FINAL

Recommendations on the implementation of selected PRIIPs RTS

Technical document

Annualization, return adjustment (drift correction), risk-based discounting, auto-callable products, KID statements

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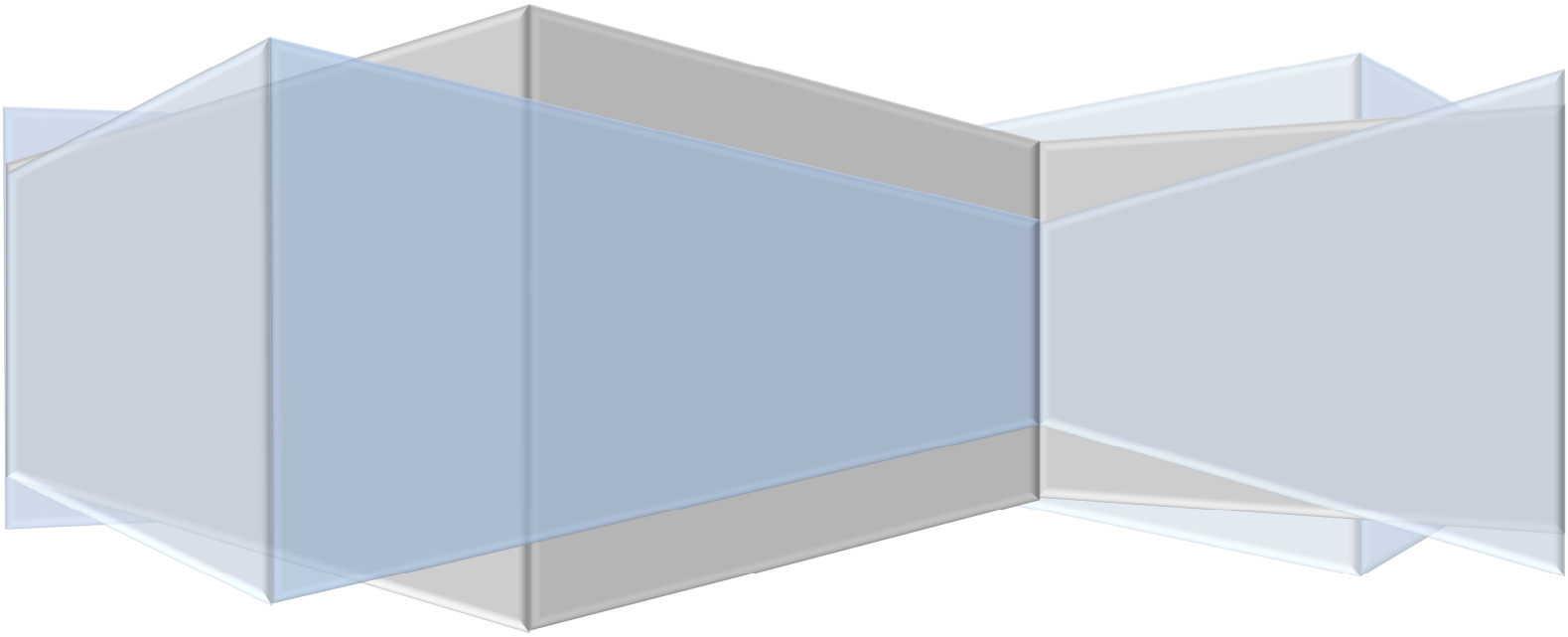

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NOTE

The recommendations set out in this paper have, in the course of 2018, jointly been drafted by the EUSIPA Technical Working Group on the application of Regulatory Technical Standards (RTS) under the EU PRIIPs Regulation (EUSIPA RTS-TWG) and were approved by the EUSIPA board.

The following banks participated in the Technical Working Group: Banca Aletti, Banca IMI, Barclays, Bayern LB, Belfius, BNP Paribas, Citi, Commerzbank, Crédit Agricole, Crédit Suisse, Deutsche Bank, DZ BANK, Erste Bank Austria, Goldman Sachs, Handelsbanken, HSBC, HypoVereinsbank, ING, Intesa San Paolo, Investec, JP Morgan, Julius Baer, Leonteq Securities AG, Morgan Stanley, Natixis, Nordea Bank AB, Raiffeisen Centrobank, Royal Bank of Canada, Société Générale, UBS, Unicredit and Bank Vontobel.

Furthermore, input was delivered by data providers and specialist firms, including Bloomberg, EDG, Fairmat, Modelity Technologies, Smarttrade and WallstreetDocs.

