Recommendation of the Consultative Committee for the Financial Sector on revision of the PRIIPs regulation

As part of the current review of the PRIIPs Regulation, the Consultative Committee for the Financial Sector (*Comité consultatif du secteur financier* – CCSF) has set up a working group bringing together all stakeholders – industry professionals, consumer associations, trade union representatives and market authorities – to provide concrete responses to the difficulties raised by this regulation.

While the CCSF supports the objectives of this regulation, i.e. to ensure the clarity and comparability of all investment products, particularly with regard to charges, and to improve the pre-contractual information given to savers, it notes that the implementation of the regulation has not yet made it possible to meet, on the French market, the expectations relating to the comparability of different financial products or those relating to the clear identification of their actual performances and overall costs.

Generally speaking, in order to implement this regulation smoothly, it considers that it is essential that the Commission take into account the feedback and consistent evidence that show that the implementation is particularly complex, on the basis of sometimes inappropriate rules, for intermediaries, while the clarity of the information for savers and their understanding of the product, particularly as regards performances and charges, is generally worsening.

The proposals below essentially apply to all the investment products presented in the Specific Information Documents, with the exception of structured products which, as they do not generally have existing past performance records, require more detailed information and explanations**.**

The work carried out by the Committee has not, as yet, led to the drafting of alternative proposals for generic Key Information Documents (KIDs) applicable to unit-linked life insurance policies. However, the representatives of insurers are working on an updated version of the KID which may be submitted to the working group in the coming weeks, but given the time constraints, it is not covered in this document.

Recommendation of the CCSF

Taking account of consumers' expectations and needs, the Committee proposes that a broad revision of the PRIIPs Regulation, to be implemented as of this year, should include the following changes:

- Incorporation of information on past performance, net of charges, covering the past ten years (including for the manager's benchmark indicator where applicable). Even though such information is not necessarily an indication of future performance, it is essential for savers to make informed choices regarding products and providers.
- Removal of the different performance scenarios. Future performance, as presented in the current Regulation, entirely contradicts the provisions of MiFID which stipulate that, if future performance is given, it should be accompanied by a warning that it is not a reliable indicator and

must not be based on simulations of past performance.[1] Moreover, due to their total lack of transparency, the performance scenarios are misleading to retail investors who are unable to understand the statistical method underlying the scenarios[2] and therefore their limitations in terms of prediction; however, it is likely that they will consider these scenarios to be performance probabilities, with upper and lower values, and will have the impression that they have been deceived if the performance turns out to be significantly different.[3]

- The performance scenarios are replaced by a description explaining to the investor the factual elements that may have an impact on the given product, under three scenarios: favourable, unfavourable and worst case.
- Detailed presentation of costs, calculated in TCR and not in RIY and changes in holding periods by only considering two periods (one year and the recommended investment period). Entry costs and all one-off costs, whether they appear in the generic KID or in specific documents, may be presented unamortised in order to give accurate information to the investor on the total cost without the risk of misunderstanding.

1. A risk indicator

Proposals:
- Indicate the holding period on which the indicator is calculated.
- Always specify the level of potential or total loss of invested capital.

Regulatory impact:
- The holding period on which the indicator is calculated: is already included in Level 2, Annex III, Articles 1, 2 and 3.
- The level of potential or total loss already appears in Level 1, Article 8, paragraph 3 d) ii) - and in Level 2, Appendix III, Article 4.c). the obligation to give a precise level (in %) in the case of partial protection. Add to (iii) "...you may lose 100% of your investment if all of the issuers of the securities held in the portfolio default at the same time".

2. Past performance, net of charges

Proposals:
- A warning stating that ***"Past performance is not an indication of future performance and only given for information purposes"***
- An indication of past performance **net of charges** for products with a performance history.
- Past performance is given on an annual basis over the last ten years and in accordance with the provisions of Commission Regulation (EU) No 583/2010 on UCITS.
- The performance of the product is presented alongside that of the benchmark used by the manager.

Regulatory impact: change to the Level 1 Regulation and new Article of the Level 2 Regulation incorporating the above proposals.
Level 1 Regulation: change Article 8 paragraph 3 (d) iii) as follows: delete "appropriate performance scenarios and the assumptions made to establish them" and replaced it with "Past performance".

[1] MiFID II delegated regulation Article 44(6)(a) and (e).

[2] Moreover, it is not explained in the document.

[3] We should recall that the last five years have been very positive, leading to overly optimistic scenarios, which results in a situation that the regulator has always wanted to avoid, namely that past performance predicts future performance.

