Frankfurt am Main,
6 December 2018

BVI's response to the Joint Consultation Paper concerning amendments to the PRIIPs KID from 8 November 2018 (JC 2018 60)

The first year of experience with the PRIIPs regime has demonstrated obvious deficiencies in the information provided in the PRIIPs KIDs. Therefore, BVI[1] welcomes the first attempt undertaken by the ESAs in the joint consultation paper to analyse the current shortcomings and to discuss possible solutions in order to prevent serious investors' detriment and to ensure meaningful product information in relation to PRIIPs.

We understand that the political context in relation to the PRIIPs regime and specifically its application to retail investment funds benefiting from the temporary exemption under Article 32 was not easy to assess. Obviously the joint consultation paper has been prepared with one political option in mind, namely preparation of the entry into force of the PRIIPs framework for UCITS and other retail funds from the beginning of 2020. However, in the meantime the Committee for Economic and Monetary Affairs in the EU Parliament (ECON) has voted in favour of prolonging the temporary exemption from scope for retail funds by two years until end 2021. The vote took place on 3 December 2018 in the context of the EU initiative for facilitating cross-border fund distribution and has been prepared by extensive compromise negotiations between the EP rapporteurs and the Commission. According to our understanding, the Council has also been involved and is willing to support the extension of the fund exemption in the forthcoming trialogue. At the same time, the timeframe for the Commission to review the PRIIPs framework and submit a report to the co-legislators accompanied by appropriate legislative proposals shall be extended only by one year until end 2019. The ECON stresses explicitly that "*without prejudice to this 24 months prolongation period, all involved institutions and supervisory authorities should endeavour to act as fast as possible to facilitate the termination of the transitional exemption of management companies as defined in Article 2(1)(b) of Directive 2009/65/EC, investment companies as referred to in Article 27 thereof and persons advising on, or selling, units of UCITS as referred to in Article 1(2) thereof from the obligations under Regulation (EU) No 1286/2014"*[2]. This means that the preparatory work on the PRIIPs review has to start with immediate effect.

Against this political background, we see no value in taking rushed and unconsidered decisions about targeted changes to the Level 2 requirements in the coming months, especially since the application of the PRIIPs regime to funds being the primary reason for this "Level 2 quick fix" will very likely be postponed. For other PRIIPs, such regulatory changes would necessitate a wave of adaptations to the shortly introduced PRIIPs KIDs with the PRIIPs review following suit with potentially more substantial changes in the near term.

The ESAs themselves admit at several places in the consultation paper that a proper assessment of benefits and drawbacks of certain approaches in general, or in relation to certain PRIIPs, was not

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's over 100 members manage assets of more than 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

[2] Recital 7c of the EU Regulation on facilitating cross-border distribution of collective investment undertakings (ECON version from 3 December 2019).

possible within the short timeframe available for preparing the consultation. They also concede that it will not be feasible to conduct consumer testing on the proposed amendments. Moreover, we understand that the ESAs will have no more than one week time after expiry of the consultation period for analysing the input provided by stakeholders and preparing technical recommendations for adapting the PRIIPs RTS. Given such enormous time pressure, it is very unlikely that the consultation process will generate effective solutions.

This concern is further aggravated by the fact that many of the persisting problems with the PRIIPs information are not even mentioned in the joint consultation paper. This applies in the first place to the problems with calculating transaction costs according to the "arrival price" methodology which systematically produces erroneous figures, including negative or excessively high transaction costs. After having provided ample evidence on the systematic flaws of the transaction cost calculations and the erroneous investor information resulting thereof, we urge the Commission and the ESAs to eventually seize the opportunity for rectifying the current problems. An extensive description of the issues and suggestions for regulatory remedies are provided in the annex to our reply.

With all that in mind, we strongly advocate to abstain from regulatory interventions into the PRIIPs framework which would be limited to Level 2 in the short term. Instead, the results of the ESAs' consultation at hand should be considered a first preparatory step towards a comprehensive review of the PRIIPs regime. The PRIIPs review to come in the near future should be based on a holistic approach and in particular, should (1) take stock of the practical functioning of the PRIIPs KIDs with due regard to the concerns brought forward by stakeholders and (2) be not limited to the technical provisions at Level 2, but also encompass problems identified with regard to Level 1 rules.

Our subsequent responses to the questions for consultation should be seen in this context and are not meant to endorse hasty regulatory solutions. We would like to reiterate once again that the ESAs and the Commission should adhere to the process foreseen in Articles 32 and 33 of the PRIIPs Regulation which shall be reinforced by the co-legislators in the near future.

ANSWERS TO QUESTIONS

***Q1.** Do you agree that information on past performance should be included in the KID where it is available?*

BVI, together with EFAMA, has always argued in favour of including past performance in the KID as the only reliable performance-related information for investment funds. Therefore, we welcome in principle the willingness on part of the Commission and the ESAs to consider inclusion of past performance information in the PRIIPs KID.

