Amendments to the PRIIPs Delegated Regulation

Changes planned for 1 January 2022

January 2020

Revision of the delegated regulation & end of the UCITS exemption

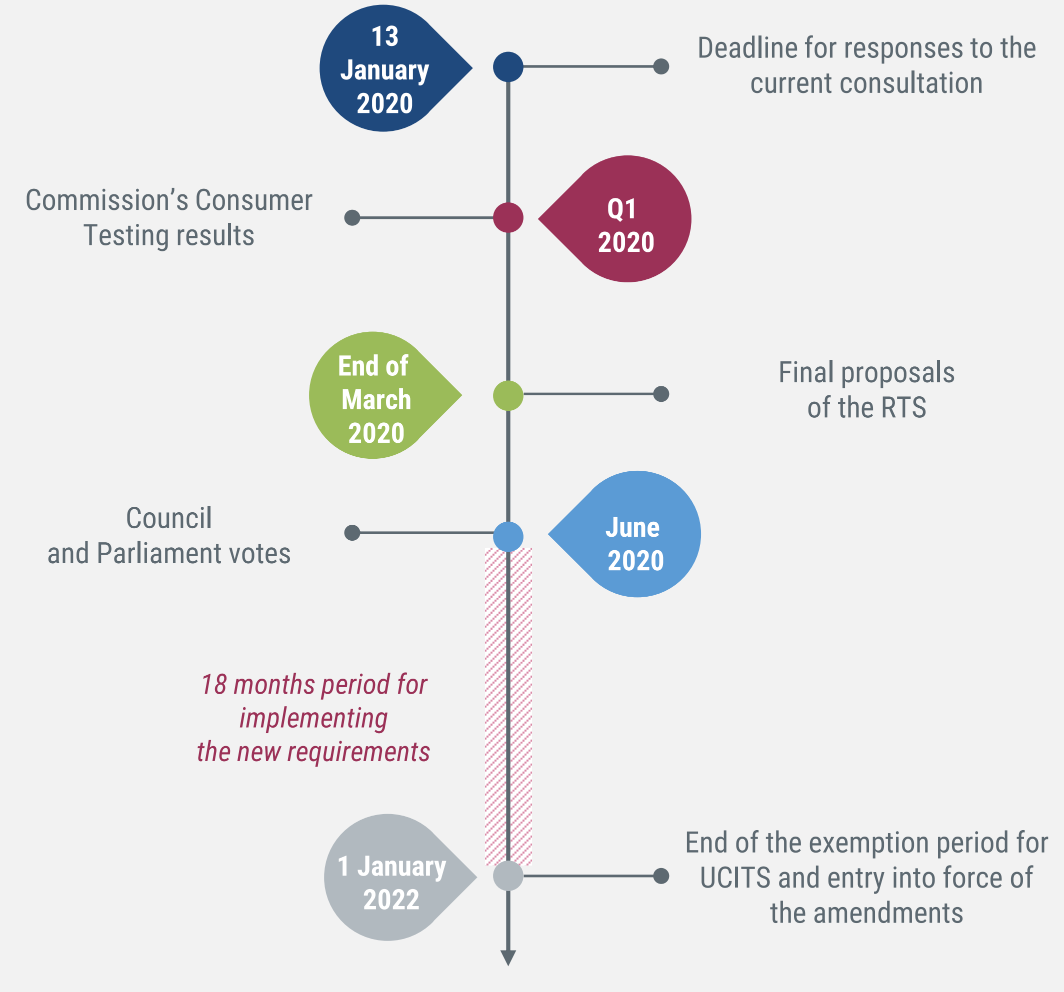
The ESAs launched a public consultation concerning amendments to the PRIIPs delegated regulation as part of their obligations to assess new legislative acts and following the difficulties encountered after the entry into force of the regulation in January 2018.

This review aims **to address the main problems identified since the implementation of the Key Information Document (PRIIPs KID) for financial products other than investment funds** and **to facilitate its application for UCITS** and **AIFs** at the end of the temporary exemption period (31/12/2021).

