To:
Mr Valdis Dombrovskis,
Vice-President
European Commission

Copy:
Mr Olivier Guersent, Director General
Mr Sven Gentner, Head of Unit

Directorate-General for Financial Stability, Financial Services and Capital Markets Union European Commission

Dr Steven Maijoor, Chair of the European Securities and Markets Authority
Mr Gabriel Bernardino, Chair of the European Insurance and Occupational Pensions Authority
Mr Andrea Enria, Chair of the European Banking Authority

Dear Vice-President,

The undersigned associations, AMAFI and the DDV, write to you with regard to the further action to be undertaken by the European Commission in relation to the Packaged Retail and Insurance-based Investment Products Regulation (Regulation (EU) No 1286/2014, "PRIIPs Regulation"). AMAFI and the DDV have been very supportive of the recent work done by the Commission and the European Supervisory Authorities ("ESAs") on the PRIIPs-Regulation.

Although we appreciate your efforts, our primary interest is that investors are provided with meaningful and clear information. In principle, we believe that the Key Information Documents ("KIDs") may be suitable for providing investors with a brief overview of the packaged retail and insurance-based investment products ("PRIIPs") facilitating comparability with other such products. This can be achieved, but requires, in particular, strict adherence to the principle of Article 6 (1) of the PRIIPs-Regulation, which states that the KID shall be accurate, fair, clear, and not misleading.

Our first practical experiences after the PRIIPs implementation in January 2018 have left us concerned that the PRIIPs regulation will not achieve its goal. The results, especially regarding in the performance scenarios and costs, are not satisfactory.

Our members have received negative reactions and many questions from investors and advisors. In practice, the KIDs are made available to the investors, but, especially in the case of investment advice, it is often necessary to hand out additional information material to adequately inform investors about the respective PRIIP.

KIDs that are drafted in full compliance with the methodologies prescribed by the PRIIPs Regulation and Delegated Regulation 2017/653 – ex RTS (hereinafter "DR"), result in investors being provided with confusing information, resulting in many questions. This is completely contrary to one of the main objectives of the PRIIPs Regulation, namely, that retail investors should be provided with the information necessary for them to make an informed investment decision and compare different PRIIPs.

We consider this situation to be of profound concern. Considering the aim is protecting retail investors, action must be taken at European level to review methodologies to make them less confusing. AMAFI and the DDV are of the strong opinion that it will not be sufficient to give interpretations via Questions & Answers (Q&A) through the ESAs. We therefore urge you to reflect on the methodologies underlying the calculations and to prepare changes to the DR.

In the following Annex to this letter, we provide you with a few examples of the confusing results in relation to the performance scenarios and costs.

AMAFI and the DDV remain at the Commission's disposal to discuss these matters further.

Pierre de Lauzun
Chief Executive for AMAFI

Dr Henning Bergmann
Managing Director DDV

Annex 1 – Incomprehensible results

I. The first and most sensitive matter is the **results of performance scenarios.**

1. For many PRIIPs products[1], the results of performance scenarios calculated in accordance with methodology of the DR appear **too optimistic**, notably with negative performance scenarios (see Example 1 in Part 1 of Annex 2). In our view, this can be explained by the **use of historical drift** which should be called into question given the particular market conditions of recent years.

    The calculation method and, in particular, the annualisation lead to incomprehensible – and in part misleading - results of **more than 1,000 percent**, especially for leverage products and products approaching maturity, where their recommended holding period (i.e. their residual maturity) becomes very short. The results also depend on the recommended holding period. With a recommended holding period of one day, the calculations can result in figures exceeding **millions** (see Example 2 in Part 1 of Annex 2).

2. Results that are difficult to understand may also occur in connection with the presentation of performance scenarios for different holding periods (interim scenarios). In particular, some manufacturers report that the results displayed in the interim scenarios **can exceed the potential performance of the specific product**. (see Example 3 in Part 1 of Annex 2)

3. In addition, performance scenarios may be not comprehensible for investors in some situations where the four performance scenarios give **identical or very similar results**.

4. The use of three different methods to compute the drifts of the scenarios within a single KID raises issues, and ultimately prevents investors from understanding the rationale of these scenarios.

5. In addition, we are facing issues for auto-call structures, as the results of performance scenarios are not well designed for such products.