Nonetheless, since the ESAs envisage presentation of past performance only in addition to future performance scenarios, we fear that inclusion of past performance might not work as a corrective factor for investor information. On the contrary, since performance scenarios are already based on the price development of the previous five years, a complementary information on past performance might basically duplicate and further endorse the simulated performance prospects, thereby hindering that investors receive balanced information. To put it another way: since the future performance scenarios for most products are broadly positive due to the overall excellent market development in the last five years, investors will not be further impressed by the information on past performance. Considering the market upturn persisting since now 10 years, inclusion of past performance which is an objective and non-questionable information in itself in addition to performance scenarios must not be expected to change the general perception by retail investors.

For PRIIPs with performance directly linked to their underlying assets, such as non-structured UCITS and AIFs ("linear products")[3], future performance scenarios impede the PRIIP KID's objective of describing investment products in a fair, clear and not misleading way, as such scenarios will necessarily incorporate a certain market view, which could be seen by many retail investors as a firm promise of return. The disclosure of past performance is well-tested for UCITS. It clearly is not a guarantee for the future, but gives an indication of how the fund has operated in the past vis-à-vis a relevant benchmark. It is factually correct and cannot be gamed because it is presented in a standardised way.

Therefore, we maintain that future performance scenarios are not suitable for linear products, especially when such scenarios are derived from past performance data. Presentation of past performance data in the UCITS KIID needs to be supplemented by a prominent warning about the limited relevance of past performance highlighting that it is not a reliable indicator of future results. For this reason, we insist on our long-standing demand (which is shared by investor representatives) that past performance should be the only performance indicator for linear products in line with the current UCITS KIID framework.

A switch to past performance as a stand-alone approach to performance information could be allowed for linear PRIIPs on the basis of the current Level 1 text. Article 8(3)(d)(iii) PRIIPs Regulation refers to disclosure of "appropriate performance scenarios" which does not necessarily imply future scenarios. Rather, the reference to "appropriate scenarios" gives discretion to the ESAs to develop adequate concepts for different categories of PRIIPs. However, should the Commission and the ESAs feel unable to exploit this opportunity, we would suggest amendments to the Level 1 Regulation explicitly allowing for the sole presentation of past performance for linear products in the PRIIP KID which should be presented a part of the PRIIPs review.

[3] We acknowledge that structured products, such as structured UCITS and in line with the UCITS KIID requirements, foresee performance scenarios that can provide beneficial information about the developments of such product in different market scenarios.

Moreover, we see substantial practical problems with introduction of past performance into the current KID framework in addition to the performance scenarios. If – as is being suggested by the ESAs – the past performance disclosures follow the current UCITS KIID rules, then we can expect the past performance disclosure to take up approximately ½ A4 page. This is confirmed by the ESAs' own consultation in which the example on page 17 takes up half a page. Given the already dense information being provided and, more importantly, the Level 1 requirement to limit the PRIIP KID to three A4 pages[4], we do not see how this information can be included without seriously impeding the overall legibility of the PRIIP KID.

Q2. *Are there challenges to include past performance information for certain types of PRIIPs?*

It must be noted that structured UCITS are currently not required to include the past performance section in the UCITS KIID, but present performance scenarios which illustrate the functioning of the formula under different market conditions[5].

In view of the difficulties and challenges with a common approach to performance-related information which might fit all types of PRIIPs, we believe there is a case for a thorough discussion and reconsideration of this issue. Broadly speaking, we could envisage a differentiation of performance presentation for PRIIPs with different return profiles (linear vs. non-linear) based on the UCITS model described above. However, this would need to be accompanied by a general debate about whether in certain instances reliability of information is more important than full comparability for all types of PRIIPs. In any case, we would expect the issue of comprehensible and appropriate performance information to be one of the priorities for the forthcoming PRIIPs review.

Q3. *Do you agree that it is appropriate for this information on past performance to be based on the approach currently used in the KII? If not, please explain your reasons and if an alternative presentation would be more appropriate and for which types of PRIIPs?*

As explained in our reply to Q1 above, we strongly believe that inclusion of past performance should not be subject to rushed decisions, but be embedded in a broader reconsideration of PRIIPs concepts as part of the forthcoming legislative review.

However, if information on past performance is to be included in the PRIIPs KID, we agree that it is appropriate to align its presentation with the standards applicable to the UCITS KIID. This way of presentation is widely accepted and has been in use for more than seven years now, allowing retail investors to get accustomed with the nature of the disclosure and to understand its content. Furthermore, we understand that presentation according to UCITS standards is also supported by investor representative organisations who, in particular, underline the value of its standardised nature and the use of an appropriate benchmark to allow (potential) investors to compare a fund's past performance with its peers as well as the relevant market.

