methodology, we also see no way to explain meaningfully to retail investors how the disclosed performance scenarios have been derived. Thus, the scenarios simply become figures that investors either misinterpret or may choose to believe in, or not when making their investment decisions.

### Misleading information

The dividend yield methodology can also provide misleading information. Based on some of our members' backtesting, the following, very worrying, examples were identified that warrant further investigation by the ESAs:

- The proposed methodology cannot take account of the change in the composition of a fund's holdings throughout the year, which could have a significant impact on the expected growth rate. Balanced or mixed-asset funds are likely to change their underlying holdings throughout the year but this will not be reflected in the future performance scenarios. It would not be operationally effective to make funds re-calculate scenarios throughout the year. Mixed asset and allocation funds are the most affected by this issue, highlighting the drawbacks of a fund-specific approach.
- Some members' backtesting suggests that the methodology is not viable in fixed income even though it does address pro-cyclicality of the current methodology. We have seen the scenarios fail to capture the range within which actual performance lies 25% of the time when applied to a strategic bond fund and 40% of the time when applied to a Sterling corporate bond index.
- A certain bias towards passively managed funds.

### Significant market data costs

The proposed revision also requires a very substantial amount of additional data points to be collected for each individual sector and country or even at an individual instrument level. This would put an unequal burden on PRIIPs with a large number of underlying investments, such as investment funds. This situation would be further exacerbated by the stringent look-through requirement, which would impact funds (especially funds of funds), as well as unit-linked insurance products.

Most importantly, the ESAs seem to overlook the very real costs attached to collecting even more market data necessary for the underlying calculations. Some of the data needed, such as daily dividend yields<sup>6</sup> (and share buyback), are currently not collected and/or stored by fund managers as part of their daily business activities and regulatory requirements.

Even in cases where they are being collected, the current licence requirements do not allow these data to be used for the purpose of calculating and disclosing performance scenarios. **Thus, the new**

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<sup>6</sup> We are currently aware of only one large data provider that can deliver daily dividend yields.

**requirements will significantly increase fund managers' cost burden as they will face stiff price demands for data that its vendors know must be acquired by law.** This burden will be disproportionately larger for small and medium-sized players and will further accelerate the trend to outsource PRIIP KID production. Such price pressure could even remove them from the market and result in fewer choices being available to investors.

This is a questionable direction of travel, given the huge increase in fees over the past years being paid by fund managers for market data. The back-testing performed by our industry is also seriously questioning whether this arduous look-through will have any demonstrable benefits for retail investors. In the end, any projections are simply educated guesses about future outcomes.

We, therefore, suggest simpler alternatives, which should be considered in detail by the ESAs before moving forward. Please see our responses to Q18-22 for more details.

**Q10: The revised methodology specifies that the risk premium is determined by future expected yields. The methodology further specifies that future expected yields should be determined by the composition of the PRIIP decomposed by asset class, country and sector or rating. Do you agree with this approach? If not, what approach would you favour?**

It is not appropriate to consider an estimator, as proposed in the consultation, to determine the expected yield or risk premia of the asset class or product.

As already explained in our reply to Q9, the proposed requirement for calculating the dividend yield of the equity is very complicated. The proposed methodology expects to use the average dividend yield for each country and sector represented, weighted by its representation. Furthermore, government bonds, corporate bonds and foreign exchange instruments would all be treated in a similar manner as equities.

In reality, such an approach would be especially onerous for fund managers. A globally diversified fund, with a reasonable spread of shares by sector, would end up requiring a complex calculation on an asset, country, currency and sector-weighted basis. Given the complexity of this undertaking, the comparability between different PRIIPs would most likely not be guaranteed, given that the estimators may also differ depending on the data sources being used.

Furthermore, the consultation paper lacks clarity on a number of crucial issues:

- It is not clear how to determine the country of origin of the asset (i.e. primary listing, country of incorporation, country of headquarters, etc.). Through bilateral discussions, we understand that the ESAs are using the primary listing to determine the country of the asset in their own testing. Although the primary listing is often a key determinant of the country of the asset, this may diverge from the approach used by some investment managers and the data vendors.
- There is also no clarity on how the sector of the asset should be determined. Data vendors allocate assets to a sector, but there is no industry standard for assigning a sector.
- In the case of a fund investing in another fund, the methodology assumes that a look-through approach is possible, in which the fund manager knows the underlying funds' daily compositions. This does not reflect reality, as this information is not always available or sometimes prohibitively priced. In any case, this does not reflect the fund exposure (see below).

- There are serious questions in relation to the estimates for real-estate investments as well as private equity or debt.

Furthermore, the methodology does not take into account a fund manager's management style (used to achieve the mandate stated in the fund investment policy) as it assumes a static portfolio composition. Due to this, the following fundamental issues arise:

- An estimator based on the market does not reflect the active management of funds: differences between actively and passively-managed funds are not reflected in the scenarios. In addition, the scenarios are net of costs. Thus, active funds will always present worse performance scenarios than index-tracking funds with similar market exposure<sup>7</sup>.
- Funds with a dynamic investment strategy change their asset allocation over time. Their holdings would be different depending on the point in time used for the calculation. In the same vein, the appraisal of derivatives can also have profound effects on a fund's allocation over time. We wonder how ex-ante information that could consistently change throughout the recommended holding period would be of any value to the investor in choosing the PRIIP.
- In some cases, reference markets cannot always be correctly determined or ascertained in terms of investment policy (market-neutral, long-short strategies, multi-manager funds, funds of hedge funds). Would a risk-free rate be the fall-back solution in such cases? But this would lead to inappropriate or even to misleading information being disclosed to investors.

**The above comments show that a much simpler and streamlined approach is needed. As an even more complex methodology will not be able to predict the future more accurately, a balance must be struck between the overall complexity and the usefulness of the resulting disclosures to retail investors. A solution that drastically reduces the complexity of the current proposal is needed. This approach should not require a look-through to the underlying assets and should not disadvantage fund managers that have fewer resources or are less able to incur additional data costs.**

Please see our response to Q18f for further information.

**Q11: The ESAs are aware that historical dividend rates can be averaged over different time spans or that expected dividend rates can be read from market data providers or obtained from analyst reports. How should the expected dividend rates be determined?**

Given the highly relevant concerns around the access and pricing of market data, we are adamant that (if the dividend yield methodology is prescribed by the ESAs) these rates should be determined and made publicly available by the ESAs. Such standardised rate tables would be essential to lower the very real costs of obtaining such market data from data providers.

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<sup>7</sup> ESMA's recent report on cost and performance agreed that active funds, in general, outperformed passively-managed funds in gross returns. While passively-managed funds achieved better overall net returns, active funds only provided slightly lower net returns (5.8% versus 5.5% at 10-year horizon).

### **Q12: How should share buyback rates be estimated?**

As mentioned previously, we are strongly against the use of share buyback rates, as we do not believe that they are an important predictor of returns alongside dividend yields and are scarcely available in Europe.

We assume that its manifestation in the consultation paper can be attributed to share buybacks having become increasingly common in the US. However, we do not see any academic evidence that would support its relevance to the European equity markets. As we would consider share buybacks to be a less significant predictor of future returns in Europe, we believe that further (academic) work is needed before considering their inclusion.

### **Q13: Do you agree with the approach for money-market funds? Are there other assets which may require a similar specific provision?**

While the approach on money market funds seems plausible, at first glance, it also contains an additional data point and needs to be properly sourced to include in the overall methodology. It also highlights that the ESAs are already aware of cases where the methodology would require further amendments to produce reasonable results. This exacerbates further the already problems described above.

### **Q14: The methodology proposes that the future variance be estimated from the 5-year history of daily returns. Should the volatility implied by option prices be used instead? If so, what estimate should be used if option prices are not available for a particular asset (equities namely)?**

We are against the use of option prices to determine volatility. Options prices are not always available for equities. More importantly, though, this would require all PRIIPs manufacturers to have access to options data, which is not the case. Receiving access to option prices will again represent a significant additional cost.

### **Q15: Do you think compensatory mechanisms for unforeseen methodological faults are needed? If yes, please explain why.**

The ESAs' proposal to include "compensatory mechanisms" highlights that there are fundamental issues in trying to project future outcomes with any sort of accuracy. This essential flaw cannot be masked by making the underlying methodology more and more complicated.

Thus, having to consider additional "compensatory mechanisms for unforeseen methodological faults", such as past performance would make an already complicated methodology even more complex and daunting. The original aim of this exercise (i.e. the disclosure of performance scenarios) was to strike a reasonable balance between retail investors being able to understand potential return outcomes while at the same time not making calculation too resource-intensive and complex. The suggested approach risks becoming more and more academic in nature and losing sight of this important balance.

In summary, the proposed compensatory mechanisms would make it even more difficult to disclose the underlying assumptions of the performance scenarios understandable to retail investors.

**Q16: Do you favour any of the options above? If so, which ones? How would you ensure that the information in the KID remains comparable for all products?**

We have issues with the options suggested by the ESAs. In terms of using past performance data, although we would be in favour of using these instead of future scenarios for funds, would not be relevant for all types of PRIIPs.

Using past performance data will not only make the calculation much more complicated, but the results would also be more difficult to explain to the investor due to the underlying assumptions used (which may differ depending on the “compensatory mechanism” being applied or not). Furthermore, there could be significant confusion, particularly where the best and worst historical figures are calculated over a different time period than that on which the scenarios are based (i.e. 5 years).

Please see our suggested alternatives approaches laid out in our responses to Q18-22.

**Q17: Are there any other compensatory mechanisms that could address unforeseen methodological faults? If yes, please explain the mechanism; explain how it ensures that scenario information in the KID allows investors to compare PRIIPs, and explain how the information for similar products from different manufacturers remains sufficiently consistent.**

As explained in our response to Q15, no additional compensatory mechanism should be considered but rather address the issue that requires the addition of compensatory mechanisms in the first place (probabilistic scenarios).

**Q18: What are your views on the use of a simplified approach such as the one detailed above, instead of the use of probabilistic methodologies with more granular asset-specific requirements?**

Due to the numerous shortcomings of the dividend yield methodology and based on our guiding principle for performance scenarios (see Q9), we are strongly in favour of a **thoroughly simplified approach instead of the probabilistic methodologies currently favoured by the ESAs**. Below we provide specific suggestions on a more simplified approach. These are based on the ESAs’ limited mandate given by the European Commission. If the revised RTS will not address the fundamental issues, we believe that it will be necessary to reopen the Level 1 Regulation to make these necessary clarifications.

*1<sup>st</sup> preference: appropriate scenarios based on historical observations*

We continue to believe that the Level 1 Regulation’s requirement for “appropriate performance scenarios, and the assumptions made to produce them” (Article 8(d)(iii) of the PRIIPs Regulation) have been too narrowly interpreted by the ESAs. The Regulation does not state that the scenarios must be future-looking. Their ultimate purpose is to allow retail investors to better understand how a certain product will function given certain market conditions. **This outcome can be achieved by providing performance scenarios based on historical observations instead of the current future scenarios.**

We understand that this proposal may work only for funds and other products with past performance data. If such scenarios do not provide meaningful results for other types of PRIIPs then, in line with our



previous comments, different – more suitable – performance scenarios must be chosen for these type of PRIIPs.

In detail, such historical observations would show retail investors how a product would have performed over the recommended holding period. The scenarios are based on historical observations of the PRIIP over a period of two times the recommended holding period.

Example scenarios based on historical observations of the last twice RHP] years	If you had invested €10.000 for [RHP] years	Observed results (i.e. over the recommended holding period)	Results observed over a [RHP] years recommended holding period, based on the last [twice RHP] years of the product's life
Favourable	What you might have gotten back after costs after [RHP] years	XX XXX.XX EUR	Best [RHP]-year performance observed over the last [twice RHP] years
	Average yearly return	XX.XX%	
Average	What you might have gotten back after costs after [RHP] years	XX XXX.XX EUR	Average [RHP]-year performance observed over the last [twice RHP] years
	Average yearly return	XX.XX%	
Unfavourable	What you might have gotten back after costs after [RHP] years	XX XXX.XX EUR	Worst [RHP]-year performance observed over the last [twice RHP] years
	Average yearly return	XX.XX%	

Here are some illustrative examples to better explain the above concept.

