

Technical Discussion Paper (JC/DP/2015/01)

Risk, Performance Scenarios and Cost Disclosures In Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs)

Response

This paper constitutes the response by the Deutscher Derivate Verband e.V. ("DDV") to EBA, EIOPA, and ESMA (the "ESAs") in connection with the Technical Discussion Paper (JC/DP/2015/01) on Risk, Performance Scenarios and Cost Disclosures in Key Information Documents for Packaged Retail and Insurance-based Investment Products ("PRIIPs") dated 23 June 2015. The DDV appreciates the opportunity to comment on the Discussion Paper and the work undertaken by the ESAs to publish a preparatory step in the preparation of the Regulatory Technical Standards ("RTS"), setting out early thinking on the part of the ESAs and allowing market participants to share their views.

The activities of DDV members represent a significant proportion of the German and potentially also the EU market of structured retail products issued.

The DDV and its members agree that improving the transparency of PRIIPs offered to retail investors is an important investor protection measure and a precondition for rebuilding the confidence of retail investors in the financial market. To prevent divergence, it is necessary to establish uniform rules on transparency at Union level which will apply to all participants in the PRIIPs market and thereby enhance investor protection. The DDV and its members have, consequently, a strong interest in a common standard for key information documents ("KID") and harmonised format and content of those documents.

In such context, the DDV expressly welcomes the Technical Discussion Paper ("TDP") on Risk, Performance Scenarios and Cost Disclosures in Key Information Documents for Packaged Retail and Insurance-based Investment Products and its contents and is grateful for the opportunity to respond to the questions as follows:

QUESTIONS:

2 Risk and Reward

2.2 Common issues for both the risk indicator and performance scenarios

2.2.1.2 *Estimations of distribution of returns*

1. Please state your preference on the general approach how a distribution of returns should be established for the risk indicator and performance scenarios' purposes. Include your considerations and caveats.

Due to our experience for classifying risk for structured products as well as comparable assets, we have a strong preference for a forward looking approach. We are convinced that this approach can be implemented for all products falling under the regulation. Of course, this approach is more sophisticated in comparison to a plain historical based approach but from our point of view a forward looking model is necessary for allowing comparability among all PRIIPs which is one of the key aims of the regulation.

2.2.2 Choice of model, choice of parameters

2. How should the regulatory technical standards define a model and the method of choosing the model parameters for the purposes of calculating a risk measure and determining performance under a variety of scenarios?

What should be the criteria used to specify the model? Should the model be prescribed or left to the discretion of the manufacturer?

What should be the criteria used to specify the parameters? Should the parameters be left to the discretion of the manufacturer, specified to be in accordance with historical or current market values or set by a supervisory authority?

We agree on your thoughts about the advantages and disadvantages of prescribing models and leaving room for manufacturers' choice respectively. In general, a detailed prescription of models and parameters will lead to the highest comparability in the resulting risk and performance calculations which is highly appreciated by our industry. On the other hand this approach implies huge initial and ongoing efforts for

regulators in the field of quantitative modelling. This area of course is the core competence of issuers and it will definitely be more efficient to use this expert knowledge. Thus, we support a reasonable compromise between a detailed prescription and an open interpretation of models. In our opinion the regulator should prescribe principal guidelines, e.g. the usage of a forward looking approach on the basis of numerical approaches (e.g. Monte Carlo simulations) together with an appropriate valuation model for the corresponding products. The details of modelling, e.g. the concrete choice of an appropriate valuation model per structure (e.g. an appropriate model for cliquet options), should be left to the discretion of the manufacturer in order to be in-line with internal pricing models. By comparing the results among the manufacturers, the regulator might identify areas where more prescription is needed in order to improve comparability.

2.2.3 Time value of money – what represents a loss for the retail investor?

3. Please state your view on what benchmark should be used and why. Are there specific products or underlying investments for which a specific growth rate would be more or less applicable?

We support the idea that performance is expressed via a comparison between the purchase price paid by the investor and the outcome after a prescribed investment period. This approach could be easily understood by investors. Benchmarks for inflation and / or risk-free rates are of course reasonable but could from our point of view produce misinterpretation / will be contrary to the focus of comparability among all PRIIPs due to the dependency on assumptions.

4. What would be the most reasonable approach to specify the growth rates? Would any of these approaches not work for a specific type of product or underlying investment?