[4] Article 6(4) of the PRIIPs Regulation.
[5] Cf. Article 36 of the UCITS KIID Regulation.

***Q4:** Do you think that information on simulated past performance should be included in the KID where actual past performance is not available? If not, please explain your reasons.*
***Q5:** If you think that information on simulated past performance should be included in the KID, what approach do you think should be used to simulate the past performance, and how should this be presented in the KID?*

In our opinion, there are instances in which the use of simulated past performance could make sense in terms of appropriate investor information. Such instances comprise in particular new share classes being launched in a fund with longer performance history or new sub-funds with portfolio composition similar to that of existing sub-funds. The conditions for the use of simulated past performance in these circumstances are already laid out in Article 19 of the UCITS KIID Regulation. We would assume that these principles could be applied to all types of PRIIPs in similar circumstances. However, it is important that the detailed rules accommodate the very different types of PRIIPs in a robust but flexible way.

Whether or not simulated past performance is an appropriate measure for all PRIIPs for which actual past performance is not available, is however a much more complex question which should be carefully assessed after analysing market evidence, arguments brought forward by stakeholders and the results of consumer testing. For this reason, we believe that this issue should be dealt with as part of the comprehensive review of the PRIIPs framework. In any case, simulated past performance information for PRIIPs must be in line with Article 44 of MiFID II Delegated Regulation which lays down the conditions for “fair, clear and not misleading information requirements” in a MiFID distribution context. The general principle of “fair, clear and not misleading” information applies also to insurance-based PRIIPs under IDD (Article 17).

***Q6:** Do you consider these amendments to the narrative explanations to be an improvement on the current performance scenario approach?*

While considering the proposed amendments to be a clear step in the right direction, they will not mitigate the far more profound issue of presenting misleading performance scenarios to investors. Such issues cannot be solved by tweaking the “small print”. This being said, we see the need for further adaptations of the explanatory text as follows:

- The key message in bold should be adapted as follows in order to send a clear message to investors about the relevance of the simulated performance scenarios and the basis for such simulations:

  “Market developments in the future cannot be ~~accurately~~ predicted. These scenarios are only an exemplary indication of the range of possible returns based on past performance data.”

- The new text suggested to replace elements A to D should allow for more flexibility in adapting it to different types of PRIIPs and various distribution models. In particular, the clause “and does not take into account the situation where we are not able to pay you” is not relevant for traditional investment funds which are assigned CRM 1 in accordance with the conditions of para. 46 of Annex II to the PRIIPs RTS and therefore should be marked as an optional information. The same applies to the phrase in the following sentence indicating that the performance figures in any case include the costs of the advisor or distributor. This can certainly be only true for commission payments from the product to distributors or advisors. The

PRIIPs KID cannot however account for and disclose any distribution fees charged directly from investors, e.g. in case of independent advice or other fee-based advice models, nor can it anticipate charges for holding a securities account with a custodial bank. In Germany, independent financial advisors are prohibited by law to receive commissions from third parties, even in case they are immediately passed over to investors. Therefore, an indication in the PRIIPs KID that product charges automatically include costs of advice or distribution might prevent the use of PRIIPs for independent financial advice.

As a result, the following text elements should be put in square brackets:
"This table indicates how your investment could perform over the next 5 years in different market circumstances, assuming that you invest 10.000 EUR. These are estimates based on relevant data from the previous 5 years **[, and does not take into account the situation where we are not able to pay you]**. The figures shown include all the costs of the product itself **[and include the costs of your advisor or distributor]**. The figures do not take into account your personal tax situation, which may also affect how much you get back."

Q7: *Do you have any comments on the analysis set out in this Section of other possible options to improve the future performance scenarios?*

As stressed above, we do not generally believe that future performance scenarios are generally the right approach to providing performance-related information for linear PRIIPs. We are also not convinced that a wider discussion on the overall methodology for performance scenarios should be included in a consultation on "targeted amendments" and dealt with in such a short timeframe.

That being said, and provided that performance scenarios will be retained in future, we see some value in the possibility to extend the historical period used to measure performance. Even though it should not be expected to provide an effective remedy to the overly positive performance scenarios in the current circumstances due to the long-lasting market upturn, generally we would assume that a longer historical period should reduce the impact of excessive market developments on simulated performance. However, since many products do not have a historical performance of 10 years, we could envisage a conditional extension of the reference period. Products with a relevant performance history exceeding 5 years could base their calculation on such longer period up to 10 years, whereas for other products, 5 years of performance data should remain the relevant standard. Eventually, however, an extension of the historical period will not solve the actual problem of projecting past performance into the future. Even figures with longer observation periods are a reflection of the past/current economic cycle and can therefore lead to reinforcing these trends well into the next economic cycle.

