Industry Responses to PRIIPs Technical Discussion Paper

August 2015

Following publication of its PRIIPs Technical Discussion Paper in June 2015 the European Supervisory Authorities have now published industry responses.

INTRODUCTION

On 23 June 2015 the Joint Committee of the European Supervisory Authorities ("ESAs") published a Technical Discussion Paper[1] on risk, performance scenarios and cost disclosures in Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs). Comments were sought from industry stakeholders by 17 August. Sixty-eight responses have now been published and this Briefing Note highlights some of the common themes and key concerns raised in the comments.

The latest discussion paper follows on from an earlier and less technical first discussion paper published by the ESAs in November 2014.

The work of the ESAs (EBA, EIOPA and ESMA) involves the development of Regulatory Technical Standards (RTS) or Level 2 rules on the specific implementation of the Key Information Documents (KIDs). The feedback from the discussion papers is being supplemented by ongoing consumer testing being carried out across the EU.

It is expected that the draft RTS will soon be published in the autumn of 2015.

AREAS COVERED BY THE TECHNICAL DISCUSSION PAPER

The discussion paper sets out 99 questions relating to the following areas of the KID:

- Construction of a risk indicator
- Performance scenarios
- Cost disclosure

Three risks are considered for the risk indicator: market, credit and liquidity risks. Four viable options are put forward for the presentation of the risk indicator. In summary the options are as follows:

1. A qualitative indicator combining market and credit risk, together with a quantitative market risk measure
2. A quantitative market risk measure based on volatility and a credit risk measure based on external credit ratings
3. Both market and credit risk assessed quantitatively by using forward looking simulation models
4. Different quantitative risk measures applied to groupings of product types

It is notable that the discussion paper states "…the ESAs are leaning towards the incorporation of credit risk in the risk indicator, whether single or multidimensional, rather than presenting it in a separate narrative."

For performance scenarios a further four options are being put forward. Broadly, considerations relating to performance scenarios relate to whether they should be historic or forward looking and if they should be probabilistic in nature or purely illustrative 'what-if' scenarios. It is noted that most responses to the first discussion paper were in favour of the what-if scenario methodology.

The performance scenario options set out are as follows:

1. Manufacturer has flexibility on what deterministic scenarios to present
2. Scenarios are prescribed by regulators
3. Probabilistic presentation of scenarios
4. Combination of the other approaches

[1] PRIIPS Technical Discussion Paper

The challenge of applying harmonised methodologies across a broad range of product types is highlighted by the costs disclosure section of the discussion paper. This section of the paper initially tries to establish the different types of costs across funds, structured products and insurance products. Specific areas mentioned include transaction costs and performance fees in the case of funds and for insurance products the costs related to the biometric risks and guarantees and the allocation of costs for with-profits contracts.

The paper then goes on to consider the different ways of presenting the overall effect of costs to the investor. Two approaches are presented: Reduction in Yield (RIY) and Total Cost Ratio (TER).

The TER displays costs as an annual percentage rate.

RIY presents cost in terms of the overall reduction in yield on the investment. It is commonly in use already in the insurance industry.

INDUSTRY RESPONSES

Sixty-eight separate responses have been published on ESMA's website[2]. These cover a broad range of industry stakeholders including insurers, asset managers and banks as well as industry representative bodies. Amongst the respondents were the Society of Actuaries in Ireland, Insurance Europe, the Association of International Life Offices "AILO" and the Association of British Insurers.

A significant number of respondents expressed dissatisfaction both with the timing of the discussion paper over the summer months and the lack of time to prepare a submission. Many respondents requested that for future consultations additional time should be allowed for considered comments.

It was also questioned why the results of consumer testing, and even the form of consumer testing, have not been made available.

Further common themes coming out of the comments include:

- A general favouring of the existing UCITs-style summary risk indicator with a narrative on credit and liquidity risk
- Most respondents support the use of 'what-if' deterministic scenarios for the presentation of performance with limited use of probabilistic approaches where it is necessary to illustrate certain features
- A number of responses highlighted the need for regulatory prescribed models rather than leaving it to the product manufacturer to determine a structure and parameterise models
- A dichotomy of opinions on the aggregate cost measure with insurers general favouring the Reduction In Yield methodology whereas other players supporting the Total Cost Ratio approach
- There was criticism of referring to the biometric risk premium on insurance products as a 'cost'. Some respondents propose not showing the biometric related charges and benefits at all whereas others would support at least splitting the investment element of a product from the insurance risk element. There was broad rejection of bundling together these elements.
- Some concerns were expressed of the potential personalisation of KIDs which it's argued goes against the key premise of the KID being a pre-contractual document
- One respondent commented that a negative consequence of the rules could be that product competition would largely focus on cost if the risk and performance measurement is not sufficiently granular enough across product types. This could be detrimental to products with the more exotic investment strategies
- The cost disclosures under MIFID II should be aligned with the PRIIPs requirements
- There is a strong desire to keep certain derivatives out of scope e.g. OTC derivatives used for hedging purposes

It is also clear from the discussion paper that many decisions have yet to be made with regard to the specification of the content of the KID. Further publication by the ESAs will be necessary before the direction of these decisions will be clear.

[2] Link to listing of industry responses on ESMA's website

HOW MILLIMAN CAN HELP

The European Commission has suggested that firms will need to be largely compliant by end 2015 to ensure full compliance by the final deadline of Q4 2016.

Therefore, a PRIIPS implementation project needs to be on the agenda now for product manufacturers and detailed planning should begin setting out the how the various requirements can be met with ongoing milestones to achieve success.

Our consultants have been involved in advising our clients on product disclosures both domestically in Ireland and across the EU market in many territories. We have undertaken a wide range of work for clients including:

- Reviews of benefit, risk and cost descriptions over a wide range of insurance products
- Preparation and review of tables of benefit and cost illustrations
- Assisting with development of governance structures including in the area of product development and distribution

As a result, we have a wide range of experience that can be brought to bear to benefit your business.

In November 2014 we published a Briefing Note summarising the key areas of content in the KID and the challenges facing firms in meeting the new requirements.[3]

ABOUT MILLIMAN

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[3] Milliman PRIIPs Briefing Note November 2014