As growth rates will highly effect the risk and performance scenario calculations, we are in general sceptical about the usage of growth rates. We support the statement that there are premiums for taking risk but it is a huge challenge to define appropriate estimations of these premiums. For simplicity reasons our proposal is to rely on the general coherence between risk and reward, meaning that the more risky a PRIIP is the higher is its risk premium.

2.2.4 Timeframe of the risk and reward information

2.2.4.1 Reflection of time frame in the risk indicator

5. Please state your view on what time frame or frames should the Risk Indicator and Performance Scenarios be based

Risk indicator: Due to our experience with a consistent risk indicator (named as Option 3 on page 39f. in this TDP) we have a preference for a short timeframe for estimation purposes. A short estimation timeframe is by nature not equal to a realistic holding period for investors but this approach reduces estimation errors to a minimum. From our point of view, a shorter timeframe leads to appropriate results, in particular when the corresponding classification is in focus and not the risk indicator itself. In addition, it can be shown that risk indications for short timeframes are also a good proxy for longer timeframes.

Performance scenarios: We follow the approach that performance scenarios should be end-of-maturity based. For products with unlimited maturity a prescribed holding period (reliable for all PRIIPs) should be applied.

2.3 Construction of a Risk Indicator

2.3.1 Measurement of Risk

2.3.1.2 Credit Risk

6. Do you have any views on these considerations on the assessment of credit risk, and in particular regarding the use of credit ratings?

Having in mind the recent and actual discussions about credit ratings, we recommend to not rely too dominantly on credit ratings when assessing credit risks. Therefore, credit risk could be evaluated quantitatively and integrated into the summary risk indicator. Using observable credit spreads (or peer group data if credit spreads are unavailable) and integrating them by rule into the market risk indicator would reduce complexity regarding the indicators and allow for a better understanding for investors. Hence, the integration of credit risk into the indicator is much easier. Also credit spreads or CDS spreads are more objective than credit ratings. Their volatility is a signal of risk which should be incorporated in the risk indicator (this is a clear advantage and not a disadvantage). In the opposite the stability of credit ratings ignores this source of risk (clear disadvantage not an advantage). Also literature shows that credit ratings react much to late compared to new information (compared to credit spreads).

The discussion here is somehow contrary to the discussion regarding fair-value / cost calculations (see question 75).

2.3.1.3 Liquidity Risk

7. Do you agree that liquidity issues should be reflected in the risk section, in addition to clarifications provided in other section of the KID?

We agree on the remarks on liquidity risks in the TDP and the difficulties to measure it quantitatively. As the assessment of liquidity will (mainly) be based on qualitative aspects, we have a preference for expressing the liquidity risk in narratives rather than including it in the summary risk indicator.

8. Do you consider that qualitative measures such as the ones proposed are appropriate or that they need to be supplemented with some quantitative measure to some extent?

Should cost and exit penalties for early redemptions be considered a component of the liquidity risk and hence, be used to define a product as liquid or not for the KID purpose?

We in general agree with the proposed qualitative measures. Quantitative measures like the bid-ask spread or trading volume (for underlyings) could be useful as long as these aspects can be measured reliable for the corresponding PRIIPs.

Cost effects due to an insufficient liquidity should be also included when liquidity risk is considered. As outlined in our answer to question 7 an explanatory text / narrative would be appropriate to address this aspect.

2.3.3 Merging the main risks into a Summary Risk Indicator (SRI)

2.3.3.1 Integrating risks

Option 1: Qualitatively based indicator combining credit and market risk, complemented by a quantitative market risk measure

9. Please state your views on the most appropriate criteria and risk levels' definition in case this approach was selected.

We clearly reject this and every qualitative approach for classifying (market) risk due to the following reasons. First, a qualitative assessment is always a lump-sum approach neglecting relevant risks for specific products. As a result, too many products will fall into one class and there will be no differentiation between certain types of PRIIPs and/or within one product type. To be concrete, according to the table displayed for Option 1, all structured products without at least 50 % protection will be categorized in risk class 5. Thus, no differentiation is made for instance between partially protected investment products (e.g. with 40 % protection) and highly risky leverage products which is not reasonable at all. In addition, an investor will not be able to understand why an equity fund investing in European equity (with no protection) will have the same risk class as a 70 % protected structured note with an European index as underlying. As a matter of fact, the risk classification system will have no value-added to investors since there is no or no reasonable differentiation among PRIIPs.