The other option to base performance scenarios for all PRIIPs on the risk neutral performance expectation disregards the risk premium of particular assets and other product-specific performance features and is therefore not a viable way forward in our view. While we understand that there are potentially other ways that disclosures can be calculated, any of these new methodologies and their outcomes must be rigorously tested and thoroughly assessed. In particular, they must be consumer tested to ensure that the information provided is of benefit to retail investors and does not have the serious potential to mislead investors, as is the case for the current performance scenarios.

Again, such a discussion should take place as part of the wider Level 1 review of the PRIIPs Regulation and cannot be thoroughly undertaken in a rushed and limited process foreseen in the current consultation.

Q8: Do you have any views on how the presentation of the performance scenarios could otherwise be improved?

There might be some value in presenting performance information to retail investors in the form of a graph instead of tables. There are even further advantages of switching to a graphical presentation which may allow (in the future) to combine both past performance data and future performance scenarios (if still considered of value) in the same graph. Any such changes should be however thoroughly considered and consumer-tested.

As regards the example for graphical presentation in section 6.1.3 (page 39) of the consultation paper, however, we disagree with showing the range of possible returns between the favourable and the stressed scenario. The stressed scenario is being calculated according to a different formula and based on different assumptions than the other scenarios. The range of possible outcomes should be thus delineated by the favourable and unfavourable scenarios with the stress scenario shown as a separate graph in order to highlight its specific nature.

Q9: *Do you agree with the proposals described in this section?*

We have the following comments on the proposals in section 4.2 of the consultation paper:

- **Market risk measure (MRM) calculation for regular investment or premium PRIIPs:** We agree with the ESAs' assessment that the current MRM formula for category 2 PRIIPs cannot be applied for regular payments. Since this problem pertains in particular to insurance-based products offering a range of investment options in funds, the industry was already forced to deal with this problem and has developed two alternative solutions which are both considered as equivalent in the Comfort European PRIIPs Template (CEPT) which is the industry standard for the provision of PRIIPs-relevant information on underlying investment options. These options are described in the CEPT as follows:

  One of the options in the following closed list to be used: LS - Lump sum, RP - Regular premium

  Method1:
  Apply Cornish Fisher methodology for every regular premium as if it was a single premium with a respective remaining holding period (e.g. if the RHP=10, then the second premium of 1000 EUR will have holding period of 9 years). Calculate the sum at RHP which represents the Cornish Fisher distribution of the flow of regular premiums. Calculate the internal interest rate that stems from the pay-out at the RHP

  Method 2:
  For category 2: Between t and t+1: Choose a random number alpha in [0, 1]. Calculate a 1y yield distribution value that corresponds to the quantile alpha between t and t+1 applying the Cornish Fisher methodology. Add the next regular premium, repeat the procedure between t+1 and t+2.
  Using this methodology 10000 paths and the corresponding percentiles are generated. The risk class is determined by calculating

$$V_T^{(2.5)} = \sum_{t=1}^{T} 1000 \cdot e^{r \cdot (T-t+1)}$$

where V^(2.5)_T is the PRIIP pay-out according to the 2.5% quantile of the distribution of the pay-out at the recommended holding period. The VEV is then calculated as:

$$VEV = \frac{\sqrt{3.842 - 2 \cdot T \cdot r} - 1.96}{\sqrt{T}}$$

The performance scenarios are determined according to Annex VI (12) and (13) RTS.

For category 3: Calculate V^(2.5)_T and VEV as above for determining the risk class.

According to our understanding, both methods produce broadly comparable results and are in any case representative for performance prospects based on regular payments. However, most fund providers use method 1 since it is based on the Cornish Fisher methodology foreseen for MRM calculations of category 2 PRIIPs. For this reason, and in order not to interfere with recently established market practices, we urge the ESAs to accept method 1 as equivalent and to allow for both calculation options in terms of category 2 PRIIPs.

- **Narratives for the Summary Risk Indicator:** While we welcome the ESAs' proposal to extend the length of the additional explanations to 300 characters as a first step, we deem it more appropriate to allow for more flexibility as regards the length of all text elements. In our view, the PRIIPs manufacturer should be able to decide which features of a product are more or less important for key investor information and thus, should be able to adapt the length of the text elements accordingly. Specifically, the additional text describing the risks not included in the SRI should be further expanded to a maximum of 600 characters and also the possible length of other text elements should be doubled. The overall limitation to maximum 3 A4-sized pages will in any case enforce the principle of clear and concise information.

- **Narrative for Performance Fees – composition of costs table:** We strongly support the proposed amendment to the narrative which will allow to provide accurate explanations for all different performance fee models implemented by investment funds. Even though a limitation to 100 characters should be feasible in this respect, we would advocate for more flexibility and for a more generous limit – e.g. 200 characters – in line with our comments above.