Possible solutions:

Re 1: A possible solution could consist in removing the use of historical drift so as to (1) avoid the pro-cyclical effect of the historical drift and (2) always present very diverse scenarios to the investor. The stress scenario is already calculated without historical drift. An alternative solution could be adapting the unfavourable scenario to use a more conservative percentile under certain circumstances. In any case, we should ensure that only one method is used to compute all the drifts of the KID. Accordingly, the value of the negative scenario should be capped at the value of moderate scenario.

Re 2: From a technical point of view, there is much to suggest foregoing the annualisation of products with a term of less than one year

We recommend conducting widespread tests with the industry to check whether any new solutions would be relevant and not confusing.

We urge the Commission to consider these issues. We would be happy to provide any assistance in exploring alternative solutions.

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[1] Please note that AMAFI and DDV members manufacture structured securities and/or OTC derivatives. We do not represent asset managers or insurers.

II. The second issue we would like to raise is the **confusion and misunderstanding caused by the concept of costs as expressed in the KIDs**.

The "costs" presented in the KIDs are *not* the costs of the product as commonly understood but actually the Reduction In Yield (RIY), which shows the annual impact of those costs on the return expected based on the moderate performance scenario. Confusion is added with the disclosure of costs and charges provided in compliance with MiFID II which should "also" represent a total of raw costs of the product costs. Accordingly, AMAFI and the DDV request that the terminology used in PRIIPs' tables or the calculation methodology to be reworded as "impact on return" to be more accurate and less confusing (see examples in Part 2, Nr. 1 of Annex 2).

In relation to costs, we would also like to raise the issue of the disclosure of costs equal to zero when the moderate performance scenario corresponds to a total loss. Since, as previously mentioned, the RIY shows the annual impact of costs on the return expected based on the moderate performance scenario, when this moderate scenario has a significant negative return, the resulting RIY suggests no or very low costs. Again, such information could be misleading for retail investors (see examples in Part 2, Nr. 2 of Annex 2).

III. The third issue we would like to address is the **sensitivity of the summary risk indicator** (SRI) to small changes in the characteristics of structured products. We have observed products with jumps of 3 or 4 SRI classes in the case of very small changes of the product characteristics. This is particularly the case for products containing barrier protection, but also applies to products with path dependency in general. The PRIIPs approach to the SRI only considers the payoff at the end of the recommended holding period, and derives the SRI out of a certain percentile of the payoff distribution. This approach can, for example, result in discrete jumps for very small changes in protection levels. Should the barrier not be touched during the recommended holding period, the payoff is protected completely (MRM class 1), whereas if the barrier is touched, the risk is comparable to the underlying instrument (usually MRM classes 3-5). Jumps can occur, for example, while changing the protection level from 50% to 55% on a yearly basis for popular underlyings, and are very hard to argue in retail investor advisory.

A potential solution could be to allow issuers to increase the MRM to a more conservative level (such as increase of up to 2 notches) where the MRM computed as the worse 2.5% quantile does not lead to a loss although the product is actually a capital-at-risk product.

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Annex 2 – Illustrative examples

Part 1. Performance scenario issues

The issues relating to performance scenario results can be explained by the positive drift created by market conditions over the last 5 years, which results in the convergence of all scenarios. Given the particular past market context, the use of historical data might not be very relevant in the case of structured securities issued by investment firms that issue interest rate- or equity-based products. Indeed, the results of calculations based on historical data are far from current expectations. In our view, the DR calculations arrive at very optimistic performance results for equity-based products (see Example 1 below). One should actually expect a divergence of results between the favourable, moderate and unfavourable scenarios. **These pro-cyclical results do not correspond with those actually expected by AMAFI and DDV members**.

Example 1

5 year Reverse Convertible (structured investment product issued by an investment firm)
Underlying: Eurostoxx 50 Index®
At the valuation date:
- if the index closes above 60% of its strike price, the investor receives 100% of the Notional Amount, plus a coupon of 15%
- otherwise, the investor receives: a payment in cash equal to the Notional Amount, decreased by the Performance of the Underlying, plus the coupon of 15%
Issue Price: 100%

Performance scenarios following the DR are incomprehensible, as they show a negative scenario without any loss, although it is a capital-at-risk product.