The proposed additional quantitative assessment within a risk class on the basis of a UCITS-like model would not solve the problem from our point of view since the investor will only have a look on the overall risk class. Secondly, we and many other issuers- as well as distributors- have very positive experience in using a quantitative approach for risk classification. The essential aim here is to reflect the dynamics of (market) risks to investors in order to allow them to better understand product risks. A qualitative assessment implies a static view on product risks. In addition, in section 2.3.2.1 of this TDP the solely qualitative approach as well as the UCITS-approach are disregarded according to very comprehensible reasons. Thus, we have a strong preference for also disregarding a combination of the two disregarded approaches.

Option 2: Indicator separating assessment of market risk - quantitative measure based on volatility - and credit risk - qualitative measure, external credit ratings

10. Please state your views on the required parameters and possible amendments to this indicator.

In general, we support a quantitative measure, so this approach is from our point of view superior to Option 1. Nevertheless, option 2 has its limitations due its

simplifications. In general, a volatility based approach is not preferable for PRIIPs with asymmetric pay-offs like structured products. The proposed use of deltas neglects certain relevant risk factors in the corresponding PRIIPs and thus can lead to imprecise risk classifications.

Delta per definition is a short-term, linear measure used for short-term hedging purposes in the trading business. Hence it is not appropriate for long-term, non-linear products such as life-insurance products.

In addition to the already cited deficits, the proposed methodology has several other weaknesses. It is easy to construct products with a delta of zero, hence the risky component would have a risk of zero although the real risk is far from being zero. The risk of guaranteed products is heavily underestimated as the leverage is not taken into consideration. In total, the method is not reliable at all.

In addition, we are convinced that a two-dimensional indicator with market and credit risk will be too complex for investors to understand. How shall investors distinguish between a product ranked 1B and 2A for instance? The implied equal weight of market and credit risk in this option does not reflect the effective credit risk especially for products with short and mid-term maturities.

Having in mind the trade-off between implementation efforts and best possible results, we prefer the more sophisticated approach in Option 3 since Option 2 will also imply significant implementation efforts for our industry.

Option 3: Indicator based on quantitative market and credit risk measures calculated using forward looking simulation models

11. Please state your views on the appropriate details to regulate this approach, should it be selected.

We have a strong preference for this approach due to our experience over the last 10 years in using the risk indicator / classification. From the beginning the aim was to achieve comparability and comprehensibility among different issuers and structures. Thus, the aim is equal to the regulatory objectives. The approach is used from issuing as well as distribution units not only for structured products but also for other asset classes (like stocks, bonds or funds), so it is applicable to all kinds of PRIIPs. Implementation effort is manageable due to the fact that it is already in place and most of the PRIIPs manufacturers are calculating risk figures like VaR for their products.

Regarding the details we also prefer short holding periods for calculating the risk figures like it is implemented for our products in various structured products markets across Europe. According to our answer to question 5, we rank the advantages of more reliable results in the risk indicator over a more realistic / suitable holding period. We are convinced that our risk indicator produces also reliable forecasts for

longer holding periods as long as a full valuation of the products with their characteristics is performed.

Option 3 is much more discriminatory than option 2, especially for guaranteed products as it properly accounts for leverage and all kind of non-linear risks.

Concerning the deficits: banks, insurance companies, investment managers have already installed very similar risk management techniques and employ these already on a single product basis. Therefore, feasibility is a much lesser issue.

12. Please state your views on the general principles of this approach, should it be selected. How would you like to see the risk measure and parameters, why?

Due to our positive experience with the VaR approach (99 % confidence level, 10 trading days holding period), we see no reason for changing parameters. As described before the short holding period is often criticized but longer holding periods will cause some forecasting problems.

Independent from the risk measure (VaR, CVaR etc) it would be necessary to have some regulatory guidelines about the calculation details. In-line with our answer to question 2, we propose a general prescription of technical guidelines like the usage of a forward looking approach on the basis of Monte Carlo simulations together with a full valuation of the corresponding products. The details of modelling, e.g. the concrete choice of an appropriate valuation model per structure (e.g. appropriate model for cliquet options), should be left to the discretion of the manufacturer in order to have some room for implementation.

Option 4: “Two-level” indicator

13. Please state your views on the potential use of a two-level indicator. What kind of differentiators should be set both for the first level and the second level of such an indicator?

