

COMMENTS MADE BY CNMV'S ADVISORY COMMITTEE ON THE JOINT ESA PUBLIC CONSULTATION ON AMENDMENTS TO THE KEY INFORMATION DOCUMENTS FOR PACKAGED RETAIL AND INSURANCE-BASED INVESTMENT PRODUCTS (PRIIPs KID)

CNMV's Advisory Committee (hereinafter the "Advisory Committee") welcomes the opportunity to comment on the joint public consultation of the European Supervisory Authorities (hereinafter the "ESAs") regarding the proposed amendments to the key information document (hereinafter the "KID") that the regulation on packaged retail and insurance-based investment products (hereinafter "PRIIPs") require to be made available to the retail investor.

1. BACKGROUND AND RATIONALE FOR THE CONSULTATION

Regulation 1286/2014 on KIDs relating to packaged retail and insurance-based investment products (hereinafter "Regulation 1286/2014")¹, applicable since 1 January 2018, requires producers of PRIIPs to prepare a PRIIPs KID for delivery to the retail investor. In addition, this Regulation is supplemented by Delegated Regulation 2017/6532, which specifies the presentation and contents of the PRIIPs KID (hereinafter "Delegated Regulation 2017/653")².

The PRIIPs Regulation establishes a temporary exemption (until 31 December 2019) from the obligation to prepare and deliver the PRIIPs KID for UCITS or other Investment Funds that publish an equivalent key information document (referred to as the "UCITS KII").

On 1 October 2018, the European Supervisory Authorities (ESAs) indicated in a letter to the European Commission their intention to issue proposals in support of regulatory amendments that would avoid the possibility of duplicating the information documents to be received by clients acquiring Investment Funds from 1 January 2020 (changes intended to facilitate the application of the PRIIPs Regulation to Investment Funds), and to address some relevant issues that have been identified since the implementation of the KID, through a consultation with a limited scope and reduced timeframe that focuses particularly on performance scenarios, given the need for such changes to be implemented from 1 January 2020 (hereinafter the "Consultation").

However, in parallel with this ESA action, discussions between the co-legislators on the date of application of the PRIIPs Regulation to Investment Funds and on the deadline for a complete review of this regulation are ongoing.

In this regard, on 3 December, the **European Parliament** voted in favour of an amendment tabled by several parliamentary groups to incorporate in the proposal for European legislation on cross-border distribution of Funds **the extension of the review of the PRIIPs regulation until 31 December 2019 and the extension of the exemption from the PRIIPs KID for UCITS until 31 December 2021**. If, as seems foreseeable, this amendment prospers and the aforementioned extension of deadlines is finally approved, the work of reviewing PRIIPs carried out so far by the ESAs, of which this public consultation forms part, should be reconsidered. Thus, as there is no longer any constraint due to the urgency of the deadlines for applying PRIIPs to UCITS, **a complete review should be carried out, extending to other matters,**

¹ Regulation 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products.

² Delegated Regulation (EU) 2017/653 of the Commission, of 8 March 2017, supplementing Regulation (EU) No. 1286/2014 of the European Parliament and of the Council, on key information documents for packaged retail and insurance-based investment products, through the establishment of regulatory technical standards with respect to the presentation, content, examination and review of key information documents and conditions for compliance of the requirement for provision of such documents.

such as transaction costs³, and whose conclusions and proposals can be validated by retail investors, who, as recipients of this information, must play a leading role in verifying the usefulness and comprehensibility of the information provided.

Therefore, in their final decision on the recommendations to be made to the Commission, the ESAs will take into account both the responses to this Consultation and the progress made in the above-mentioned policy discussions.

2. CONTENTS OF THE CONSULTATION

The proposed changes are presented in Section 4 of the document which, in turn, is divided into three main sections:

Section 4.1:

This Section includes proposals to change the approach to the presentation of performance scenarios in the PRIIPs KID, proposing to include additional information (on past returns) as well as changes in the presentation and narrative of the explanations, but without changing the methodology to generate future performance scenarios. In addition, other alternative options that have been considered are described.