- **Growth assumption for the RIY calculation:** We disagree with the suggestion to base RIY calculation on a standard growth assumption of 3% for all PRIIPs. The very purpose of the RIY calculations is to make the impact of costs on performance palpable to investors. Since under the current PRIIPs framework all products are required to simulate future performance, the most probable results of such simulations should be used as the basis for illustration of the impact of costs. The proposed switch to a standardised performance assumption of 3% only further demonstrates the lack of trust on the part of the ESAs as regards the relevance of performance scenarios for proper investor information. The solution to this problem can only be an in-depth open discussion on the general concept of performance information in the forthcoming PRIIPs review. In case, however, that linear products will not be required anymore to produce performance scenarios, we would see value in relying on a standardised growth rate. In such instances, a general growth assumption of 3% could be reasonable.

Q10: *Do you have any comments on the proposed approaches in relation to the analysis and proposals in this section?*

When reading section 4.3 of the joint consultation paper, it is not at all clear what the ESAs have in mind when suggesting adaptations to the PRIIPs framework in order to incorporate certain parts of the UCITS KIID Regulation. In general, the current PRIIPs regime does not make any distinctions in regulatory standards based on the product wrapper (except for the cost which needs to account for different cost structures common in certain product types). However, it seems that now the ESAs are considering to include certain new paragraphs specifically for UCITS, while contemplating further adaptations for all PRIIPs based on the UCITS KIID standards. Such "all PRIIPs" seem to include, in view of the ESAs, in particular retail AIFs. However, it is not clear why KID disclosure standards for UCITS should be at all different from that applicable to retail AIFs since both fund wrappers can use the same legal structures and offer broadly similar investment propositions to investors.

Overall, on the basis of the consultation paper we are not able to identify the specific provision from the UCITS KIID Regulation which the ESAs propose to implement in the PRIIPs context in the short term and to distinguish such provisions from those requiring further consideration. In any case, however, the sheer number of articles identified by the ESAs as relevant once again showcases that the shift from the UCITS KIID to the PRIIP KID is not a trivial exercise. Given the ESAs' very high-level and preliminary analysis, we expect that the proposed additions to the PRIIPs delegated acts will not be "targeted" but rather large in size. Moreover, the industry will not be able to see and comment on any of the detailed "UCITS additions" to the PRIIPs framework until they are sent to the co-legislators for approval early next year. In these circumstances, we are not convinced that the howsoever envisaged adaptations of the PRIIPs framework can be coherent and provide added value to investors. On the contrary, the approaches discussed by the ESAs only once again highlight the need for a proper and well-staged regulatory process to be followed as part of the comprehensive PRIIPs review.

This need is even more exemplified by the ESAs' comments on page 30: "*According to the UCITS Directive (Article 78), the UCITS KII currently needs to be provided not only to retail, but also to professional investors. Given that the PRIIPs Regulation applies to products made available to retail investors, the ESAs have worked under the assumption that should UCITS be required to provide a PRIIPs KID to retail investors the UCITS KII may still be provided to professional investors. However, this is also subject to any decision by the co-legislators on the exemption in Article 32 of the PRIIPs Regulation*."

It cannot be stressed enough that the legal requirement under the UCITS Directive to produce a KIID for each managed UCITS and to provide it before investing regardless of whether the specific fund is meant to be distributed to retail investors has ever since be a source of red tape and annoyance for both fund providers and investors. It is very clear to anyone with insights into client relationships that professional investors have no interest in the concise product factsheet which is the KIID. The PRIIPs Regulation takes these circumstances into account by making the duty to produce a key information document (PRIIPs KID) conditional upon the product being made available to retail investors. Furthermore, the obligation to provide the PRIIPs KID applies only in case of advice or sale services to retail investors.

Hence, it is entirely inconceivable that the ESAs and the Commission might even contemplate maintaining UCITS KIIDs for the purpose of informing professional investors. The duty arising in this respect under the UCITS regime is only a by-product of the general all-encompassing approach under the UCITS Directive which does not differentiate between different investor types, but always applies the highest protection standards designed for retail investors. Maintaining UCITS KIIDs for professional investors would not only result in the supply of inappropriate information, but also duplicate administrative efforts for producing, updating and publishing KI(I)Ds. Potentially, two different KI(I)Ds with inconsistent information would need to be produced for one and the same fund and published on the manufacturer's website which will only create confusion. The additional costs associated therewith will ultimately be borne by all investors in a fund.

Therefore it is in our view out of the question to maintain UCITS KIIDs as an information documents solely for professional investors. Since the UCITS KIID has never aimed at informing potential professional investors which are in no need of protection in this regard, its general abolition will not create a regulatory gap. Nonetheless, should the ESAs and the Commission perceive the need to provide professional investors with key information on a product, then this should take place in line with the general standards for key information of retail investors, be it the UCITS KIID or the PRIIPs KID. Duplicative and inconsistent information documents on the same product should be avoided in any event. We must once again caution, however, that a regulatory requirement to submit a KID to professional investors in the course of the distribution process will only create additional costs and red tape without any added value for investor information.

