



Regulatory Newsflash

The Joint ESAs published their final draft Regulatory Technical Standards (RTS) on PRIIPs

The Joint ESAs published their final draft Regulatory Technical Standards (RTS) on PRIIPs on 7 April. The PRIIPs Regulation requires that firms that manufacture, sell or advise on packaged retail and insurance-based investment products (PRIIPs) must provide retail investors with a Key Information Document (KID). The RTS cover the presentation, content, review and provision of the KID, including the methodologies for risk and reward and cost calculations. They follow a consultation paper published in November 2015, a technical discussion paper published in June 2015, and a general discussion paper published in November 2014.

PRIIPs will apply to a wide range of firms, such as banks, insurers and asset managers. It will cover a broad range of products offered to retail investors such as derivatives (both exchange traded and OTC), structured products, retail packaged insurance products, AIFs and UCITS (although there is an initial exemption for UCITS until 2019). The rules on the more costly elements for firms of producing the KID are contained in these RTS, such as establishing the necessary systems for collecting data for the summary risk indicator (SRI), the performance scenario, and the summary cost figures. As such, the RTS is an important document for firms.

The main changes in the RTS, compared to the consultation document, concern the methodologies underpinning the SRI and the performance scenario.

Key areas covered in RTS

Summary risk indicator

The calculation for and format of the SRI is set out in the RTS. Annex III sets out what the SRI should look like and, as was consulted on, it uses a scale of one to seven in terms of the risk of the PRIIP. The SRI should be assigned according to Credit Risk Measure (CRM) and Market Risk Measure (MRI) classes. The methodology for the MRM calculation varies by PRIIP category. The number of PRIIPs categories has been reduced from five to four, compared to the consultation document. Both the quantitative market risk methodologies, namely Cornish-Fisher expansion and Bootstrapped VaR, remain in the RTS with the addition of a more prescriptive formula for simulation of underlying prices under Bootstrapped VaR. The methodology for the calculation of the CRM should be based on the credit assessment of the PRIIP's manufacturer or relevant obligor by external credit assessment institutions (ECAI), with further allocation of credit assessments to credit quality steps.

The RTS also includes rules regarding additional narrative that should accompany the SRI and where additional warnings are required for certain PRIIPs e.g. where there are liquidity concerns or the PRIIP is denominated in a currency different to that of the Member State where it is marketed.

Performance scenarios

The draft RTS sets out requirements on the calculation and presentation of performance scenarios corresponding to favourable, moderate and unfavourable outcomes for retail investors at recommended holding and intermediate periods. There have been changes to the methodologies underpinning the performance scenarios, as compared to the RTS consultation. The methodology has been simplified for exchange traded derivatives (ETDs): performance scenarios at recommended holding periods should be shown in the form of a payoff diagram and scenarios at interim periods are not required. For PRIIPs other than ETDs, the draft RTS pre-defines intermediate periods depending on the recommended holding period and contains prescriptive methodology (for both recommended and interim holding periods) based on the distribution of returns derived for the calculation of MRM. The implications of this are that the calculations of performance scenarios have to be aligned with MRM calculations and manufacturers of OTC derivatives have to simulate the distribution of underlying returns under the MRM methodology, even if the MRM for OTC derivatives is set at 7.

Costs

Information on costs in the KID is intended to allow retail investors to compare costs across the wide range of PRIIPs. The information must summarise the overall impact of the costs, in monetary and percentage terms, as well as show how costs accumulate for different holding periods. For this, the ESAs have opted for use of a Reduction in Yield indicator. The KID must also identify the key costs of the cost structure in a summary breakdown of costs. The ESAs have therefore set out the different types of costs (one-off, ongoing and incidental) that must be included for the different types of PRIIPs. There are different methodologies to calculate or estimate the different types of (implicit or explicit) costs. The RTS also set out rules on the presentation of costs in the KID and the format that should be used.

Presentation and content of the KID

The RTS sets out the mandatory template and layout that must be used for the KID, including certain mandatory text. The template for the KID in Annex I is broadly similar to what was consulted on in November, with some minor wording changes and the addition of a section near the top of the template for the 'comprehension alert' that must be included for certain products deemed not simple and difficult to understand.

PRIIPs that offer multiple investment options

Where PRIIPs offer multiple investment options for retail investors, manufacturers will be allowed to take one of two approaches: (i) produce separate KIDs for each underlying investment option, containing information about both the PRIIP in general and

about the option in particular; or (ii) produce a generic KID describing the overall PRIIP, and provide specific information in a separate document/s about the option details.

Review, revision and republication of the KID

The RTS requires that the PRIIP manufacturer must revise and republish the KID at least every year, as well as where there is a change that “significantly affects” or is likely to affect significantly the information contained in the KID. Importantly, for PRIIPs traded on exchanges, such as futures, calls and puts, the joint ESAs have sought to “calibrate the KID to avoid a situation in which continuous (‘real time’) updating is needed”. In addition to monitoring changes in the SRI, the draft RTS requires monitoring of changes in the performance scenarios, with a 5% change threshold set for moderate performance scenarios.

Providing the KID in good time

Similar to what was proposed in the consultation, the RTS sets out that the person selling or advising on the PRIIP must provide the KID “sufficiently early” for retail investors to be able to consider it when making their investment decision. The RTS also sets out some additional factors that should be taken into account to determine the timing and delivery of the KID e.g. the complexity of the PRIIP and investor knowledge, experience and needs.

What's next?

Firms will have to comply with the PRIIPs Regulation by 31 December 2016. As such, they are working towards a challenging deadline. Given the delay that has been proposed for the MiFID II application date and the linkages between MiFID II and PRIIPs, there have been calls for a delay on the PRIIPs application date from industry and from the German delegation in the Council. However, support for this is not widespread during the MiFID II negotiations and so firms should continue to work towards the 2016 deadline.

The RTS will now go to the European Commission for adoption; the Commission has indicated its intention to adopt the RTS before Summer 2016. The European Parliament and Council will then have a period of scrutiny before the RTS are published in the Official Journal (one to three months depending on whether the Commission requires any amendments to the RTS). The Joint ESAs also intend to publish detailed guidance on the SRI, performance scenarios and cost information, as well as FAQs for PRIIPs on the methodologies in the RTS.

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