EUSIPA would like to thank in particular WallstreetDocs for their instrumental support in coordinating and preparing the relevant work streams and Modelity Technologies for their work on the risk-based discounting topic.

IMPORTANT: Recommendations relating to **future rules** are put into a red frame so to set them visually apart from recommendations relating to the practice under currently applicable RTS.

DISCLAIMER

While EUSIPA and the participating members of the EUSIPA RTS-TWG have undertaken their best efforts to achieve solutions that can be applied in practice, EUSIPA cannot be held liable for the technical correctness or regulatory compliance of the views and methodologies outlined in these recommendations.

RECOMMENDATION 1

Relating to the application of specific current Regulatory Technical Standards of the EU PRIIPs Regulation and to new RTS rules or explanatory guidance to be drafted

On the aspect of: ANNUALIZATION and Recommended Holding Period (RHP)

Problem, legal situation, further background

Problem – Annualization describes the requirement to convert the performance scenarios and costs calculated for periods other than one year to one year. The application of this requirement to structured products with a Recommended Holding Period (RHP) of less than one year, especially those having an RHP of one day, as is the case for most open-end leverage products, leads to unrealistic outcomes.

Legal situation – As for the Recommended Holding Period, the RTS do not define how the RHP should be determined. However, the table shown in point 42 of Annex II of the RTS appears to draw a connection between the RHP and the term of a product.

As for the annualization, the scenario tables included in Annex V of the RTS require the disclosure of the "average return per year" – similarly, point 33 of Annex IV of the RTS refer to the "average annual return"; this is interpreted to require some type of annualization of the return implied by the yield shown under "what you might get back after costs". The RTS leave open the question whether returns should be annualized for all products in all circumstances and how the annualized figures should be calculated (i.e., with or without compounding).

Further background - In July 2018 the ESA Q&A paper on PRIIPs RTS was amended with regard to specific RHPs and their consideration under the annualization requirement. The relevant clause now reads (Q&A, page 23 under point 1): "Where the RHP of the PRIIP is less than one year, as this is not explicitly envisaged by the Delegated Regulation, it should be assumed that the performance scenarios should reflect the projected return over the RHP, whilst the disclosure obligations in the performance scenarios for over 1 year and half of the RHP would not be applicable."

Scope and practical relevance

The application of the RTS rule referred to above is relevant for all structured products with a recommended holding period or maturity below one year. Currently EUSIPA counted around 1,739.000 non-matured products on the seven EU national markets for which the association keeps a database. Of these, around 1.217.000 products are leverage products with maturities typically shorter than a year.

Nature of EUSIPA recommendation

The EUSIPA recommendation seeks in its first part to harmonize the RHPs chosen for different categories of structured products under the current RTS and then indicates whether the performance scenarios should be annualized, integrating the recently amended Q&A's, where possible.

In a second part EUSIPA makes a recommendation on introducing, under future Level 1 legislation, a new approach to the Recommended Holding Period (RHP) concept. The recommendation then links this new approach, in a further step, to the question of whether an annualization should be required or not.

ANNUALIZATION and Recommended Holding Period (RHP)

1. EUSIPA recommendations on the practice of implementing currently applicable RTS

EUSIPA Recommendation	Issuers should base the scenario calculation on the following RHP...	Issuers should, under the currently applicable RTS ...
... for open-end LEVERAGE products:	**1 day (*)**	**Do not use annualization.** *See ESMA Q&A paper in its version published on 19 July 2018 (page 23).*
... for closed-end LEVERAGE products:	**No recommendation.**	*See ESMA Q&A paper in its version published on 19 July 2018 (page 23).*
... for open-end NON-LEVERAGE products (e.g. trackers):	**5 years (*)**	**Use annualization, if remaining RHP > 1y**
... for NON-LEVERAGE products with a remaining maturity of less than one year:	**Maturity**	**Do not use annualization.** *See ESMA Q&A paper in its version published on 19 July 2018 (page 23).*
... for NON-LEVERAGE products with a remaining maturity of more than one year:	**Maturity (*)**	**Use annualization.**

(*) Clarification: *This recommendation is not meant to preclude issuers from applying longer or different RHPs than the ones shown above, should the usage and/or structure of a financial instrument suggest that doing so leads to more adequate investor information. (An example would be longer RHPs for open-end low-leverage ETFs or warrants.)*

As for the Recommended Holding Period, EUSIPA also is aware of, and sees a sufficient legal basis for, the current practice of issuers for leverage products to include an explanatory text appearing under the stated recommended holding period, indicating that for the relevant product it is not possible to determine the period with sufficient certainty, and that investors should not rely on the stated period for their investment decisions.