As the description of the approach is generic it is difficult to evaluate it. In general, an additional / further distinction of the risk classes might be helpful for the investors. However, the proposed first level distinction is too broad, it should be more granular.

As outlined in our previous answers we are convinced that an appropriate quantitative risk indicator reflects all risk factors for every individual PRIIP. Thus, there is no need for a two-level indicator from our point of view.

2.3.3.2 Scale of the Risk Indicator

14. Do you have suggestions or concrete proposals on which risk scale to use and where or how the cut-off points should be determined?

Due to our positive experience with our approach, we support the classification system in Option 3 which is used in various structured products markets across Europe and which is mentioned as an example in the TDP. If other classification schemes are considered, we prefer at least a five-class scale.

2.4 Performance scenarios

2.4.3 Assessment of different approaches

(What-if: manufacturer choice; What-if: prescribed approach; Probabilistic approach)

15. Please express your views on the assessment described above and the relative relevance of the different criteria that may be considered.

The most relevant aspect of performance scenarios is to illustrate potential outcomes of the investment. As the estimation of real probabilities of these outcomes is difficult, we are of the view that performance scenarios should not be accompanied by probabilities. Thus, we in general prefer a What-If approach similar to the German product information sheet (PIB).

2.4.4.1 Definition and numbers of scenarios

What-if: manufacturer choice

16. Do you think that these principles are sufficient to avoid the risks of manufacturers presenting a non-realistic performance picture of the product? Do you think that they should be reinforced?

From our point of view, the regulator should publish guidelines for performance scenario in any case. These should be similar to those for structured UCTIS (CESR-1-1318).

What- if: prescribed approach

17. Do you think the options presented would represent appropriate performance scenarios? What other standardized scenarios may be fixed?

In general, we do not support the idea of historical scenarios. For instance, product characteristics of PRIIPs (structured products) are dependent on the actual market environment (e.g. coupons) and their moneyness (e.g. cap), so a historical scenario would be misleading. Regarding growth rates, we are also convinced that they would produce misleading results (see our answer to question 4 in addition). Regarding prescriptions, we prefer an approach similar to the UCITS structured funds where general guidelines are given. The manufacturers than should compile these guidelines to suitable performance scenarios on a per structure level.

Probability approach

18. Which percentiles do you think should be set?

As mentioned, we do not favour this approach and therefore do not support the usage of probabilities for consistent percentiles for PRIIPs.

Combined approach

19. Do you have any views on possible combinations?

We have a strong preference for the What-If perspective and see no need for combinations with a probability perspective.

2.4.4.2 Other methodological issues to calculate performance in each scenario

20. Do you think that credit events should be considered in the performance scenarios?

In general, we do not see a value-added for investors here. In addition, this information could be misleading for instance when a credit event will be associated

with a total loss of capital which is not true because of recovery rates. Of course, if credit events are a core characteristic of the PRIIP (e.g. credit linked notes), they should be considered in the performance scenario section.

21. Do you think that such redemption events should be considered in the performance scenarios?

We think that such events should be considered in the performance scenario section as long as these are part of the product functionality / structure. E.g. an early redemption resulting from an auto-callable feature should be integrated somehow.

22. Do you think that performance in the case of exit before the recommended holding period should be shown? Do you think that fair value should be the figure shown in the case of structured products, other bonds or AIFs? Do you see any other methodological issues in computing performance in several holding periods?

We support the idea that performance scenarios help the investor to get a clear understanding about the PRIIPs' functionalities. Thus, we think that the performance scenario section should be as simple as possible. In our opinion integrating too many pieces of information (like showing the fair-value) would overburden this section.

3 Costs

3.1 Identifying the costs

3.1.1 Funds

Q 23 – Q 44

3.1.2 Life-insurance products

Q 45 – Q 58

3.1.3 Structured products, derivatives, CFDs & SPVs

- **Introduce a distinction between the investment's price and the margin/fees that have been incorporated in the price.**

- **An alternative solution is to establish cost disclosures on the basis of the ‘fair value’ or ‘intrinsic value’ of the product.**

