

Performance KID (Annex IV & V)

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Outline

1. Performance in general
2. Performance - steps
3. Performance and derivatives
4. Other topics

Presentation of the Risk and Reward work stream

- **RRWS** to feed into the PRIIPs Subgroup on the different risk and reward disclosure aspects of the PRIIPs Regulation
- **Chair:** AFM
- **9 members** (ACPR, AMF, BaFIN, BdP, CNMV, CONSOB, FCA (UK), FSMA, MNB (central bank of Hungary) + EIOPA)

Performance in general

Performance Scenarios

- **Performance scenarios in the KID: unfavourable, moderate and favourable**

Annex IV

- **At the recommended holding period and intermediate periods**

Annex IV

- **Insurance related event**

Annex IV

- **Format of presentation**

Annex V

Performance Annex IV

- When is a 4th scenario required?
- Which intermediate periods need to be included in the KID?
- Is it necessary to show the 1 year intermediate period for PRIIPs with a long lifespan (such as insurance products)?
- What to show when time to maturity of a PRIIP is < 1 year?
- What if the historical data give either a too positive or too negative result?

Performance – steps Category 2

Determining Performance

Step 1

Determine the calculation amount that shall be used for the Performance scenarios. This shall be done according to point 90 of Annex IV

Step 2

The Performance scenarios will show both monetary units and percentages.

Question 3

Does the PRIIP require an initial investment?

YES

The percentage terms are the average annualized return of the investment which shall be calculated considering net performance as a numerator and the initial investment amount or price paid as denominator.