The three topics subject to amendments are addressed within the consultation paper published in October 2019:

- Costs & Charges
- Performance scenarios
- PRIIPs offering a range of options for investment (Multi-Option Products - MOPs)

Intended timeline for the application of the amendments to the PRIIPs Delegated Regulation



The ESAs' main proposals

Costs and charges

Presentation and calculation methodology

- Removal of the intermediate time period (RHP/2) for products with a recommended holding period (RHP) lesser than 8 years
- Display of return per year before (gross) and after (net) costs deduction in the "costs over time" table
- Review of costs' description narratives
- Display of costs breakdown in euros
- Proposal of two options for the calculation of transaction costs: adjustment of the current methodology and proposal of a new discretionary methodology

Performance scenarios

Presentation and calculation methodology

- Removal of the stress scenario and the intermediate performance scenarios (at 1 year and at RHP/2)
- Inclusion of information on past performance
- Revision of the performance scenarios methodology so that the observed historic growth of the asset is no longer used
- Use of illustrative scenarios for category 3 PRIIPs

MOPs

Multi-Option Products

- Identification of the 4 most relevant options or combinations
- Provision of complete information for these 4 options or combinations
- Inclusion of a short narrative in the "specific information document" for investment options specifying whether all fees to be paid by the investor are mentioned
- Disclosure per risk class of costs and impact on return in the "costs over time" table of the generic KID

Costs and charges

The ESAs, PRIIP manufacturers and distributors agree on issues related to understanding and interpreting costs and charges presentation in the current PRIIPs KID.

❖ Main issues raised by stakeholders

1. Tables overloaded with unnecessary information for investors
2. Inconsistencies between information disclosed in the PRIIPs KID and in MIFID II costs presentation: in particular "Reduction In Yield" (RIY) vs "total costs over investment"
3. Possible misunderstanding of "Reduction In Yield" (RIY) by investors
4. Risk of confusion linked to the presentation of some information (entry costs, exit costs, etc.)

❖ ESAs' main proposals

Revision of the intermediate period (Table 1: costs over time)

- Removal of the intermediate time period (RHP/2) for products with a recommended holding period (RHP) lesser than 8 years and proposition of a fixed intermediate time period of 5 years for products with an RHP> 8 years
- Reflection on adding a 10-year intermediary period for products with a high RHP

Reduction in return (table 1: costs over time)

- Display of return per year before (gross) and after (net) costs deduction in the "costs over time" table
  Warning: this is a gross return extrapolated based on the net performance and the cost indicator. There will be a gap with the gross performance calculated by portfolio managers according to GIPS standards

Narratives review (table 2: composition of costs)

- Review of entry and exit costs' narratives
- Display of management fees collected in % of the value of investment
- Merger of incidental costs' rows (performance costs and carried interest)

Proposal of 4 options for the presentation of costs and charges

- Enhancement of the "costs over time" table with the display of costs breakdown
- Display of costs in € in the "composition of costs" table

Costs and charges

❖ Focus on the presentation preferred by regulators

"Reduction in return" table according to option 3 of the consultation

When you invest [10.000 / 1.000 EUR per year] We have assumed the product performs as shown in the moderate performance scenario	If you end / exit / surrender / terminate / lapse after 1 year	[Only for PRIIPs with RHP 8 years or more] If you end / exit / surrender / terminate / lapse after 5 years	If you exit after [recommended holding period] years
Impact on return over time			
Return per year before costs	%	%	%
Return per year after costs	%	%	%
Reduction in return each year due to costs	- %	- %	- %

- Manufacturers are opposed to a super gross return concept which presupposes the possibility of having a cost-free return
- The modalities to include entry fees collected by distributors are still subject to discussions

"Composition of costs" table according to option 3 of the consultation

Type of cost		Description of cost	Costs over time		
			If you end / exit / surrender / terminate / lapse after 1 year	[Only for PRIIPs with RHP 8 years or more] If you end / exit / surrender / terminate / lapse after 5 year	If you exit after [recommended holding period] year
One-off costs	Entry costs	**[X% of the amount invested / premium paid] or [x% of the first Y premiums / investments]** Where the costs are embedded in the price or premium: **These costs are already included in the [price / premium] you pay.** [Where distribution costs are included in entry costs] This includes [monetary value] EUR costs of distribution of your product. [Where the manufacturer only knows the maximum distribution cost]. This is the maximum you could pay. **The person selling you the product will inform you of the exact charge.**	€	€	€
	Exit costs	**X% of the value of your investment at that time.** Where the costs are embedded in the price: These costs will be included in the price you get. Where they apply only for disinvestment prior to the recommended holding period. **These costs only apply in case of** (explain circumstances or an example in max 100 characters: **exit before maturity/termination of the product/exit out of the (monthly/….) liquidity windows).** For details, refer to section "How long should I hold it and can I take my money out early?"	€	€	€
Ongoing costs	Management fees and other costs	**X% of** (value of the investment / other basis) [per year / other time period] [where applicable] (of which % are management fees)	€	€	€
	Transaction costs	**X% of (value of the investment per year)** This is an estimate of the costs of us buying and selling underlying investments for the product.	€	€	€
Incidental costs	[Performance fees / carried interest / other]	**X% of** (…describe in max 100 characters). Where applicable [cross-reference to prospectus] *[Only include row where applicable]*	€	€	€