Level 2 Regulation:
Annex V, part 1, add a new Article 3:
It may be useful to provide retail investors with PRIIP's part performance. If available, PRIIP's past performance is presented using the Y model in part 2. Performance is indicated net of charges. A warning stating that **"*Past performance is not an indication of future performance and only given for information purposes*"**.
Annex V, part 2:
Presentation of past performance using the UCITS KID to which investors are accustomed.

3. Performance scenarios

The term "*performance scenarios*" is confusing because some investors may believe that such scenarios will become reality. In addition, these scenarios are based on the average return and historical volatility of the product over the last five years and are therefore linked to the past behaviour of the products, whereas they are presented as if they were future projections. Lastly, they are calculated in a non-transparent way that does not allow the investor to establish a link between these scenarios and reality. It is likely that investors will consider these scenarios to be performance probabilities, with given upper and lower values, and will feel deceived if the performance turns out to be significantly different. They do not comply with the obligation laid down in Article 1 of Annex V of the delegated Regulation: "*Performance scenarios must be presented in an accurate, fair, clear and non-misleading manner that should be understood by the average retail investor*".

Proposal

We believe that the term "performance scenarios" has up to now been understood in the narrow sense of "what will happen in the future". And still, after years of studies and discussions on this subject, no method meets this objective. That is why we are proposing, for linear products (Category 2 investment funds), an alternative interpretation of the term "scenarios" meaning illustrations of possible returns over the recommended investment horizon and based on clear assumptions.
Rather than giving improbable and non-transparent scenarios, we suggest an explicative approach, describing the product's behaviour to the investor.

- The term *"performance scenarios"* is replaced by *"What can be expected from the product: illustration of possible returns".*
- Choice of three scenarios (favourable, unfavourable, worst-case) over a single period: the recommended period.
- Explanations in the form of simple and clear comments (descriptions) on the factors that determine the behaviour of the product.

- below, examples of descriptive illustrations for a fund invested in European equities:

What factors will mainly affect my future return?
The main driver of the fund's performance will be the evolution of European equity markets, resulting from multiple factors and chiefly the overall health of global and European economies. The fund's performance is compared to a reference index (benchmark) and tends to be correlated to the growth rate of this index. Please **verify the value of the index at the time you wish to invest in the fund** and exercise caution, especially if the index is trading close to its historical high. **Warning - Be aware that sudden changes to investors' perception of the prospect for gains can result in severe swings of the index at short notice and losses for the fund**.
Favorable Scenario - What would affect my return positively?
A healthy economy will in general result in higher or growing company profits and market value, which will trigger a positive performance for the fund. Specifically, the fund's performance is driven by the profits of large companies of the euro area, notably comprising financials (17%), industrials (13%), petroleum (7%), electric utility (7%), and technology (10%) in France (38%), Germany (27%) and Spain (10%) primarily.
Unfavorable scenario - What would affect my return negatively?
A depressed or receding economic environment, caused by a slump in consumer spending or rise of unemployment in Europe, will generally result in lower company profits and market value, which will trigger a negative performance for the fund.
Worst-case secenario - The maximum potential loss **is 100% of the investment**. There is no minimum guaranteed return.

Regulatory impact:

Level 1 Regulation – Art. 8 paragraph 3 d) iv

- change iv) as follows. Create a section "*What can be expected from the product: illustration of possible returns"*
- the paragraphs formally iv) and d) v) are numbered v) and vi).

Level 2 Regulation

In Article 3 paragraph 3

- Replace the term *"four scenarios*" by "*What can be expected from the product: illustration of possible returns"*

In Annex IV,

Article 1: delete *"these four performance scenarios are a stressed scenario, an unfavourable scenario, an intermediate scenario and a favourable scenario"* and replace by "*examples should show favourable, unfavourable and worst-case scenarios"*.

Article 2: replace it by *"examples of behaviour must be drawn from a sufficiently long period so as not to be distorted by recent market conditions and relate to the recommended investment period"*.

The rest of Annex IV and Annex V are deleted.

4. Presentation of the costs

A wide range of costs are given in the generic KIDs and are more accurate but do not include contract fees in the Specific Information Documents. In addition, three total costs are given for PRIIPs and are "affected" by a performance scenario and an investment period (RIY), which makes the document difficult to interpret and compare. Lastly, PRIIPs create implicit transaction fees and impose them in the total costs of the product, which is misleading information for the investor and contrary to European regulations (MiFID and IDD) that exclude costs resulting from market fluctuations.[4]

Consumer representatives proposed that, "in the case of multi-option products (MOPs), the total cost ratio (TCR), including the cost of the package (e.g. life insurance policy) should be indicated in the "Specific Information Document". This proposal was refused by representatives of insurers who objected that they could not give the total cost of the underlying in the Specific Information Document, notably because they did not produce these documents.

