



European Securities and  
Markets Authority

## Reply form for the Technical Discussion Paper on PRIIPs



## Responding to this paper

EBA, EIOPA and ESMA (the ESAs) welcome comments on this Technical Discussion Paper on Risk, Performance Scenarios and Cost Disclosures in Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs).

### *Instructions*

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response so as to allow them to be processed more efficiently. Therefore, the ESAs will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type < ESMA\_QUESTION\_PRIIPs\_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

- if they respond to the question stated;
- contain a clear rationale, including on any related costs and benefits; and
- describe any alternatives that the ESAs should consider

### **Naming protocol**

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESA\_TDP\_PRIIPs\_NAMEOFCOMPANY\_NAMEOFDOCUMENT.

E.g. if the respondent were XXXX, the name of the reply form would be:

ESA\_TDP\_PRIIPs\_XXXX\_REPLYFORM or

ESA\_TDP\_PRIIPs\_XXXX\_ANNEX1

To help you navigate this document more easily, bookmarks are available in “Navigation Pane” for Word 2010 and in “Document Map” for Word 2007.

### **Deadline**

Responses must reach us by **17 August 2015**.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input/Consultations’.



### ***Publication of responses***

All contributions received will be published following the close of the consultation, unless you request otherwise. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with the ESAs' rules on public access to documents.<sup>1</sup> We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Board of Appeal of the ESAs and the European Ombudsman.

### ***Data protection***

Information on data protection can be found on the different ESAs' websites under the heading 'Legal notice'.

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<sup>1</sup> See <https://eiopa.europa.eu/about-eiopa/legal-framework/public-access-to-documents/index.html>.



## General information about respondent

Name of the company / organisation	BNP PARIBAS
Activity	Banking sector
Are you representing an association?	<input type="checkbox"/>
Country/Region	France

## Introduction

**Please make your introductory comments below, if any:**

< ESMA\_COMMENT\_PRIIPs\_1 >

BNP Paribas Group ([www.bnpparibas.com](http://www.bnpparibas.com)) is a European leader in banking and financial services, with a significant and growing presence in the United States and leading positions in Asia. The Group has one of the largest international banking networks, with a presence in over 75 countries and nearly 190,000 employees including 147,000 in Europe - among whom 18,000 in Italy, 16,500 in Belgium, 58,000 in France and 3,700 in Luxembourg. BNP Paribas enjoys key positions in Corporate and Investment Banking, Private Banking & Asset Management, Insurance, Securities Services and Retail Banking.

Prior to answering to the specific questions of the technical discussion paper (TDP), BNP Paribas would like to draw the Joint Committee's attention on the following issues:

### 1. Scope of the PRIIPs Regulation

We welcome the clarification on which investment products are considered within the scope of the PRIIPs Regulation – this clarification is essential both for manufacturers and distributors – provided within the ESAs' discussion Paper issued on 17 November 2014.

According to Table 2 of the discussion paper dated 17 November 2014, any OTC derivatives are included in the scope of the PRIIPs Regulation.

However, we believe that Derivatives products based on an OTC bilateral contract used by the retail clients should be outside of the scope of the Regulation when they represent agreements between the counterparties to exchange predetermined cash flows (such as FX forwards, FX swaps, etc.) for the following reasons:

- The exchanged amounts are known in advance according to the terms and conditions of the forward contract, unless there is a tacit or explicit/contractual understanding that the contract will not be physically settled but closed out,
- Provided the contracts are expected to be physically settled, there is no amount repayable subject to fluctuations as stated in the definition of a PRIIP in Article 4(1).

### 2. Entry into effect of the RTS

The final rules concerning the content of the KID will be known around September 2016, leaving manufacturers with only 4 months to implement the necessary IT developments to produce the KID if the date of entry into effect of the RTS were to be 31 December 2016.

BNP Paribas therefore suggests that the Joint Committee postpone to one year after the date of entry into force of the regulation endorsing the RTS, the entry into effect of these requirements, and thus of the requirement for manufacturers to draw up a KID which will be provided to retail clients.

### 3. Adoption of a balanced approach to define the content of KIDs

Finally, BNP Paribas would like to stress the fact that the sheer volume of products concerned by the PRIIPs Regulation represents a major challenge for manufacturers from an implementation point of view,

all the more that timely availability of the KID is key to certain products, so that it is critical that RTS strive for ease of implementation. While they should obviously result in meaningful and accurate information being delivered to the end investor, the RTS should balance the need for exhaustiveness and methodological perfection with the need for simplicity both for the sake of clients' usage of the KID and manufacturers' ability to compute the relevant figures and produce the KID in large volumes and timely.

In this regard, it is a concern to BNP Paribas that some of the options set out in the TDP currently under consultation are of such a complexity that readability for investors may be harmed and feasibility for manufacturers is questionable.

As a consequence, BNP Paribas is of the opinion that a balanced approach should be adopted by the Joint Committee of the ESAs to setting the KID's content, particularly as regards the risk indicator, the performance scenarios and the costs disclosure, which need to be scalable and relatively stable considering the stock of products concerned on which updates may be needed.

#### 4. Main general comments

Our main general comments on the technical aspects of PRIIPs are summarized below:

- BNP Paribas is perfectly aware that the ESAs' work is not easy and that tough choices are to be made. In this context, we would like to insist on the fact that **technical choices should be based on proved, tested, well understood techniques and with a reasonable cost of implementation**. Given the limited timeframe, one should modestly admit that the objective cannot be to get the "perfect solution", but a solution which is "understandable, not misleading, not increasing asymmetry" for investors and that is cost effective. **As a result we have a preference for the Option 2 ("product volatility"), as it is the closest to the current UCITS SRRI to which retail investors are accustomed.**
- **Performance scenarios –"what if prescribed scenarios"** We favour this option as it will define certain standardized scenarios, without any implication about their likelihood, which would be used by all manufacturers and all types of products. General guidelines could be published for each type of PRIIPs (structured products, funds, insurance products), similar to the guidelines already applicable to UCITS and structured UCITS (CESR 10-1318).
- **Benchmarks:** BNP Paribas is of the view that manufacturer should **not be required to necessarily display a benchmark in performance scenarios**. Yet, if a benchmark is deemed to be required, a) the amount initially invested or b) the risk free rate are probably the best among the 3 options.
- **Risk premia.** For equities and commodities structured products , **should the ESA select performance scenarios be probabilistic**, BNP Paribas would prefer condition b. with the asset growing at risk free rate adjusted by an asset specific risk premium, set by the regulators with very prescriptive conditions (e.g. for equities **the risk premium should probably be between 4% and 7% p.a.** ).
- **Regarding Costs, BNP Paribas generally prefers the Total Cost Ratio for Funds and Structured products** (The RIY is only relevant for some specific insurance products with deterministic premiums and deterministic fixed rate and redemption). Generally retail investors are familiar with OCR for funds. As a result we believe the TCR is more understandable for retail and achieves better comparability between funds and other PRIIPs.

< ESMA\_COMMENT\_PRIIPs\_1 >

**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.**

<ESMA\_QUESTION\_PRIIPs\_1>

It is of utmost importance that the retail investors understand the performance scenarios, and that these give a fair appreciation of the products and allow for comparability.

Due to the large spectrum of products included in the PRIIPs regulations, defining a single model is a challenge: although the deterministic approach seems to be the most suitable for insurance-based products (euro funds), it must be noted that it is not adapted to a wide array of products including insurance unit linked products and structured products. **It is our view that Option c) Stochastic modelling based on parameters estimated from current market prices of derivatives and other forward looking contracts” is the one solution that can cover all PRIIPs products.**

Option c) is the most accurate methodology to compute risks related to derivative instruments (i.e. the Greeks) associated with structured products and structured UCITS funds. And the Greeks (delta, vega, rho, etc...) should definitely be used to compute the risk indicator of PRIIPs embedding a derivative element. One of the benefit of option c) is that it is based on current market prices and not on historical parameters that may not be representative of future outcomes.

Option a) implies full reliance on historical data, which is more prone to manipulation than reliance on market prices.

Option b) could be considered; as historical parameters are somehow more observable than implied ones for illiquid markets (both options b and c would be easily observable for illiquid markets). However, this option is less accurate than option c), especially if the VaR or Expected shortfall at maturity is chosen to compute the risk indicator.

Option d) will be problematic for regulators to ensure it is the right parameters that are used in the right context, especially since the range of PRIIPs is so wide.

Option e) could be a solution but the existence of conflicts of interest would need to be addressed.

**Regarding the distribution of returns to be used for undertaking for collective investment (hereafter “UCI”):** we prefer the use of historical data which is simpler and less costly to implement. A distribution of returns obtained from historical data has the potential to offer the biggest transparency retail investors.

**With respect to insurance contracts:** the distinction between insurance-based products and insurance unit-linked products is misleading, we have to distinguish between the investments backing the insurer's undertakings :

- internal funds managed by the insurer (euro fund and euro growth funds (or “Euro croissance funds”) in respect of which the insurer can provide its customers with risk/performance indicators,
- unit-linked products in respect of which the insurer intends to refer to the KID relating to the underlying asset.

**Concerning internal funds managed by the insurer,** the risk/performance indicator should preferably be based on :

- option 1, which may be combined with option 4 (depending on local applicable regulations),
- a determinist scenario as stochastic method is meaningless for this type of fund which is managed in a mutualized manner by insurers in accordance with the undertakings and warranties binding the insurer towards its customers and the performance of which is not directly linked to financial markets (valuation at the historic cost instead of fair value or market value, reserve for profit sharing, capitalization reserve, etc...).