*Example of an equity fund with a 5-year RHP*

Example scenarios based on historical observations	If you had invested 10.000 EUR	Observed results	Results observed over a 5-year recommended holding period, based on the last 10 years of the product's life
Favourable	What you would have got back after costs at the end of 5 years	20 816.55 EUR	Best 5-year performance observed over the last 10 years
	Average yearly return	15.79%	
Average	What you would have got back after costs at the end of 5 years	15 217.54 EUR	Average 5-year performance observed over the last 10 years
	Average yearly return	8.76%	
Unfavourable	What you would have got back after costs at the end of 5 years	10 746.92 EUR	Worst 5-year performance observed over the last 10 years
	Average yearly return	1.45%	

In terms of methodology, the observations used are derived from all the rolling five-year periods (in rolling monthly terms) observable over a 10-year period, twice the RHP. This method would have the benefit of being more likely understandable to an average retail investor. For funds with no sufficient history, proxies could be used as an example.

*Example of a bond fund with a 3-year RHP*

Example scenarios based on historical observations	If you had invested 10.000 EUR	Observed results	Results observed over a 3-year recommended holding period, based on the last 6 years of the product's life
Favourable	What you would have got back after costs at the end of 3 years	11 929.34 EUR	Best 3-year performance observed over the last 6 years
	Average yearly return	6.06%	
Average	What you would have got back after costs at the end of 3 years	10 525.85 EUR	Average 3-year performance over the last 6 years
	Average yearly return	1.72%	
Unfavourable	What you would have got back after	9 569.10 EUR	Worst 3-year performance over the

	costs at the end of 3 years		last 6 years
	Average yearly return	-1.46%	

*Example of a short-term bond fund with a 1.5-year RHP*

Example scenarios based on historical observations	If you had invested 10. 000 EUR	Observed results	Results observed over a 1.5-year recommended holding period, based on the last 3 years of the product's life
Unfavourable	What you would have got back after costs at the end of 1.5 years	9 766.87 EUR	Worst 1.5-year performance observed over the last 3 years
	Average yearly return	-1.56%	
Average	What you would have got back after costs at the end of 1.5 years	9 862.64 EUR	Average 1.5-year performance observed over the last 3 years
	Average yearly return	-0.92%	
Favourable	What you would have got back after costs at the end of 1.5 years	10 112.36 EUR	Best 1.5-year performance observed over the last 3 years
	Average yearly return	0.75%	

2<sup>nd</sup> preference: future performance scenarios based on standardised rates

If the ESAs discard all the evidence brought forward against future performance scenarios (both for the current methodology as well as for the dividend yield approach) and insist on the use of future performance scenarios, we persist that these **future performance scenarios** should, at the very least, be **based on standardised growth rates**.

These standardised rates, however, would need to have the following features to make them workable for PRIIPs manufacturers:

- They should be provided by a single independent third party (such as the ESAs) free of charge. This will avoid diverging growth rates being put forward by data providers and significantly reduce the costs of this individual data collection by PRIIPs manufacturers. Furthermore, a single European provider will also ensure that there are no divergences between EU Member States. Last but not least, these tables would have to be revised at regular intervals to properly reflect changing market conditions.
- The standardised rates should provide growth rates for the unfavourable, moderate and favourable scenarios and not just the favourable (which is how we interpret the “maximum growth rates”).
- Furthermore, they should contain sufficient granularity with regards to each asset class and sub-class without the need for a look-through. To achieve the right level of granularity these growth tables should contain the same asset classes as the transaction cost tables for new PRIIPs.
- The growth rates should be net of all charges or the performance scenario should be produced before charges (gross of costs). This is necessary as actively-managed funds tend to have higher gross returns but also higher ongoing costs than passively-managed funds (this has been confirmed by ESMA’s latest cost and performance study). This is important as taking the broadly same gross performance and then showing it net of each fund’s costs would create an inherent bias towards actively-managed funds. Such bias should be avoided. It is essential that EU laws not favour a particular management style. We believe that sufficient comparability of costs is still ensured, as investors will have the dedicated cost tables for comparison.

- PRIIPs manufacturers should have no flexibility in applying the standard rates, i.e. they should not be allowed to lower them if they feel this is necessary. This will remove a great deal of complexity from the calculation and increase comparability between similar types of PRIIPs.

#### Further simplified methodologies by EFAMA members

We are mindful that a large number of EFAMA members have spent considerable resources over the last few months back-testing the ESAs' proposals in more detail and providing alternative methodologies (including the extension of the historical period from 5 to 10 years). We would encourage the ESAs to look at their evidence and potential solutions in further detail.

**Q19: Do you consider the use of a single table of growth rates appropriate? If no, how should the methodology be amended?**

Please consider our response to Q18.

**Q20: More generally, do your views about the use of a probabilistic methodology vary depending on the type of product (e.g. structured products vs non-structured products, short-term vs long-term products)? For which type of products do you see more challenges to define a probabilistic methodology and to present the results to investors?**

The ESAs should consider the option of showing different types of performance metrics for different types of products. The UCITS KIID differentiates between 'linear' and 'structured' funds to provide performance information. The same logic should be followed in the PRIIP KID, i.e. different methodologies for structured products, funds, insurance products. Also, different approaches already exist with regards to the underlying methodologies which differ between PRIIPs categories.

**Q21: Do you think these alternative approaches should be further assessed? If yes, what evidence can you provide to support these approaches or aspects of them?**

Please consider our response to Q18 with regards to our proposals for alternative approaches.

**Q22: Are there any other approaches that should be considered? What evidence are you able to provide to support these other approaches?**

Please consider our response to Q18 with regards to our proposals for alternative approaches.

**Q23: Do you think illustrative scenarios should be included in the KID as well as probabilistic scenarios for structured products?**

It is odd that the inclusion of illustrative scenarios (as well as probabilistic scenarios) is considered only for structured products. Furthermore, illustrative scenarios should replace the existing probabilistic scenarios rather than being added to the existing performance disclosures. Providing different types of performance scenarios for the same product will be confusing and likely misleading.

In line with our response to Q20, we urge the ESAs fundamentally to reconsider their approach towards performance scenarios. The current experiences with the PRIIP KID have shown that it is impossible to provide meaningful comparisons between all types of PRIIPs. The ESAs must also consider that different type of performance scenarios are relevant for different types of products. This conclusion forms the basis of the UCITS KIID, in which there are different disclosures for structured and non-structured UCITS.

We, ultimately, see no reason why such an option (to explore the value of 'what if' scenarios being used and replacing probabilistic scenarios) should not be explored for other types of PRIIPs.

**Q24: If not, do you think illustrative scenarios should replace probabilistic scenarios for structured products?**

See our response to Q23.

**Q25: Do you agree with this approach to define PRIIPs which would show illustrative performance scenarios using the existing definition of Category 3 PRIIPs? If not, why not? Where relevant, please explain why this approach would not be appropriate for certain types of Category 3 PRIIPs?**

See our response to Q23.

**Q26: Would you be in favour of including information on past performance in the KID?**

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 performance is, at least, based on actual (i.e. historical) facts and is presented in a standardised way that shows how the fund is run and allows for easy comparisons. It must be noted that consumer representatives are fully aligned with EFAMA on this matter.

Based on these experiences, we agree that past performance should be included in the KID for linear PRIIPs (AIFs, UCITS and unit-linked insurance-based investment products) and for linear investment options (AIFs, UCITS, internal insurance funds).

Its inclusion is of paramount importance as past performance (although not a guarantee for the future) provides investors with comparable objective information about the relative merits of product managers and the capacity of an investment product to meet its objectives and to deliver value for its investors.

Similar to the UCITS KIID, the use of an appropriate benchmark, where relevant, would inform investors how the fund has performed in the past. That being said, prominent warnings about the relevance of past performance must also be included in the PRIIP KID, highlighting that it is not a reliable indicator of future results.

**Q27: Would your answer to the previous question be different if it were possible to amend Article 6(4) of the PRIIPs Regulation?**

Our answer to the previous question would remain unchanged. However, the three-page limit set in Article 6(4) of the PRIIPs Regulation is a very pressing issue, not only in relation to the inclusion of past performance. As the ESAs are suggesting to transpose many of the UCITS KIID-specific disclosures into the PRIIP KID (Section 9 of the consultation paper), the current three-page limit may be an issue for some products.

Furthermore, more space will also be needed for upcoming pre-contractual disclosures mandated in sustainable finance regulation. We recall that the Commission is already required under PRIIPs Regulation Art. 8(4) to develop delegated acts in order to disclose “specific environmental and social objectives”. This work was put on hold due to work on the sustainable finance action plan. Eventually, such disclosures will make their way into the PRIIP KID and thus require further space to be set aside.

Last but not least, as already highlighted in our response to Q1, the use of digital solutions will require changes to the wider European distribution framework and cannot be achieved solely through the PRIIPs Regulation.

**Q28: Do you think that it can be more appropriate to show past performance in the form of an average (as shown in the ESA proposal for consumer testing) for certain types of PRIIPs? If so, for exactly which types of PRIIPs?**

We are firmly against the proposal to disclose past performance in the form of an average as misleading and insist on preserving the existing UCITS KIID methodology. One of the essential benefits of past performance is to showcase a PRIIP’s past volatility in order to highlight the benefit of investing with a long-term horizon.

**Q29: Do you have any comments on the statement that would supplement the display of past performance (e.g. with regard to the presentation of costs which are not included in the net asset value (NAV))?**

An additional narrative will be required to explain the relationship between past performance and future performance scenarios, as described in our answer to Q30.

Otherwise, the presentation of past performance should follow the UCITS guideline, including narrative such as the narratives related to costs:

*“Performance is shown after deduction of ongoing charges. Any entry/exit charges are excluded from the calculation.”*

**Q30: Are you of the opinion that an additional narrative is required to explain the relationship between past performance and future performance scenarios?**

We strongly believe that the display of past performance should replace performance scenarios for funds, keeping in line with the UCITS KIID approach. If both are to be kept, an additional narrative will be required to explain the relationship between past performance and future performance scenarios. In essence, it must be made clear that past performance cannot be used to predict future performance.

However, past performance data could be used to produce “appropriate performance scenarios” (see our response to Q18).

**Q31: Do you see merit in further specifying the cases where the UCITS/AIF should be considered as being managed in reference to a benchmark, taking into account the provisions of the ESMA Questions and Answers on the application of the UCITS Directive?**

First, it is important to note ESMA’s controversial interpretation of the requirements in its March 2019 review of the UCITS Q&As. More specifically, as per the answer to Question 8b thereof, ESMA offers its interpretation of whether a given investment approach “includes or implies a reference to a benchmark” by referring to an open-ended list of examples. According to the answer, it is sufficient for a benchmark index “to play a role in the management of the UCITS” for the management company to have to disclose it in the KIID (including in past performance). Although ESMA’s wording recognises the onus on the management company to determine whether a UCITS is in practice managed according to a benchmark, the subsequent list of non-exhaustive examples provides cases where ESMA believes this to be the case. Among these are disparate possible uses of benchmarks by a UCITS management company, ranging from portfolio construction to the calculation of performance fees, additionally including uses of indicators to set internal risk limits, remunerate individual staff, in contracts with third parties, etc. Few of these uses, however, are material to the actual pursuit and delivery of the UCITS investment objective.

Second, the fact that an index is generically “playing a role” in the management of a UCITS is not sufficient to categorise the management of the fund as benchmark-dependent. There is, therefore, a need in the PRIIP KID context to be more specific on the function a chosen benchmark serves, as some functions may be completely unrelated to the attainment of the investment objectives. Failing this, it would be difficult to see how any UCITS would not be a fund managed with reference to a benchmark and would thereby introduce a bias against actively-managed strategies that do not refer to a benchmark.