Q11: *Do you have any comments on the preliminary assessment of costs of benefits?*
Q12: *Are you able to provide information on the costs of including information on past performance for different types of PRIIPs?*
Q13: *Are there significant benefits or costs you are aware of that have not been addressed?*

As stated on many occasions above, we maintain that there is no value in implementing rushed and not well considered changes to the PRIIPs framework on the half-way to the PRIIPs review. A staggered approach to rectifying the PRIIPs KID would result in two consecutive implementation projects. The relevant IT solutions would need to be reprogrammed twice, potentially leading to two extraordinary occasions on which the PRIIPs KID would need to be updated. We also believe that "churning" the contents of the PRIIPs KID once or even several times will certainly not contribute to enhancing investors' confidence in the KID itself and investment products in general. In any case, changes to the KIDs following both the "Level 2 quick fix" and the subsequent PRIIPs review would need to be properly communicated to distributors and investors which would also duplicate costs and efforts.

These arguments should be carefully reconsidered in light of the recent ECON vote in favour of extending the fund exemption under Article 32 of the PRIIPs Regulation by another two years and the expected support for this initiative in the Council. Clearly, a baseline scenario in which no regulatory intervention takes place and thus two key information documents – one according to UCITS and another according to PRIIPs standards – will need to be provided to fund investors can no longer be perceived as a valid assumption for assessing costs and benefits of the ESAs' proposals. Hence, we urge the ESAs and the Commission once again to abstain from regulatory interventions into the PRIIPs framework in the short term, but to use the results of the current consultation as a first preparatory step towards a comprehensive review of the PRIIPs regime.

As regards the specific cost analysis, we disagree with the statement that UCITS providers will incur "no additional implementation costs" for including information on past performance. While UCITS and other fund providers are accustomed to calculating and disclosing past performance according to UCITS standards, they will of course need to undertake IT implementation efforts for adapting the PRIIPs disclosure, if already subject to PRIIPs KID obligations. This will result in additional costs. Furthermore, information delivery standards for funds used as underlying investments in unit-linked insurance contracts will need to be adapted to cater for past performance data. As a result, additional implementation costs will occur for the providers of such insurance products.

ANNEX: Requests for targeted adaptations of the "arrival price" methodology for calculating transaction costs (Annex VI para. 12 to 20 of the PRIIPs RTS)

As stated in our general comments above, we are deeply disappointed that the ESAs do not seize the opportunity of the current consultation in order to address the issue of erroneous and misleading transaction cost figures being provided to investors under the current PRIIPs framework and their inconsistency with MiFID II and IDD requirements. These problems occur under the new calculation methodology for transaction costs invented by the ESAs (so-called "arrival price" methodology).

When designing the PRIIPs, MiFID II and IDD frameworks, EU legislators decided to reconsider (i) what should be considered a cost and (ii) how it must be disclosed to clients on an ex-ante basis. The new "all costs" figure under PRIIPs, MiFID II and IDD now includes the ex-ante disclosure of transaction costs (and performance fees).

Transaction costs consist of "explicit" costs (such as broker commissions, platform charges, transaction taxes, etc.) and "implicit" costs. Especially in fixed income markets, broker fees are not explicitly charged to clients, but are included in the price margin of either bid or ask price and thus account for implicit costs. This is undisputable in principle, as is the fact that MiFID II, IDD and PRIIPs strive to capture such implicit charges. However, it is not clear - and has never been openly debated - whether implicit costs shall also account for other elements. Conceptually, only "payments to third parties to meet costs necessarily incurred in connection with the acquisition or disposal of assets" are perceived as transaction costs under the PRIIPs framework[6]. The MiFID II and IDD texts provide further indications for the understanding of costs by specifying that "underlying market risks" (i.e. market movements) should not be considered a cost[7].

Regardless of these essential clarifications, the ESAs designed an approach (in the course of the Level 2 implementation process) on how to estimate implicit transaction costs, the "arrival price" methodology[8], which systematically treats market movement in the price of an asset between the time of order submission and order execution (so-called "slippage") as a cost factor. Such market movement is therefore reflected in the transaction cost calculations and disclosed as cost to investors. Since movement in the price can be either positive or negative, the effect is that the actual identifiable costs of a transaction – the "explicit" costs – are in each single case distorted and either under- or overestimated in the eventual calculation results. This has the following grave implications for transaction cost information under PRIIPs:

- **Investors will not be able to understand the figures shown:** In terms of cost disclosure, the PRIIPs framework makes no difference between "explicit" and "implicit" transaction costs. Both are thrown together and shown as one single aggregated figure. The accompanying explanation only states that these are "costs of buying and selling underlying investments for the product". However, disclosure of figures impacted by the element of price movement with such a blank statement will be misleading for retail investors. It is quite clear that an average retail investor will consider as transaction costs only payments to any party somehow involved in the transaction process. Considering market price movements as costs is not the usual way

[6] Cf. annex VI para. 5 j) of the PRIIPs RTS.
[7] Cf. Art. 24 (4) 2nd subparagraph of MiFID II, Art. 29 (1) 2nd subparagraph IDD.
[8] To be precise, this model has been developed for funds operating for more than three years. An intermediate methodology called "new PRIIPs" exists for funds which operate for less than three years.

of looking at the issue[9]. Interested investors who might try to take further insights into transaction cost figures displayed in the fund annual report will be utterly confused, since those figures account for explicit costs only. This might impair investors' confidence and discourage them from making financial investments altogether.