**Concerning unit-linked products,** we are comfortable with option 2 and stochastic method.

<ESMA\_QUESTION\_PRIIPs\_1>

**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?**

<ESMA\_QUESTION\_PRIIPs\_2>

Fine-tuning or detailing the assumptions in the RTS at EU level might prove to be very difficult notably because of (1) the different spectrums of products available in different markets and (2) the differences in investment behaviour and capital at expense across the EU.

- Setting similar assumptions for all products would most likely result in retail investors not receiving relevant information and certain products outperforming others based on the KID although they might not be the best fit for all retail investors. This is notably the case for insurance-based investment products providing additional benefits. As such, it is important that the level II measures do not result in information that might be confusing or even misleading to retail investors.

- In addition, as far as different investment behaviours are concerned, it is also of utmost importance to ensure that retail investors are not directed away from certain products that match their interests and investments on the basis of a KID only because it is not tailored to the features of the products appropriately. For example, the average investment by a retail consumer could significantly differ from country to country as a result of investor behaviour and/or average purchasing power.

In this context, high-level general principles for the performance scenarios should be set at EU level, while the fine-tuning or detailing of the assumptions to be used should be developed by the different PRIIPs manufacturers in cooperation with the local supervisory authorities to ensure a certain level of comparability between the different products and within certain product classes. This would also ensure that the assumptions and methodology used do not impact the product development and ultimately the product design.

**For structured of Unit-linked products**

The model and the parameters used to compute risk indicator should be consistent with the ones used to price and hedge the products, hence should not be prescribed with the risk otherwise of not being adapted to the products.

The model should be left to the discretion of the manufacturer but he should be required to disclose the model name and its assumptions upon request of the ESAs. The advantage of allowing manufacturers to choose the most appropriate model and market parameters is that it will match market practices.

Parameters should be based on current observable market prices. In case of illiquid underlying or in the absence of a market, reasonable assumptions would need to be made and indicated in the KID.

**For other Insurance based products (Euro funds or equivalent)**

As regards the performance scenarios, deterministic modelling is more suitable to facilitate retail investors' understanding. It is also believed that performance scenarios should be prescribed as otherwise, there is a risk that the chosen scenarios are unreasonable and that retail investors cannot get comparable information. Moreover, only prescribed scenarios ensure legal certainty for PRIIPs manufacturers.

**For UCI**

We recommend the use of historical data, as stated in answer to question 1.

<ESMA\_QUESTION\_PRIIPs\_2>

**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?**

<ESMA\_QUESTION\_PRIIPs\_3>

**BNP Paribas is of the view that manufacturers should not be required to systematically display a benchmark in performance scenarios, for the following reasons:**

1) a benchmark is relevant only for products whose investment objective is to track or beat a benchmark. This can be the case for some funds. Yet, many products do not have such objective such as an auto-callable PRIIP whose objective is to provide downside protection and a coupon if the underlying rises moderately or a unit-linked insurance policy whose allocation in funds can be entirely reshuffled.

Using the risk free rate or the inflation rate as a general benchmark is not meaningful for many products. The benchmark needs to be tailored to the product; it should be set in an appropriate manner as part of the product governance obligation of the manufacturer.

Generally speaking, the use of inflation is in our view inadequate because it is not investable by a retail investor and thus provides poor comparability. In addition, inflation rates vary depending on the country of the investor, whereas the manufacturer produces one KID only per product wherever it is distributed – for products distributed in several countries, the choice of the rate shown in the KID is therefore unlikely to be a true reflection of the actual situation of the end investor.

The risk free rate poses the same problem, as each country will have its own risk-free rate, sometimes significantly different from the others as experienced in the Eurozone. In addition, the notion of risk-free rate in itself is put into question since the financial crisis.

The choice of an appropriate benchmark also depends on each investor's risk appetite and risk premium, and on the product type.

If a benchmark is deemed necessary, we have the following comments on the proposed options:

#### **For structured products**

- a) The amount initially invested is probably an option that is too conservative in a higher rate environment.
- b) The risk free rate is probably the best among the three options. Yet the ESA would have to prescribe the rate to be used to have consistent results between manufacturers. In this situation, we would recommend the money market rate for each currency, EUR EONIA, USD FedFunds, etc...
- c) Inflation, is not an investible benchmark, so it is not directly relevant for a retail investor.

#### **For insurance based products and UCI**

The first option (ie. the amount invested without any adjustment) is the most suitable notably because:

- It is the simplest and easiest to understand option for retail investors.
- This feature is not included in pre-contractual information disclosure for other products (MiFID and UCITS for instance)
- Inflation is not a risk that is inherent only to PRIIPs but also affects other investment products that are excluded from the scope of the PRIIPs Regulation (eg. real estate, etc.). Therefore, this information is not useful for retail investors nor does it increase comparability or transparency of products.

The definition of "loss" should be based on the option which is general, simple and most understandable and meaningful for retail investors. Therefore, the amount invested without any adjustment should be the level against which performance is measured.<ESMA\_QUESTION\_PRIIPs\_3>

<p><b>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?</b></p>
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<ESMA\_QUESTION\_PRIIPs\_4>

The asset growing at the risk free rate adjusted for an asset specific risk premium (with the hypothesis that the risk premium is different from zero and constant in time – ie. **Option b) is the most appropriate approach to be taken to specify the growth rates.** It is our view that this rate should be explicitly set by regulators (e.g. for equities the risk premium should probably be between 4% and 7% p.a.). This would ensure all manufacturers use the same equity risk premium and would be simple to implement.



Option a) presented in the TDP (ie. the asset grows at the risk free rate with the hypothesis that the risk premium is equal to zero) is too unrealistic and therefore inadequate, given that assets' risk premia are almost never equal to zero. For example, for equities and commodities, should performance scenarios be probabilistic, a growth rate set to the risk free rate would not be satisfactory because a risk premium exists for these products.

Option c) (ie. the asset grows at the risk free rate adjusted for an asset specific risk premiums adjusted for the current market conditions) is probably the most realistic but would result in an overly complex model. As regards equities, Bloomberg publishes some expected return levels in EQRP and CRP functions, which may be used for regulatory calculations as these levels are objective, based on accurate economic models and independent from manufacturers. Yet, they are subject to changes, which would be problematic if they are too frequent, and would therefore be less stable than a prescribed risk premium set by the ESAs.

It must be noted that this approach would not work for credit and rate products whose models generally do not incorporate a risk premium.

As for actively managed UCITS (open ended) we hardly see how they could simulate the performance of their NAV in a forward looking performance scenario other than by simulating the portfolio return for a given holding period. Probabilistic performance scenarios are not well suited for funds.

<ESMA\_QUESTION\_PRIIPs\_4>

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

<ESMA\_QUESTION\_PRIIPs\_5>

**BNP Paribas is strongly in favour of scenario c. whereby the risk indicator would be calculated based on the recommended holding period** and a warning would be added explaining the possible variation in risk over time. This approach ensures true comparability between products.

As regards products with a fixed tenor, the recommended holding period would be the whole tenor of the product, which would enable the risk indicator to be a true reflection of the potential outcomes of the product and the performance scenarios to be descriptive of the entire pay-off. This would not be the case if the risk indicator had to consider a shorter investment horizon, not at all representative of the product economics. Similarly, any performance scenarios based on a shorter tenor (such as 10 days for a 5 year product) would be an incorrect description of the potential outcomes of the product. A different approach would be detrimental to comparability between products. Furthermore, overall comparability of the performance could be ensured anyhow by annualizing numbers (e.g. internal rate of return, annualized volatility or cVaR corresponding to the average "annual loss").

With respect to insurance based products, the holding period should be defined by applicable regulation, as there is no recommended holding period for such products : concerning life term insurance contracts, their duration depend on the life duration of the insured individual.

BNP Paribas is therefore in favour of a flexible approach whereby a standardised holding period assumption would be required only for open ended products.

Furthermore, scenario c. is the simplest to implement and understand and does not hinge on arbitrary choice of intermediate times as option a. or estimations as option b. (with a resulting figure not necessarily relevant for an investor willing to hold the product during the recommended holding period). Finally, option a. strikes us as not being compliant with the level 1 requirement to show an aggregated risk indicator, as several figures would have to be displayed.

<ESMA\_QUESTION\_PRIIPs\_5>

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



<ESMA\_QUESTION\_PRIIPs\_6>

BNP Paribas agrees that the credit risk of a PRIIP relates to the risk for the investor that the issuer or obligor fails and that it is not dependent on the underlying assets where the PRIIP is invested in, such credit risk being reflected in the PRIIP's market risk.

We are not in favour of relying on CDS levels or funding spreads for the following reasons:

- Some product manufacturers do not have CDS traded in the market but only a credit rating
- CDS or funding spreads are often subject to changes (sometimes volatile changes) whereas rating agencies classification offers greater stability.

**For structured products: in our view the best approach to credit risk would be based on one or more of the main rating agencies classification**, looking both at short term and long term ratings, because they are objective and under regulatory supervision, they provide better stability than a CDS spread, and are usually available for all manufacturers/obligors. The list of eligible rating agencies registered with ESMA is sufficiently broad for this purpose.