Investment EUR 10 000				
Scenarios		1 year	3 years	5 years
Stress scenario	What might get back after costs	EUR 4 258.40	EUR 5 334.05	EUR 4 574.81
	Average return each year	-57.42%	-18.88%	-14.46%
Unfavourable scenario	What might get back after costs	EUR 9 108.71	EUR 9 894.09	EUR 11 500
	Average return each year	-8.91%	-0.35%	2.83%
Moderate scenario	What might get back after costs	EUR 10 364.88	EUR 11 060.52	EUR 11 500
	Average return each year	3.65%	3.41%	2.83%
Favourable scenario	What might get back after costs	EUR 10 895.07	EUR 11 087.92	EUR 11 500
	Average return each year	8.95%	3.50%	2.83%

The below example uses the same product, but with zero drift applied to the negative scenario. All the other scenarios are conducted in accordance with the DR. It clearly illustrates that investors can actually lose their capital (in this case only 66.97% of the Notional Amount is repaid).

Investment EUR 10 000				
Scenarios		1 year	3 years	5 years
Stress scenario	What might get back after costs	EUR 4 258.40	EUR 5 334.05	EUR 4 574.81
	Average return each year	-57.42%	-18.88%	-14.46%
Unfavourable scenario	What might get back after costs	EUR 8 514.56	EUR 8 022.66	EUR 6 696.90
	Average return each year	-14.85%	-7.08%	-7.71%
Moderate scenario	What might get back after costs	EUR 10 364.88	EUR 11 060.52	EUR 11 500
	Average return each year	3.65%	3.41%	2.83%
Favourable scenario	What might get back after costs	EUR 10 895.07	EUR 11 087.92	EUR 11 500
	Average return each year	8.95%	3.50%	2.83%

Example 2

Unlimited Knock-Out-Warrant (structured leverage product with knock-out)
Underlying: DAX
Issue Date: 30 January 2017
Strike equals Barrier: 13,604.4925 (23 January 2018, 12:31)
Ratio: 0.01

Scenarios		Sample period (1 calendar day)
Stress scenario	What might get back after costs	**EUR 0.16**
	Average return each year	-100.00%
Unfavourable scenario	What might get back after costs	**EUR 0.16**
	Average return each year	-100.00%
Moderate scenario	What might get back after costs	**EUR 26 852.60**
	Average return each year	61 511.99%
Favourable scenario	What might get back after costs	**EUR 56 261.74**
	Average return each year	168 855.34%

The calculation method and the annualisation lead to incomprehensible results. With a recommended holding period of one day, the calculations can result in figures exceeding millions.

Example 3

"US-Dollar Geldmarkt-Floater" (USD Money Market Floatter - structured investment product)
Underlying: 3-month USD LIBOR
Issue Date: 20 April 2018
Maturity: 24 April 2021
Currency of the product: USD
Minimum coupon: 1.75 %
Maximum coupon: 2.75 %

Investment USD 12 000				
Scenarios		1 year	3 years	RHP (maturity)
Stress scenario	What might get back after costs	**USD 12 638.62**	**USD 12 706.26**	**USD 12 836.81**
	Average return each year	5.32%	2.90%	2.26%
Unfavourable scenario	What might get back after costs	**USD 12 938.03**	**USD 12 942.38**	**USD 12 991.44**
	Average return each year	7.82%	3.85%	2.67%
Moderate scenario	What might get back after costs	**USD 12 943.58**	**USD 12 941.85**	**USD 12 994.53**
	Average return each year	7.86%	3.85%	2.68%
Favourable scenario	What might get back after costs	**USD 12 947.17**	**USD 12 944.34**	**USD 12 996.90**
	Average return each year	7.89%	3.86%	2.69%

The current methodology of the DR can be understood as implying result in values that exceed the potential performance of the product (e.g. 2.75% maximum coupon vs. 7.89%)

Part 2. Cost issues

1. Confusion on the concept of "total costs"

The second row of the below table, entitled "Impact on return (RIY) per year" is clear: it is the Reduction In Yield (RIY), *i.e.* the impact of all costs on the annualized return based on the moderate performance scenario, calculated in accordance with items 70 to 72 of the DR Annex VI.

Investment [€10 000] Scenarios	If you cash in after [1] year	If you cash in after [recommend holding period/2]	If you cash in [at the end of the recommen-ded holding period]
Total costs	⬚	⬚	⬚
Impact on return (RIY) per year	⬚%	⬚%	⬚%

Unfortunately, the **title of the 1st row "Total costs" presented in the KIDs is incomprehensible for the investor, because these are not the costs of the product as commonly understood.** Rather, it is actually the Reduction In Yield (RIY) expressed in monetary terms and cumulative to the holding period (as Article 5(2) of the DR requires the specification of a single number in monetary and percentage terms).