Third, in terms of presenting UCITS investors with information that is “fair, clear and not misleading”, we observe that only those benchmarks that are relevant to the implementation of a given investment strategy deserve to be disclosed in the future PRIIP KID’s past performance section, alongside that of the fund. From a strict interpretation of the answer to Question 8b in the current UCITS Q&As, investors would be left attempting to make sense of the performance of multiple indices represented in the relative bar chart, most of which would not be relevant to inform investors on how the UCITS has actually performed.<sup>8</sup> The resulting confusion for investors from bloating the PRIIP KID with needless or non-material information would thus conflict with management companies’ fiduciary obligations when disclosing product performance to a retail investor. Lastly, it would also challenge the logic of a PRIIP KID as a short and user-friendly document.

EFAMA, therefore, believes that the transition from a UCITS KIID to a PRIIP KID will be an ultimate opportunity for ESMA to review its current interpretation of Article 7(1)(d) and related KIID Regulation requirements, in a manner that is consistent with the management company’s fiduciary duty and geared to enhance the quality of information disclosed to investors.

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<sup>8</sup> As an example, one could consider an absolute return UCITS fund, where the portfolio manager selects some 10%-15% of the portfolio using an emerging market equity index. Such “bottom-up” portfolio construction technique allows such index to merely guide a relatively small part of the portfolio’s composition. Consequently, the index’s performance is not sufficiently representative of that of the whole portfolio (which can be diversified across other asset classes, derivatives, cash, etc.) for the index to be disclosed in the “Past Performance” section of the future PRIIP KID. The same considerations would apply to other “internal” uses of indices, not solely related to portfolio construction.

**Q32: Do you see the need to add additional provisions for linear unit-linked insurance-based investment products or linear internal funds?**

No comments.

**Q33: Do you agree that a fixed intermediate time period/exit point should be used instead of the current half the recommended holding period to better facilitate comparability?**

A better understanding by retail investors of costs should be the overarching motivation for any modifications to the cost disclosures. Many of the ESAs' proposals, however, expand on the number of cost points, e.g. Option 3 encompasses 32 (!) cost figures/percentages compared to the current 12 data points. This risks that the modified cost disclosures become incomprehensible for the average investor. It is therefore essential to strive for more simplicity and to focus on the most relevant figures from the investor's point of view.

In the interests of simplicity, we believe that only a one-year and recommended holding period (RHP) should be used in the cost disclosures. The current  $\frac{1}{2}$  RHP should be deleted. This would reduce the amount of information being presented to retail investors by one third without depriving investors of essential new insights.

Furthermore, RHPs vary immensely between different types of PRIIPs, so there is little sense in trying to strive for complete comparability. It is more important to provide meaningful information. Thus, the standardised one-year period is of crucial importance, as it already gives investors a sense of the immediate entry costs and potential early exit costs.

Should the ESAs ignore our suggestions and decide to keep the intermediate time period in the cost tables, (1) a fixed holding period (for example, 5 years) should be used in order to facilitate comparability in line with our arguments above and (2) such intermediate cost disclosures should be applied only to long-term PRIIPs (with a RHP of over 10 years).

**Q34: In this case (of a fixed intermediate time period), do you agree to show costs if the investor would exit after 5 years for all PRIIPs with a recommended holding period of at least 8 years? Or do you prefer a different approach such as:**

Please see our comments to Q33 above.

**Q35: Do you think it would be relevant to either (i) use an annual average cost figure at the recommended holding period, or (ii) to present both an annual average cost figure and a total (accumulated) costs figure?**

It is important not to overload retail investors with too many disclosures. For both one year and the RHP, there should be a total cost figure (in monetary amounts) as well as a RIY-style figure, which showcases the impact on return per year.

Comparability between products with different RHPs will best be ensured by presenting annual average cost figures that should be in any case included in the PRIIPs cost disclosures. Information on total accumulated costs could be added if it does not lead to information overload and is easy to understand.

We prefer displaying total costs as the sum of the individual cost items as suggested for options 2 to 4.

**Q36: Do you think that it would be helpful, in particular for MiFID products, to also include the total costs as a percentage of the investment amount?**

The concept of RIY currently used to disclose product costs to retail investors is too complex and misleading for many PRIIPs. The fact that the costs include a time horizon and a yield assumption represents a new type of theoretical disclosure that clients have not generally been familiar with and one that they will never experience in reality. Its complexity significantly increases the risk that, at best, it is ignored by investors and, at worst, it is misunderstood by investors. This is especially the case for one-off entry costs as they are divided over the product's recommended holding period, thus making the client assume that the impact on the initial investment is much lower than what it actually is.

We, therefore, strongly support the ESAs' intentions to limit the application of RIY to relevant insurance products while improving comparability with MiFID II disclosures. **Due to the vast majority of funds being distributed in a MiFID II environment, it is absolutely crucial that investors receive the same cost disclosures through the PRIIP KID and MiFID ex-ante disclosures at the point of sale.** Hence, it is crucial that the product costs presented in both disclosures match and provide investors with meaningful information (in addition to the specific investment services cost disclosures).

This being said, **the proclaimed MiFID II alignment is not yet realised in the ESAs' proposals.** In particular, options 2 to 4 require that all cost elements be calculated on the basis of the moderate performance scenario, which is generally not relevant for MiFID II disclosures. The impact of the moderate scenario leads to distorted cost figures that are of no use for MiFID II calculations. Only option 1 might potentially achieve consistency with MiFID II for products qualifying as PRIIPs. However, this option implies entirely different calculations for PRIIPs and IBIPs.

Under MiFID II, illustrations of the impact of costs on returns are generally based on the assumption that the annual return each year will cover the relevant costs (meaning that the value of the investment at the end of each year is equal to the initial investment amount). This assumption could also be used instead of the moderate performance scenario for calculating product costs for the PRIIP KIDs. This modification of the calculation approach would be easy to implement and could be evolved on the basis of the current provision in annex VI para. 71 c) of the PRIIPs RTS, which stipulates a standardised performance assumption for funds not yet subject to the PRIIPs Regulation. Specifically, the indication of 3 % should be replaced by the following wording:

(c) ...the performance shall be ***assumed to offset all costs for the relevant period of calculation.***

Moreover, while alignment with MiFID II is particularly relevant for funds, structured products and other PRIIPs qualifying as financial instruments, it might make sense to stipulate such performance assumption for cost calculations by all PRIIPs in order to provide comparability of cost disclosures.

**Q37: In this context, are there PRIIPs for which both performance fees and carried interests are applied?**

We are not aware of PRIIPs applying both performance fees and carried interests.



**Q38: Do you agree with this analysis from the ESAs? If yes, what are your views on the extent to which fees related to the management of the underlying real estate assets, i.e. the properties themselves, should be taken into account in the calculation of the cost indicators?**

We agree with the ESAs' previous assessment with regards to the performance fee narrative that allows a suitable narrative for all types of performance fee models rather than just benchmarking models.

With regards to the cost calculations for real estate funds (and other PRIIPs investing in real assets), we agree that further clarity is necessary. The overall goal of this exercise should be to align the cost calculations MiFID II to ensure consistent ex-ante cost disclosures being provided to investors.

Therefore, we consider it a matter of urgency to provide further clarification with respect to the following two considerations that are essential for ongoing cost calculations for real asset PRIIPs:

*(1) Costs incurred in connection with property holdings (or holdings of other real assets) as underlying investments in a PRIIP*

Funds investing in real assets are currently required to include payments to providers of property management and similar services in the calculation of recurring costs under para. 5(b)(vi) of Annex VI. The apparent logic is that property management forms part of the fund manager's charge but is provided by a third party.

**However, expenses incurred in connection with property holdings (or holdings of other real assets), such as operating costs and maintenance costs, should not be relevant for the purpose of the ongoing cost calculation.**

Non-apportion-able operating costs such as incidental expenses (including payments for water and waste disposal, road cleaning, other cleaning services, energy supply, real estate tax and insurance coverage) and maintenance costs (including maintenance work and inspection performance, renovation and repair measures) are incurred by any person holding real estate or other real assets. They are not specific to the management of investment funds nor related to property management or similar services. To use a similar example, costs incurred in the operations of stock corporations are clearly not to be taken into account when calculating recurring cost figures for PRIIPs investing in equities or having equities as underlying investments. Such operating costs have an impact on the market value of the relevant stocks but are not included in the cost calculations. In order to ensure comparability of cost information to investors, the same approach should apply to funds investing in real assets in order not to discriminate against them through the required cost disclosures.

Should the ESAs ignore our suggestions and retain expenses incurred in connection with property holdings in the ongoing cost calculation, then – at the very least – such costs should not be grouped with management charges but are reported as a separate item in second cost table.

*(2) Recurring interest payments at asset level which are an intrinsic part of a PRIIP's investment strategy should not be viewed as a cost*

Changes need to be made regarding the interpretation of "financing costs related to borrowing" (under para. 5(h) of Annex VI).

Debt financing of real assets serves the purpose of optimising the return on equity with a view to enhancing investors' performance. In relation to real estate or other real assets, interest payments are inherent to any economically viable investment. They are not specific to the management of investment

funds or other PRIIPs, and should not be taken into account in the recurring cost calculation. Moreover, a meaningful cost disclosure should enable investors to determine the costs of managing a specific PRIIP as an extra cost in comparison to direct investments in the relevant assets. If PRIIP management costs were to be mingled together with costs inherent to direct investments e.g. in real estate, investors would not be able to make meaningful comparisons of management cost-efficiency across products. On balance, qualifying regular interest payments on asset financing as costs would undermine the economic purpose of debt financing and be detrimental to the comparability of different investment products for retail clients under a cost perspective.

While clarification of these aspects is crucial in order to align the understanding of costs for real asset PRIIPs and to provide for comparable cost disclosures to investors, such clarification need not necessarily entail amendments to the PRIIPs Delegated Regulation. In our view, it should be sufficient to provide for further guidance in this respect by means of Q&As at Level 3. On a related note, however, it would be helpful to rectify the wording in para. 5(h) of annex VI. In our view, consideration of financing costs should not depend on whether financing has been provided by a related or a third party. Consequently, the addition in brackets should be deleted.

(3) In particular, for costs and charges relating to real estate funds (and other PRIIPs investing in real assets) should be accounted for only once, it should be clarified that the principle of non-double counting of cost (set forth in point 77 of the RTS) applies.

### **Q39: Do you agree with the ESAs' preferred option 3 to revise the cost tables?**

We agree that the cost tables need to be revised. However, all options presented by the ESAs expand the cost presentation with even more data points than are currently present. The ESAs' preferred Option 3 has 32 (!) cost figures/percentages – compared to twelve at the moment. The second table also mixes calculated information (RIY) with information displayed in the prospectus

In the interest of retail investors, the ESAs should aim at reducing the number of specific cost elements being disclosed by focusing on the most relevant figures from their viewpoint.

We make specific suggestions for a simplified solution, which can be found in our response to Q40.

### **Q40: If not, which option do you prefer, and why?**

#### Misleading nature of the RIY presentation

We still believe that the concept of RIY currently used to disclose product costs to retail investors is too complex and misleading for many PRIIPs. We agree with the ESAs' summary in section 8.2.2 of their consultation paper. Also, MiFID II (and IDD) do not require the disclosure of costs in a RIY format, which leads to the unacceptable situation that a PRIIP being sold through advisory channels will lead to two different product cost disclosures being presented to the investors.

The RIY concept could be dropped outright for other alternative disclosure types such as UCITS KIID style disclosures. These would have the core advantage of providing cost figures without assumptions (i.e. return). This data can then be used for other purposes such as online calculators.

If the ESAs, however, **insist to dismiss our strong concerns and keep the RIY indicator, the RIY indicator should be maintained only in Table 1 (not Table 2).**

Changes to Table 1 (due to the misleading nature of “return per year before and after costs”)

However, we strongly argue against the proposed changes to the presentation of table 1 in relation to the impact of costs on the return in percentage terms (i.e. including a reduction in return before and after costs).

First, in trying better to explain the concept of reduction in yield/return, even more information is suggested to be presented to retail investors. We strongly doubt that this additional information (three lines instead of one) will be understood by retail investors.