**As far as credit risk is concerned for insurance-based investment products:** the Solvency II regime already incentivises the diversification of insurers' risks and ensures the financial capability of insurers to fulfil their contractual obligations, even under stressed conditions. In addition, in some countries, insurers' credit risk is further reduced thanks to insolvency guarantee schemes which should, therefore, be taken into account when assessing the credit risk. Depending on how credit risk is understood, the credit risk of the underlying financial instruments can be relevant for unit-linked products although it is key to stress that the credit risk of the underlying assets may end-up being already reflected in the PRIIP's market risk and should under no circumstances be accounted for twice. With respect to underlying financial instruments backing the insurer's undertakings expressed in units, the market risk should be disclosed in the KID relating to those financial instruments and not in the KID for insurance based products. As a matter of fact, investments in the euro fund or euro growth fund (or "Euro croissance fund") managed by an insurer is quite different from the market risk relating to those financial instruments and commingling them would be very confusing for the customers.

<ESMA\_QUESTION\_PRIIPs\_6>

**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?**

<ESMA\_QUESTION\_PRIIPs\_7>

It is important to distinguish liquidity risk from the liquidity profile of a product as the liquidity profile refers to characteristics of the product. For example, retail investors may purchase insurance-based investment products because, among their various objectives (beneficiaries' appointment clause in case of death of the insured...) they seek a long-term investment, which is a feature of the product rather than a risk.

BNP Paribas is of the view that liquidity should be described by a narrative below the risk indicator but should not be incorporated as a quantitative component in the risk indicator (inaccurate and confusing for the investor).

If this approach were chosen, then redundancy should be avoided with the section "Can I take my money out early" due to the limited length of the KID.

<ESMA\_QUESTION\_PRIIPs\_7>

**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?**

<ESMA\_QUESTION\_PRIIPs\_8>

BNP Paribas considers that the qualitative measures proposed by the ESAs are relevant:

- (i) a product is traded or will be traded on a regulated market or MTF
- (ii) a liquidity provider exists (either manufacturer or other parties)
- (iii) market rules ensure liquidity under normal conditions and/or,

(iv) when regular redemption dates are offered throughout the life of the product under normal market conditions.

We do not think that quantitative measures are appropriate to measure liquidity risk as they do not incorporate important qualitative factors. In our view, all of the measures proposed are imperfect assessments of liquidity risk and we would favour describing liquidity risk in a narrative built on the criteria suited to the product among those suggested above.

Should it be decided that a quantitative measure is required, the most reliable measure is in our view the bid/ask spread for structured products. For insurance based products, we strongly believe that only a qualitative measure would be appropriate, as the liquidity risk is covered by the insurer. For example, in the French law context, the insurer has one month to pay the beneficiaries once identified in case of death of the insured, and two months to pay the policyholder in case of partial or full redemption of the contract, irrespective of whether the contract is invested in liquid or illiquid assets.

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?

No. Liquidity is a topic different from exit penalties. Transparency on exit penalties and costs for early redemptions should be provided but in the cost section of the KID.

For insurance based-products with a fixed term such as accumulation contracts (excluding life insurance contracts), it should be taken into account that a fixed term is in many cases a valuable feature for the customer and should therefore not be treated as a liquidity risk; otherwise this could wrongly lead to the product being described as an overall risky instrument in the summary risk/reward indicator.

Introducing a narrative on cost and exit penalties in the section would nevertheless help investors defining if a product is rather liquid or rather not, relative to a time horizon.

<ESMA\_QUESTION\_PRIIPs\_8>

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

<ESMA\_QUESTION\_PRIIPs\_9>

**General issues with this approach**

**This approach, as it is not based on quantitative rationales, is more a product classification than a true risk measure.** Even though it may seem easier to read for an investor, it is not suitable for structured or insurance unit-linked products and it is the option with the main drawbacks compared to the other ones considered:

- It is not robust because **it creates inconsistencies between products with similar risks**, hence creating an unlevel playing field, in particular between funds and structured products. For example, a bond fund would have a risk class of 2 as a non-structured PRIIP, while a 50% capital-protected note on the same bond fund (i.e. providing capital protection on the downside and a limited gearing on the upside) would fall into a higher risk class of 4. Similarly, a delta1 note collateralised by the bond fund's shares (hence free of issuer risk) would receive a risk rating of 5. This approach hence does not sort products according to the risk of losing capital (see below bullet 3 of our recommendations);

- Because it is not quantitative, it does not provide stable enough ratings with respect to products traded on the secondary market whose KIDs would have to be updated continuously as market prices change. For example, a note protecting 100% of the initially invested principal, issued by a A-issuer, could be purchased at 125% in the secondary market, meaning that only 80% of the amount invested ( $125\% \times 80\% = 100\%$ ) would be protected at maturity: should its KID be updated to show a risk class of 4 when the ratio of the secondary market price divided by the initially invested principal crosses the risk class threshold (100% – risk class 1, 90% – risk class 3, 80% – class 4) ?

- It does not account for market risk.

### **Recommendations on criteria and risk levels' definition**

- If this indicator were selected, it should not have to be updated during the life of the product, since the capital protection thresholds (100% class 1 / 80% class 3 / 50% class 4) are defined based on the initial capital invested. A disclaimer that the indicator is static based on the initial capital invested could be added to avoid any misunderstanding for exchange traded products bought on the secondary market.
  - All products with a conditional capital protection would fall into risk class 5 (out of 6) regardless of their risk profile. This option should therefore be supplemented with a quantitative market risk indicator for products with conditional capital protection (based on option 2 - volatility based or option 3 - VaR or cVaR).
  - This indicator also **disregards market risk and does not consider the likelihood of receiving income: two capital guaranteed products** (one with a very high but also very unlikely coupon, and one with a guaranteed coupon) could have the same rating of 1, while their income profiles are fundamentally different for the investor. Strike versus capital guarantee should also be addressed: a product with a 70% capital guaranty and a call strike at 70% should not have same risk class of 5 as a product with the same capital guaranty but a call strike at 100% because the first product gives the investor a much higher chance of receiving 100% capital back, while with the second product, the underlying needs to perform a lot more (call pay-out of at least 30%) for the investor to get his capital back.
  - we would recommend not setting any limits to tenors since the risk classes are defined based on the risk of loss "at the investment horizon". Yet, should maximum tenors be required, we suggest allowing 10 years for the risk class 1 and 15 years for the risk class 3.
  - The criteria defining the risk levels should be consistent across products, especially structured PRIIPS and non-structured PRIIPS. For example, risk class 2 should only include bond funds where all the bond holdings are rated above creditworthy solvency level [e.g. rating BBB-], which is the level required for securities falling in risk class 2.
  - We agree that the level of the partial guarantee corresponding to class 3 could be 80%, and 50% in class 4, but products with a conditional capital protection (i.e. with barriers) should be seen as more defensive and therefore should be included in class 3 or 4 instead of class 5.
  - To ensure consistency with the UCITS SRRI, the scale should be composed of 7 levels.
  - Short Term Money Market Funds AIF with exactly the same features as Short Term Money Market Funds UCITS should be also included in category 1.
- <ESMA\_QUESTION\_PRIIPs\_9>

<b>10. Please state your views on the required parameters and possible amendments to this indicator.</b>
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<ESMA\_QUESTION\_PRIIPs\_10>

**We are in favour of this option because it is easier to implement than option 3, including for smaller manufacturers. From a practical point of view, it produces similar results as a VaR based methodology with less complexity.** This option together with option 3 has been tested on a sample of more than 140 various structured products. Both options produced similar results in terms of dispersion of products on the risk scale and applicability to different types of PRIIPs. Another advantage of option 2 is that it is manageable by manufacturers without the need for external resources to run the model and that it is built on the same model as the one used for UCITS hence avoiding significant operational changes for asset managers in implementing PRIIPs.

The TDP mentions that it may not be compliant with the level one text referring to a summary risk indicator because of the two-dimension indicator it advocates. Although we consider that the two components of the indicator does not make the indicator non-compliant with level 1 and that it is better to distinguish the two components (credit and market risks) for the sake of investors, merging the two dimensions into one is not an issue from a technical point of view, just a matter of presentation. It could be done by choosing the worst dimension or calculating the average of the two dimensions.

The TDP also mentions that it is based on volatility calculated for a very short period (5 or 20 days) then scaled to an annual volatility. We would like to highlight that it is not the case: it is based on (i) historical

volatility on a 5 year observation period (based on the current UCITS methodology but it could also easily be extended to the whole maturity of the product) and (ii) the delta which is calculated for the overall maturity of the product.

**As regards the disadvantages mentioned p. 38:**

- Applicability: whilst certain product types may require an adjustment of the method in order to take into account their specificities, it has to be noted that (i) this is the case of all methodologies which will all need adjustments for certain products and (ii) in the particular case of insurance products which is mentioned, the risk indicator based on volatility can be easily calculated.

- Reliability: We do not agree with the statement that the method does not work well for non-linear products because the delta approach can also be applied to those.

- Lack of academic or theoretical support: this has not prevented the choice of such volatility-based model for UCITS (CESR 10-673). Volatility is concept widely used and well-documented in finance.

- BNP Paribas does not agree that robustness is a weakness of option 2. On the contrary, it is one of its advantages:

a. Correlation is taken into account by the model as follows:

- For a single asset\_1, Risky Component Risk Contribution = Capital at Risk x Delta(1) x Volatility(1)
- And for multiple assets, Risky Component Risk Contribution = Capital at Risk x Sqrt[ Sum{ i=1,...,N, Sum( j=1,...,N Delta(i) x Delta(j) x Covariance(i,j) ) } ]

b. Delta is easy to verify and is homogeneous between issuers

c. The model leads to very consistent results for products purchased in the secondary market.