59. To what extent are those two approaches similar and should lead to the same results?

As long as the definitions of price and margin / fees are the same, both approaches lead to the same results. The difference between the PRIIP's price and the fair value will lead to all margin / fees incorporated in the price. On the other hand, subtracting all margin / fees from the PRIIP's price will lead to the fair value. The key challenge here is to define the fair value. As outlined in the TDP, the fair value is a plain theoretical value which is not tradable at all. Thus, we believe that the issuer estimated value (IEV) is a reasonable basis for deriving corresponding margins / fees for PRIIPs. The IEV concept is well-known in structured products' markets, so we have a preference for this concept providing a transparent disclosure for PRIIPs. Our members state the IEV of structured investment products already in the German product information sheets. The difference between the issue price of the product plus a front-end load fee, where applicable, and the IEV includes the expected issuer margin and, where applicable, a sales commission. The expected issuer margin covers, inter alia, the operational costs incurred by the issuer for structuring (e.g. costs of drawing up the securities prospectuses, costs of admission of the structured securities to listing), market making (i.e. costs of continuous price fixing on the exchange and over the counter) and settlement of the respective structured financial instrument, and it also includes the expected profit for the issuer.

60. In comparison to structured products, do you see any specificity of costs of structured deposits? Do you think that the potential external guarantees of structured deposits might just have to be taken into account in the estimation of the fair value of these products?

In general we see no difference between structured deposits and structured products as both are based on similar investment strategies. Specific wrapper characteristics and costs should be replicated in the price.

3.1.3.1 List of costs to be taken into account

A. Entry costs

61. Do you agree with the above mentioned list of entry costs? Which of these costs are embedded in the price? Should we differentiate between “delta 1” and “option based” structured products? In which cases do you think that some of these costs might not be known to the manufacturer? Which of these types of costs should be further defined?

As a general comment, it is in our view imperative that the representation of the costs in the PRIIPs-KID is in line with the cost disclosure according to MiFID II. MiFID II distinguishes between the costs of the financial instrument and the costs of the financial services provided. In addition, MiFID II requires the disclosure of different cost components contained in these two cost pools: entry costs, ongoing costs and exit costs. This approach should also be followed by the PRIIPs-Regulation.

Regarding the list of entry costs and its inclusion in the (purchase) price: We agree to most of the cost components displayed in the list. We do not follow for instance point e) in the list because capital protection will be realized via option contracts and therefore be replicated / part of the hedging costs.

Due to the fact that a detailed differentiation of cost components on a single PRIIPs-basis is not possible for our industry (for instance because of lump sum cost for documentation), we propose to only separate costs on a greater level. A separation by the costs origin is useful here, meaning that entry costs could be separated in distribution fees (paid to advisor / distributor) and manufacturer fees (paid for manufacturer for the product’s design). As all entry costs of structured products are embedded in the purchase price, there is from our point of view no need for a detailed separation.

Regarding “delta 1” and option based products: “Delta 1” products do also include derivative components, so a differentiation is not necessary.

Regarding unknown costs to the manufacturers: We are not aware of unknown product costs.

B. On-going costs

62. To what extent do you think these types of costs should be further defined and detailed?

Regarding structured products typically all cost components are reflected in the entry costs, so a further definition is not necessary. On-going costs can occur for instance for underlyings with management or license fees, e.g. a fund underlying or a

structured underlying with quanto feature. These on-going costs are already disclosed today.

C. Exit costs

63. How would you estimate ex ante the spread referred to above in (b), in the case the product is listed as in the case it is not? Should maximum spreads, when available, be considered? Should the term “proportional fees” be further defined? Which definition would you suggest?

Since spreads are dependent on market developments (e.g. the underlying development), it would be challenging to give a realistic ex ante estimation for maximum spreads. Regarding proportional fees: In our opinion “proportional fees” is equal to a proportional deduction of the disbursed amount in case of early exit. Here a definition of the basis amount is required, i.e. are the proportional fees charged in terms of the notional or the actual value / price of a PRIIP?

D. Other

64. Do you agree with the list of costs outlined above? Which types of costs would require more precise definitions? To what extent should the methodology be prescriptive in the definition and calculation methodologies of the different types of costs?

Yes, in general we agree with the costs outlined before (besides the aforementioned aspects e.g. regarding capital protection costs).

65. Would you include other cost components?

No.

66. Under which hypothesis should the costs of the underlying be included?

Please see our answer to question 62.

67. How would you deal with the issue of the amortization of the entry costs during the life of the product? For derivatives it will be notably important to define what the invested capital is, in order to calculate percentages. The possibilities include: the amount paid (i.e. option premium price or initial margin/collateral) or the exposure (to be defined for optional derivatives). Do you see other possible approaches on this specific point?