Proposals:

- The two selected periods (one year and the recommended period) are presented.
- The costs presented are no longer "distorted" by return assumptions for a given investment period. For a better clarity and comparability of information, the actual annual costs are presented in a legible manner by using the Total Cost Ratio (TCR) in a single table (see below).
- The implicit transaction costs – which are theoretical costs – are eliminated.
- Distribution costs, when they are not known precisely by the producer, are published at their maximum amount in the section presenting costs. This clarification "in the section presenting costs" is necessary for a uniform understanding of Annex VII:
    - Annex VII, Table 1: *"The person selling you or advising you about this product may charge you other costs If so, this person will provide you with information about these costs, and show you the impact that all costs will have on your investment over time."*
    - Annex VII, Table 2:

Coûts d'entrée	[...] %	L'incidence des coûts que vous payez lors de l'entrée dans votre investissement. [Il s'agit du montant maximal que vous paierez; il se pourrait que vous payiez moins]. *[ET/OU lorsque les coûts sont intégrés au prix, par exemple dans le cas des produits d'investissement packagés de détail autres que des fonds d'investissement]* L'incidence des coûts déjà inclus dans le prix. [Il s'agit du montant maximal que vous paierez; il se pourrait que vous payiez moins]. *[Lorsque les coûts de distribution sont inclus dans les coûts d'entrée]*Ceci inclut les coûts de distribution de votre produit.

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Entry costs (%). The impact of the costs you incur when entering the investment. [This is the maximum amount you might pay; you may pay less]. [And/or when the costs are included in the price, for example in the case of packaged investment products, other than investment funds. The impact of costs is included in the price. [This is the maximum amount you might pay; you may pay less]. [When the distribution costs are included in the entry costs]. This includes the distribution costs of your product.

[4] MiFID 2014/65/EU, Art. 24(c): *[…The information about all costs and charges, including costs and charges in connection with the investment service and the financial instrument, which are not caused by the occurrence of underlying market risk, shall be aggregated to allow the client to understand the overall cost [...]* , IDD 2016/97/EU, *Art. 29. c): idem*

Regulatory impact:

- Add annex VI Part 1 - I: recurrent costs: 4.b) "including, where applicable, distribution of your investments".
- Amend Annex VI by changing the notion of implicit costs which takes into account the price difference between the time when the order is placed on the market and the time when the order is executed.
- Annex VII: delete the first two paragraphs.
    - Replace the RIY calculation method by the TCR.
    - The periods presented are 1 year and the recommended period.
    - All one-off costs are given unamortised.
- Consequential amendment of Article 5 of the delegated regulation.
- Change Annex VI, Article 3(a):
    - Distribution costs, insofar as their amount is known to the manager. If it is not, the amount to be indicated in the cost breakdown is the maximum amount of known potential distribution costs for the PRIIP in question, stating that the exact amount will be provided by the distributor:
    - Change Annex VII by removing Table 1 (which is integrated into Table 2).
    - Change Table 2 of Annex VII (example below).

This recommendation was adopted unanimously at the CCSF plenary meeting, on January 21st 2020.

INVESTISSEMENT : EUR 10,000 **This table shows the impact of the costs on your investment over one year and the recommended holding period.**				
		If you cash in after one year	**If you cash in after the recommended 3-year period**	
One-off costs	Maximum Entry costs	1%	0.34%	The entry cost is paid the first year when entering your investment; This is the most you will pay, and you could pay less.
	Maximum Exit costs	0%	0%	
Ongoing costs	Portfolio transaction costs*	0.05%	0.05%	The impact of the costs of us buying and selling underlying investments for the Fund each year.
	Other ongoing costs	1%	1%	The impact of the costs that we take each year for managing your investments
Incidental costs	Performance fees	0	0	…
	Carried interest	0	0	…
Annualised Total Costs		**2.05%**	**XX%**	The annualised total of costs that impact your investment. It may be less depending on the one-off fees.
Cumulated Total costs in €		**€ 205**	**€ XX**	The cumulated total of costs expressed in euro for a EUR 10 000 investment

**the transaction costs include explicit transactions costs and charges and do not include implicit transactions costs. The implicit transaction costs for this portfolio is of 0.04% bp each year.*