In summary, this method based on volatility indeed neglects certain factors (it is a first order approximation). However, it is very close to a full valuation approach. Hence, the gain this method offers in terms of simplicity and ease of implementation (in particular given the variety of PRIIPs) widely exceeds in our view the disadvantages that certain risk factors are not totally accounted for.

**Other advantages of the method, not listed in the TDP, are the following:**

- Comparability: this option can be applied to all products covered by PRIIPS as it combines a "bond component" and a "risky component". It provides for a level playing field between funds and structured products on funds contrary to option 1.

- Supervision: there is no barrier to entry for national competent authorities or independent valuation companies to perform an external control of the indicator computed by manufacturers (all independent valuation companies are able to compute delta and historical volatility at no extra cost).

- Discriminatory: testing results show that option 2 provides discriminatory results on a wide sample of products. We keep these results at the disposal of the Joint Committee should it be willing to examine them.

<ESMA\_QUESTION\_PRIIPs\_10>

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

<ESMA\_QUESTION\_PRIIPs\_11>

Option 3 is our second best option after option 2.

BNP Paribas agrees with the list of disadvantages of this option listed in the TDP and considers that they far outweigh its potential benefits.

A measure based on 50% expected shortfall should be preferred over a measure based on a low percentile VaR (95% or 99%) as it encompasses more information about the product's return distribution, which is crucial to ensure comparability among PRIIPs.

**As regards the advantages mentioned p. 40:**

BNP Paribas agrees that option 3 is applicable to a wide range of PRIIPs, gives reliable risk estimates, ensures comparability, and has a good discrimination power (especially with 50% ES rather than with 95% VaR). However because of its complexity, it may not be as robust as option 2 the other methodologies contemplated in the TDP. Yet, a VaR ES is more robust than option 1.

**As regards the disadvantages mentioned p. 40:**

Because of its sophistication, option 3 has certain drawbacks:

- Interpretation by investors: a methodology based on probabilities of occurrence of extreme risks is potentially difficult for consumers to interpret correctly.
- Implementation costs: the option would cause high implementation costs both for manufacturers and for regulators to supervise. UCITS managers would bear high implementation costs, as the methodology they currently use would have to be changed. In addition, it is based on a wide range of data (volatility, dividends, rates, correlations) which entails (i) access costs (ii) processing capacity (iii) important storage capacity and (iv) a robust audit trail. This option can thus discriminate against smaller PRIIPs producers who do not have the needed resources to implement it. In addition, because the indicator is complex to compute, it may lead to the emergence of a business related to its calculation, creating an external access cost borne by manufacturers. These two aspects would create a barrier to entry to manufacturing PRIIPs, which is not consistent with the aim to foster competition and provide a wide array of products to investors. In any case, should this option be selected, the methodology should be made available publically in a detailed enough manner and free of charge to allow manufacturers, especially smaller ones, to use it.

.<ESMA\_QUESTION\_PRIIPs\_11>

**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?**

<ESMA\_QUESTION\_PRIIPs\_12>

**BNP Paribas agrees that a forward looking model that uses the end of maturity as the default holding period is a good alternative to option 3. Yet, option 2 would still be our preferred option because its minor disadvantages are significantly outweighed by its robustness, ease of implementation and comparability with the UCITS' SRRI.**

<ESMA\_QUESTION\_PRIIPs\_12>

**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?**

<ESMA\_QUESTION\_PRIIPs\_13>

As the description of the levels is very generic, this option is difficult to comment upon.

The use of two levels can be confusing for the retail investor. This would be the case for example in a situation where the first level differentiates the products merely on characteristics such as capital at risk (e.g. A for principal protected products, B for products with capital at risk such as Athena notes or a UCITS bond fund, and C for contingent liability products such as CFDs) and the second level on a more quantitative measure (such as a volatility or loss).

This option could also make it difficult to understand or compare products. Let's take the example of two products:



- One with bond funds as underlying and principal at risk, with a very low volatility – its risk indicator would be B1 (where B is the grade for the first level and 1 the grade for the second level based on volatility),  
 - The other one is a principal protected note with a higher volatility – its risk indicator would be A5 (where A is the grade for the first level and 5 the grade for the second level based on volatility).  
 It seems fairly hard for the average retail investor to compare these two products based on these indicators.

<ESMA\_QUESTION\_PRIIPs\_13>

**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?**

<ESMA\_QUESTION\_PRIIPs\_14>

The indicator already used for UCITS should be leveraged, as it is already known by a sizeable portion of retail investors in EEA since its implementation in 2010. It should however be modified to include a second dimension for the credit risk (to be used when there is credit risk, associated with the issuer, or the guarantor when applicable, i.e. for securities, structured deposits and some unit-linked insurance products). Credit risk would also be rated on a scale of 7 buckets, differentiated via the use of letters (from A to G) for example.

The cut-off points could be as follows:

Market	Risk Rating Aggregate Volatility above or equal to:	Volatility less than:
1	0%	0.5%
2	0.5%	2%
3	2%	5%
4	5%	10%
5	10%	15%
6	15%	25%
7	25%	∞

  

Credit Risk	Rating Long Term classification (from major credit rating agencies)
A	AAA
B	AA+, AA, AA-
C	A+, A, A-
D	BBB+, BBB, BBB-
E	BB+, BB, BB-
F	B+, B, B-
G	anything strictly below B- or non-rated by any of the rating agencies registered with ESMA ( <a href="http://www.esma.europa.eu/page/List-registered-and-certified-CRAs">http://www.esma.europa.eu/page/List-registered-and-certified-CRAs</a> )

<ESMA\_QUESTION\_PRIIPs\_14>

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

<ESMA\_QUESTION\_PRIIPs\_15>

The primary purpose of performance scenarios is to be illustrative. Scenarios should help the client understand how the product works and how returns are calculated. **The what-if prescribed approach seems therefore the most suitable.** Level 3 guidelines could be published for each type of PRIIPs (structured products, funds, insurance products) similar to the guidelines already applicable to UCITS (CESR 10-1318).

The option chosen should allow small manufacturers to manually draw performance scenarios in compliance with the guidelines, while larger manufacturers would probably automate the production of performance scenarios by relying on certain quantiles of the payoff distribution.



For structured UCI, we are in favor of "what if prescribed approach" similar to guidelines already applicable to UCITS (CESR 10-1318).

For insurance products, this methodology could not be applied easily to insurance based products (euro-fund and euro growth fund (or Euro croissance fund) due to asset/liability interactions.

<ESMA\_QUESTION\_PRIIPs\_15>

**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?**

<ESMA\_QUESTION\_PRIIPs\_16>

Yes, we think they are sufficient, as far as the products are approved by regulators.

As far as we are aware, the CESR's guidelines for structured UCITS (CESR/10-1318), which are consistent with the what-if manufacturer approach, worked well in the UCITS space and we do not see the need to reinforce them. As per the guidelines, the manufacturer is best place to decide between a table or a graph. We believe this should be maintained for PRIIPs.

<ESMA\_QUESTION\_PRIIPs\_16>

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

<ESMA\_QUESTION\_PRIIPs\_17>

**The what-if prescribed approach is BNP Paribas's preferred option.**

Guidelines would be helpful as we do not fully agree with the option as it is presented in the TDP for the following reasons:

a) Past performances are not a good representation of future performance. What matters to the investor in the performance scenario is the future performance. We would therefore not recommend using past performances to build performance scenarios. The scenarios outcome would depend too much on the given reference period and the chosen underlying. This would create a bias towards underlying which historically performed well. In addition, using past performances may be misinterpreted by and misleading for end-investors (an implicit link could be made between past and future performances ); even if a disclaimer can be added to the document to warn the investors that the past is not an indication of the future, it's preferable to completely disconnect past performances and performance scenarios; making a link could be prejudicial for both the manufacturers and the investors.

b) Setting a fix growth rate of the underlying (for ex 10%) does not seem appropriate, as the level of the rate needs to be adapted to the pay-off.

<ESMA\_QUESTION\_PRIIPs\_17>

**18. Which percentiles do you think should be set?**

<ESMA\_QUESTION\_PRIIPs\_18>

Our preference is for a what-if prescribed approach with the possibility, but not the obligation, for manufacturers to automate performance scenarios using quantiles of the payoff distribution. **The chosen quantiles would need to be symmetrical around the 50% percentile (for example 10/50/90 or 25/50/75) and a risk premium should be set per asset class.**

**An option is to use 10/25/50/75/90 (equivalent to very bullish, bullish, median, bearish, very bearish) as it should roughly cover all situations and, when published in a table, it just adds two lines (i.e. not a major issue as regards the KID's length).**

Please note that a probability approach for Performance scenarios is only meaningful if risk premia are used to compute the distribution.





<ESMA\_QUESTION\_PRIIPs\_18>

**19. Do you have any views on possible combinations?**

<ESMA\_QUESTION\_PRIIPs\_19>

Combinations of historical, hypothetical, and probabilistic scenarios are hard to explain to clients. Such combinations would also be extremely costly to implement as they involve a mix of computing and manual interventions on the KID. BNP Paribas is strongly against a combination of these 3 approaches.

<ESMA\_QUESTION\_PRIIPs\_19>

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

<ESMA\_QUESTION\_PRIIPs\_20>

Credit events should only be represented in the performance scenarios for CLN-type products. Credit events relating to the issuer (or underlying bond risk in case of repackaging) are already included in the risk indicator.