More importantly though, the concept of disclosing a “return per year before costs” is conceptually and fundamentally flawed. This figure is pure fiction, as it requires PRIIPs manufacturers to re-include all costs into the PRIIP, resulting in a “super gross” figure (i.e. net returns without any costs) that assumes that there are no opportunity costs for investors. This would even include implicit transaction costs. This would clearly mislead retail investors into believing that returns are for free. **The ‘return per year before/after costs’ disclosure, therefore, should be outright deleted and a single line displaying RIY should be maintained.**

In addition, further important changes would need to be made to Table 1:

- As the RIY calculation is based on the moderate scenario returns, the RIY figures are not comparable between products. As argued previously, it is also impossible correctly to determine the future. Therefore, the cost scenarios should not be tied to the moderate performance scenario, but rather assume a net-zero performance (except for guaranteed products, for which the guaranteed return should be used).
- Costs are presented in monetary as well as percentage terms on a total cost basis. The latter will make the crucial alignment with the MiFID ex-ante cost disclosures.

Overall, Table 1 would look as follows:

<b>When you invest [10.000 EUR] / [1.000 EUR per year]</b>	<b>If you exit after 1 year</b>	<b>If you exit after [recommended holding period] years</b>
Total costs over time per year in €	€	€
Total costs over time per year in %	%	%
Reduction in return each year due to costs in %	%	%

Table 2

Overall, Table 2 would look as follows:

Type of costs		Description of costs
<b>One-off costs</b>	<b>Entry costs<sup>9</sup></b>	<b>[X% of the amount invested / premium paid] or [x% of the first Y premiums / investments] is not invested into the [PRIIPs].</b> <i>Where the costs are embedded in the price or premium:</i> <b>These costs are already included in the [price / premium] you pay.</b> <i>[Where distribution costs are not included in the entry costs]</i> <b>The person selling or advising you may charge an additional entry fee up to y% of the amount invested.</b>
	<b>Exit costs</b>	<b>X% of the value of your investment at that time.</b> <i>Where the costs are embedded in the price:</i> These costs will be included in the price you get. <i>Where they apply only for disinvestment prior to the recommended holding period.</i> <b>These costs only apply in case of (explain circumstances or an example in max 100 characters):</b> <b>exit before maturity/termination of the product / exit out of the (monthly/....) liquidity windows.</b> For details, refer to section "How long should I hold it and can I take my money out early?"
<b>Ongoing costs</b>	<b>Management fees and other costs</b>	<b>X% of (value of the investment / other basis) [per year / other time period] [where applicable] (of which % are management fees)</b>
	<b>Transaction costs</b>	<b>X% of (value of the investment per year)</b> This is an estimate of the costs of us buying and selling underlying investments for the product.
<b>Incidental costs</b>	<b>[Performance fees / carried interest / other]</b>	<b>X% of (...describe in max 100 characters). Where applicable [cross-reference to prospectus]</b> <i>[Only include row where applicable]</i>

Here is an example for a fictitious fund:

When you invest [10.000 / 1.000 EUR per year]	If you end after 1 year	If you exit after 5 years
Total costs over time per year in €	204 €	124 €
Total costs over time per year in %	2,04%	1,24%
Reduction in return each year due to costs in %	2,11%	1,29%

Type of costs		Description of costs
<b>One-off costs</b>	<b>Entry costs</b>	<b>1% of the amount is not invested into the fund. The person selling or advising you the product may deduct you <b>additional fees up to 2%</b> of the amount invested.</b>
	<b>Exit costs</b>	<b>0% of the value of your investment at that time. These costs only apply in case if you exit before maturity (5 years).</b>
<b>Ongoing costs</b>	<b>Management fees and other costs</b>	<b>0.55% of the value of the investment per year (of which 0.45% are management fees).</b>
	<b>Transaction costs</b>	<b>0.2% of the value of the investment per year. This is an estimate of the costs of us buying and selling underlying investments for the product.</b>
<b>Incidental costs</b>	<b>Performance fees</b>	<b>20% if the fund outperforms the benchmark and above its previous high watermark. [0,30% in our example]</b>

<sup>9</sup> In order to deliver the most accurate information to the investor, any entry/exit fees that are not known by the manufacturer should only be disclosed in the second cost table. Integrating the maximum entry cost into the total cost figure is not accurate, as it is a common practice for distributors to negotiate a rebate on entry costs. Disclosing the maximum is therefore inexact and misleading. The total and precise entry costs paid are disclosed by the distributor under MIFID and IDD requirements.

In line with the above, we would suggest the following amendments:

- Point 3(a) of Annex VI: "Distribution fee, to the extent that the amount is known to the management company. If the actual amount is not known to the management company, the maximum of the possible known distribution costs for the specific PRIIP shall be shown **in the composition of the costs in the Table 2 (Annex VII).**"
- Point 62 of Annex VI: "For the calculation of the summary cost indicator the costs to be disclosed referred to in point 72 of this Annex shall be the total costs. This shall equal for investment funds the sum of the costs as referred to in points 1 and 2 of this Annex, **to the extent that the actual amount of one-off costs paid by the investor is known to the management company, plus the sum of the costs as referred to in points 4 and 6 of this Annex;**"

Alternative solution combining cost disclosures into a single table

Alternatively, one could also combine Table 1 and Table 2 into a single table. The below suggestion makes the following assumptions:

- Combining the information in the current two cost tables into one cost table.
- Deletion of the figures for the half RHP to reduce the amount of information presented.
- The return used in the RIY (or now called “reduction in return” calculations would be equal to the PRIP’s costs (i.e. using a net return assumption of zero presuming that the investors get back their original investment). Such an assumption would align the cost disclosures in the one-year column with the ex-ante cost disclosures under MiFID II, thus creating a crucial link for retail investors.
- Improving the language around the individual cost elements.

The revised single cost table would look as follows:

Investment [EUR 10 000]				
This table shows the impact on return per year (Please note that we are assuming no performance for the product).				
		If you cash in after [1] year	If you cash in [at the end of the recommended holding period]	What are they?
		€[...]	€[...]	Total costs
		[...] %	[...] %	Reduction in return per year
One-off costs	Entry costs	[...] %	[...] %	The amount that is deducted from the amount you invest. The impact of the costs you pay when entering your investment. The person selling you or advising you the product may charge you <b>additional fees up to a level of x%</b> of the amount invested when entering your investments.
	Exit costs	[...] %	[...] %	The impact of the costs of exiting your investment.
Ongoing costs	Ongoing costs	[...] %	[...] %	The impact of the costs that we take each year for managing your investments.
	Portfolio transaction costs	[...] %	[...] %	The impact of us paying any commission or fee to any intermediary in order to buy or sell underlying investments within the product.
Incidental costs	Performance fees	[...] %	[...] %	The impact of the performance fee. We take these from your investment if [insert a brief explanation of the conditions under which performance fees are charged with a maximum of 100 characters in plain language].
	Carried interest	[...] %	[...] %	The impact of carried interests. We take these when the investment has [performed better than x%]. [A payment of y% of the final return will take place subsequently to the exit of the investment.]

**Q41: In particular, do you think that the proposed changes to the presentation of the impact of costs on the return in percentage terms (i.e. including reduction in return before and after costs) is an improvement on the current presentation?**

As highlighted in our response to Q40, we are strongly against the proposed changes to the presentation of the impact of costs on the return in percentage terms (i.e. including a reduction in return before and after costs).

First, in trying better to explain the concept of reduction in yield/return, ever more information is suggested to be presented to retail investors. We strongly doubt that this additional information (three lines instead of one) will be understood by retail investors.

Second, the concept of disclosing a “return per year before costs” is conceptually and fundamentally flawed. This figure is pure fiction, as it requires PRIIPs manufacturers to re-include all costs into the PRIIP, resulting in a “super gross” figure (i.e. gross returns without any ongoing charges or transaction costs) that assumes that there are no opportunity costs for investors. Gross returns occur after transaction hence there can be no returns gross of transaction costs. A different level of transaction costs would require a different set of transactions that would provide different gross return results. Suggesting that there can be returns gross of all costs, could mislead retail investors into believing that returns are for free. This disclosure, therefore, should be outright deleted.

#### **Q42: Do you have other comments on the proposed changes to the cost tables?**

Please see our answers to Q39-42 above.

#### **Q43: What are your views on the appropriate levels of these thresholds? Please provide a justification for your response.**

We are disappointed to see that there are no specific questions relating to the wide-ranging ESAs' proposals on a new or revised transaction cost methodology. We will use our reply to Q43 to provide our extensive feedback, going beyond the ESAs' question on the appropriate levels of the suggested thresholds, which is only one aspect of the wider methodology. With regards to the question on the level of appropriate thresholds, please see our counterproposal in the detailed revisions below.

Before providing our comments on the proposals, we offer some high-level observations in response to the ESAs' guiding principles in relation to transaction costs (as laid out on page 42f of the consultation paper).

The ESAs state that “implicit transaction costs [...] have a material impact on the investment return”. As a consequence, it must be ensured that they “trade in a way that is in their investors' best interests”. While we can agree with each of these principles in isolation, their combination highlights the ESAs' fundamental misunderstandings about transaction costs (and in particular implicit transaction costs) that have from the outset plagued discussions around the “correct” methodology.

First and foremost, **the principles of acting in the best interest of investors** (which naturally extend to the management of transactions and their inherent costs) **are already enshrined in all EU legislations** that govern PRIIPs product manufacturers, i.e. UCITS Directive, AIFMD, MiFID II and IDD. Not doing so would already be in breach of these requirements. It is therefore rather superfluous that the ESAs try to reinforce this principle through a disclosure methodology for the PRIIP KID.

Second, it is **questionable whether the mere disclosure of implicit transaction costs would help retail investors in their investment decisions** (i.e. the overall aim of the PRIIP KID) and that its disclosure encourages less trading in the investors' best interests. The fund manager is already incentivised to optimise trading in the investors' best interest. The wrong type of disclosure and/or methodology may create cost pressures that incentivise managers not to trade (even when trading might be in investors' best interests). The incentive to minimise unit transaction costs already exists in the existing best execution framework. Overall, the proposals create an incentive to minimise turnover as a means to minimise transaction costs expressed in terms of % of NAV, which could be to the

disadvantage of the investors. It could even have the negative effect that fund managers seek to lower overall transaction costs by not transacting, even if this would be in the overall interest of the investors. **Also, the methodology chosen by the ESAs contradicts MiFID II and IDD, which argue that “market movements” should not be considered a cost.**

On a positive note, we agree with many of the ESAs’ high-level principles (as stated on page 41f of the consultation). We agree with the general approach taken for both OTC transactions and real assets (which includes only explicit costs). We also concur that any chosen methodology should be proportionate (but not just for low turn-over funds).

### **Detailed revisions to Option 2**

With that in mind, we have a **very strong preference for Option 2**, as it successfully corrects many of the current methodology’s errors and provides a more proportionate framework for calculating transaction costs. Nevertheless, Option 2 would benefit from further refinements in a number of areas, such as the general approach taken for OTC transactions, the definition of the derogations, standardised spread tables, etc.

In line with a proportional regulatory approach, the ESAs (or an independent third party) could provide relevant spread table figures free of charge. Such an approach would greatly reduce the costs and resources currently needed to calculate these costs figure while creating a more reliable, proportional and comparable methodology. Furthermore, a single European provider will also ensure that there are no divergences between EU Member States. It is worth noting, that already European authorities are providing the relevant figure for comparison purposes, even in other fields<sup>10</sup>.

EFAMA’s detailed revisions are shown below **in red**.

#### **Transaction costs – General**

7. The information about all costs and charges, including transaction costs incurred by the PRIIP, which are not caused by the occurrence of underlying market risk, shall be calculated and disclosed to the client. Transactions costs shall include explicit charges and where applicable implicit charges.
8. Transaction costs shall be calculated using the methodology described in points 10 to 18 of this Annex for investments in the following instruments:
  - (a) transferable securities as defined by Article 2 of Commission Directive 2007/16/EC (1);
  - (b) other instruments for which there are frequent opportunities to dispose, redeem or otherwise realise at prices that are publicly available to market participants and that are either market prices or prices made available or validated by valuation systems independent of the issuer.
9. Transaction costs shall be calculated using the methodology described in points 22 to 24 of this Annex for investments in other instruments or assets.