2. EUSIPA recommendation on the position regarding future legislation, RTS and/or Q&A

EUSIPA is convinced that the concept of indicating a Recommended Holding Period should not be applied to some financial products.

Recommending a holding period makes it necessary to know or to assume, with a high level of certainty, the most likely reason for the investment. Some products manufacturers, however, do not have access to the information on why the retail investor buys the product nor can they make a reliable assumption on this. Products for which this would be relevant are, for example, most leverage products. These are being bought continuously for both hedging and speculation purposes.

For all products for which an RHP cannot be indicated EUSIPA would suggest allowing for the use of "Time Reference Periods" ("**TRP**") instead, so to ensure that performance scenarios and costs are provided which are comparable with information in KIDs for other products.

The decision on whether no RHP (but instead a TRP) can be indicated for a product needs to be made on the basis of a product specific- decision. This decision will be a judgement based on various criteria. These include:

- Whether a product is closed-end (has a maturity) or is "open",
- In case of closed-ended product, the time span until maturity,
- The level of leverage, if any, and
- The volatility expectation.

Based on the technical discussions held before the Q&A change, EUSIPA would have suggested the following links between RHP/TRP and an annualization requirement to set out in Q&A's:

If RHPs or TRPs used for a product have a length of (…)	**(…) it should be set out in the RTS that (...)**
1 day	**(…) it is mandatory not to annualize.**
Less than one 1 year	**(…) it is not mandatory to annualize (*).**
More than 1 year	**(…) it is mandatory to annualize.**

(*) This recommendation is meant to allow issuers both (i) making use of annualization for products with a maturity of less than one year where doing so would result in correct/less misleading information and also (ii) to make no use of annualization for other products with a maturity of less than one year for the same reason. Background is that scenarios for investment products with a maturity of less than one year typically would benefit from an annualization. Scenarios for leverage products typically would not.

For all of the above RHPs/TRPs variations it should be mandatory to indicate in the KID whether the values finally shown in the performance scenario section have been established using annualization or not.

RECOMMENDATION 2

Relating to the application of specific current Regulatory Technical Standards of the EU PRIIPs Regulation and to new RTS rules or explanatory guidance to be drafted

On the aspect of: RETURN ADJUSTMENT (also called "drift correction")

Problem, legal situation, further information

Problem – Return adjustment or drift correction essentially deals with the question how returns delivered by the reference asset to which a product is linked before the end of each Intermediate Holding Period (IHP), and thus also before the Recommended Holding Period, should be figured into the performance scenario calculation for these points in time (IHPs and RHP).

Legal situation - In point 12 of Annex IV of the RTS it is stated that "the expected return (…) shall be the return observed over the period as determined under point 6 of Annex II" – the reference to "the return observed" is generally read to imply that the performance scenarios should be simulated based on historical returns without making the risk neutral adjustment to the return population that point 22(c) of Annex IV requires in the context of the MRM calculation.

The flow diagrams published by the ESAs (the "Flow Diagrams") appear to contradict this reading of the RTS by saying that "the performance scenarios hinge on the same simulated data as the MRM calculations [*Note:* which require a risk neutral adjustment], hence manufacturers are not required to make a new simulation when switching from the MRM to the Performance Scenarios calculations," although they omit any reference to a risk neutral adjustment when summarizing the steps issuers have to go through to calculate the scenarios.

Further information - Current practice varies widely between different issuers. Variants include, using historical returns for IHPs and RHP, using risk neutral returns for IHPs and RHP, using risk neutral returns for IHP and historical returns for RHP, and using historical returns or risk neutral returns, whichever is worse.

Scope and practical relevance

The application of the RTS rule referred to above is relevant for all structured products, and particularly for those which have an RHP of more than one day. At the end of Q2 2018, EUSIPA counted around 1,739.000 non-matured products on the seven EU national markets for which the association keeps a database.

Nature of EUSIPA recommendation

The EUSIPA recommendation outlines the industry's point of view for new rules on the subject to be drafted, for example, as future RTS.

RETURN ADJUSTMENT

1. EUSIPA position on the practice of implementing currently applicable RTS

Given the ambivalent RTS guidance and divergent practice among different manufacturers (use of historical returns vs. risk neutral adjusted returns vs. "mixed" approach), particularly in light of the cost of implementing any changes to the current practice, EUSIPA does not make a recommendation as to whether, and how, manufacturers should adjust the bootstrapped returns for the purpose of calculating the performance scenarios.