Considering that a 2 level risk indicator already mentions the credit risk, it's not useful to implement the credit risk in the performance scenarios.

<ESMA\_QUESTION\_PRIIPs\_20>

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

<ESMA\_QUESTION\_PRIIPs\_21>

Only automatic early redemptions or holder puttability for a given value on fixed dates should be explained in the scenarios. Voluntary redemptions (i.e. selling the product back in the secondary market) should not be considered in the scenarios. This aspect of the product is dealt with in the section entitled "How long should I hold it and can I take my money out early?"

<ESMA\_QUESTION\_PRIIPs\_21>

**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?**

<ESMA\_QUESTION\_PRIIPs\_22>

Performance in the case of exit before the recommended holding period should not be shown in the scenarios.

As for a given scenario, the fair value is difficult to compute (conditional expectation), it should not be used for scenarios. A critical issue is that for future periods the scenario's starting point itself is uncertain and the retail client will likely misinterpret the conditional expectation of the intermediate performance displayed.

<ESMA\_QUESTION\_PRIIPs\_22>

**23. Are the two types of entry costs listed here clear enough? Should the list be further detailed or completed (notably in the case of acquisition costs)? Should some of these costs included in the on-going charges?**

<ESMA\_QUESTION\_PRIIPs\_23>

A generic definition should be given for entry (and exit) costs or ESAs should preferably give an exhaustive list. A definition or an exhaustive list should clarify that entry/exit charges are separated from “on-going” charges.

Their very nature is to be charged up-front once (or at the end) and deducted from the amount invested by (or returned to) the client.

Consequently, entry and exit costs should never be included in the “on-going” charges since they are not “on-going” by nature but charged only on two occasions (entry & exit).

Including them into the on-going charges would be wrong information delivered to the client.

<ESMA\_QUESTION\_PRIIPs\_23>

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

<ESMA\_QUESTION\_PRIIPs\_24>

The list is complete but the information delivered to the client should stay simple. As regards to carried interest in the case of private equity fund, they should be explicitly mentioned in a specific line as it is the case now and not included in the “on-going” charges. The reason is that carried interest is only charged when the fund is closed, on the condition that there is a capital gain and that this capital gain has reached a predefined level.

<ESMA\_QUESTION\_PRIIPs\_24>

**25. Should these fees be further specified?**

<ESMA\_QUESTION\_PRIIPs\_25>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPs\_25>

**26. Should these fees be further specified? The “recovering fees” cover the following situation: when an investor receives income from foreign investments, the third-country government may heavily tax it. Investors may be entitled to reclaim the difference but they will still lose money in the recovering process (fee to be paid).**

<ESMA\_QUESTION\_PRIIPs\_26>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPs\_26>

**27. Should these fees be further specified? The “recovering fees” cover the following situation: when an investor receives income from foreign investments, the third-country government may heavily tax it. Investors may be entitled to reclaim the difference but they will still lose money in the recovering process (fee to be paid).**

<ESMA\_QUESTION\_PRIIPs\_27>

Recovering fees as described by the ESAs would be incurred in the tax recovery process initiated by the individual investor. Hence, such fees do not apply at the level of the fund and thus cannot be ascertained by the product manufacturer. Moreover, the amount of fees might considerably vary depending on the fund investor’s domicile, the foreign tax rules and the specificities of the recovery procedure applicable in the relevant third country. In the end, such fees might even not be applicable at all if the investor fails to initiate the recovery process.

If these recovering fees are directly paid by the fund to benefit to all holders they usually are paid to either a legal advisor or the depositary and should appear under the corresponding heading.

<ESMA\_QUESTION\_PRIIPs\_27>

**28. This list is taken from the CESR guidelines on cost disclosure for UCITS. What is missing in the case of retail AIFs (real estate funds, private equity funds)?**

<ESMA\_QUESTION\_PRIIPs\_28>

The issue of double counting is pertinent also in relation to other cost items. Thus, we ask the ESAs to clarify in the general provisions concerning the cost section that as a matter of principle, cost items should be only included in the calculation if they are effectively charged to the fund and not covered by other cost positions.

<ESMA\_QUESTION\_PRIIPs\_28>

**29. Which are the specific issues in relation to this type of costs?**

<ESMA\_QUESTION\_PRIIPs\_29>

Performances fees are unknown at the point of sale; its amount varies depending on the performance reached at year end, every year being different, an annual and regular % cannot be disclosed. The performance fee could be null. We consider that a description of the principles of calculation of the performance fee will be sufficient to disclose.

<ESMA\_QUESTION\_PRIIPs\_29>

**30. Is it relevant to include this type of costs in the costs to be disclosed in the on-going charges? Which are the specific issues in relation to this type of costs? Which definition of Costs for capital guarantee or capital protection would you suggest? (Contribution for deposit insurance or cost of external guarantor?)**

<ESMA\_QUESTION\_PRIIPs\_30>

Yes, with respect to **funds only** (i.e. not structured products and not insurance based products,) we agree that cost of capital guarantee effectively paid to a bank should be disclosed. The costs of capital guarantee or capital protection should be disclosed either in %, or in basis point or in reduction in yield.

<ESMA\_QUESTION\_PRIIPs\_30>

**31. Which are the specific issues in relation to this type of costs? Should the scope of these costs be narrowed to administrative costs in connection with investments in derivative instruments? In that respect, it could be argued that margin calls itself should not be considered as costs. The possible rationale behind this reasoning would be that margin calls may result in missed revenues, since no return is realized on the cash amount that is deposited, and that:**

<ESMA\_QUESTION\_PRIIPs\_31>

Derivative instruments are standard financial instruments and should not be considered as having specificities in all fields, for example holding costs. Payments incurred for the holding of financial derivative instruments shouldn't be considered as costs but as part of an investment strategy decision. The margin calls for example are expected to be compensated by the gain generated by purchase and sale of the derivative instruments. They are part of a global strategy which will result on a net gain or loss for the client. Carving out the cost of missed revenues on margin calls would be inadequate.

<ESMA\_QUESTION\_PRIIPs\_31>

**32. Which are the specific issues in relation to this type of costs? Should this type of costs be further detailed/ defined?**

<ESMA\_QUESTION\_PRIIPs\_32>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_PRIIPs\_32>

**33. How to deal with the uncertainty if, how and when the dividend will be paid out to the investors? Do you agree that dividends can be measured ex-post and estimated ex-ante and that estimation of future dividends for main indices are normally available?**

<ESMA\_QUESTION\_PRIIPs\_33>  
NA  
<ESMA\_QUESTION\_PRIIPs\_33>

**34. Is this description comprehensive?**

<ESMA\_QUESTION\_PRIIPs\_34>  
NA  
<ESMA\_QUESTION\_PRIIPs\_34>

**35. Can you identify any difficulties with calculating and presenting explicit broker commissions? How can explicit broker commissions best be calculated ex-ante?**

<ESMA\_QUESTION\_PRIIPs\_35>  
No difficulties with presenting actual broker commissions on ex-post based on historical records; for new funds with no records, broker commissions cannot be calculated but only estimated. A disclaimer should warn the client that the broker commissions are only estimated.  
<ESMA\_QUESTION\_PRIIPs\_35>

**36. How can the total of costs related to transaction taxes best be calculated? How should this be done to give the best estimate ex-ante? Are there other explicit costs relating to transactions that should be identified? Do you think that ticket fees (booking fees paid to custody banks that are billed separately from the annual custodian fee paid for depositing the securities) should be added to this list?**

<ESMA\_QUESTION\_PRIIPs\_36>  
No difficulties with presenting actual transaction taxes on ex-post based on historical records; for new funds with no records, transaction taxes cannot be calculated but only estimated. A disclaimer should warn the client that the transaction taxes are only estimated.

<ESMA\_QUESTION\_PRIIPs\_36>

**37. As regards the abovementioned estimate, can the fair value approach be used?<sup>2</sup>**

<ESMA\_QUESTION\_PRIIPs\_37>  
No, a fair value approach of the broker commission cannot be made; the bid-ask spread reflects other elements such as market risk and liquidity risk. Their respective proportion in the spread is fluctuant along with the market conditions and the broker commission is not stable.  
<ESMA\_QUESTION\_PRIIPs\_37>

**38. Can you identify any other difficulties with calculating and presenting the bid-ask spread? Do you believe broker commissions included in the spread should be dis-**

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<sup>2</sup> One could also argue that all fund managers either have their own dealing desk or sub-contract this to other dealing desks. Since the principle of Best Execution is paramount, the dealers should know the typical spread in the securities with which they deal.

**closed? If so, which of the above mentioned approaches do you think would be more suitable for ex-ante calculations or are there alternative methods not explored above?**

<ESMA\_QUESTION\_PRIIPs\_38>

The bid-ask spread reflects other elements such as market risk and liquidity risk. Their respective proportion in the spread is fluctuant along with the market conditions and the broker commission is not stable. We don't believe the broker commissions included in the spread could be disclosed.

<ESMA\_QUESTION\_PRIIPs\_38>

**39. Do you believe that market impact costs should be part of the costs presented under the PRIIPs regulation? If so, how can the market impact costs best be calculated? How should this be done to give the best estimate ex-ante?**

<ESMA\_QUESTION\_PRIIPs\_39>

No, we don't think that market impact costs should be disclosed since it cannot be accurately calculated on each transaction. There's no proper method to distinguish between market impact and market risk if the price moves along when the order is executed. Our members strongly oppose any reference to a proprietary model and the costs that it would imply.

