

**Finance Watch comments on the Technical Discussion Paper on Risk, Performance Scenarios and Cost Disclosures in Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs)**

To EBA, EIOPA and ESMA  
(Submitted electronically)

Brussels, 17 August 2015

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Its 70+ civil society members from around Europe include consumer groups, trade unions, housing associations, financial experts, foundations, think tanks, environmental and other NGOs. To see a full list of members, please visit [www.finance-watch.org](http://www.finance-watch.org).

Finance Watch was founded on the following principles: finance is essential for society and should serve the economy, it should not be conducted to the detriment of society, capital should be brought to productive use, the transfer of credit risk to society is unacceptable, and markets should be fair and transparent.

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Only the questions that are relevant to Finance Watch are reproduced here.

We agree to the publication of this response.

For further questions, please contact Frédéric Hache, Head of Policy Analysis at Finance Watch at [frederic.hache@finance-watch.org](mailto:frederic.hache@finance-watch.org).

Finance Watch welcomes this important consultation and salutes the excellent work done by the ESAs.

We hope to see follow up work on other key elements of the PRIIPs framework in future consultations, notably the comprehension alert, since this is an essential and complementary tool in our view to reduce the risk of mis-selling.

Past consumer protection issues such as children's toys with lead or cars that can overturn were not addressed simply by disclosing a higher risk grade on the information document and ensuring unbiased sales advice. Similarly, packaged products with features shown to be detrimental to retail investors should arguably not be sold or at the very least have a clear prominent warning.

***Question 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.***

In order to establish the distribution of returns, we prefer approach 'c' when the implicit parameters are traded in the market, and approach 'b' otherwise.

Approaches 'a', 'd' and 'e' are clearly inferior as they can give rise to sampling errors or manipulation.

***Question 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 would favour allowing manufacturers to use their own models, provided they use the same model to calculate the risk indicator and performance scenarios that they use for their internal risk management and where applicable for the calculation of their regulatory capital.

While prescribing a model would be a more certain way to avoid gaming, we recognize the costs of this approach both for manufacturers and supervisors and therefore favour the above approach.

However we strongly recommend random checks and deterring penalties in case of non-compliance / misleading use of a model as an indispensable complement to make this approach effective.

***Question 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?***

The benchmark to be used should be the amount invested grown at the risk-free growth rate for products up to a certain maturity threshold to be determined (e.g. 5 years). The benchmark to be used for longer products (e.g. maturity above X or recommended holding period above X) should be the amount invested grown at the risk-free growth rate plus the rate of inflation.

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

We believe that the time frame to be used should be the recommended holding period for open-ended products.

The Risk Indicator and Performance Scenarios of fixed term products should be calculated and displayed both based on the term of the product and in case of early exit, in order to display the difference in risk.

Similarly we believe that open-ended products where investor's risk changes materially depending on the timing of the exit should calculate and display two sets of Risk Indicators and Performance Scenarios in order to display the impact, using the most appropriate time frame.

While we appreciate that it might make the document more complex, experience shows that narrative explanations have a very limited impact and are thus not sufficient.

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

As stated in our response to the previous consultation, we strongly favour this option (option 3) over the other ones.

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

We agree with the assessment described above. We agree with the fact that probabilistic scenarios could lead to manufacturers designing their products to optimize presentation, however we note that this risk also exists with scenarios chosen by the manufacturer. We also agree with the importance of having balanced, meaningful and not misleading scenarios that offer a degree of comparability between products.

At the very least if we were to go for a what-if - manufacturers' choice approach, the positive and negative scenarios have to be symmetrical (i.e. have an equal probability of occurrence).

What-if manufacturer's choice would be a good option if supervisors had the resources to truly ensure that the scenarios are balanced and not misleading.

As we fear that it will be too resource intensive, we would therefore favour having three probabilistic scenarios (best scenario within a X confidence interval, worst case scenario within a X confidence interval, medium scenario) + additional scenario chosen by the manufacturer when appropriate to display specific features such as triggers or performance caps.

The scenarios should be net of all costs.

***Question 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?***

We believe that these principles are sufficient, provided they are consistently enforced and the penalties in case of non-compliance should be strong enough to act as a credible deterrent.

As we fear that supervisors will not have sufficient resources to consistently enforce compliance, the severity of the penalties should be inversely proportional to the likelihood of being caught.

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

We do not think that the options presented would represent appropriate performance scenarios.

If historical scenarios were to be used, it is crucial that the reference period be much longer than the recommended holding period in order to be meaningful.

Also rather than using a predefined growth rate, we would favour instead using predefined percentiles of the distribution as discussed above, in order to make performance scenarios more comparable across products.

***Question 18: Which percentiles do you think should be set?***

We believe that consumer testing should be used to determine the percentiles: consumers should be shown several percentiles, and one should then assess the percentiles that lead to the least mis-selling.

10th-90th would lower the risk that manufacturers shift risk in the tail, but if it is found that retail investors who invest in structured products are "more greedy than fearful", this might lead them to overweight the comparatively more attractive return compared to the comparatively higher risk of loss.

***Question 19: Do you have any views on possible combinations?***

We would favour a combination of a positive scenario (X percentile) + a negative (Y percentile) or a worst case scenario + a medium scenario + where applicable an additional scenario to illustrate specific features of the products not illustrated in the other scenarios.

***Question 20: Do you think that credit events should be considered in the performance scenarios?***

Credit events should be considered in the performance scenarios since they can affect the return.

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

Redemption events should be considered in performance scenarios as they are important features of the products.

***Question 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 think that performance in the case of exit before the recommended holding period should be shown in case it is likely to be materially different (e.g. products with principal protection only at maturity, products with a low liquidity).

Fair value including the likely bid-offer spread could be the figure shown.

***Question 24: How should the list be completed? Do you think this list should explicitly mention carried interest in the case of private equity funds?***

We think that this list should explicitly mention carried interest in the case of private equity funds.

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

The second option proposed is typically gamed by manufacturers by recording only part of the margin on its balance sheet when the product is sold and recording the rest of it only months later. The reason for this is that many clients request marked-to-market valuations of their products very shortly after the transactions and banks are reluctant to disclose the margin they took on the product. Therefore the second option is not desirable in our view.

Admittedly without proper supervision and deterring penalties a manufacturer might also choose to not disclose entirely the full margin in the first option as well.

We would thus favour a fair value approach including all embedded margins, recognised and to be recognised in the future. Given the resources available for supervisors to ensure compliance, we would also recommend deterring penalties.