Section 4.2:

This section presents potential changes in a limited number of other practical and technical issues detected since the implementation of the PRIIPs Regulation and based on information collected by the ESAs.

Among the issues raised in the consultation, the priority is to incorporate the proposed changes in Section 4.1, so that minor amendments could be included in a limited way in Delegated Regulation 2017/653 and implemented through level 3 supervisory convergence instruments, such as Questions and Answers (Q&As).

The proposed amendments concern issues related to the calculation of the market risk measure for PRIIPs of periodic premiums, self-cancelling products, the explanatory texts of the summarised risk indicators, the explanatory texts of the return/composition fees reflected in the table of costs and the assumption of growth for the calculation of the return reduction.

Section 4.3:

This Section raises the possibility of other changes to Delegate Regulation 2017/653 should the temporary exemption from the PRIIPs KID for UCITS and other Investment Funds be ended. In this case it would be necessary, on the one hand, to delete certain provisions contained in Delegated Regulation 2017/653 relating to products with multiple investment options and, on the other hand, to assess the inclusion of parts of Commission Regulation (EU) No 583/2010 relating to the UCITS KII and the conditions to be met when providing such data. In particular, opinion is sought on the inclusion of the following articles of Delegated Regulation 583/2010 in Delegated Regulation 2017/653:

³ Whose current calculation methodology has been questioned by both users of financial services and producers of PRIIPs, as stated in Better Finance & Efama's joint statement of 16 October 2016 (<https://www.efama.org/Pages/BETTER-FINANCE-AND-EFAMA-RELEASE-A-JOINT-LETTER-ON-PACKAGED-RETAIL-AND-INSURANCE-BASED-INVESTMENT-PRODUCTS.aspx>)

- Chapter I: Purpose and general principles. Article 2(2)
- Chapter II: Form and presentation of the KII. Article 4, paragraphs 4, 6 and 12.
- Chapter III: Contents of the sections of the KII. Articles 7, 9 and 15 to 21.
- Chapter IV: Specific structures of UCITS. Articles 25 to 28, 31, 32, 34 and 35

Other Sections:

Section 5 of the document includes an analysis of the costs and benefits of the proposed changes and sections 6 and 7 include annexes relating to sections 4.1 and 4.3 respectively.

3. EXECUTIVE SUMMARY OF CONCLUSIONS

Before answering the questions raised in the Consultation, the following observations are highlighted as a conclusion that can be drawn from the analysis of the Consultation as a whole:

- a) **Insufficient consultation time and unintended consequences:** it may be understandable that the Consultation should be approached with such a short timeframe, given the need for the amendments resulting from the consultation and the proposals by the ESAs to be implemented no later than January 2020. However, throughout the Consultation, very technical questions are raised on a large number of issues that merit further reflection, even a greater contrast with the practical experience that both entities and retail investors are having with the preparation, supply and use of the KID.

Again, due to lack of time, it is not possible to make such a contrast. However, the urgency of adopting quick fixes without sufficient reflection and contrast may lead to inappropriate solutions being adopted, with consequent cost being incurred by the institutions and confusion and loss of confidence in the market on the part of the retail investor.

- b) **Review of Level 1:** in addition to the previous issue, the proposals to modify some issues would require, for their logical implementation, not only to modify level 2 of the PRIIPs regulation (Delegated Regulation 2017/653), but also to review certain issues of the PRIIPs regulation at level 1 (Regulation 1286/2014), an issue that is not by any means the subject of debate at this stage of the review process.
- c) **Difficult comparability between non-comparable products:** finally, this analysis reveals a difficult balance between the purpose of the PRIIPs regulation to provide comparable and consistent information on all PRIIPs, and the imperative need to allow some flexibility in certain types of products for which it is not possible to provide certain data, for the simple reason that not all products are the same (and do not require real past returns for those products which do not have it (page 14 of the Joint Consultation Paper).