Retail investors may take a decision on the basis of something that is called "cost", but is actually an impact on return. A possible solution to avoid such confusion would be to add **an explanatory note**, for example as presented below:

Added explanatory note

Investment EUR 10 000	If you cash in after 1 year	If you cash in after 3 years	If you cash in at maturity
Impact on return in EUR	EUR X	EUR X	EUR X
Impact on return (RIY) per year	x%	x%	x%

Example

> On the issue of consistency with MiFID II, below is an example of a product where the information on costs provided to clients is as follows:
> - "Total costs" indicated in the KID (if you cash in after 1 year): 358.04 EUR / RIY = **3.58%**
> - "Total costs" indicated in accordance in the "MiFID II Costs disclosure form" = **3.10%**

The retail client will have difficulty understanding the difference between these two pieces of information that, given their terminology, seem to refer to the same item. To make it easier for retail investors to understand, it would be preferable that cost information in PRIIPs be entitled "impact on return" (in euro) instead of "total costs".

2. RIY equal to 0 cost where the moderate scenario corresponds to a total loss

Below is an example of the issue we raised regarding the disclosure of costs equal to zero when the moderate performance scenario corresponds to a total loss.

Example

> 1 year Put Warrant (derivative)
> Underlying: Eurostoxx 50 Index®
> Strike Price: closing price of underlying spot on the strike date
> Redemption: Nominal per Warrant * Max(0; 100% - Underlying Price / Strike Price)
> Issue Price: 9.15% of the Nominal per Warrant
> Fair Value: 8.15%
> The raw cost (as per Article 24(4) of MiFID II) is therefore **1% entry cost.**
> Bid-Ask = 1% (i.e. 0.50% cost of mid to bid)

Scenarios		Maturity
Stress scenario	**What you might get back after costs**	**EUR 0**
	Average return each year	-100%
Unfavourable scenario	**What you might get back after costs**	**EUR 0**
	Average return each year	-100%
Moderate scenario	**What you might get back after costs**	**EUR 0**
	Average return each year	-100%
Favourable scenario	**What you might get back after costs**	**EUR 19 685.33**
	Average return each year	96.13%

Investment EUR 10 000	If you cash in at maturity
Total costs	**EUR 0**
Impact on return (RIY) per year	**0%**

This table shows the impact on return per year			
One-off costs	**Entry costs**	**0.0%**	The impact of the costs you pay already included in the price.
	Exit costs	0.0%	The impact of the costs of exiting your investment when it matures.
Ongoing costs	**Portfolio transaction costs**	0.0%	The impact of the costs of us buying and selling underlying investments for the product.
	Other ongoing costs	0.0%	The impact of the costs that we take each year for managing your investment.
Incidental costs	**Performance fees**	0.0%	The impact of the performance fees. We take these from you investment if the product outperforms its benchmark.
	Carried Interest	0.0%	The impact of carried interest.

How does the DR arrive at these numbers?

RIY at year 1 is equal to the difference between internal rate of return without cost and internal rate of return with cost = (moderate scenario without cost / fair value -1) – (moderate scenario with costs / offer price -1) = (0 / 9.15% -1) – (0 / 8.15% -1) = -100% - (- 100%) = 0.0%

This error could easily be addressed by changing paragraphs 70 to 72 in Annex VI of the DR, by allowing for a **calculation of a Total Expense Ratio** expressed as the annualized amount of entry cost and adding the annual ongoing costs. This would result in the following:

Investment EUR 10 000	If you cash in at maturity
Total costs	**EUR 100**
Impact on return (RIY) per year	**1%**

This table shows the breakdown of the total expense ratio due to various cost components			
One-off costs	**Entry costs**	**1.0%**	The **cost** you pay already included in the price **(expressed on an annualized basis).**
	Exit costs	0.0%	The **costs** of exiting your investment when it matures **(expressed on an annualized basis)**.
Ongoing costs	**Portfolio transaction costs**	0.0%	The **costs** of us buying and selling underlying investments for the product **(expressed on an annualized basis)**.
	Other ongoing costs	0.0%	The **costs** that we take each year for managing your investment **(expressed on an annualized basis)**.
Incidental costs	**Performance fees**	0.0%	The **costs** of the performance fees. We take these from you investment if the product outperforms its benchmark **(expressed on an annualized basis)**.
	Carried Interest	0.0%	The **costs** of carried interest **(expressed on an annualized basis).**

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