#### **Transaction costs for instruments defined under point 8 of this Annex**

##### **I. Explicit transaction costs**

10. Explicit costs include costs and charges incurred by the PRIIP, and paid out of investor’s financial investment in the PRIIP, in order to acquire or dispose of the underlying assets of the PRIIP, such as but not limited to commissions paid to brokers or other intermediaries, stamp duty or market taxes, contract

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<sup>10</sup> For example, please see the guidelines on stress test scenarios under the MMF Regulation (ESM34-49-164). Part. 4.8 Guidelines on the establishment of additional common reference stress test scenarios.

fees and execution fees for OTC derivatives, legal advisers for real estate transactions, ~~clearing fees and booking fees charged by the custodian for other assets~~, where relevant.

*Explanation:* This is not a transaction cost because it is not a cost necessarily incurred as a result of transacting (it is incurred as a consequence of employing a custodian). It is included in ongoing costs as per point 5(a)(iv) of Annex VI of the RTS. If the ESAs wish to maintain the references to explicit transaction costs, then the drafting should match that in point 16.

11. Explicit costs shall be calculated as the sum of costs incurred by the PRIIP over the previous three years, for all individual transactions undertaken by the PRIIP and in the base currency of the PRIIP, averaged over one year. This sum shall be converted into a percentage by dividing by the average net assets of the PRIIP over the same period. *Where the PRIIPs is experiencing large subscriptions or redemptions from investors, the cost ratio could be measured at a higher frequency (months or quarters, for example). In such instances, the transaction cost percentage shall be the sum of the annualised percentages calculated over shorter periods.*

*Explanation:* These are the cases of portfolios that experience a significant variation in net assets (large inflows or withdrawals) over a short period of the year and whose average net assets calculated over a year do not are more representative and in any case more related to the level of costs.

For example, if a portfolio has low net assets for most of the year, then experiences significant inflows at the end of the year, the % of the significant transaction costs generated at the end of the year compared to low average assets will be disproportionate.

If a large variation in the fund's assets leads to manifestly inaccurate and misleading results, one solution may be to perform the calculations over shorter durations, for example by calculating an average of the quarterly or monthly rates. The formula is the following:

$$\frac{\sum_{i=1}^3 \frac{\text{sum of costs incurred during the year } i}{\text{average net assets over the year } i}}{3}$$

or

$$\frac{\sum_{i=1}^{36} \frac{\text{sum of costs incurred during the month } i}{\text{average net assets over the month } i}}{36}$$

*Additional consideration:* It may also be possible to achieve the same outcome as above by simply deleting the last sentence of point 11 ("This sum shall be converted into a percentage by dividing by the average net assets of the PRIIP over the same period.").

### Implicit transaction costs

12. In addition, other charges, which are not explicit costs, impact the overall performance of the PRIIP when acquiring or disposing of underlying assets. These are deemed implicit costs and shall be disclosed by the manufacturer of the PRIIP ~~to demonstrate how transactions are executed on terms that are most favourable to the client.~~

*Explanation:* Best execution is already covered by MiFID/MiFIR.

13. Implicit costs shall be calculated as the sum of such individual charges incurred by the PRIIP over the previous three years for all individual transactions undertaken by the PRIIP. They shall be calculated in the base currency of the PRIIP, and averaged over one year. This average annual sum shall also be converted into a percentage by dividing by the average net assets of the PRIIP over the same three year period. ~~Where these figures are negative, implicit costs shall be deemed to be zero such that the level of transaction costs cannot be less than the amount of explicit costs.~~ *Where the PRIIPs is experiencing large subscriptions or redemptions by investors, the cost ratio could be measured at a higher frequency (months or quarters, for example). In such instances, the transaction cost percentage shall*



*be the sum of the annualised percentages calculated over shorter periods.*

*Explanation: same as above.*

14. Any and all processes developed by the PRIIP manufacturer to manage, mitigate and measure implicit costs shall be fit for purpose and documented in a clear and sufficiently detailed manner. Implicit costs shall be identified by comparing the execution price recorded for a specific transaction with a suitable reference price. The identification of a suitable reference price shall be duly recorded and follow the approaches set out in points 15 to 18 of this Annex in a manner that is consistent with documented internal procedures of the PRIIP manufacturer to manage, mitigate and measure implicit costs, applied consistently across transaction types.

#### *OTC transactions*

15. For OTC transactions, ~~where the manufacturer has obtained executable prices from multiple counterparties or where live executable prices are available, implicit transaction costs shall be measured by reference to such prices. In any such case, the number of units traded shall be multiplied by either the reference price of the instrument subtracted from the execution price for each purchase undertaken by the PRIIP or the execution price subtracted from the reference price of the instrument for each sale undertaken by the PRIIP;~~
  - a. *where a transaction is executed after bid prices and offer prices have been obtained from more than one potential counterparty, the arrival price shall be taken to be:*
    - i. *If the best bid price is below the best offer price, the mid-point between the best bid price and best offer price;*
    - ii. *If the best bid price is higher than the best offer price, the best bid price in the case of a sale or the best offer price in the case of a purchase.*
  - b. *Where a transaction is executed without both bid prices and offer prices having been obtained, the implicit transaction cost shall be calculated according to point 16..*
- ~~16. By way of derogation from point 15 of this Annex, where the manufacturer is able to demonstrate that the transaction data used is statistically meaningful, sufficiently granular and proper governance and controls are in place to ensure that the data is sufficiently representative of the actual trade, implicit transaction costs shall be measured by reference to prices obtained for previous transactions in assets bearing similar characteristics (e.g. duration, maturity, coupon, call / put ability) and liquidity, using transactions previously executed by the manufacturer or a third party or using available indexes. This derogation shall apply in all cases where a manufacturer undertakes fewer than [250] transactions in a three year period for an individual PRIIP, or where the total consideration for all transactions undertaken over 3 years is less than [25%] of the net asset value of the product.~~
16. *By way of derogation from point 15 of this Annex, where the manufacturer is able to demonstrate that the transaction data used is appropriate, sufficiently granular and proper governance and controls are in place to ensure that the data is sufficiently representative of the actual trade, implicit transaction costs shall be measured by reference to prices obtained for previous transactions in assets bearing similar characteristics (e.g. duration, maturity, coupon, call-/put-ability) and liquidity, using transactions previously executed by the manufacturer or a third party or using available indexes, or using spread tables such as defined for the purpose of point 19(b) [New PRIIPS methodology]. This derogation shall apply in all cases where:*
  - i. *Turnover is less than [30%] of the net asset value of the product or*
  - ii. *the total consideration for the transactions benefiting from this derogation is less than [10%] of the total consideration for all transactions undertaken during the calculation period or*
  - iii. *the total transaction costs benefiting from this derogation is less than [2 basis points] of the asset under management or less than [5%] of the product total recurring costs.*

*Explanation:* We understand that this second derogation allows the manager to use data from similar transactions executed by the manufacturer or a third party or using available indexes, etc. without having to demonstrate that the data used is relevant, sufficiently granular and proper governance and controls are in place

to ensure that the data is sufficiently representative of the actual trade. We would welcome the ESAs to confirm this interpretation.

*Transactions negotiated on platforms for listed instruments*

~~17. For transactions negotiated on platforms, implicit transaction costs shall be measured by reference to the price of the instrument at the time the order is transmitted by the portfolio manager or the trader or, if justified by the manufacturer on the basis of the asset type or liquidity or availability of market data, by reference to a relevant intraday price available for the day of the transaction, or by reference to the opening or previous closing price for that security where relevant. In any such case, the number of units traded shall be multiplied by either the reference price of the instrument subtracted from the execution price for each purchase undertaken by the PRIIP or the execution price subtracted from the reference price of the instrument for each sale undertaken by the PRIIP.~~

17. *For listed instrument transaction negotiated on platforms, implicit transaction cost shall be measured:*
- *Either by the reference to the mid-market price of the instrument at the time the order is executed.*
  - *Or if justified by the manufacturer on the basis of the asset type or liquidity or availability of market data, by reference to a relevant intraday mid-price available for the day of the transaction;*
  - *Or by reference to a relevant half spread, such as defined in point 19 [New PRIIPS methodology].*

*In any such case, the number of units traded shall be multiplied by either (1) the reference price of the instrument subtracted from the execution price for each purchase undertaken by the PRIIP or (2) the execution price subtracted from the reference price of the instrument for each sale undertaken by the PRIIP.*

~~18. By way of derogation from point 17, where the manufacturer is able to demonstrate that the transaction data used is statistically meaningful, sufficiently granular and proper governance and controls are in place to ensure that the data is sufficiently representative of the actual trade, implicit transaction costs shall be measured by reference to prices obtained for previous transactions in the same or similar securities presenting similar characteristics (e.g. size, industry) and liquidity, deriving from transactions executed by the manufacturer or a third party or using available indexes. This derogation shall apply in all cases where a manufacturer undertakes fewer than [250] transactions in a three year period for an individual PRIIP, or where the total consideration for all transactions undertaken over 3 years is less than [25%] of the net asset value of the product.~~

18. *By way of derogation from point 17, where the manufacturer is able to demonstrate that the transaction data used is relevant, sufficiently granular and proper governance and controls are in place to ensure that the data is sufficiently representative of the actual trade, implicit transaction costs shall be measured by reference to prices obtained for previous transactions in the same or similar securities presenting similar characteristics (e.g. size) and liquidity, deriving from transactions executed by the manufacturer or a third party or using available indexes, or using spread tables such as defined for the purpose of point 19 b [New PRIIPS methodology]. This derogation shall apply in all cases where:*

- i. Turnover is less than [30%] of the net asset value of the product or*
- ii. the total consideration for the transactions benefiting from this derogation is less than [10%] of the total consideration for all transactions undertaken during the calculation period or*
- iii. the total transaction costs benefiting from this derogation is less than [2 basis points] of the AUM or less than [5%] of the product total recurring costs.*

## Transaction costs for new PRIIPs

19. For PRIIPs that have been operating for less than 3 years, transaction costs shall be estimated according to the following:
  - a. estimating the total costs incurred from the costs calculated under the method described under points 10 to 18 of this Annex for a period representing the highest multiple of one year that the PRIIP has been operating, averaged over one year;
  - b. for a PRIIP that has been operating for less than one year, by estimating the portfolio turnover in each asset class with the costs estimated according to the methodology referred to in points 10 to 14, 16 and 18 of this Annex.
20. Estimates of portfolio turnover for a PRIIP that has been operating for less than one year must be made on a consistent basis with the investment policy disclosed in the offering documents. Estimates of portfolio turnover for a PRIIP that has been operating for more than one year must be consistent with actual portfolio turnover.
21. For PRIIPs that have been operating for less than three years and that invest predominantly in assets other than assets as referred to in point 8 of this Annex, the PRIIP manufacturer shall estimate the transaction costs ~~on the basis of the fair value method using comparable assets by reference to previous transactions in comparable assets, using transactions previously executed by the manufacturer or data issued by an independent third party.~~

## Transaction costs for assets defined under point 9 of this Annex

22. When estimating transaction costs for assets other than assets as referred to in point 8 of this Annex, transaction costs shall be deemed to consist of explicit costs only and shall be calculated as *the annual average of* the aggregate of the costs directly associated with the transaction including all charges, commissions, taxes and other payments (such as anti-dilution levies), where those assets are made from the ~~assets payments~~ of the PRIIP *over the previous three years. In the case of cost depreciation over a period specified in the product's accounting policies, actual costs should be equal to the cost amounts depreciated over the last 3 years.*

*Explanation:* It is essential to clarify the general principles of transaction cost calculation, as they are not laid out in detail in Option 2 (they are now in the section detailing the explicit/implicit costs).