But undoubtedly the greatest risk in the search for the "fully comparable" objective is that the reliability of the data is endangered⁴: in order to apply the same information requirements to all categories of products, it is necessary to provide data that (i) do not provide value (future returns on linear products), or (ii) are not real (simulations of past returns on products that do not have this data) or in which reporting past returns is not relevant and may confuse the retail investor as it happens in the case of guaranteed interest-rate life insurance to maturity.

⁴ In accordance with Article 44 of Delegated Regulation 2017/565 on MiFID II organisational requirements, distributors are required to provide information to investors that is "fair, clear and not misleading".

4. ANSWERS TO THE QUESTIONS RAISED BY THE ESAs

Section 4.1: Performance scenarios:

- 1) Do you agree that information on past returns should be included in the KID where (such information is) available?
- 2) Are there challenges (difficulties) in including information on past returns for certain types of PRIIPs?

As a general reflection, the inclusion of past returns in the PRIIPs KID, where such information is available, seems an appropriate measure, although the following observations are made:

a) The **inclusion of past returns along with future performance scenarios** as an appropriate solution for all types of PRIIPs raises the following questions:

- For **linear products** (unstructured UCITS and AIFs), whose value is directly and exclusively related to the value of the underlying assets, the provision of performance scenarios does not provide any great value. It could even be perceived by the retail investor as some form of market prediction or promise of expected future returns.

For the same reason, past returns are reliable and useful data for these types of PRIIPs, provided that a forceful warning is made, as in the UCITS KII regarding past returns not being a reliable indicator of future results.

- On the other hand, for **non-linear products** (such as structured products), whose value depends not only on the value of the underlying assets but also on other components such as the time horizon, the use of historical data or prices to illustrate past returns does not adequately reflect the range of possible results of the product in question⁵.

Moreover, in the case of structured products, past returns do not exist and would have to be obtained by means of a simulation (See questions 4 and 5).

The same applies to the case of guaranteed interest-rate life insurance to maturity, in which reporting past returns is not relevant and may confuse the retail investor, since these are certain future guarantees granted by the entity Insurance company, which may be very different from the guarantees offered in the past by the insurer in relation to similar guaranteed products that are already closed to commercialization.

For this reason, the approach adopted by the ESAs to require information on past returns only from those PRIIPs that have such information⁶, is correct, in line with the current UCITS regulatory

⁵ Note 18 of the Joint Consultation Paper: "Structured products and structured UCITS are composed of investments with a fixed time horizon and where the elapsed time is a component of the value. Because time is a factor in the value of the investment, the daily price changes reflect both the passage of time and the change in value due to changes in market condition. For this reason, price histories of structured products and structured UCITS are arguably less reflective of the range of outcomes available to the investor at a particular instance of time."

⁶ Page 14 of the Joint Consultation Paper: "... the ESAs would propose to include information on past performance in the KID whenever it is available. While this may mean that past performance information is not included for all PRIIPs, this is in line with the current approach in the UCITS KII used for new non-structured UCITS in accordance with Commission Implementing

approach, which does not require the provision of past returns for structured UCITS. **However, as a consequence of this approach, this would be one of the points where the comparability objective that should prevail in the PRIIPs regulation would not be met. On the contrary, the requirement to provide performance scenarios should only be established for non-linear products and exempted for linear products, such as unstructured UCITS and guaranteed interest-rate life insurance to maturity**, for the reasons indicated above.

- b) Secondly, there is a **practical problem with the introduction of past returns into the current KID**. If the Level 1 Regulation is not amended, the KID will remain limited to three A4 pages. If to the already dense information currently to be provided, past performance information has to be added in a visible format and this information already occupies half a page (see the example included by the ESAs on page 17 of their Consultation), it is not clear how all the KID information can be provided without seriously jeopardising the overall intelligibility of the KID.