2. EUSIPA recommendation on the position regarding future legislation, RTS and/or Q&As

Many equities markets have experienced bull market conditions for much of the past five years. Therefore, calculating the performance scenarios based on a reference asset's historical performance will in the present market tend to show return figures that may be significantly more positive than those which investors can actually achieve over the recommending holding period. To counter the risk that investors may place undue reliance on the performance scenarios, the KIDs state that the scenarios "are an estimate of future performance based on evidence from the past on how the value of this investment varies, and are not an exact indicator".

In light of this and the fact that the KIIDs for UCITS funds already include performance scenarios based on the fund's historical performance, EUSIPA recommends that, in order to achieve a level playing field at a certain end, the performance scenarios for structured products at the recommended holding period and those until the IHP should be presented on the basis of the underlying reference asset's historical performance.

EUSIPA further recommends that for intermediate holding periods, a risk neutral adjustment is done to any simulation that runs from the end of an intermediate holding period to the end of the recommending holding period. This position is supported by the fact that the RTS make it clear that the IHP values should be indicative of tradeable prices (by requiring manufacturers to attach the label "what you might get back after costs" to the performance scenarios).

IMPORTANT: The above recommendation applies to equity-based products only.

RECOMMENDATION 3

Relating to the application of specific current Regulatory Technical Standards of the EU PRIIPs Regulation and to new RTS rules or explanatory guidance to be drafted

On the aspect of: RISK-BASED DISCOUNTING

Problem, legal situation, further information

Problem - Risk-based discounting essentially deals with the question how future cash flows of the product after each IHP should be figured into the calculation of the respective IHP values.

Legal situation - On the question whether discounting is permitted or even prescribed, there are no clear statements in the RTS. Comments made in Consultation Paper JC 2015 073 from the European regulators before they issued their RTS recommendation to the European Commission, from November 2015, stated (on p. 52, under no. 14) that "the scenarios at an intermediate stage of the recommended holding period shall be defined to represent reasonable market circumstances at that point in time. The performance shown will reflect the estimated exit price of the instrument at that point in time." On the other hand, in an ESMA presentation of July 2016, a seemingly different statement was made for at least one of the product categories used for the calculation of the SRI and the performance scenarios, which read "on each intermediate date, evaluate the PRIIPs value on three underlying prices corresponding to the three percentiles of underlying prices distribution simulated as per MRM calculation, save that prices shall not be corrected for the risk neutral expectation and expected performance shall not be discounted using discounting factor (point 19 (a) and (b) of Annex IV)."

Further information – Practice amongst issuers differed widely with divergences starting already at the level of whether a risk-free or a risk-based discounting rate is to be used. The main problem as for the risk-based discounting was how the standardization of the risk factor which is interlinked to the issuer's credit rating could be achieved. Further issues included whether the risk-based discounting should be based on a 3-months' LIBOR or an OIS rate, whether specific assumptions had to be made for the stress scenario and, finally whether stochastic or deterministic discounting was applicable for rate-products so to establish a basis for common discounting methodology. All of these items are addressed in the EUSIPA recommendation.

Scope and practical relevance

The application of the RTS rule referred to above is relevant for all structured products with an RHP of more than one year since the KIDs for those products are required to show at least one set of IHP values. At the end of Q2 2018, EUSIPA counted around 1,739.000 non-matured products on the seven EU national markets for which the association keeps a database. Of these, around 483.000 products are investment products with maturities typically stretching across several years.

Nature of EUSIPA recommendation

The recommendation seeks to harmonize the practice under the currently applicable RTS only. An adaptation of current Q&As is not considered necessary to enact such harmonization.

RISK-BASED DISCOUNTING

EUSIPA recommendation on the practice of implementing currently applicable RTS

EUSIPA recognizes that the methodology used to calculate the IHP values shown in the performance scenario table varies among market participants. However, EUSIPA also believes that the RTS requirement to show IHP values that reflect "what [the investor] might get back after costs" implies that these values should approximate a risk-neutral price, which requires some form of risky discounting of the future cash flows that go into the calculation of the IHP values.

As for the discount rate to be used in this exercise, EUSIPA endorses the recommendations set forth in the document "Methodology for risk-based discounting cash-flows at interim holding periods", which is attached hereto as Annex A.

The paper outlines different approaches to the issue that are broadly reflective of manufacturers' current practices and sets forth parameters which have been designed to ensure that the different approaches lead to results that are broadly comparable between market participants.