~~Where the asset has been bought or sold at a price that is materially different from its fair value, implicit costs shall be calculated as follows: (execution price — fair value price)\*number of transactions.~~

*Explanation:* Differences to fair value are either losses (e.g. prohibited for German retail funds) or gains for the fund. Conceptually, they are not transaction costs and should not be seen as such.

23. For assets that are not measured at fair value, transaction costs are incremental costs determined in accordance with the product's accounting policies.
24. ~~The transaction cost estimate must not be less than the amount of actual identifiable costs directly associated with the transaction.~~

*Explanation:* This point is no longer required due to the lack of implicit transaction costs.

## Treatment of anti-dilution mechanisms

25. Where a PRIIP has a pricing mechanism that offsets the impact of dilution from transactions in the PRIIP itself, the amount of benefit accruing to the ongoing holders of the PRIIP from anti-dilution mechanisms may be deducted from overall transaction costs *up to an amount equal to the implicit transaction costs*

incurred within the PRIIP using the following methodology:

*Explanation:* Anti-dilution mechanisms must apply to both explicit and implicit transaction costs.

- a. the monetary amount of any anti-dilution levy, or other payment in connection with a transaction in the PRIIP itself;
- b. the benefit to the PRIIP of issuing units (or otherwise enabling investment in the PRIIP) at a price other than the mid-price, or of cancelling units (or otherwise enabling redemption of funds from the PRIIP) at a price other than the mid-price, provided that the PRIIP itself receives the benefit, shall be calculated as follows:
  - (i) the difference between the price of units issued and the mid-price, multiplied by the net number of units issued;
  - (ii) the difference between the price of units cancelled and the mid-price, multiplied by the net number of units cancelled.

### **Detailed revisions to Option 1**

While not being our preferred choice, we understand that the ESAs may wish to pursue Option 1. While it is an improvement over the current methodology, some more essential changes are required to make the methodology workable.

**In essence, the arrival price methodology must be removed completely and replaced by a half-spread approach for equities and OTC transactions.** We understand why the arrival price methodology, in theory, produces both positive and negative trade-per-trade transaction costs and should, theoretically, “average out to approximately zero”. However, EFAMA and its members have extensively proven that in many cases it does not do so.

The ESAs, therefore, contradict themselves by ignoring the negative implicit transaction costs their own methodology produces. Also, the zero-floor for aggregate implicit costs hides the fact that (too high) positive transaction costs can be misleading. In addition, the methodology would apply only to equities but not to OTC instruments, it would create a skew that must be deleted.

EFAMA’s detailed revisions are shown below **in red** below.

### **Calculation of specific types of costs of investments funds**

#### *Transaction costs*

7. Transaction costs shall be calculated on an annualised basis, based on an average of the **aggregate** transaction costs incurred by the PRIIP over the previous three years. Where the PRIIP has been operating for less than three years, transaction costs shall be calculated using the methodology set out in point ~~25~~ 24 of this Annex.
8. The aggregate transaction costs for a PRIIP shall be calculated as the sum of the transaction costs as calculated in accordance with points ~~9 to 29~~ 9 to 23 of this Annex in the base currency of the PRIIP for all individual transactions undertaken by the PRIIP in the specified period. This sum shall be converted into a percentage by dividing by the average net assets of the PRIIP over the same period. **Where the PRIIPs is experiencing large subscriptions or redemptions from investors, the cost ratio could be measured at a higher frequency (months or quarters, for example). In such instances, the transaction cost percentage shall be the sum of the annualised percentages calculated over shorter periods.**

*Explanation:* These are the cases of portfolios that experience a significant variation in net assets (high inflows or outflows, large inflows or withdrawals) over a short period of the year and whose average net assets calculated over a year do not are more representative and in any case more related to the level of costs. For example, if a portfolio has low net assets for most of the year, then

experiences significant inflows at the end of the year, the % of the significant transaction costs generated at the end of the year compared to low average assets will be disproportionate.

If a large variation in the fund's assets leads to manifestly inaccurate and misleading results, one solution may be to perform the calculations over shorter durations, for example by calculating an average of the quarterly or monthly rates. The formula is the following:

$$\frac{\sum_{i=1}^3 \frac{\text{sum of costs incurred during the year } i}{\text{average net assets over the year } i}}{3}$$

or

$$\frac{\sum_{i=1}^{36} \frac{\text{sum of costs incurred during the month } i}{\text{average net assets over the month } i}}{36}$$

*Additional consideration:* It may also be possible to achieve the same outcome as above by simply deleting the last sentence of point 8 (“This sum shall be converted into a percentage by dividing by the average net assets of the PRIIP over the same period.”).

9. ~~Where implicit transaction costs are negative, a minimum of explicit transaction costs shall be disclosed.~~

*Explanation:* The ESAs argue that the arrival price methodology, in theory, produces both positive and negative trade-per-trade transaction costs and should, theoretically, “average out to approximately zero”. It was evidenced that this is not the case. The ESAs, therefore, contradict themselves by ignoring the negative implicit transaction costs their own methodology produces. Also, the zero-floor for aggregate implicit costs hides the fact that (too high) positive transaction costs can be misleading. In addition, the methodology would apply only to equities but not to OTC instruments, it would create a skew that must be deleted.

10. When calculating the transaction costs incurred by the PRIIP over the previous three years, actual transaction costs ~~shall~~ **must** be calculated using the methodology described in points ~~13 to 25~~ ~~12 to 18~~ of this Annex for investments in the following instruments:
- (a) transferable securities as defined by Article 2 of Commission Directive 2007/16/EC<sup>[footnote]</sup>;
  - (b) other instruments that there are frequent opportunities to dispose of, redeem, or otherwise realise at prices that are publicly available to market participants and that are either market prices or prices made available, or validated, by valuation systems independent of the issuer.
11. Estimates of transaction costs using the methodology described below in points ~~24 to 26~~ ~~19 to 20~~ of this Annex ~~shall~~ **must** be used for investments in other instruments or assets.

*Treatment of anti-dilution mechanisms*

12. Where a PRIIP has a pricing mechanism that offsets the impact of dilution from transactions in the PRIIP itself, the amount of benefit accruing to the ongoing holders of the PRIIP from anti-dilution mechanisms may be deducted from the **overall** transaction costs incurred within the PRIIP using the following methodology:
- (a) the monetary amount of any anti-dilution levy, or other payment in connection with a transaction in the PRIIP itself, that is paid to the PRIIP may be subtracted from the total transaction costs
  - (b) the benefit to the PRIIP of issuing units (or otherwise enabling investment in the PRIIP) at a price other than the mid-price, or of cancelling units (or otherwise enabling redemption of funds from the PRIIP) at a price other than the mid-price, provided that the PRIIP itself receives the benefit, shall be calculated as follows and may be subtracted from the total transaction costs:
    - (i) the difference between the price of units issued and the mid-price, multiplied by the net number of units issued;

- (ii) the difference between the price of units cancelled and the mid-price, multiplied by the net number of units cancelled.

*Actual transaction costs*

13. Explicit costs include costs and charges incurred by the PRIIP, and paid out of investor's financial investment in the PRIIP, in order to acquire or dispose of the underlying assets of the PRIIP, such as but not limited to commissions paid to brokers or other intermediaries, stamp duty or market taxes, contract fees and execution fees for OTC derivatives, legal advisers for real estate transactions, ~~clearing fees and booking fees charged by the custodian for other assets~~, where relevant.

*Explanation:* This is not a transaction cost because it is not a cost necessarily incurred as a result of transacting (it is incurred as a consequence of employing a custodian). It is included in ongoing costs as per point 5(a)(iv) of Annex VI of the RTS. If the ESAs wish to maintain the references to explicit transaction costs, then the drafting should match that in point 16.

14. Explicit costs shall be calculated as the sum of costs incurred by the PRIIP over the previous three years, for all individual transactions undertaken by the PRIIP and in the base currency of the PRIIP, averaged over one year. This sum shall be converted into a percentage by dividing by the average net assets of the PRIIP over the same period. **Where the fund is experiencing large subscriptions or redemptions by investors, the cost ratio could be measured at a higher frequency (months or quarters for example). In such instances, the transaction cost percentage shall be the sum of the annualised percentages calculated over shorter periods.**

*Explanation:* This should address the issue of irrelevant transaction cost ratios due to inflows and outflows.

*Additional considerations for points 13 & 14:* Going one step further, both point 13 and 14 could even be deleted, as the definition of explicit transaction costs is only required due to the introduction of the zero-floor for implicit transaction costs.

15. The actual transaction costs for each transaction shall be calculated on the following basis:
- (a) for each purchase undertaken by the PRIIP, the **mid-market** price of the instrument at the time the purchase order is ~~transmitted to another person for execution~~ **executed** (the purchase 'arrival price') shall be subtracted from the net realised execution price of the transaction. The resulting value shall be multiplied by the number of units purchased;
- Explanation:* It is essential to remove the market movement for the cost calculation. This can be achieved by using the mid-market price at the time of execution.
- (b) for each sale undertaken by the PRIIP, the net realised execution price of the transaction shall be subtracted from the **mid-market** price of the instrument at the time the order to sell is ~~transmitted to another person for execution~~ **executed** (the sale 'arrival price'). The resulting value shall be multiplied by the number of units sold.

16. The net realised execution price shall be determined as the price at which the transaction is executed, including all charges, commissions, taxes and other payments (such as anti-dilution levies) associated with the transaction, either directly or indirectly, where those payments are made from the assets of the PRIIP.

17. The arrival price shall be determined as the mid-market price of the investment at the time when the order to transact is ~~executed transmitted to another person. For orders that are transacted on a day that is not the day that the order was originally transmitted to another person, the arrival price shall be determined as the opening price of the investment on the day of the transaction or, where the opening price is not available, the previous closing price. Where a price is not available at the time when the order to transact is transmitted to another person (due to the order initiated outside market opening hours or in over the counter markets where there is no transparency of intra-day prices for example), the arrival price shall be determined as the most recently available price or, where a recent price is not available, as the opening price on the day of the transaction or, where the opening price is not available, the previous closing price. Where an order is executed without being transmitted to another person, the~~

~~arrival price shall be determined as the mid-market price of the investment at the time when the transaction was executed.~~

*Explanation:* Using the mid-price at the time of execution renders obsolete these fallbacks which are required by the slippage methodology.

*For orders executed in several transactions, the transaction costs may be calculated either for each individual execution, or using the volume-weighted average mid-market price of the instrument during the period of execution as the arrival price, or by calculating the transaction cost of the first or last execution, as appropriate given the characteristics of the order and of the instrument and the timeframe of execution of the order.*

*Explanation:* It is necessary to clarify how orders with multiple executions may be handled. By changing the definition of arrival price to the “price at which the order is executed”, there is a risk that it is interpreted as requiring the calculation to be performed for each partial execution of a single order.

Where information about the time when the order *is executed* ~~to transact is transmitted to another person~~ is not available (or not available to a sufficient level of accuracy), or where information about the *mid-market* price at that time is not available, *it is permissible to calculate the transaction cost as described in point 20(b) use as the arrival price the opening price of the investment on the day of the transaction or, where the opening price is not available, the previous closing price.*

*Explanation:* It has been extensively evidenced that these fallbacks create erroneous and misleading implicit transaction costs.

~~When calculating transaction costs using data prior to 31 December 2017, intra-day prices may be considered as not available.~~

*When calculating transaction costs using data prior to [end date of the exemption UCITS exemption], intra-day prices may be considered as not available.*

*Explanation:* This derogation for UCITS and AIF benefitting from the “UCITS exemption” must be maintained until the end of the exemption period (currently 31 December 2021). It cannot be expected from exempted funds to already start collected data necessary for the transaction cost calculation.

18. Costs associated with transactions undertaken by PRIIPs and concerning financial instruments that fall within one of the categories referred to in items 4 to 10 of Section C of Annex I to Directive 2014/65/EU shall be calculated in the following way:

(a) for instruments that are standardised and where there is regular trading in the instrument itself (for example an index future on a major equity index), transaction costs shall be calculated with reference to the instrument itself. The arrival price shall be determined as the mid-price of the instrument;

*Explanation:* For instruments that are standardized and where there is regular trading in the instrument itself, the tick size regime is 1 or below meaning that the concept of mid-price is irrelevant. As a result, all standardised instrument don't have implicit cost versus execution price.