- **PRIIPs transaction costs cannot be used for MiFID II and IDD disclosures:** Due to the systematic inclusion of price movements, the current "arrival price" approach to transaction cost calculations is clearly incompatible with MiFID II and IDD requirements. Transaction cost figures calculated in accordance with the "arrival price" methodology cannot be legitimately used for the purpose of cost disclosure under MiFID II and IDD. This is especially obvious in many cases where market movement leads to an understatement of costs if compared with actual identifiable charges. The statements in the ESMA Q&As on MiFID II investor protection topics indicating that distributors can rely on PRIIPs data or are even expected to use the "arrival price" methodology[10] are not suitable for alleviating the civil liability risk arising from Level 1 provisions. In practice, transaction costs are therefore already being calculated differently for the same fund for PRIIPs and MiFID II purposes which is problematic today, but will become unbearable once investment funds will be bound to produce PRIIPs KIDs and both diverging figures will be disclosed to investors at the point of sale.

Moreover, it is important to note that the risk of under- or overstating costs is not a purely theoretical issue. The impact of price movements on "arrival price" calculations can be quite significant, especially as regards transactions in less liquid assets without transparent intraday prices or if the order transmission time stamps are not available. In both cases, the "arrival price" methodology allows for calculations to be based on the opening price of the day of the transaction or the previous closing price. In case of transactions in assets without price transparency, i.e. fixed-income assets, calculations based on opening or closing prices are even explicitly required as fallback solutions for calculating "arrival price" transaction costs[11]. This said, a survey among our members already applying the "arrival price" methodology for delivering PRIIPs-compliant cost figures to MOP issuers has revealed the following distribution of transaction costs:

Transaction costs	Total	Share
Smaller -1%	54	1.4%
Between -1% and 0%	491	12.9%
Between 0% and 1%	3.072	80.9%
Between 1% and 2%	136	3.6%
Greater than 2%	42	1.1%
minimum value	-64.57%[12]	
maximum value	4.0%	
Number of share classes included	3,795	

[9] The treatment of price movement as a cost factor stems from the academic debate about measuring best execution for equity trades in markets with full price transparency. For the purpose of best execution, the so-called "waiting factor" (price development between the time of investment decision and the time of order execution) is being considered relevant for assessing implementation shortfall as the difference between the optimum and the realised yield. This is a highly sophisticated concept of measuring best execution in certain markets. However, it has been neither developed with the purpose of educating retail investors about transaction costs in funds nor in any way adapted to the perception of this group of recipients.
[10] Cf. Q&As 6 and 12 in section 9 on costs and charges information.
[11] Cf. para. 14 third sentence
[12] Due to the effect of swing factor following large redemptions from the fund.

The overall share of negative transaction costs in this sample is 14.4 percent which account for 545 share classes. Given that the participants to our survey are large fund managers with a diversified offer of retail funds as regards both investment strategies and asset classes, we can assume that the outcome can be taken as representative for the European fund sector. Projected to the entire EU fund market, 14.4 percent amount to approximately 20,000 share classes which would display negative transaction costs. However, it must be clarified that while negative transaction costs are the most obvious symptoms of erroneous results being produced by the “arrival price methodology”, the flaws due to the impact of price movements occur in each and every calculation and thus pertain also to the majority of funds seemingly displaying reasonable figures.

Therefore, in order to facilitate provision of consistent and comprehensive cost figures to fund investors, it is key that the “arrival price” methodology is adjusted by eliminating any impact of price movements on the PRIIPs calculations. This aim can be achieved by making the following targeted improvements to the ‘”arrival price” methodology which are also promoted by EFAMA:

1. Shift of timing for determining the “arrival price”

The point in time at which the mid-market price of an investment ("arrival price") needs to be determined should be shifted from the time when the order is transmitted to the broker to the time of order execution.

Reasons:

- This measure would eliminate the impact of market movement in the price of an asset between transmission and execution of an order on the calculation results. This in turn would largely prevent the occurrence of negative transaction costs.

- Removing the influence of market movements on the calculations would render the results compliant with the provisions of MiFID II and IDD. Transaction costs calculated according to such amended “arrival price” method could then also be used for cost information at the point of sale. A uniform approach to determining transaction costs under PRIIPs, MiFID II and IDD will enhance the comprehensibility of transaction cost figures for both distributors and investors and contribute to an overall consistent cost disclosure.