Besides, Best execution rules are already in place. Best execution results from a number of elements (speed, price, cost, place...) and cannot be over weighted on a single component (market impact).

Lastly, and for all these reasons, MIFID II hasn't retained market impact on its cost disclosure list.

<ESMA\_QUESTION\_PRIIPs\_39>

**40. How should entry- and exit charges be calculated considering the different ways of charging these charges? How should this be done to give the best estimate ex-ante? Can you identify any other problems related to calculating and presenting entry- and exit fees?**

<ESMA\_QUESTION\_PRIIPs\_40>

Dual pricing, swing pricing and anti-dilution levy are done to prevent the holders of the funds to pay for the entry (or exit) charges induced by a new investor (or by an existing investor); so they shouldn't be integrated into the TCR paid by the current investors since they're not paying it. For the new investor entering the fund (and symmetrically for the investor leaving the fund) the net cost of entry (or exit) cannot be known on an ex-ante basis; knowing them on ex-ante would lead to risk of market timing and late trading and would violate the rules governing swing pricing. We recommend that only upfront entry and exit charges be disclosed in the TCR for such products (other than insurance based products, as further explained hereinafter (answer 45)).

<ESMA\_QUESTION\_PRIIPs\_40>

**41. Which other technical specifications would you suggest adding to the abovementioned methodology? Which other technical issues do you identify as regards the implementation of the methodology?**

<ESMA\_QUESTION\_PRIIPs\_41>

On ex-post, when transaction costs are known, portfolio turn-over rate should take subscriptions and redemptions of the unit in the formula to give an accurate %.

As explained above, only explicit costs can be taken into account.

<ESMA\_QUESTION\_PRIIPs\_41>

**42. Do you think that an explicit definition of performance fees should be included? Do you think the definition by IOSCO is relevant in the specific context of the cost disclosure of the PRIIPs Regulation?**

<ESMA\_QUESTION\_PRIIPs\_42>

Yes, an explicit definition should be given and the IOSCO definition is relevant.

<ESMA\_QUESTION\_PRIIPs\_42>

**43. What would be the appropriate assumption for the rate of returns, in general and in the specific case of the calculation of performance fees?**

<ESMA\_QUESTION\_PRIIPs\_43>

Illustration of Performance fees should be calculated with the rate included in the different performance scenarios.<ESMA\_QUESTION\_PRIIPs\_43>

**44. Which option do you favor? Do you identify another possible approach to the disclosure and calculation of performance fees in the context of the KID?**

<ESMA\_QUESTION\_PRIIPs\_44>

Performance fees should be indicated as costs but excluded from the TCR and indicated in a separate line.

On an ex-ante basis, the separate line mentions the method of calculation and refers to the performance scenarios disclosed in the PRIIPs /KID for illustration of the method : performance fees are illustrated with each performance scenario so the investor can figure out the mechanism between performance and fees. On ex-post basis, actual historical performance fees could be disclosed together with the actual past annual performances. Simulations based on benchmarks or peer groups are not relevant and are misleading.

<ESMA\_QUESTION\_PRIIPs\_44>

**45. Which of the above mentioned options 1 and 2 for the calculation of aggregate costs would you prefer? Do you agree with above mentioned assumptions on the specificities of the costs of life-insurance products? How should the breakdown of costs showing costs specific to the insurance cover be specified? Do you think that risk-type riders (e.g. term or disability or accident insurances) have to be disregarded in the calculation of the aggregated cost indicator? How shall risk-type rider be defined in this context? (one possible approach might be: A risk-type rider in this context is an additional insurance cover without a savings element, which has separate contractual terms and separate premiums and that the customer is not obliged to buy as a compulsory part of the product).**

<ESMA\_QUESTION\_PRIIPs\_45>

Biometric risk premia should not be considered as costs, hence they should neither be included in the global costs indicator, nor shown in a separate and specific cost indicator. Those premia cover various risks (death, accident, disability...) covered by life term insurance contracts, therefore those warranties cannot be viewed nor treated as investment products.

Generally, costs that should be taken into account into the costs indicator should be direct and costs compulsorily incurred only (i.e., no option should be exercised by the customer to incur such cost).

Costs relating to the type of underlying assets backing units or optional warranties may not be relevant to all customers, depending on their choices on investments and warranties. Therefore taking into account all

those optional costs for the purpose of elaborating the costs indicator would be irrelevant and misleading for consumers.

KID may mention the normal/usual costs :

- entry fees,
- on-going costs/management fees,
- arbitration fees,
- transfer or exit costs.

However the cost indicator should refer to costs compulsorily incurred, i.e., entry fees and on-going costs.  
<ESMA\_QUESTION\_PRIIPs\_45>

**46. Do you think this list is comprehensive? Should these different types of costs be further defined?**

<ESMA\_QUESTION\_PRIIPs\_46>

We do not agree with the proposed list of costs. Irrespective of whether they represent entry, on-going or exit costs, they cannot be detailed in such a way. As a matter of fact, the main principle governing insurance activities is risks mutualization. In consideration for receiving the same amount for a type of contracts, the insurer warrants all over the duration of the agreement (until the death or full redemption) the payment of an indemnity to its customer who is still alive in certain cases or to the beneficiaries appointed by the customer, in case of customer's death. Those costs take into account several parameters that vary in time duration. Detailing those parameters at a certain point of time would be meaningless, and would provide no relevant or useful information to the consumers. The consumers only need clear information on the following : how much fees have I to pay ?

For insurance products (euro funds and euro growth funds (or "euro croissance funds"), the 'solvency' cost:

- is not really a useful information for our clients (what matters is the total amount of fees paid),
- cannot be easily isolated and computed as a part of the annual management fees,
- depends on the Solvency Ratio (own funds/SCR).

<ESMA\_QUESTION\_PRIIPs\_46>

**47. Do you agree that guaranteed interest rate and surrender options should be handled in the above mentioned way? Do you know other contractual options, which have to be considered? If yes how?**

<ESMA\_QUESTION\_PRIIPs\_47>

Guaranteed performance rates cannot be assimilated to costs within the framework of insurance business : it reflects the undertakings of the insurer and its reasonable and prudent projections, not the cost of an underlying derivative instrument. As a result, guaranteed rates cannot be seen as costs.

Likewise, options for early exit are at the customer's choice and should not be taken into account for the costs indicator (they are not compulsorily incurred). <ESMA\_QUESTION\_PRIIPs\_47>

**48. Should the methodology for the calculation of these costs be further specified?**

<ESMA\_QUESTION\_PRIIPs\_48>

Not relevant <ESMA\_QUESTION\_PRIIPs\_48>

**49. Do you think this list and breakdown is comprehensive?**

<ESMA\_QUESTION\_PRIIPs\_49>

Detailing the calculation method of profit sharing in an insurance company is a highly tricky exercise. For example, how should the reserve for profit sharing that is not allocated immediately to the customers' contracts by increase of the euro fund value but should be distributed thereafter (within a 8 years period,



provided that the customers have not requested the full redemption and the insurance contract is still in force by that time - no customer's death), but is allocated to the customers' contracts in the insurer's financial statements? It seems almost impossible to translate in the KID in a clear and understandable way for consumers who are not insurance experts.

All over the insurance contract's life, only on-going costs should be taken into account in the costs indicator.

<ESMA\_QUESTION\_PRIIPs\_49>

**50. Should the methodology for the calculation of these costs be further specified? How?**

<ESMA\_QUESTION\_PRIIPs\_50>

Costs should be expressed in the same way as in the contractual documentation, irrespective of whether they are expressed as percentages of the redemption value or as fixed costs.

<ESMA\_QUESTION\_PRIIPs\_50>

**51. Should the methodology for the calculation of these costs be further specified? How?**

<ESMA\_QUESTION\_PRIIPs\_51>

Same answer as above <ESMA\_QUESTION\_PRIIPs\_51>

**52. Should the methodology for the calculation of these costs be further specified?**

<ESMA\_QUESTION\_PRIIPs\_52>

Same answer as above <ESMA\_QUESTION\_PRIIPs\_52>

**53. Should the methodology for the calculation of these costs be further specified? How? Do fund related costs also exist for with profit life insurance products?**

<ESMA\_QUESTION\_PRIIPs\_53>

No

<ESMA\_QUESTION\_PRIIPs\_53>

**54. How to ensure that the look-through approach is consistent with what is applied in the case of funds of funds?**

<ESMA\_QUESTION\_PRIIPs\_54>

Indirect costs, including those relating to the underlying assets selected by the customers, will be detailed in the KID and any other information documentation relating to those assets (such as KID for UCITS).