(b) for linear instruments ~~that are customised, and where there is no price transparency or regular trading in the instrument itself, transaction costs shall be calculated with reference to the underlying asset(s). The arrival price shall be calculated based on the price(s) of the underlying assets, using appropriate weightings if there is more than one underlying asset. Where the cost of transacting in the instrument is materially higher than the cost of transacting in the underlying asset, this must be reflected in the transaction cost calculation~~ *or non-linear instruments where the manufacturer has obtained one-way executable price from multiple counterparties ( request for quotes) implicit transaction costs shall be measured by reference to the best bid (in case of a sale) or the best offer( in case of a purchase);*

(c) ~~for non-linear instruments, it is permissible to calculate the transaction costs as the difference between the price paid or received for the instruments and the fair value of the instrument, on the basis described in points 36 to 46 of this Annex. By way of derogation, for non-linear instrument, where the manufacturer is able to demonstrate that the transaction data used is~~

*statistically meaningful, sufficiently granular and proper governance and controls are in place to ensure that the data is sufficiently representative of the actual trade, implicit transaction costs shall be measured by reference to prices obtained for previous transactions in the same or similar securities presenting similar characteristics (e.g. size) and liquidity, deriving from transactions executed by the manufacturer or a third party or using available indexes.*

~~19. In calculating the costs associated with foreign exchange, the arrival price must reflect a reasonable estimate of the consolidated price, and must not simply be the price available from a single counterparty or foreign exchange platform, even if an agreement exists to undertake all foreign exchange transactions with a single counterparty.~~

20. By way of derogation from points 13-19 of this Annex for transactions executed on an over-the-counter basis **or transactions of illiquid listed instruments**, the actual transaction costs shall be calculated in the following way:

(a) Where a transaction is executed after **both** bid prices and offer prices have been obtained from more than one potential counterparty, the arrival price shall be taken to be:

(i) If the best bid price is below the best offer price, the mid-point between the best bid price and best offer price;

(ii) If the best bid price is higher than the best offer price, the best bid price in the case of a sale or the best offer price in the case of a purchase.

(b) Where a transaction is executed without both bid prices and offer prices having been obtained, the transaction cost shall be calculated by multiplying the number of units transacted by half the value of the spread ~~calculated for between the bid price and the offer price of the instrument~~. The value of this spread shall be calculated on the following basis:

(i) Where available, from a composite of live market bid/offer quotes; or

(ii) Where live market quotes are not available by reference, to spreads obtained for either previous transactions in assets bearing similar characteristics (e.g. duration, maturity, coupon, call-/ put-ability) and liquidity, using transactions previously executed by the manufacturer or data **verified provided** by an independent third-party, or from an independent third-party's **valuation of to value** the asset.

21. In calculating the costs associated with orders that are initially entered into an auction, the arrival price shall be calculated as the mid-price immediately prior to the auction.

~~22. By way of derogation from points 13-21 of this Annex, where a product undertakes fewer than [250] transactions in a three year period, or where the total consideration for all transactions undertaken over 3 years is less than [25%] of the net asset value of the product, the manager may calculate transaction costs using the methodology described in point 20.~~

22. *By way of derogation from points 13-19 of this Annex, transaction costs may be calculated using the methodology described in point 20, provided that at least one of the following conditions are met:*

*i. Turnover during the calculation period is less than [30%] or*

*ii. the total consideration for the transactions benefiting from this derogation is less than [10%] of the total consideration for all transactions undertaken during the calculation period or*

*iii. the total transaction costs benefiting from this derogation is less than [2 basis points] of the AUM or less than [5%] of the product total recurring costs.*

~~23. In calculating the costs associated with foreign exchange, the arrival price must reflect a reasonable estimate of the consolidated price, and must not simply be the price available from a single counterparty or foreign exchange platform, even if an agreement exists to undertake all foreign exchange transactions with a single counterparty.~~

*Explanation:* This new paragraph incorrect for a number of reasons: (1) It is not compatible with the current practices, i.e. contracts and systems. (2) The cost of changing the practices, contracts and systems would be disproportionate compared to the resulting differences of a small number of basis points. (3) Such a new device is not necessary for the manager for evaluating the quality of its counterparty. Should the prices not be good enough, the manager will simply



change its counterparty.

#### Transaction costs for other assets

24. In calculating the costs associated with non-financial assets, the **aggregate** transaction costs shall be calculated as the **aggregate sum** of the actual costs directly associated with the transaction including all charges, commissions, taxes and other payments (such as anti-dilution levies), where those **assets payments** are made from the assets of the PRIIP. **In the case of cost depreciation over a period specified in the product's accounting policies, actual costs should be equal to the cost amounts depreciated over the last 3 years.**
25. When estimating transaction costs for assets other than assets as referred to in point ~~10~~<sup>9</sup> of this Annex, the methodology in point ~~14~~<sup>12</sup> of this Annex shall be used and the arrival price shall be calculated as follows:
- a. for a sale:
    - i. the arrival price shall be calculated as the previous independent valuation price of the asset, adjusted for market movements, where appropriate, using an appropriate benchmark index;
    - ii. where a previous independent valuation price is not available, the transaction costs must be estimated based on the difference between the transaction price and an appraisal of the fair value of the asset prior to sale;
  - b. for a purchase:
    - i. the arrival price shall be calculated as the previous independent valuation price of the asset, adjusted for market movements, where appropriate, using an appropriate benchmark index, where such a price is available;
    - ii. where a previous independent valuation price is not available, the transaction costs must be estimated based on the difference between the transaction price and an appraisal of the fair value of the asset prior to purchase.

~~26. — The transaction cost estimate must not be less than the amount of actual identifiable costs, if any, directly associated with the transaction.~~

#### Transaction costs for new PRIIPs

27. For PRIIPs that have been operating for less than 3 years and that invest predominantly in assets as referred to in point ~~9~~<sup>10</sup> of this Annex, transaction costs may be calculated either by multiplying an estimate of portfolio turnover in each asset class with the costs calculated according to the methodology referred to in point (c), or as an average of the actual transaction costs incurred during the period of operation and a standardised estimate on the following basis:
- (a) for the highest multiple of six months that the PRIIP has been operating, transaction costs shall be calculated on the basis described in points ~~12 to 18~~<sup>14 to 23</sup> of this Annex;
  - (b) for the remaining period up to three years, transaction costs shall be estimated by multiplying an estimate of portfolio turnover in each asset class **with the costs calculated** according to the methodology referred to in point (c);
  - (c) the methodology to be used differs depending on the asset class and shall be determined as follows:
    - i. For the asset classes indicated in the table below, **explicit and implicit** transaction costs shall be calculated as the average of the estimated cost of transaction (based on bid-ask spreads divided by two) for the relevant asset class under normal market conditions.  
To estimate the cost, **similar transaction data may be used, or** one or more reference indexes shall be identified for each asset class. Then, the average bid-ask spreads of the **data or of the** underlying indexes shall be collected. ~~The data collected shall refer to the closing bid-ask spread at the tenth business day of each month during the last year.~~

*Explanation:* This should allow observing data on every transaction throughout the month (this is currently the practice used in the “AFG spread table”).

The bid-ask spreads collected shall then be divided by two to obtain the estimated cost of transaction for each point in time. The average of those values is the estimated *implicit* cost of transaction in each asset class under normal market conditions.

***To estimate the explicit transaction costs, an average of explicit transaction costs from the product manufacturer actual transactions may be used.***

Explanation: The current text is too ambiguous on how explicit transaction costs should be calculated.

***These estimates of implicit and explicit transaction costs shall be established using a segment of asset classes relevant for the underlying assets of the PRIIP, i.e. it may be more detailed if the PRIIP invests in specific asset classes, or less detailed for asset classes which will be less frequently traded by the PRIIP.***

Explanation: We try to introduce a proportional approach to the calculation methodology. The asset class segmentation included in the PRIIPs Regulation may not be relevant depending on the product strategy. Different spread tables may be more or less detailed (e.g. the current AFG spread table does not provide details emerging market equities).

Asset	
Government bonds	Government bonds and similar instruments developed market rating AAA-A
	Government bonds and similar instruments developed market different rating below A
Government bonds emerging markets (hard and soft currency)	Government bonds emerging markets (hard and soft currency)
Investment grade corporate bonds	Investment grade corporate bonds
Other corporate bonds	High yield corporate bonds

- ii. For the asset classes indicated in the table below, transaction costs (including explicit costs and implicit costs) shall be estimated either by using comparable information or by adding estimates of explicit costs to estimates of half the bid-ask spread, using the methodology described in point (i).

Asset	
Liquidity	Money market instruments (for the sake of clarity, money markets funds not included)
Shares developed markets	Large-cap shares (developed markets)
	Mid-cap shares (developed markets)
	Small-cap shares (developed markets)

Shares emerging markets (all caps or where possible may be split into large, mid and small caps)	Large-cap shares (emerging markets)
	Mid-cap shares (emerging markets)
	Small-cap shares (emerging markets)
Listed derivatives	Listed derivatives

iii. For the asset classes indicated in the table below, the transaction cost is the average of the observed cost of transaction (based on bid-ask spreads divided by two) in this asset class under normal market conditions.

When identifying the observed cost of transaction, results of a panel survey *or a relevant set of historical transactions* may be taken into account.

Asset	
OTC	OTC Exotic options
	OTC Plain vanilla options
	OTC IRS, CDS and similar
	OTC Swaps and similar instruments (different from IRS, CDS and similar)
	OTC FX Forwards developed markets
	OTC FX Forwards emerging markets

28. Estimates of portfolio turnover for a PRIIP that has been operating for less than one year must be made on a consistent basis with the investment policy disclosed in the offering documents. Estimates of portfolio turnover for a PRIIP that has been operating for more than one year must be consistent with actual portfolio turnover.
29. For PRIIPs that have been operating for less than three years and that invest predominantly in assets other than assets as referred to in point 9-10 of this Annex, the PRIIP manufacturer shall estimate the transaction costs on the basis of the fair value method using comparable assets.

**Q44: If UCITS would fall in the scope of the PRIIPs Regulation, do you agree that the coexistence of the UCITS KII (provided to professional investors under the UCITS Directive) and the PRIIPs KID (provided to retail investors under the PRIIPs Regulation) would be a negative outcome in terms of overall clarity and understandability of the EU disclosure requirements? Are you of the view that the co-legislators should therefore reconsider the need for professional investors to receive a UCITS KII, as the coexistence of a PRIIPs KID together with a UCITS KII (even if not targeted to the same types of investors) would indeed be confusing, given the differences in the way information on costs, risks and performance are presented in the documents? Alternatively, are you of the view that professional investors under the UCITS Directive should receive a PRIIPs KID (if UCITS would fall in the scope of the PRIIPs Regulation)?**

In essence, EFAMA fundamentally disagrees with continuing to provide a UCITS KIID to professional investors.

First, the KIID is not a useful document for professional investors, as it was not designed with professional but rather retail investors in mind. Furthermore, professional investors are often in need of, and more than capable of digesting more complex information. Much more targeted information is made

available to them as part of their due diligence, ongoing business relationship and/or at their individual request. We are therefore confident that the abolition of the UCITS KIID will not create any problems for professional investors.

Second, in cases where professional share classes are also open to retail investors, a situation would again arise where, for the same fund, there are two different key information documents. This will cause significant confusion for investors and will, operationally, unnecessarily costly and in some cases unfeasible to implement for firms. We understand that the underlying reason for this consultation was to avoid providing diverging information to investors. The ESAs proposal would perpetuate this scenario.

Third, the production of both a PRIIP KID and a UCITS KIID will require the expenditure of additional and unwarranted resources by the fund industry to produce a document of little or no use for professional investors.

Fourth, the UCITS KIID is not considered to fulfil all the MiFID cost disclosures and distributors must exchange with the fund manager to receive the missing information (e.g. performance fees and transaction costs). Not phasing out the UCITS KIID would, therefore, require a revision to the UCITS KIID to bring it in line with the current legal disclosure requirements set forth by MiFID II.