(See ANNEX A on following page)

ANNEX A to recommendation 3 (risk-based discounting)

Methodology for a risk-based discounting of cash-flows at interim holding periods

Introduction

The objective of this paper is to outline a proposed methodology for discounting, relating to Interim Holding Periods (IHPs) based on the manufacturer's Credit Risk Measure, which is defined in the latest RTS[1]. The idea is to take the manufacturer's credit spread into account in order to reflect the credit risk premiums when discounting cash-flows at IHPs. However, to allow comparability, the methodology suggests **using industry-common spreads prescribed as a function of the CRM**, as opposed to allowing each manufacturer to apply its own internal spread or use an ad-hoc methodology for discounting at the IHP. This is achieved by employing the historical yields of financial institutions per credit rating, in order to derive a measurement of the manufacturer's credit spread and the subsequent discount factors.

This paper has the following objectives:

1) For all products, propose one set of funding spread as a function of the CRM to be used by all manufacturers to become industry-standard.
2) For rates products, where RTS Annex II item 23 requires a simulation of a rates curve, explain how we can apply either stochastic discounting, or a simplified approach with a different discount curve per scenario.

After describing the methodology, this paper presents the results of calculated credit spreads and example of discounted product values based on the proposed methodology as of today's market data.

Part A - Considerations

One goal is to provide a discounting method that reflects the manufacturer's credit risk on the one hand, but **still simple to compute** on the other hand. In order to achieve this, some simplifications were used in the calculation.

1. Using CRM as a credit quality measure: the RTS contains a set of rules that describe how to aggregate manufacturer's credit risk into one Credit Quality Step (hereinafter: CQS) and then CRM. So, instead of using the manufacturer's credit rating/s as input, the calculation is using the CRM, which existing PRIIPS implementations should already have available, as they calculate it for determining the SRI. The CQS and CRM guidelines already take into consideration various credit related issues, such as multiple different credit ratings for the same entity, collateralization arrangements, cascading, etc.

[1] EU Commission delegated regulation (EU) 2017/653 of 8 March 2017) in Annex II points 37 to 51

Rating category	AAA	AA	A	BBB	BB	B
CQS	0	1	2	3	4	5
CRM	1	1	2	3	4	5

2. Using EUR and USD denominated credit spreads instead of credit spreads per currency: calculating currency-specific credit spread for many currencies requires a much larger set of market data and calculations. To be in line with the goal of **simplicity, credit spreads are only calculated for EUR and USD, for which a sufficient amount of 5Y financing spreads exists, and the average of the two spreads is used**. Clearly, when performing the discounting, the credit spreads have to be added on top of the risk-free rate in the product's currency. This simplification assumes the credit spreads mainly express the credit risk, and therefore are similar between currencies.
3. Using credit spreads that are calculated based on 5Y yield curves, instead of credit spread per maturity:
    a. For maturities longer than 5 years – the spreads do not change significantly.
    b. For shorter maturities – the spreads become tighter, so using the 5Y can be considered a conservative approach.
4. Longest available history (of yields, risk-free rates and derived spreads) is used, leading to consistent results that do not change significantly over a long period of time, eliminating the need to update the calculated results.

Part B – Methodology

1. We used the yield curves of financial institutions per CRM for:
    i. CRM 1 – rating AA (for the CRM 1, this paper only takes into account historical funding spreads of AA issuers and disregard the AAA data corresponding to CQS 0 and CRM 1)
    ii. CRM 2 – rating A
    iii. CRM 3 – rating BBB
    iv. Higher CRMs (i.e. lower ratings) – relevant reliable information could not be found, the extrapolation approximation used to generate their spreads is explained in point 9 below.
2. We were using **5 years of historical information** available on a daily basis.
3. For each CRM we used one yield curve from EU and one from the US.

4. For the risk-free rate, we used a daily history of Libor 3 months.

5. For each date in the history, we calculate the spread by subtracting the risk-free rate from the relevant yield.

6. For each of the above CRMs (i.e. CRMs 1, 2 and 3) we collect the following data :

   i. We take the 99th highest percentile spread for 1Y IHP stress scenario over the last 5 years.
   ii. We take the 95th highest percentile spread for RHP/2 stress scenario over the last 5 years.
   iii. We take the 90th highest percentile spread for IHPs in the unfavourable scenario over the last 1 year.
   iv. We take the median spread for IHPs in the moderate scenario over the last 1 year.
   v. We take the 10th highest percentile spread for IHPs in the favourable scenario over the last 1 year.
   vi. We repeat the above for twice, one for the EU spreads and one for the US spread.
   vii. For the output table, for each CRM we used the average of EU and US spreads, rounded up to 5bps.