Taking them into account in the KID relating to the insurance agreement would result in double-counting and would be confusing for the customers. It would not achieve the purpose to provide them with a clear and useful documentation. <ESMA\_QUESTION\_PRIIPs\_54>

**55. Should the methodology for the calculation of these costs be further specified?**

<ESMA\_QUESTION\_PRIIPs\_55>

Same as answer 50 <ESMA\_QUESTION\_PRIIPs\_55>

**56. Which above mentioned or further options do you support, and why? More generally, how to measure costs that are passed to policy holders via profit participation mechanisms? Would you say that they are known to the insurance company? Do**



**you think an estimate based on the previous historical data is the most appropriate methodology for the calculation of these costs?**

<ESMA\_QUESTION\_PRIIPs\_56>

Same as answer 49. In addition, how to deal with the minimum amount of profit sharing to be compulsorily allocated to the customers? That would be much too complicated to explain in a clear and understandable way for consumers who are not insurance experts. <ESMA\_QUESTION\_PRIIPs\_56>

**57. Is this type of costs really specific to with-profit life-insurance products? Do you agree that these costs should be accounted for as on-going costs?**

<ESMA\_QUESTION\_PRIIPs\_57>

Same answer : costs should be expressed in a global manner as detailed in answer 45 => costs which are direct and compulsorily incurred only should be disclosed, without reference to indirect costs. <ESMA\_QUESTION\_PRIIPs\_57>

**58. Do you think the list of costs of life-insurance products presented above is comprehensive? Which types of costs should be added?**

<ESMA\_QUESTION\_PRIIPs\_58>

Same as answer 45 <ESMA\_QUESTION\_PRIIPs\_58>

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

<ESMA\_QUESTION\_PRIIPs\_59>

Generally the two approaches do not give the same results. They could lead to the same results if the fair value included the hedging costs and the cost of capital and direct costs linked to the issuance of the product (such as SPV legal costs and index licensing costs).

<ESMA\_QUESTION\_PRIIPs\_59>

**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?**

<ESMA\_QUESTION\_PRIIPs\_60>

We do not see any specific cost for structured deposits. Their pricing is based on the same funding grids as EMTNs.

<ESMA\_QUESTION\_PRIIPs\_60>

**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?**

<ESMA\_QUESTION\_PRIIPs\_61>

One needs to differentiate costs that are borne by the manufacturer such as legal costs, costs associated with capital requirements, and hedging costs (i.e. costs), and costs that are passed on to the client such as sales commissions, distribution costs (ie). The first ones are costs where the manufacturer loses mon-

ey if he makes a wrong assumption and these costs raises and that do not deteriorate the product's features. The second ones are costs which generate revenue for the manufacturer.

Accordingly, BNP Paribas considers that, among the costs listed, sales commissions and structuring costs are relevant entry costs but not the others:

- Hedging costs are embedded in the price and borne by the manufacturer,
- Legal fees are embedded in the general cost base of the manufacturer
- The cost of the capital guarantee or capital protection is borne by the manufacturer when setting the zero coupon price at the time of the trade. If rates change the impact in value of the zero coupon is a risk for the manufacturer, which is not passed on to the client.
- The implicit premium is also a cost borne by the manufacturer as the cost of the capital guarantee.

In our view, there is no rationale for differentiating between delta one and option based structured products (delta one is a particular case of an option).

**Cases where manufacturer will not know all costs:**

- When a product designed by the manufacturer is repackaged in another wrapper, the manufacturer will not know the fees linked to the final wrapper.
- When a fund is the underlying of a structured product, the manufacturer will not know the costs linked to the fund.

<ESMA\_QUESTION\_PRIIPs\_61>

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

<ESMA\_QUESTION\_PRIIPs\_62>

Costs related to coupon payments and costs of the underlying, are not costs passed on to the client. They are included in the general cost base of the manufacturer and they do no impact the client or deteriorate the product features. It is therefore inappropriate to include them in the list of on-going costs.

However, if a running fee is paid to the distributor and impacts the product performance (e.g. running fee of a CPPI or a Delta1), this should be disclosed as on-going charge. <ESMA\_QUESTION\_PRIIPs\_62>

**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?**

<ESMA\_QUESTION\_PRIIPs\_63>

(a) By Proportional fees, we understand penalties for early exit expressed in % of Notional (e.g. for a product which has exit penalties such as 1% in year 1, 0.5% year 2, 0.25% in year 3 and nothing from and including year 4 until maturity. These should be disclosed in the cost section, but not double counted in the total cost ratio (TCR) as they would only occur under specific circumstances.

(b) Bid-mid spreads paid by the purchaser to sell the product are not exit cost and should not be treated as such.

Maximum spreads should not be considered unless the manufacturer commits to a firm bid-ask maximum spread.

<ESMA\_QUESTION\_PRIIPs\_63>

**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?**

<ESMA\_QUESTION\_PRIIPs\_64>

As explained in Q61 and 62, a difference must be made between costs that are borne by the manufacturer and costs that are passed onto the client, i.e. costs that generate revenue for the manufacturer.

It is also fundamental that the list of costs remains simple to understand for the client, and not too long due to the KID's limited length. We would therefore recommend to display:

(a) sales commissions (or distributor commissions), split between upfront sales commissions and running sales commission (usually there is no sales commission upon exit;

(b) structuring costs (also called "manufacturing cost") split between upfront manufacturing costs, running manufacturing cost and exit charges if any.

All other items listed in the TDP should be excluded, as they are not costs supported by the investor.

Some concrete examples would be welcome in the RTS or the final consultation paper on the computation of these costs for different types of given products, as the development in the TDP seems quite abstract (we would consider that sales commissions = distribution fees and structuring cost = margin generating revenue for the manufacturer).

<ESMA\_QUESTION\_PRIIPs\_64>

#### **65. Would you include other cost components?**

<ESMA\_QUESTION\_PRIIPs\_65>

No, we would include only the 2 cost components mentioned in our answer to Q64, as these are the only costs passed on to the investors.

<ESMA\_QUESTION\_PRIIPs\_65>

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

<ESMA\_QUESTION\_PRIIPs\_66>

The Cost of the underlying (e.g. index licence cost) is a cost borne by the manufacturer, implicitly included in the Direct Costs (see our answer to Q59) and priced upfront.

It should not be included in on-going costs. <ESMA\_QUESTION\_PRIIPs\_66>

#### **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?**

<ESMA\_QUESTION\_PRIIPs\_67>

BNP Paribas does not foresee any issue with the amortisation of entry costs. If issues have been identified by the Joint Committee, it would be helpful to have examples to discuss.

BNP Paribas believes the term "invested capital" is misleading for structured products :

- Notional invested or denomination are the correct legal terms which should be used: the payoff of the structured products is based on the notional, which may be different from the "invested capital" defined as purchase price \* notional.

- For products "in units" (i.e. without a denomination such as call paying absolute difference between spot and strike), an hypothetical denomination could be set to the strike level, so that payoff is expressed in percentage of the strike.

As long as the denomination of the Security, or the Notional Invested for a structured deposit, is clearly displayed on the KID, we do not foresee any issues. <ESMA\_QUESTION\_PRIIPs\_67>

**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)?**

<ESMA\_QUESTION\_PRIIPs\_68>

No : the hedging costs are embedded in the upfront price of the product, and should there be any later adjustment, the induced cost would be supported by the manufacturer and not passed on to the investor.

<ESMA\_QUESTION\_PRIIPs\_68>

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

<ESMA\_QUESTION\_PRIIPs\_69>

BNP Paribas generally agrees, however the pricing models and pricing parameters used to determine the IEV and calculate the costs should not be prescriptive, as manufacturers will need to be able to use their internal models / parameters to make it works.

In particular, there are 2 elements with which BNP Paribas disagrees:

- The TDP states that “the valuation procedure should be periodically reviewed and updated if necessary, following periodic reporting”. Manufacturers’ pricing models are already reviewed by external auditors as part of their certification of the firms’ accounts. Accordingly the valuation procedure should only be updated if such reviews by external auditors show irregularities or weaknesses.

- The TDP indicates that “it is also suggested to disclose hedging costs of structured products”. While the assessment of the hedging costs’ initial level is a key component of the initial determination of the product price, their actual realisation is without impact to the cost charged to the investor or to the product’s price on the secondary market. In other words for structured products, as opposed to funds, the profit or loss incurred by the manufacturer in connection with the hedging-trading activity that follows the sale of the product is without impact to the investor on the value of his investment.

<ESMA\_QUESTION\_PRIIPs\_69>

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

<ESMA\_QUESTION\_PRIIPs\_70>

Costs do not need to be updated for fixed term PRIIPS because they are known at the outset and will not vary. For funds (or open ended PRIIPS), KID should be updated whenever the on-going or exit costs change.<ESMA\_QUESTION\_PRIIPs\_70>

**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?**

<ESMA\_QUESTION\_PRIIPs\_71>

As expressed earlier, internal models are the best approach.

Accordingly, as pricing models rely on the assumption that the risk premium is set at zero (risk neutral environment), there is no need for a prescriptive approach.<ESMA\_QUESTION\_PRIIPs\_71>

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

<ESMA\_QUESTION\_PRIIPs\_72>

No<ESMA\_QUESTION\_PRIIPs\_72>

**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?**

<ESMA\_QUESTION\_PRIIPs\_73>

As expressed earlier, the industry has a long experience of using forward looking models based on a well-developed theoretical basis.

Although they are useful to calibrate model parameters, backward looking models cannot be used for valuation purposes as they do not provide a full valuation model: past data do not provide an adequate view on the future evolution of the underlying.

<ESMA\_QUESTION\_PRIIPs\_73>

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

<ESMA\_QUESTION\_PRIIPs\_74>

It should not be prescriptive: for currencies having a mature swap market, the swap rate curve could be used consistently with market practice. For exotic currencies the manufacturer should have to possibility to define an appropriate reference.

<ESMA\_QUESTION\_PRIIPs\_74>

**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?**

<ESMA\_QUESTION\_PRIIPs\_75>

BNP Paribas does not believe that other market data should be used to determine the credit risk as it is already implicitly included in the funding spread curve.

<ESMA\_QUESTION\_PRIIPs\_75>

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

<ESMA\_QUESTION\_PRIIPs\_76>

The absence of observable market data does not prevent the manufacturer from valuating a product as long as the funding spread is known (the credit risk is implicitly included in the funding spread).