As KID figures including cost information will be updated on a regular basis, all costs embedded in the purchase price of the PRIIP will be disclosed to investors. Thus, a potential amortization will be visible during the corresponding PRIIP's lifecycle.

68. Do you think that there are products with ongoing hedging costs (to ensure that the manufacturer is able to replicate the performance of the derivative component of the structured product)?

Yes. Such hedging costs will be reflected in the purchase price as well as the corresponding underlying.

3.1.3.2 Specific issues related to certain types of costs: calculation of the fair value

69. Do you agree with the general framework outlined above?

As outlined in our answer to question 2, we support a reasonable compromise between a detailed prescription and an open interpretation of models. In our opinion the regulator should prescribe principal guidelines, e.g. the usage of a forward looking approach on the basis of numerical approaches (e.g. Monte Carlo simulations) together with an appropriate valuation model for the corresponding

products. The details of modelling, e.g. the concrete choice of an appropriate valuation model per structure (e.g. an appropriate model for cliquet options), should be left to the discretion of the manufacturer in order to be in-line with internal pricing models. By comparing the results among the manufacturers, the regulator might identify areas where more prescription is needed in order to improve comparability.

70. Which criteria should be chosen to update the values in the KID when input data change significantly?

In our opinion the discussion about update cycles has to consider two aspects. On the one hand KID values like the risk indicator should be as up-to-date as possible in order to account for the current market developments. On the other hand the values should be as stable as possible since it will in general be a huge challenge for advisers to operate on a near-time updateable KID in daily business.

From our point of view a regular update is a reasonable trade-off between being up-to-date and stability. Our risk indicator / classification for instance is updated on a weekly basis.

71. As the evolution of underlying asset/s should be taken into account, are there specific issues to be tackled with in relation to specific types of underlying? To what extent should the RTS be prescriptive on the risk premium?

As outlined above valid risk premiums are hard to define. Thus, we have a preference for following the standard assumptions in derivatives pricing, i.e. a risk-neutral world with a zero drift / risk premium of zero for modelling purposes.

72. Are you aware of any other assumptions to be set?

No.

73. Having in mind that most of the applied models in banking are forward looking (e.g. using implied volatility instead of historical volatility) which are the pros and cons of backward looking approach and forward looking approach?

We have a strong preference to use forward-looking models due to their widespread usage in banking and our experience with a forward-looking approach for a risk indicator. We do not see any advantage of a plain backward looking besides simplicity. Important to know in our opinion is that certain forward-looking models also use historical data.

74. Do you think that there are other risk free curves that could be considered?

No.

75. Do you think that there are other market data that could be used to determine the credit risk? Do you think that implied credit spreads from other issuer bonds (other than structured products) could be used?

Deriving credit spreads from other issuer bonds is a valid alternative for getting up-to-date spread information especially for issuers with illiquid CDS-contracts. This approach / question is somehow contrary to question 6, the discussion about the implementation of credit risk in the risk indicator.

76. How would you determine the credit risk in the absence of market data and which are the criteria to identify the comparable?

In the absence of market data appropriate peers have to be defined in order to determine the credit risk. In case peers are not available, fixed (worst-case) values for credit risk can be determined.

77. How would you include the counterparty risk in the valuation? Would you include specific models to include counterparty risk in valuation (CVA models)? How would you consider the counterparty risk for pure derivatives?

In general, this question addresses a broad spectrum in derivatives modelling. So, to give a short answer we recommend an appropriate inclusion of counterparty risk taking into account all relevant drivers, for instance, corresponding collateralization agreements.

Concerning structured products it is worth mentioning that manufacturers take all counterparty risks from hedging on their own. Thus, investors are not affected by counterparty risks here.

78. In which circumstances do you think parameters cannot be computed/estimated using market data? What would you suggest to deal with this issue?

(Partially) unobservable market data is not a rarity in financial modelling, e.g. for exotic underlyings or options observable market data is often missing. In these cases valid assumptions or approximations in-line with industry as well as theoretical standards have to be applied. As these approximations will be reflected in the purchase price of a PRIIP and therefore in the corresponding cost disclosures in the KID, it will be transparent to investors that potentially higher costs will occur in such a PRIIP.