Therefore and in view of the above observations, **the decision to include past returns together with performance scenarios in the PRIIPs KID should be part of the complete review of the PRIIPs regulation and be accompanied by the necessary changes in the Level 1 Regulation** and the extension of the PRIIPs KID to UCITS for an orderly implementation **that would allow differentiation between different product categories when providing information on performance** (past returns for linear products and performance scenarios for non-linear products).

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

In the event that past performance information is included in the PRIIPs KID, this Committee considers that such information should be based on the approach used in the UCITS regulation governing the KII, as it is information with a high degree of standardisation that has been used for more than seven years and, therefore, is well known by the retail investor.

4) Do you think that information on simulated past returns should be included in the KID in cases where actual past returns are not available? If not, explain your reasons.

5) If you believe that information on simulated past returns should be included in the KID, what approach do you think should be used to simulate past returns, and how should this be presented in the KID?

In accordance with the current methodology included in the PRIIPs regulation, the performance scenarios must be calculated using information on past returns and, therefore, it seems reasonable, a priori, that in the case of products for which there are no real past returns, such returns should be simulated, using some of the methodologies that the ESAs propose in their consultation.

Regulation (583/2010)22 (hereinafter "UCITS Regulation 583/2010"). In terms of the aim of comparability, there would also continue to be information on possible future performance scenarios for all PRIIPs".

However, whether or not simulated past performance is an adequate measure for all PRIIPs that do not have real past returns is a much more complex issue that must be carefully assessed and would require adequate time and contrast and should be addressed in the full review of the PRIIPs Regulation.

In addition, any information on simulated past returns must be in line with the UCITS regulation which already establishes⁷ certain rules in this area, envisaging a very limited number of conditions (new share class, subordinated funds and merging of funds) to avoid their use as much as possible.

Finally, in no case is it considered that past returns, whether real or simulated, should be included in the KID of the guaranteed interest-rate life insurance to maturity, where reporting past returns is not relevant and may confuse the retail investor, since these are certain future guarantees granted by the insurance company, which may be very different from the guarantees offered in the past by that insurer in relation to similar guaranteed products that are already closed to commercialization.

6) Do you consider that these modifications to the explanatory texts are an improvement with respect to the current approach on performance scenarios?

Starting from the importance of warning the retail investor that performance scenarios are based on simulations, the proposal by the ESAs to reinforce the narrative next to the illustrations of performance scenarios with short, clear messages in bold seems appropriate, similar to the warnings currently required by the UCITS regulation for the KII.

7) Do you have any comments on the analysis in this section of other possible options for improving future performance scenarios?

Although some of the methodologies considered by the ESAs as an alternative to the current methodology for calculating performance scenarios could represent an improvement⁸, it does not seem that the opportune place and time to assess this issue is in a specific review in such a limited timeframe, without sufficient time for reflection and without the appropriate contrast, and should be addressed in the complete review of the PRIIPs Regulation.

8) Do you have an opinion on how the presentation of performance scenarios could be improved?

The proposal by the ESAs (included on page 39 of their Consultation) to present information on performance scenarios in the form of a chart rather than numerical tables is for this Committee the most understandable form for retail investors.

⁷ In Article 19 ("*Use of historical performance simulations*") of the UCITS KIID Regulation (Commission Regulation (EU) No 583/2010).

⁸ Some industry sector is in favour of extending the exposure period from 5 to 10 years, as an alternative to the current methodology.

However, it should be noted that the stress scenario is calculated in accordance with Delegated Regulation 2017/653 with a different formula and based on assumptions other than those of the other three scenarios (unfavourable, moderate and favourable) ⁹. Therefore, the example used by the ESAs comparing the stress scenario and the favourable scenario does not seem to be the most appropriate, and it would be more appropriate to compare favourable and unfavourable scenarios in the same chart, showing the stress scenario in a separate chart.

Section 4.2: Other specific modifications

9) Do you agree with the proposals described in this Section?

Although the proposals by the ESAs on the different issues raised appear to be sound, they are very technical issues that would require further and deeper examination.