Asset Managers would like to limit the table to a breakdown disclosed in % of assets under management (alignment with MIFID II, no RIY)

The above presentation (ESAs' favorite option among 4 proposals) meets a strong opposition from the actors consulted because of its complexity and information overload.

❖ Calculation methodology of implicit transaction costs

Despite the inconsistencies noted in the results obtained with the current methodology, the ESAs propose some marginal adjustments and maintain the prescriptive approach based on the arrival price (slippage methodology).

At the same time, the ESAs have decided to include draft proposals for a more principles-based approach, which is not their preferred option.

Option 1: Adjustment of the current methodology of calculating transaction costs

1 OTC transaction costs

- Calculation of an "**arrival price**" if "**bid prices**" and "**offer prices**" are obtained from more than one counterparty
- Calculation of a **spread** if the transaction prices are not available

2 Threshold for a simplified methodology

- Introduction of a **threshold** for the application of a **simplified methodology based on** a **minimum** number of transactions or on the turnover over the last three years

3 Transaction costs of real assets

- Sum of the **real costs** associated with the transaction (fees, commissions, taxes, etc.)

4 Adjustment of negative costs

- Disclosure of a **minimum of explicit transaction costs** when the implicit transaction costs are negative

Option 2: Proposal of an alternative "discretionary" methodology for the calculation of transaction costs

1 Similar approach for explicit fees

- No significant change compared to the existing methodology for calculating explicit transaction costs

2 Calculation of implicit costs

- Identifying **implicit costs** by comparing the transaction **execution price** to an appropriate **reference price**

3 Identification of a reference price

- Determination of the **reference price** through a methodology that would be **developed and formalized by the manufacturer** and based either on a transaction price of the same instrument or on a price obtained from transactions with the same characteristics.

This approach could lead to a generalization of the new PRIIPs methodology based on a spread table

While some adjustments were welcomed by Asset Managers, a disagreement remains on the relevance of displaying implicit transaction costs and its impact on investment decisions.

They also remain unfavorable to the "arrival price" methodology, preferring the discretionary approach which solves more methodological problems, and recommends additional adjustments.

Presentation of performance scenarios

The current presentation of future performance scenarios is criticized for the overload of information displayed.

Regulators proposed to simplify this presentation and to add a new section on past performance. These proposals could evolve following the responses to the consultation and the results of the consumer testing initiated in parallel by the regulators.

❖ Presentation of future performance scenarios

Scenarios	What you might get back after costs following [recommended holding period] (3)	Average return [per year/over recommended holding period]	Estimated chance this scenario occurs (4)
Minimum (2)	*<u>If there is no minimum guaranteed return</u> [There is no minimum guaranteed return. You could lose some or all of your investment]* *<u>If there is a minimum guaranteed return, this should be stated as a figure.</u>*		
Unfavourable (1)	€	%	<u>10 in 100 chance you do worse</u>
Moderate (1)	€	%	<u>50 in 100 chance you do worse</u>
Favourable (1)	€	%	<u>90 in 100 chance you do worse</u>

1. Removal of the stress scenario
2. Display, where applicable, of the minimum guaranteed return
3. Removal of 1 year and RHP/2 scenarios
4. Integration of narratives on the estimated probability for the occurrence of each performance scenario

❖ Inclusion of information on past performance for category 2 & 4 products

With an objective to replace the UCITS KIID by the PRIIPs KID, the regulator proposed to include the past performance section in the PRIIPs KID for category 2 and 4 products

The calculation methodology and presentation would be similar to those of the UCITS Regulation.

In general, Asset Managers and investors' representatives support the proposal for a simplified presentation of future performance scenarios and the inclusion of past performance. However, they remain concerned that the display of scenarios occurrence probabilities will mislead investors.