Last but not least, if the UCITS KIID is not fully phased out, the ESAs' assessment to delete Article 12-14 of the Delegated Regulation regarding multi-option PRIIPs (MOPs) would become null and void as certain products would still produce only UCITS data, which would then have to be accepted by MOP producers.

**We, therefore, insist that the UCITS Directive is amended accordingly and the UCITS KIID Regulation repealed in order to have only one Key Information Document for retail investors from 01 January 2022.**

#### **Q45: What are your views on the issue mentioned above for regular savings plans and the potential ways to address this issue?**

We very much welcome the fact that the ESAs envisage re-examining the treatment of saving plans under Article 13(4) of the PRIIPs Regulation. This is essential as a savings plan enjoys great popularity among retail investors in a number of EU member states.

In essence, we suggest an alignment with the current arrangements for savings plans for UCITS. This means that where an investor concludes a saving plan contract, the KIID is provided to aid his/her investment decision. Afterwards, all subsequent subscriptions are processed automatically and the (re)provision of the UCITS KIID is not required, unless a change is made to the subscription arrangements – for example, due to an increase or decrease in the subscription amount, which would require a new subscription form. This understanding is derived from the ESMA UCITS Q&A.

Moreover, since the PRIIPs Regulation requires product manufacturers to publish PRIIP KIDs on their websites, investors in saving plans will always have access to the latest available version of the KID. Investors can generally either download an up-to-date version of the UCITS KIID via their distributor's online service or from the manufacturer's website, or they can contact their distributors direct. This procedure takes sufficient account of investor protection without unduly overburdening the administration of saving accounts.

**For these reasons, we strongly support the amendment of Art. 13 (4) of the PRIIPS Regulation in accordance with the current market practice under the UCITS Q&As.**

With that in mind, we also seek confirmation that a modified KID needs to be made available again only when there has been a significant change in line with Art. 10 of the PRIIPs Regulation and Art. 15 (2) of PRIIPs RTS.

Last but not least, a number of national regulators require product manufacturers to inform each fund investor of specific changes in the fund and allow him or her to consequently exit the fund with no costs ramifications<sup>11</sup>. In the case of the revision of the PRIID KIDs (based on the amended RTS), it should be made clear that investors do not benefit from such special exit privileges in case there have been no changes to the underlying fund.

**Q46: Do you agree that these requirements from Article 4 should be extended to all types of PRIIPs, or would you consider that it should be restricted to Management Company of UCITS or AIFs?**

Before responding to your question, we make a more general comment on the UCITS KIID to PRIIP KID transition. This exercise cannot be merely a copy/paste from UCITS into PRIIPs but should rather look closely at what disclosures make sense in the new PRIIPs framework. More disclosures do not necessarily enhance retail investors' understanding. Furthermore, these changes will also form the basis of a large number of changes to the current UCITS Directive to abolish the UCITS KIID.

With that in mind, we agree that these requirements should be extended to all types of PRIIPs. That being said, we ask the ESAs to consider the following technical comments:

- *Paragraph 4* is already included in the PRIIPs regime.
- *Paragraph 6*: This is already done in practice as nothing prohibits the inclusion of logos and corporate branding in a PRIIP KID. Nothing in the PRIIPs regime prohibits the mentioning of the corporate group, even though this could, for clarification purposes, be included in an ESMA Q&A. We would not propose to include this in the Level 2 (or Level 1) Regulation, given that this might be misunderstood as an incentive to overstate the reputational benefits of the wider group. It should be permitted, but not encouraged, as each product should be seen as a stand-alone decision based on its risks and rewards, rather than it belonging to a known name.
- *Paragraph 12*: The disclosure related to the NCA of the PRIIPs manufacturer is already disclosed in accordance with Art 1(d) of the PRIIPs Delegated Regulation. The additional information in relation to the Fund's NCA should be permitted, but not required. This would cause an un-level playing field for the many AIFs that are unregulated. At most, the NCA of the Management Company or AIFM could be permitted in the "Type" description by an ESMA Q&A. Moreover, in many cases, both the manufacturer and product are regulated by the same Competent Authorities. For the sake of clarity and simplicity, whenever they are the same, a single mention should be sufficient.

**Q47: Do you agree that this requirement should be extended to all types of PRIIPs, or would you consider that it should be restricted to Management Company of UCITS or AIF?**

Yes, we agree that these requirements should be extended to all types of PRIIPs, but are mostly relevant for UCITS managed by a Management Company and AIFs.

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<sup>11</sup> E.g. in France, AMF instruction 2011-19 and 2011-20

However, the amendments of the Q&A should be made following an in-depth analysis of the compatibility of the PRIIPs and the UCITS regimes. Amending the Q&A without having assessed this in more detail will cause significant confusion within the market, especially if these elements are transposed into the PRIIPs regime simply because they used to apply to UCITS. It might be worth considering the creation of a distinct category for UCITS within the PRIIPs framework (as UCITS will usually fall into Category 2, but there are also liquid AIFs which should not be receiving the same treatment as a UCITS). It would then be easier to distinguish the treatment of UCITS within the PRIIPs Regulation, without impacting the treatment of other AIF PRIIPs.

**Q48: Do you agree that these requirements should be extended to all types of PRIIPs, or would you consider that they should be restricted to the Management Company of the UCITS or AIF?**

In line with our previous response, we highlight the need for an in-depth assessment and a potential separate category for UCITS. This is essential as the UCITS framework cannot be transposed into PRIIPs without thorough adjustments.

In the light of the above comments, the ESAs should look in particular at the following issues arising from the UCITS KIID transposition:

- Article 7 (specific contents of the description): This requirement should be extended to all PRIIPs.
- Article 9 (principles governing the identification, explanation and presentation of risks): This requirement should be extended to all PRIIPs. The narrative for risk description in the PRIIP KID should not be restricted in terms of length.
- Article 15 to 19 (Past performance): See our response to Q26-31.
- Article 20 and 21 (Practical information and cross-references): Generally, our preference is to keep the current PRIIPs rules as regards practical information. If the UCITS provisions will be applied to PRIIP UCITS and PRIIP AIFs, this requirement should be extended to all PRIIPs.

In any case, we do not believe that the content of the current Article 20 (“practical information”) should be included in the “What is this product?” section meant to reflect key information about the investment objectives and strategies of a PRIIP. In the UCITS KIID, practical information is shown at the bottom of page 2 which is where an ordinary reader expects to find references to further information. In the PRIIP KID, this part corresponds to the “other relevant information” section that will already include a link to the website where further information is available (Art. 8 (2) of the PRIIPs RTS). If considered necessary even in view of the three-page limit constraining the PRIIP KID, practical information under Art. 20 should be integrated into this section.

**Q49: Do you have any comments on the proposed approaches in relation to the analysis and proposals in this Section, and in particular on the extent to which some of the abovementioned requirements should be extended to other types of PRIIPs?**

In line with our previous response, we highlight the need for an in-depth assessment and a potential separate category for UCITS funds. This is essential as the UCITS framework cannot be transposed into PRIIPs without thorough adjustments. These include, for example:

- PRIIP KIDs do not need to mention dividend income being distributed or reinvested. This should be mandatory, at least for UCITS. However, it should be required to explain that capitalisation shares do not necessarily mean less return for the investor, as this might give rise to a negative perception when comparing AIFs, where it is common to have capitalisation shares and thereby no dividend, and UCITS which often do pay dividends.
- Having to name specific strategies, such as growth, value or high dividends, is not currently required in a PRIIP KID. Would requiring this risk mislead investors and what would be the criteria for determining the strategy in AIFs (given it is not so clear-set)? For retail investors, however, it should be mentioned for the sake of comparability.
- The UCITS KIID requires an explanation of the asset management techniques such as hedging, arbitrage etc. This is not needed in a PRIIP KID and if such terms need to be explained for all PRIIPs (including AIFs), the three-page limit will become increasingly unrealistic.
- Should the PRIIPs regime take inspiration from Article 14 of the UCITS Regulation where fewer figures are included through the use of cross-reference?

**Q50: Do you think this proposal would be an improvement on the current approach?**

We are doubtful whether the proposal would be an improvement over the current approach for a number of reasons.

First, the ESAs' proposal to provide investors with information on, at least, the four most commonly selected MOPs options would be information overload and might not be well understood by investors, for a number of reasons:

- The ESAs have also attempted to provide more transparency on costs by including a split of costs by asset class. This would result in overwhelming investors with a huge number of different figures (up to 84) and would create the erroneous impression that there is a link between asset class and costs, which we do not believe to be the case. It is also possible for MOPs to include assets from only one of two asset classes. In this case, the use of ranges within an asset class is no improvement on the current PRIIPs presentation.
- The presentation of four options will likely be seen as the recommended options, although this may not be the case.
- Not all options are offered by all distributors, so the consumer may be presented with different options to those recommended. The only way to avoid this is to make different KIDs for different distribution channels. Producing this volume of documents is impracticable given the doubtful added value.

- There has been no consumer testing on these new proposals. Without this, it is impossible to know whether they are an improvement on the current PRIIPs presentation.

Second, it would contradict the Level 1 requirement to provide standardised information in a short and concise manner due to a number of unclear assumptions:

- The assumptions used to identify the most commonly selected options are not clear, nor is it clear how to adapt to changes in consumer preferences over time.
- It not clear how the most commonly selected options would also reflect the diversity of investment objectives or risks exposure of a MOP.
- It is not clear how to present a MOP where more than four options are commonly chosen. We assume that more than four would need to be presented but this presents legal uncertainty, as the discretion of which options to choose and how many lies entirely with the manufacturer.
- All this uncertainty means that manufacturers of MOPs will have to engage in constant market monitoring and updating of the KIDs to ensure continued compliance. This sort of monitoring is not prescribed by the PRIIPs Regulation (or IDD).

Third, the proposal would be both burdensome and complex to implement – especially for open architecture MOPs.

In addition, the ESAs make the link to the IDD product oversight and governance requirements, as all options included in the product should be suitable for the target market under IDD, which would make all options presented the ‘most preferred’.

**Q51: Do you envisage significant practical challenges to apply this approach, for example for products which allow the investor to choose between a wide range or large number of options?**

Please see our response to Q50.

**Q52: Do you see any risks or issues arising from this approach in relation to consumer understanding, for instance whether the consumer will understand that other combinations of investment options are also possible?**

Please see our response to Q50.

**Q53: Do you think this proposal would be an improvement on the current approach?**

Please see our response to Q50.

**Q54: Are there other approaches or revisions to the requirements for MOPs that should be considered?**

Please see our response to Q50.



**Q55: Do you have any comments on the preliminary assessment of costs and benefits?**

There is a high risk that if the flaws of the PRIIPs Regulation are not adequately addressed prior to the implementation of the amended Level 2 Regulation, PRIIP KIDs will not serve their purpose of providing investors with the information they need to make an informed decision. Instead, investors will be overwhelmed by information which may, in the worst case, not be applicable and/or helpful.

The cost and benefit within the industry to become compliant, which may involve a number of stages of amendments, is not sensible. We strongly recommend taking further time and consultation with the industry to ensure that the changes made are adequate for the expansion of the PRIIPs regime to UCITS. If necessary, an additional deadline to the extension, rather than implementing unsuitable changes, should be considered.

We would also favour a grandfathering period, which would permit firms to review and amend their PRIIP KIDs as part of their annual review, rather than having to be compliant with the amended Level 2 Regulation by a fixed date. This would significantly reduce the cost and effort within the market, and the number of documents foisted on investors.

**Q56: Are you able to provide information on the implementation costs of the proposed changes, in particular regarding, (1) the proposed revised methodology for performance scenarios (using a reference rate and asset specific risk premia), and (2) the overall changes to the KID template?**

It is not easy to assess implementation costs for the performance and cost methodology changes. We do not currently believe that the suggested change to the performance methodology provides a reasonable improvement considering the additional costs and uncertainty.

**Q57: Are there significant benefits or costs you are aware of that have not been addressed?**

No comments.

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