7. The percentiles are measured over the last 5 years, to be consistent with the RTS.

8. **Spreads data will be refreshed on a quarterly basis**, to reflect market developments.

9. As mentioned, the higher CRMs, i.e. lower ratings, are missing a reliable relevant market data. For them, we used an extrapolation as described below:

   i. For every historical date, we used the existing AA, A, BBB EU and US spreads and extrapolate the daily spreads for CRM 4 (i.e. BB), CRM 5 (i.e. B) and CRM 6 (i.e. <B).

   ii. To be consistent with the VEV exponential behaviour, we used Excel's GROWTH function, which produces a function of the form a*m^n, assuming m to increase linearly.

   iii. From this point, we continued as we did for CRM 1, 2 and 3, taking the spread abovementioned percentiles also for BB, B, <B.

   iv. For BB and B, we could find historical series, however only for all corporates (i.e. not just financials) and only in the US. Running the same methodology we used for CRM 1, 2 and 3 on these historical series led to results in the same ballpark figures of the extrapolation results, providing additional proof the methodology used is in line with the market.

Part C – Equity, FX, Credit Linked Products: Use of the Results

For these products, the PRIIPs Regulatory Technical Standards (RTS) do not require a simulation of a full rate curve. Indeed, the RTS Annex IV points 27 to 30 describe the scenarios as follows:

27. The unfavourable scenario shall be the estimate of the value of the PRIIP at the start of the intermediate period consistent with the 10th percentile.

28. The moderate scenario shall be the estimate of the value of the PRIIP at the start of the intermediate period consistent with the 50th percentile.

29. The favourable scenario shall be the estimate of the value of the PRIIP at the start of the intermediate period consistent with the 90th percentile.

30. The stress scenario shall be the estimate of the value of the PRIIP at the start of the intermediate period consistent with the percentile level that corresponds to 1% for 1 year and to 5% for the other holding periods of the simulated distribution as set out in point 13.

To allow **comparability between the scenarios, the same discount curve and credit spread can be used across all scenarios.**

Yet, for the stress scenario, to the extent the underlying volatility is stressed, though the RTS does not explicitly recommend using a different credit spread, the option can be given to take a low historical percentile of the credit spread over the last 5 years and use this as a stressed discounting:

- A **majority of issuers** members of EUSIPA and national associations wish to apply **the same credit spread to all 4 scenarios** and can do so.
- Yet, for issuers have the view that a stressed credit spread should be used for discounting the stress scenario, these issuers have the **option but no obligation to apply "stressed discounting"** using the stressed spread for the stressed scenario as low historical percentile (e.g. 1% or 5% percentile of a 5 years history of data. (see (*) in the table below).

Results: Average EUR & USD Spreads

Manufacturers that are using the Libor for risk-less:

Scenarios	Spread Percentiles	AA	A	BBB	BB	B	<B
Short Stress(*)	99%	0.80	1.15	2.15	2.75	3.45	4.15
Long Stress(*)	95%	0.75	1.00	1.85	2.35	3.00	3.65
Unfavourable Moderate Favourable	50%	0.45	0.65	1.05	1.35	1.70	2.00

(*) - optional application

Based on the last 5 years, manufacturers that are using the OIS for risk-less should increase all the spreads above by 25bp (e.g. single A Short Stress will become 1.40).

Part D – Rates Products: Use of the Results

For rates products, the RTS Annex II point 23 does require a simulation of a rates curve. EUSIPA has observed that its issuer members of the various national associations generally apply the following 2 technical possibilities:

a. **Stochastic Discounting**
   Simulating the full curve and not only the payoff leg of the structured products means that the discounting at IHP is consistent with the shape the curve at the 1st,

5th , 10th, 50th, and 90th percentiles of the distribution of discount factor that the 10,000 simulations produce.

In this case, applying a stressed spread on top of stochastic curve is not recommended. The risk-free curve should be stochastic and use the same spread across all scenarios.

Results: Average EUR & USD Spreads

Manufacturers that are using the Libor for risk-less:

Scenario	Spread Percentile	AA	A	BBB	BB	B	<B
All	50%	0.45	0.65	1.05	1.35	1.70	2.00

Based on the last 5 years, manufacturers that are using the OIS for risk-less should increase all the spreads above by 25bp (e.g. single A Short Stress will become 1.40).

b. **Deterministic Discounting**

In the case of deterministic discounting, EUSIPA recommends that a different spread per scenario can be applied to approximate the outcome of stochastic discounting.