79. Would it be meaningful to prescribe specific pricing models for structured products, derivatives and CFDs? If yes which are the pros and cons of parametric and non-parametric models?

As outlined in our answers to question 2. and 69. a detailed prescription of pricing models seems not be effective. We recommend a prescription of subordinated guidelines.

3.2 Aggregating the costs

80. What should be the value of x? (in the case of UCITS, $x=5$, but the extent to which this is appropriate for other types of PRIIPs, notably life-insurance products, is unclear).

We recommend to set x in-line with the general archiving requirements for the whole KID.

81. Should this principle be further explained / detailed? Should the terms “rank pari passu” be adapted to fit the different types of PRIIPs?

This question is not applicable for structured products since there are no different share classes for one product.

82. What should be the relevant figure for the initial invested amount to be taken into account for the calculation of cost figures? Should a higher initial investment amount be taken into account not to overestimate the impact of fixed costs? How should the situation of products with regular payments be taken into account for that specific purpose? (Would an invested amount of 1 000 euros per period of time be a relevant figure?)

We recommend to take as a reference for all cost calculations in each product one single unit or the minimum denomination, the calculation amount or the minimum trading size of the relevant PRIIP due to the fact that specific amounts or standard figures are typically not investable in total within one PRIIP. Therefore it seems to be more meaningful for investors to have a cost break down on the smallest possible investment size.

83. For some life-insurance products, the costs will differ on the age of the customer and other parameters. How to take into account this specific type of PRIIPs for the purpose of aggregating the costs? Should several KIDs for several ages be considered?

This question is not applicable for structured products.

3.2.1 Summary indicators

3.2.1.1 Total Cost Ratio (TCR)

84. Do you agree with the abovementioned considerations? Which difficulties do you identify in the annualisation of costs?

We agree with the considerations. An annualisation of costs has its difficulties especially for products expiring within 1 year. But on the other hand, annualized values are well-known by investors due to the similarities to interest rates.

85. Which other assumptions would be needed there? In the case of life-insurance products, to what extent should the amortization methodology related to the amortization methodology of the premium calculation? To what extent should the chosen holding period be related to the recommended holding period?

This question is not applicable for structured products.

Possible issues relating to the implementation of the TCR approach to the different types of costs of the different types of PRIIPs

Entry-Exit costs

88. What would be other options to define the TCR ratio in the case of structured products? Do you identify other specific issues in relation to the TCR if applied to structured products? Another possible approach could be to use the ratio between the total amount of costs over the holding period and the average net investment (assumed during the whole period, in order to take into account future additional investments, partial withdrawals, payments (i.e. programmed investments or disinvestments)). Do you think this approach would be appropriate? For derivatives, it might be the case that it is necessary to further define the concept of investment to be used as denominator of the ratio. Possibilities include the use of the actual sums paid and received (i.e. initial margins, variation margins, collateral postings, various payoffs, etc.) or the use of the exposure (i.e. market value of the derivative underlying). Do you think these approaches would be appropriate?

We agree with the description in the TDP that in the case of structured products the TCR will in practice equal the ratio of the Entry-Exit costs to the value of the products (or to the invested amount), because the on-going charges figure approximately equals zero. In case on-going charges occur (e.g. management fees for underlyings), they should be incorporated.
As stated above the costs can be derived by the difference between purchase price and issuer estimated value (IEV) of the PRIIP. The TCR results from an annualisation of all costs according to the PRIIP's maturity / recommended holding period. This TCR in p.a. terms is from our point of view equal to a reliable RIY figure.

3.2.1.2 Reduction in Yield (RIY)

Possible issues relating to the implementation of the RIY approach to the different types of costs of the different types of PRIIPs

94. In addition to the abovementioned issues and the issues raised in relation to TCR when applied to structured products, do you identify any other specific issue in relation to the implementation of the RIY approach to structured products?

See our answer to question 88., we believe that the TCR can be used in a RIY approach when costs are scaled to p.a. values.

3.2.1.4 Cumulative effects of costs

Rate of returns / growth rates

95. Do you agree with the above-mentioned assessment? Should the calculation basis for returns be the net investment amount (i.e. costs deducted)? Do you identify specific issues in relation to the calculation per se of the cumulative effect of costs?

We have a preference for calculating returns on the basis of gross investments. We believe that investors have in mind the gross amount invested when they are concerned about the return of their investment.