<ESMA\_QUESTION\_PRIIPs\_76>

**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?**

<ESMA\_QUESTION\_PRIIPs\_77>

Similar to credit risk, CVA models could be used at the discretion of the manufacturer. CVA models are market practice within the interbank market but barely used for retails products.

<ESMA\_QUESTION\_PRIIPs\_77>

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

<ESMA\_QUESTION\_PRIIPs\_78>

The partial un-observability of parameters is not a novelty in finance. To some extent, it may even be argued that the very reason for developing models is the need to be able to convert discrete observations

of parameters (or their proxies) in a continuous model. In other words, financial institutions are used to cope with situations where some parameters may not be observed. While we do not believe that it would be possible to list all situations where this un-observability may happen, we note that these situations do not create a detriment to investors and without impact to the cost structure.

As an example, in case of hedging disruption, meaning the manufacturer is not in a position to acquire the hedge, a valuation may still be determined and such situations are described in the base prospectus / ISDA definitions.

<ESMA\_QUESTION\_PRIIPs\_78>

**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?**

<ESMA\_QUESTION\_PRIIPs\_79>

No. It is not possible to prescribe a model that would give reliable prices for a decent proportion of structured products. Instead it is much effective to rely on internal models, which are audited by prudential regulators.

<ESMA\_QUESTION\_PRIIPs\_79>

**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).**

<ESMA\_QUESTION\_PRIIPs\_80>

BNP Paribas does not foresee any particular issue to keep TCR records for five years, which is the same length as the one applicable to funds and is generally the retention period used in financial matters.

<ESMA\_QUESTION\_PRIIPs\_80>

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

<ESMA\_QUESTION\_PRIIPs\_81>

This point seems to be relevant for funds only, not for structured products.

<ESMA\_QUESTION\_PRIIPs\_81>

**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?)**

<ESMA\_QUESTION\_PRIIPs\_82>

An assumption of EUR 1000 (or equivalent in another currency) seems reasonable as a denomination or notional.

For structured products, the relevant figures should be:

- the denomination for securities
- an hypothetical denomination set to the strike level for products "in units"
- the notional for structured deposits

<ESMA\_QUESTION\_PRIIPs\_82>

**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?**

<ESMA\_QUESTION\_PRIIPs\_83>

It would be much too difficult, expensive and cumbersome to prepare one KID as pre-contractual information documentation per age! This also explains why biometric risk premia should be excluded (they are the only costs that may vary depending on the customer's age).

<ESMA\_QUESTION\_PRIIPs\_83>

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

<ESMA\_QUESTION\_PRIIPs\_84>

No difficulties are expected, the cost should be annualised over the recommended holding period.

<ESMA\_QUESTION\_PRIIPs\_84>

**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?**

<ESMA\_QUESTION\_PRIIPs\_85>

**For structured products:** the most simple is to amortise in a linear fashion the entry and exit costs over the recommended holding period.

**For life-insurance products:** The duration for projections in life insurance is not necessarily the recommended holding period. It corresponds rather to the minimum period, as French Insurance Code requires to select a duration that complies with the objectives and projects of the insured persons. A projection on the medium duration of the portfolio or a standardized duration (such as 15 years?) would be more appropriate.

<ESMA\_QUESTION\_PRIIPs\_85>

**86. This definition of the ratio is taken from the CESR guidelines on cost disclosure for UCITS. Is it appropriate also in the case of retail AIFs? Should it be amended? Another approach to calculate these costs is to calculate the ratio of the total of these amortized costs to the invested amount in the fund. However in that case the question remains as to how to aggregate this ratio with the on-going charges ratio. 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?**

<ESMA\_QUESTION\_PRIIPs\_86>

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<ESMA\_QUESTION\_PRIIPs\_86>

**87. What would be other options to define the TCR ratio in the case of life-insurance products? What about the case of regular payments or regular increasing? Which**



**definition would you favour? How to ensure a level playing field and a common definition with the other types of PRIIPs in this regard? 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? To what extent do these possible calculation methodologies fit the case of insurance products with regular payments?**

<ESMA\_QUESTION\_PRIIPs\_87>

A calculation such as Total Costs Ratio may be used in the context of life term insurance on the basis of standardized hypothesis (as for redemption value tables in the French Insurance Code). Those hypotheses should be simple in order to ascertain that they will be understandable for the consumers.

It would be preferable to calculate the total costs on the basis of the average redemption value than the amounts originally invested at the time of the execution of the life insurance contract, to the extent that on-going costs are calculated on the basis of the then actual redemption value.

<ESMA\_QUESTION\_PRIIPs\_87>

**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?**

<ESMA\_QUESTION\_PRIIPs\_88>

Expressing the cost as a percentage of the average net investment is not appropriate in our view because for structured products, all cost calculations are based on a percentage of the notional amount or denomination. TCR for structured products should be a percentage of the denomination or notional amount.

<ESMA\_QUESTION\_PRIIPs\_88>

**89. This definition of the ratio is taken from the CESR guidelines on cost disclosure for UCITS. Is it appropriate also in the case of retail AIFs? Should it be amended? 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?**

<ESMA\_QUESTION\_PRIIPs\_89>

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<ESMA\_QUESTION\_PRIIPs\_89>



**90. These different aforementioned principles are taken from the CESR guidelines on cost disclosure for UCITS. Is it also appropriate in the PRIIPs context?**

<ESMA\_QUESTION\_PRIIPs\_90>  
TYPE YOUR TEXT HERE  
<ESMA\_QUESTION\_PRIIPs\_90>

**91. To what extent do the principles and methodologies presented for funds in the case of on-going charges apply to life-insurance products?**

<ESMA\_QUESTION\_PRIIPs\_91>  
Please refer to answer 87, hypothesis imposed by a regulation are necessary in this context, to ensure comparability of the insurance products. <ESMA\_QUESTION\_PRIIPs\_91>

**92. Do you think this methodology should be further detailed? To what extent do you think this methodology is appropriate and feasible (notably in terms of calibration of the model)? It might indeed be considered that valuation models for Solvency II usually are not likely to be designed for per contract calculations. Life insurers may restrict the calculation of technical provisions in the Solvency II-Balance-Sheet to homogenous risk groups. Furthermore they are allowed to use simplified calculation methods if the error is immaterial at the portfolio level. As profit sharing mechanisms in many countries are applied on the company level and not on a per contract level, projected cash flows from future discretionary benefits will not easily be broken down on a per product or even a per contract basis with the existing Solvency II-Valuation-Models.**

<ESMA\_QUESTION\_PRIIPs\_92>  
Calculation method should be understandable by the customer : therefore a projection with standardized hypothesis, facilitating comparability between life insurance products, is of utmost importance. In addition, it seems to us useless and confusing for consumers to detail the quite complicated mechanics of highly sophisticated models such as those referred to in Solvency II Directive, as they are elaborated in the basis of hundreds of parameters, that may be at the insurer's hand or not, that are generally too difficult to understand for non-insurance experts such as retail consumers, and that may not provide the consumers with a more relevant or more useful information than a deterministic projection with standardized hypothesis laid down by applicable regulation.  
<ESMA\_QUESTION\_PRIIPs\_92>

**93. Do you identify any specific issue in relation to the implementation of the RIY approach to funds?**

<ESMA\_QUESTION\_PRIIPs\_93>  
TYPE YOUR TEXT HERE  
<ESMA\_QUESTION\_PRIIPs\_93>

**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?**

<ESMA\_QUESTION\_PRIIPs\_94>

We do not see how a RIY approach could be implemented for structured products. "Incorporating" the costs could be understood in different ways, and rely on so many hypothesis that it would be impossible to prescribe them (leading to RIY computations that would change according to the underlying assumptions)  
<ESMA\_QUESTION\_PRIIPs\_94>

**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?**

<ESMA\_QUESTION\_PRIIPs\_95>

For structured products, returns should be calculated on the denomination amount (e.g. EUR 1000 or equivalent in local currency) which means net of implicit entry costs.

Regarding the growth rate on the invested amount to estimate cumulative effect of costs, a zero growth rate seems appropriate for structured products. This simply means the denomination (used as the basis to express cost) remains unchanged throughout the life of the product.

<ESMA\_QUESTION\_PRIIPs\_95>

**96. Is this the structure of a typical transaction? What costs impact the return available to purchasers of the product?**

<ESMA\_QUESTION\_PRIIPs\_96>

Generally yes. Manufacturing costs usually cover the cost of running the SPV. The cost of running the SPV is borne by the manufacturer using it, there is no "amount charged to the investor by the SPV" as the TDP suggests. The treatment of SPVs' costs should be similar to the one of structured EMTNs.

<ESMA\_QUESTION\_PRIIPs\_96>

**97. What costs impact the return paid on the products?**

<ESMA\_QUESTION\_PRIIPs\_97>

SPVs should be treated in the same way as structured products, please refer to Q61.

<ESMA\_QUESTION\_PRIIPs\_97>

**98. What are the potential difficulties in calculating costs of an SPV investment using a TCR approach?**

<ESMA\_QUESTION\_PRIIPs\_98>

No difficulty. TCR is applicable to EMTNs, as well as SPVs<ESMA\_QUESTION\_PRIIPs\_98>

**99. What are the potential difficulties in calculating costs of an SPV investment using a RIY approach?**

<ESMA\_QUESTION\_PRIIPs\_99>

RIY is not suitable for structured products or funds.<ESMA\_QUESTION\_PRIIPs\_99>