Results: Average EUR & USD Spreads

Manufacturers that are using the Libor for risk-less:

Scenarios	Spread Percentiles	AA	A	BBB	BB	B	<B
Short Stress	99%	0.80	1.15	2.15	2.75	3.45	4.15
Long Stress	95%	0.75	1.00	1.85	2.35	3.00	3.65
Unfavourable	90%	0.70	0.95	1.65	2.05	2.55	3.05
Moderate	50%	0.45	0.65	1.05	1.35	1.70	2.00
Favourable	10%	0.25	0.40	0.70	0.90	1.15	1.40

Based on the last 5 years, manufacturers that are using the OIS for risk-less should increase all the spreads above by 25bp (e.g. single A Short Stress will become 1.40).

The funding spreads should be updated on a quarterly basis.

RECOMMENDATION 4

Relating to the application of specific current Regulatory Technical Standards of the EU PRIIPs Regulation and to new RTS rules or explanatory guidance to be drafted

On the aspect of:

AUTO-CALLABE PRODUCTS (applicable to all products with an early redemption feature, and with respect to certain of the questions discussed below, any product with a payoff before maturity)

Problem, legal situation, further information

Problem – Autocallable products usually have a fixed maturity but can nonetheless be terminated early upon pre-defined conditions. It is unclear how this feature of a possible premature termination should be considered for the establishment of the performance scenarios in the KID.

Legal situation – RTS do not set out specific rules for autocallable products.

Further information – The key question is whether auto-call payments on paths that are subject to early redemption should be accrued to maturity. Underlying is the question whether it should be assumed that investors reinvest the amount they receive in case of an early redemption at the risk free rate. Should no such reinvestment be assumed, the question arises of whether paths subject to early redemption be treated the same as paths that go to maturity. Fundamentally, the question needed to be answered whether auto-call paths (i.e., prematurely terminating scenarios) should as such be excluded from the performance simulation of an auto-call product.

Scope and practical relevance

The harmonization of the practice with regard to auto-callable products is relevant for all structured products with an auto-call feature and, more generally (see below recommendation 1C), for all products with a scheduled premature pay-off. At the end of Q2 2018, EUSIPA counted around 1,739.000 non-matured products on the seven EU national markets for which the association keeps a database. Of these, around 483.000 products are investment products with maturities typically stretching across several years. Depending on the respective local market, around 80-90% of such investment products with longer maturities are construed in a way that they have either regular annual coupon (interest) payment and/or an auto-call-based payout before maturity.

Nature of recommendation

The recommendation seeks to harmonize the practice under the currently applicable RTS. An RTS change or adaptation of current Q&As is not considered necessary to enact this harmonization but could be helpful in terms of clarifying the regulatory position on a European level.

AUTO-CALLABLE PRODUCTS (applicable to all products with payoff before maturity)

1. EUSIPA recommendations on the practice of implementing currently applicable RTS

A. Auto-call payments should not be accrued to the RHP

EUSIPA is of the view that for bootstrap paths that trigger an auto-call event, the auto-call payment should not be accrued to the product's scheduled maturity. In other words, for the purpose of displaying a product's yield and return in the RHP column of the performance scenario table, it should not be assumed that the investor reinvests the auto-call payment for the remainder of the term of the product.

While from a finance perspective, it may be seem a technical choice to accrue auto-call payments in order to show the yields and returns of the different scenarios at the RHP on a comparable basis, retail investors in practice find it difficult to understand the resulting values. It is also worth noting that not accruing auto-call payments will in normal market conditions tend to understate, rather than overstate, outcomes. Therefore, in EUSIPA's view, the recommended practice promotes investor comprehension of KIDs without materially altering the mix of information.

B. In calculating IHP values, auto-call payments should be considered with their time value

EUSIPA recognizes that the methodology used to calculate the IHP values shown in the performance scenario table varies among market participants. EUSIPA believes that where a manufacturer calculates these values using a methodology that considers the average of the future cash flows payable by the manufacturer, any auto-call payments so payable should be considered with their time value rather than with their numerical value. By way of example, where a product has an annual auto-call feature and a remaining of term of three years, in calculating the IHP 1 values, a manufacturer should discount any auto-call payments after two years over a period of one year (*i.e.*, the two-year mark where the payment is made minus the one-year measuring point for IHP 1), whereas any payment at maturity should be discounted over a period of two years (*i.e.*, the scheduled maturity of three years minus the one-year measuring point for IHP 1).

C. The principles outlined above with respect to auto-call payments should also be applied to other types of early payments, such as coupon payments or instalment payments

EUSIPA recommends that the above principles in terms of accrual, time value and ongoing costs be applied *mutatis mutandis* to other types of payments that occur before a product's scheduled maturity. This includes coupon payments and instalment payments.