Presentation of performance scenarios

❖ Calculation methodology of future performance scenarios

The ESAs defended the use of probabilistic scenarios and the current methodology while proposing an amendment to the **estimator of the growth rate*** taking into account pro-cyclicality issues.

This methodology is being tested on all types of products to assess its relevance. However, given its complexity, the regulator remains open to consider other alternatives.

Growth rate based on the **mean of all the observed returns** (M1*N)		Growth rate based on **expected annual return du** (g*T)
M1: mean of all the observed returns in the sample over the period **N**: number of trading periods in the recommended holding period	▶	**g**: expected annual return calculated using the **dividend yield methodology** **T**: the length of the recommended holding period in years

The dividend yield methodology

Step 1: breakdown of the expected return into the sum of a **reference rate**, common to all assets in the same country, and an asset specific **risk premium.**

Step 2: estimation of the **reference rate** of each asset based on the interest rate curve derived from sovereign bond prices of the country of the asset.

Step 3: estimation of the **risk premium** for each asset class based on the **average dividend yield** (or other distributions depending on the asset class) paid to the PRIIP and attributable to the holder of the PRIIP. This average rate is calculated using the average dividend yield for **each country/sector represented in the fund** weighted by its representation.

To avoid any remaining inconsistencies, the ESAs proposed to introduce **compensatory mechanisms** to cap the resulting scenarios.

- Example: Capping the favorable scenario to match the maximum return observed in the past.

While this new methodology overcomes the pro-cyclicality issues, Asset Managers have pointed out many downsides related to its complexity, to data sourcing and costs, and to the misleading results it could generate.

❖ Inclusion of illustrative scenarios for category 3 PRIIPs

The ESAs proposed to introduce the **illustrative scenarios, used in the UCITS KIID** and more suited to structured products, in order to avoid defining a new methodology that could lead to inappropriate results.

However, as this approach gives the discretion to manufacturers to select the scenarios, it does not allow comparison between products, and therefore cannot replace the current approach.

The ESAs proposed, for stakeholders' feedback, **a combination of both approaches** for category 3 PRIIPs, even if it can result in a potential overload of information for the investor.

(*) The growth rate is the first component of the formula for calculating the performance scenarios.

Multi-Option Products (MOPs)

Following the implementation of the rules related to PRIIPs offering a range of options for investment, the regulators noted some issues on the understanding of the PRIIPs KID when a "generic KID" and a "specific information" for the underlying investment option are provided.

❖ Main issues related to the current presentation

1. Interaction between 2 presentations: generic PRIIPs KID and UCITS KIID for options
   - *Once the exemption is lifted,* investors will have *a single PRIIPs presentation* that will facilitate comparison and aggregation of the fees they would be required to pay.

2. Difficulty in identifying total costs to be paid in addition to fees disclosed for investment options

3. Lack of information allowing comparison between the different possible combinations
   - *Information on combinations is not required by the regulation.*

❖ ESAs' main proposals

Complete information on 4 most relevant investment options or combinations

- Disclosure of a more complete information (investment objectives, risk indicator, performance scenarios, costs, etc.) relating to the 4 most relevant options or combinations of options
- Maintaining the existing approach for the remaining options

Identification of the 4 most relevant investment options or combinations

- Identification of the most relevant investment options or combinations of options during the product validation process, as those (expected to be the) most frequently selected by investors

Inclusion of short narratives in the "specific information" document

- Narrative as to whether the costs shown in the specific information document include all costs to be paid by the investors when investing in that option via the MOPs
- Reference to PRIIPs offering the investment option and their generic key information document

Breakdown of costs by risk class

- Displaying costs and impact on return by risk class in the "costs over time" table of the generic KID

Conclusion

As of 1 January 2022, **all UCITS and AIFs intended for retail customers must have a PRIIPs KID available**. To date, regulators do not foresee any gradual switchover scenario.

As soon as the final version of the RTS is published by the end of March 2020, Asset Managers will be able to act, **define their roadmap** and **anticipate the difficulties of a mass switchover**.

The KID production model must be **strong enough,** not only to ensure the availability of **all KIDs on 1 January 2022,** but also to **support an update of the entire production in the following weeks**, taking into account data as of 3 December 2021 (performance figures and potentially costs figures).

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