- Market movement (also called “slippage”) is not recognised as a cost under the PRIIPs framework. Conceptually, PRIIPs requires taking into account “payments to third parties to meet costs necessarily incurred in connection with the acquisition or disposal of assets” (cf. annex VI para. 5 j)). Such payments can be explicitly charged when executing transactions or implicitly included in the bid and ask spread. The impact of market movements on the quality of execution is being captured and analysed in the context of "best execution", but is not related to costs.

- The impact of market movements is strongly dependent on the trading strategy: For a fund manager, it is possible to place a limit order with the broker for the purchase of a share or to monitor the market and only commission the broker when the desired price level has been reached. In both cases, the price of the share would be identical, while the transaction costs could display significant variations under the current arrival price methodology.

- There are currently major problems in obtaining information about the timing of order transmission to the broker (so-called order transmission time stamp) when the portfolio management for a fund is delegated to a third party. Absent these timestamps, fund managers must calculate “arrival price” costs by using the opening prices of the trading day or the closing prices of the previous day (cf. Annex VI para. 15 of the PRIIPs RTS). The calculation results are then potentially distorted by the price movement during an entire trading day. The information about the timing of order execution (so-called order execution time stamp) is easily available and already being provided by external portfolio managers on a trade-by-trade basis.

2. Recourse to half average spreads for transactions in illiquid assets

In the case of illiquid assets for which no intraday market prices or no market prices in general are available, the use of average spreads should be allowed as a basis for transaction cost calculation. The same should apply to transactions where the available mid prices are inaccurate or not representative for the specific trade.

Reasons:

- The arrival price methodology relies upon the availability of intraday market prices as a basis for calculation. For many less liquid securities which are only occasionally traded on the market, such intraday prices are not available. This pertains to some niche market segments, such as small cap shares or emerging markets corporate bonds. Regarding OTC derivatives which are negotiated and agreed on a bilateral basis, market prices are not at all available.

- Fixed income trading poses a different problem: data providers such as Bloomberg, Reuters or Markit may offer price data for bond trades which are, however, derived from internal valuations and in many cases not representative for the execution conditions of specific market participants. In addition, these valuation prices can considerably vary depending on the internally applied valuation model and the data provider from which the prices are obtained. They are therefore largely meaningless and unsuitable as reference values for calculating transaction costs.

- According to the current fallback solution in the absence of intraday prices, transaction costs are to be calculated by using the opening prices of the trading day or the closing prices of the previous day (cf. annex VI para. 14 of the PRIIPs RTS). This leads to the problematic influence of price movements on the calculation results as explained above. The more illiquid a financial instrument is, the greater the distortions in the calculations. These distortions cannot be eliminated under the applicable PRIIPs standards; they are intrinsically embedded in the methodology for illiquid financial instruments. Moreover, the current PRIIPs rules do not provide any solution for the problem of inconclusive price data e.g. in case of bonds.

- Recourse to calculation on the basis of average spreads observed in certain asset classes would largely eliminate distortions due to price movements and consequently, render the calculation results for less liquid financial instruments compliant with MiFID II and IDD requirements. Calculation relying on average observed spreads is already recognised as a standard under PRIIPs for newly launched funds (cf. annex VI para. 21 c) of the PRIIPs RTS). In practice, the relevance of this “estimation methodology” is by far greater since it is used by many fund providers for calculating transaction costs under MiFID II. The procedure for determining the average spreads can vary and ranges from estimations based on the identified reference indexes to average spreads from proprietary trades and standardised spread tables.

- Reliance on average spreads means that transaction costs under the estimation methodology are significantly less susceptible to fluctuations than the results of the “arrival price” calculations. By applying the estimation methodology firms could largely avoid conspicuous deviations between the transaction costs forecast in the PRIIPs KID and the ex-post cost reporting on transaction costs according to MiFID II. Confusion and dissatisfaction among investors and distributors should decrease.

3. Redefinition of the calculation approach for transactions in real assets

Calculation of transaction costs for real assets, such as the purchase and sale of real estate, should be based solely on actual identifiable costs.

Reasons:

- Calculation of transaction costs for real assets in accordance with the “arrival price” methodology makes no sense. The “previous independent valuation price”, which is to be used as the arrival price for real estate transactions and thus as the reference value for the calculation (cf. annex VI para. 19 of the PRIIPs RTS), has no relevance for determining transaction costs since the actual acquisition or disposal price does not include any implicit cost elements.

- The acquisition costs of real assets are known in detail and already disclosed in the annual fund reports. They encompass in particular notary and brokerage fees, land registry costs and taxes for real estate transfer. Thus, costs of transactions in real assets should be calculated by summing up those actual identifiable cost items directly associated with a transaction.