

JC 2019 6.3

8 February 2019

Joint ESA supervisory statement concerning the performance scenarios in the PRIIPs KID

Statement

This supervisory statement of the European Supervisory Authorities (ESAs) addresses the response to concerns that the information in the Key Information Document (KID) for Packaged Retail and Insurance-based Investment Products (PRIIPs) describing what the retail investor could get in return (“performance scenarios”) can in certain cases provide retail investors with inappropriate expectations about the possible returns they may receive.

The overall objective of this statement is to achieve a high, effective and consistent level of regulation and national supervision promoting a level playing field and the protection of retail investors.

In the view of the ESAs the performance scenarios could, based on the recent economic environment, provide an overly positive outlook for potential future returns if they are taken to be best estimate forecasts. This relates, in particular, to where products have experienced positive returns over the previous five years that are above the long-term norm. It is important therefore that retail investors are made fully aware of the limitations of the figures provided in the performance scenarios.

The ESAs’ assessment is based on the observations collected and analysis conducted by the ESAs and by National Competent Authorities (NCAs) in the European Economic Area (EEA) since the implementation of the PRIIPs KID at the start of 2018.

PRIIP manufacturers are recommended therefore to take the following into account in relation to the presentation of performance scenarios by means of the Templates A and B of Part 2 of Annex V of the Commission Delegated Regulation (EU) 2017/653¹:

- In view of the potential risk that the performance scenarios may provide retail investors with inappropriate expectations about the possible returns they may receive, it is recommended to include a statement in the KID warning the retail investor of the limitations of the figures shown.
- For the purpose of consistency, it is recommended that the following approach is taken, or a similar approach where adjustments to the proposed wording are necessary to reflect specific features of the PRIIP:
 - To add under the heading of “Performance scenarios” within the section “What are the risks and what could I get in return”, an additional warning that:

¹ Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents (*OJ L 100, 12.4.2017, p. 1*).

Market developments in the future cannot be accurately predicted. The scenarios shown are only an indication of some of the possible outcomes based on recent returns. Actual returns could be lower².

- It is recommended to highlight this text, for example by using a bold format.
- The other relevant information provided to the retail investor in relation to the PRIIP at the pre-contractual or post-contractual stage could also include additional explanations or put the performance scenario figures in the KID in additional context.
- Any steps taken should be proportionate and should provide information that is complementary to the existing information within the KID. Any additions to the KID should be limited to what is considered essential to ensure that the presentation of performance scenarios is fair, accurate, clear and not misleading. Retail investors should not be encouraged to disregard the information in the KID.

NCA's are recommended to monitor whether the steps taken by PRIIP manufacturers are in line with the above recommendations.

Context

Article 6(3)(d)(iii)) of the PRIIPs Regulation³ requires PRIIP manufacturers to include appropriate performance scenarios and information about the assumptions made to produce them in the KID. Commission Delegated Regulation (EU) 2017/653 sets out how this is to be done. For most PRIIPs⁴ the prescribed methodology requires an illustration of how the PRIIP could perform according to four different scenarios (stress, unfavourable, moderate and favourable). The figures presented in these scenarios are generally derived from a model which simulates possible outcomes based on the returns or prices, and fluctuations in those returns, over the previous 5 years. In summary:

- The unfavourable, moderate and favourable scenarios reflect the 10th, 50th and 90th percentile returns respectively⁵;

² The last sentence is only applicable where the performance can be worse than shown in the performance scenarios.

³ REGULATION (EU) No 1286/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

⁴ There is an exception, for example, for options and futures traded on a regulated market to present performance in the form of a pay-off structure graph (Article 3(5) of Commission Delegated Regulation(EU) 2017/653.

⁵ Future outcomes are impossible to predict. However, a model of how prices evolve in a financial market can be used to estimate the distribution of returns accessible to the investor. The methodology for performance scenarios assumes that the model results in the distribution of returns for the PRIIP (or the assets underlying the PRIIP) observed over the past 5 years. The historical distribution of returns is used to estimate the distribution of returns of the PRIIP at the end of the recommended holding period. The 10th, 50th and 90th percentile returns are read from this estimated distribution.

- The stress scenario is calculated using a different model with a view to setting out significantly unfavourable impacts.

At the same time, the PRIIPs Delegated Regulation states that the performance scenarios shall be presented in a way that is fair, accurate clear and not misleading and that is likely to be understood by the average retail investor (Annex V, Part 1, Point 1).

During the ESA Consultation Paper (CP) published in November 2018⁶ on amendments to the PRIIPs KID, the ESAs recognised the concern that the performance scenarios could, in view of the recent economic environment, provide an overly positive outlook of potential returns. This relates to, in particular, where a product has experienced positive returns over the previous five years, that can be seen as above the longer-term norm. Given the very positive performance of many asset classes over previous years, it is acknowledged that this issue pertains to a wide range of PRIIPs. While the KID must already include statements to clarify that the actual return will vary depending on the performance of the market, the ESAs stated that the feedback since the implementation of the KID would suggest that these explanations may not be conveying the intended messages as clearly as they should do. Therefore, the ESAs proposed that changes to how the information is presented in the KID could reduce the risk that the meaning of these figures is misinterpreted or that there is undue reliance on them.

In addition, the ESAs also stated that they are aware that some PRIIP manufacturers have decided to supplement the information in the KID on the basis that the performance scenarios may be seen to provide too positive potential returns to retail investors in the current environment. In some cases such practices have been discussed with their NCA.

While these practices may have been with a view to protecting retail investors, some of them raise supervisory concerns in terms of the extent to which they contradict rather than complement the other information in the KID. Therefore, in the CP the ESAs stated that they intend to communicate their views on these practices in order to promote appropriate and consistent approaches prior to a review of the PRIIPs framework.

⁶ JC 2018 60