D. IHP 1 values, IHP2 values and RHP values should be calculated independently of each other

As discussed above, market practice regarding the calculation of IHP values varies. EUSIPA does not endorse or recommend any particular calculation methodology. However, EUSIPA is of the view that the values for the different calculation points (IHP 1, IHP 2 and RHP) should be simulated, and the results for the different scenarios be sorted, independently of each other.

2. EUSIPA recommendation on the position regarding future legislation, RTS and/or Q&A

Based on the discussion with its members, EUSIPA will support the above positions in any discussions with ESMA and other regulators regarding future Q&A clarifications of the current RTS or any RTS amendments.

RECOMMENDATION 5

Relating to the application of specific current Regulatory Technical Standards of the EU PRIIPs Regulation and to new RTS rules or explanatory guidance to be drafted

On the aspect of: Additional KID statements

Problem, legal situation, further information

Problem – This issue concerns those parts of the KID where information is given to investors on how to understand the contents of a KID. In some cases, such information can be seen as not clear enough for investors, in particularly regarding the methodological approaches underlying prescribed KID figures (and where these figures are particularly prone to misunderstandings by investors).

Legal situation – The RTS generally follow a prescriptive approach as regards such explanatory statements in KIDs and prescribe their exact wording.

Further information - Current practice varies between different issuers. In particular, a number of issuers added additional statements in their KIDs, even where not explicitly foreseen by the RTS. This was particularly the case in connection with KID contents impacted by calculation methods which may result in potentially misleading information.

Scope and practical relevance

The application of the RTS rules referred to above is relevant for all structured products, as the KID statements referred to appear in KIDs for all products. At the end of Q2 2018, EUSIPA counted around 1,739.000 non-matured products on the seven EU national markets for which the association keeps a database.

Nature of EUSIPA recommendation

The EUSIPA recommendation outlines the industry's point of view on both existing practice of some banks and new rules on the subject to be drafted, either as RTS or as rules to be added to the current Q&A.

ADDITIONAL KID STATEMENTS

Some of the prescribed KID information items, notably some of the figures to be calculated based on general methodological approaches (SRI, RIY, performance scenarios), cause a tangible risk of being misunderstood by investors not familiar with the concepts underlying such information items. Such misunderstandings could defeat the KID's purpose, to provide investors with a sound basis for their investment decisions, in a worst case scenario they could even be seen to create litigation risk.

In line with the general requirement of Art. 6 (1) of the PRIIPs Regulation for KIDs to be "accurate, fair, clear and not misleading", some issuers of retail structured products, as represented by EUSIPA and its national member associations, therefore have seen a need, in some cases, to provide additional explanations in their KIDs on the background and meaning of such information, even where not explicitly foreseen by the RTS. This was particularly the case in connection with KID contents impacted by calculation methods which may result in potentially misleading information.

Other issuers have so far not added additional explanatory statements in their KIDs, but would support clarifications in the prescribed KID wordings regarding the background and meaning of KID information (potentially by way of additional Q&As).

The following cases are commonly identified as potentially causing misunderstanding on the side of investors. EUSIPA therefore believes that for these cases, additional explanations would support investors in comprehending the content of the KID, and regards the statements indicated for each of these cases as one way of providing the relevant explanation.

The below list reflects internal EUSIPA discussions on the matter, but is not necessarily exclusive, or indicative of all wordings currently used in KIDs.

SRI	For detailed information about all risks please refer to the risk sections of the legal documentation as specified in the section "Other relevant information" below.
Performance Scenarios	*To be added below the table:* You should not base your investment decision on the expectation that any of these scenarios, which are based on calculation methods prescribed by law using historical data, will occur. Actual returns may be different, and in many future scenarios, could be worse.
Cost – Over Time	*Indicated words to be added to the sentence above the table:* The Reduction in Yield (RIY) shows what impact the total costs you pay will have on the investment return you might get *in the moderate scenario shown above*. *Indicated words to be added in the "Cost over time" table where actual cost is shown:*[2]

[2] In addition, in one case, for the information regarding Composition of Cost, a number of issuers have taken the view that the risk of misleading investors can only be avoided by providing additional information and explanations, presented in a footnote: "The split of the actual estimated costs of the product as a percentage of the product notional amount is estimated to be as follows: entry costs: XXX%, exit costs: YYY% [and other ongoing costs: ZZZ%.".

Total costs (*measured as impact on return in monetary terms*)				

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