Section 4.3: Changes arising from the possible end of the exemption in Article 32 of the Regulation to include UCITS in the PRIIPs regulation

10) Do you have any comments on the approaches proposed in relation to the analysis and proposals in this Section?

The proposal of the ESAs to incorporate more than 15 articles (out of a total of 39) of Regulation 583/2010 into Delegated Regulation 2017/653, either through their express and individualised inclusion in that regulation, or through a cross-reference to the provisions of the Regulation governing the KII, warrants the following comments:

- a) **The large number of articles from the UCITS regulation identified by the ESAs** for their implementation in the PRIIPs regulation shows once again that the transition from the UCITS KII to the PRIIPs KID is not a trivial matter and evidences the need to re-establish the original sequence, as provided for in Article 33 of Regulation 1286/2014, on review and, depending on its result, application or not of the PRIIPs KID to UCITS and other Investment Funds that publish an equivalent KID.
- b) **The ESAs reflect (do not state) on page 30: "Under the UCITS Directive (Article 78), the UCITS KII must currently be provided not only to retailers, but also to professional investors. Since the PRIIPs Regulation applies to products made available to retail investors, the ESAs have worked on the assumption that, should the UCITS be required to provide a PRIIPs KID to retail investors, the UCITS KII can still be provided to professional investors. However, this is also subject to any decision by the co-legislators on the exemption from Article 32 of the PRIIPs Regulation". On this issue there are serious doubts that the approach put forward is the most beneficial for the following reasons:**
 - The provision of a key information document for professional investors who are able to understand more complex information does not seem to be of much use.

⁹ The stress scenario was added in Delegated Regulation 2017/653, with a different methodology from the one used for the original three scenarios, once it became clear that, based on the good results of the last decade, even the unfavourable scenario could yield positive returns.

- If the UCITS KII has to be maintained for professional investors, two key information documents (the PRIIPs KID for retailers and the UCITS KII for professionals) should be drafted, with the consequent use of resources.
 - In cases where professional share classes are also open to retail investors, there may be a situation where for the same Investment Fund there are two KIDs, with different methodologies and presented differently, which would create confusion for investors, discouraging them from using them instead of facilitating informed decision-making, as the ESAs have pointed out on several occasions.
- c) In relation to the **proposal by the ESAs to cross-reference** the provisions contained in Regulation 583/2010 **rather than implementing them individually**, this Committee considers it more appropriate to implement the UCITS KII rules to be incorporated into Regulation 2017/653, which would make it possible to improve and further adapt some of the UCITS KII rules and ensure their compatibility with alternative Investment Funds and those PRIIPs that are not UCITS.
- d) With regard to the specific proposals for **incorporating the articles of Regulation 583/2010 into Delegate Regulation 2017/653** indicated in section 2 of this document, it should be noted that, in the opinion of this Committee, they would require a more measured reflection that would allow, as indicated in the previous section, a more detailed technical adaptation.
- e) From all the above observations, it may be inferred that there is a **need for more in-depth reflection on an adequate transition from the UCITS KII to the PRIIPs KID** but the current framework for action does not allow it.

Section 5: Preliminary assessment of costs and benefits

11) Do you have any comments on the preliminary assessment of costs and benefits?

12) Can you provide information on the costs of including past performance information for different types of PRIIPs?

13) Are there any significant benefits or costs that you are aware of that have not been addressed?

As has been stated throughout the paper, the transition from the UCITS KII to the PRIIPs KID will entail significant costs for entities that are not accompanied by a visible benefit for retail investors. In addition, it should be borne in mind that even after consultation with the ESAs there will be many unresolved issues that make orderly planning for the implementation of PRIIP changes difficult.

This situation would be exacerbated if this transition were to take place before the end of 2019. On the contrary, such costs and difficulties would be significantly reduced if the extension of the review of the PRIIPs regulation until 31 December 2019 and the extension of the exemption from the PRIIPs KID for UCITS until 31 December 2021 are finally approved, deadlines that would allow a more exhaustive review of level 1 and 2 of the PRIIPs regulation.

Madrid, 10 December 2018