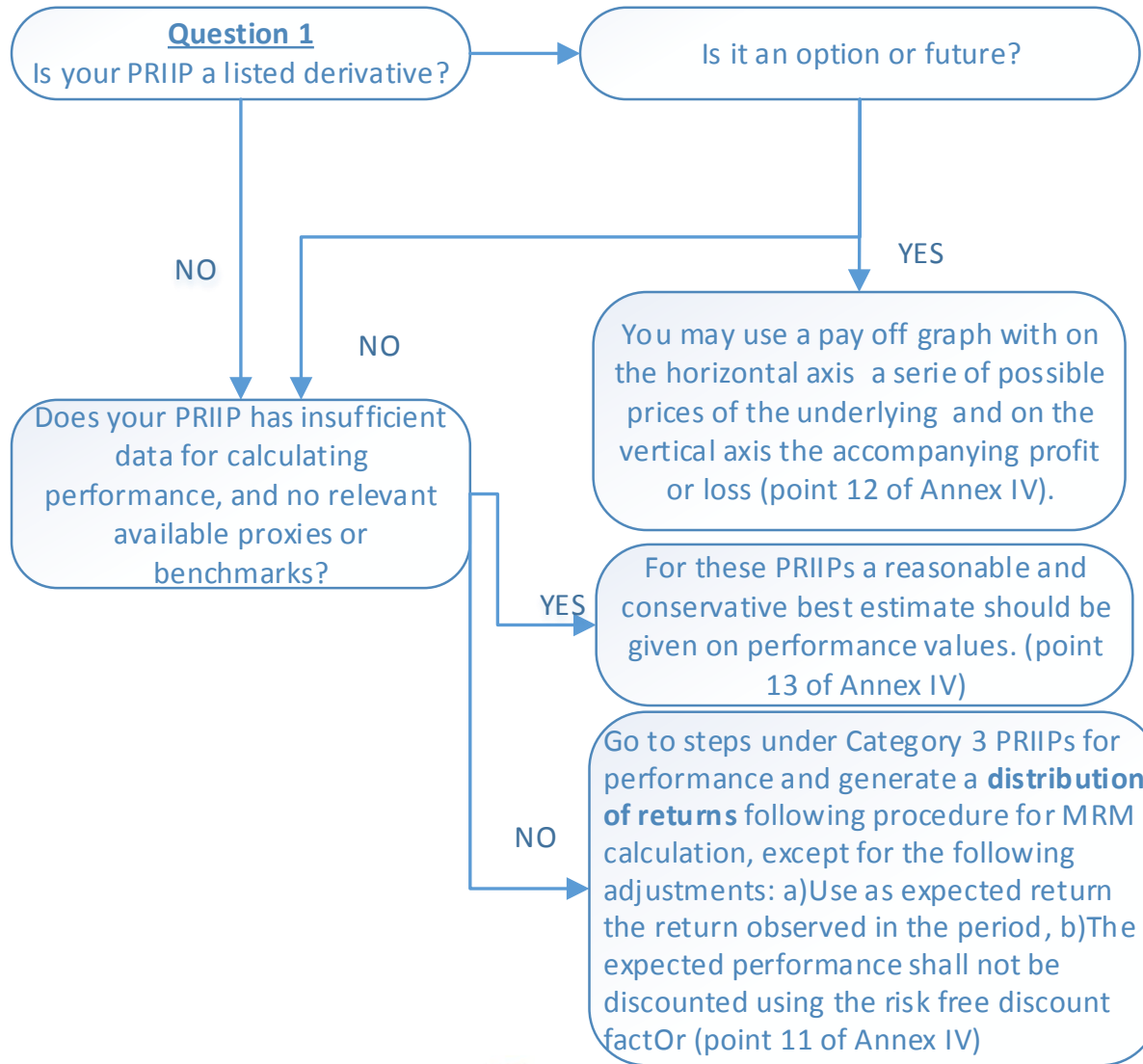
NO

The percentage shall be calculated considering the nominal value of the contract and a foot note added to explain this.

Question 4

What is your PRIIP Category?
Determining your PRIIP Category is explained in the first section of this decision tree.

Determining Performance for Category 1 PRIIPs



Determining Performance for Category 2 PRIIPs

Step 1; How to calculate the performance values at the Recommended Holding Period.

A minimum of three scenarios needs to be shown. You need the following in order to calculate the **performance values at the Recommended Holding period**. Most values are known already from the calculation for risk. Except for N.

- N; is the number of trading days, weeks or months within the RHP. So if the RHP is 5 years and their is daily price data, the $N = 5 * \sim 252 = 1260$.

Unfavorable scenario;

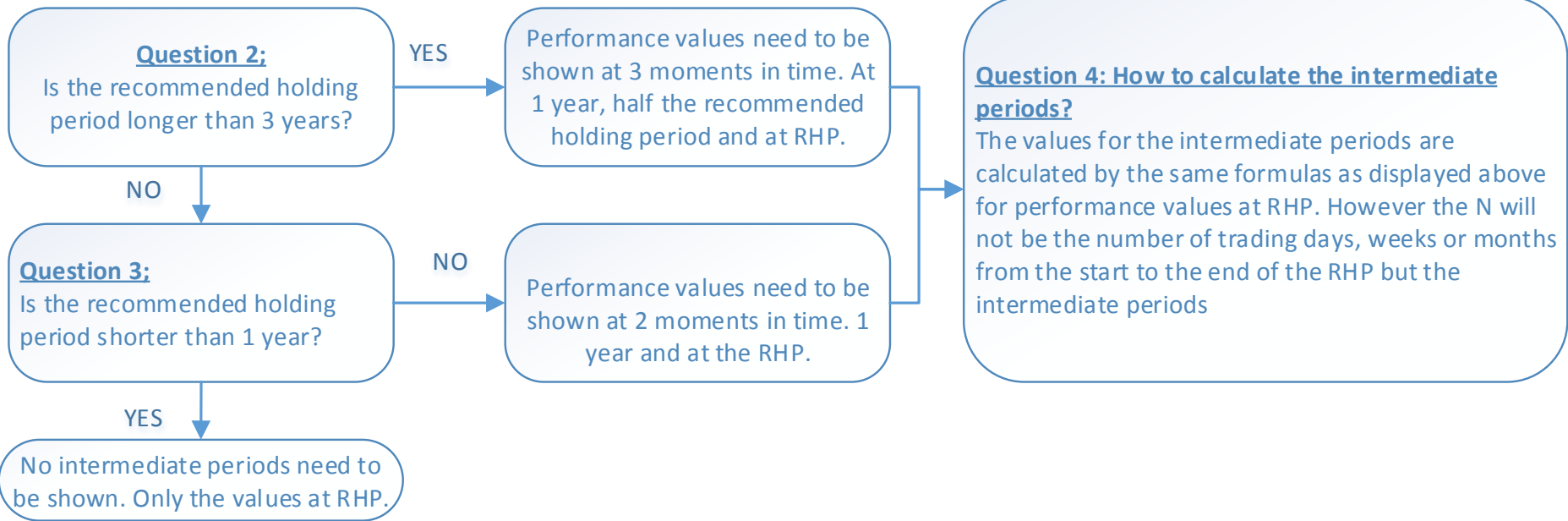
$$\text{Exp} [M1 * N + \sigma \sqrt{N} * (-1.28 + 0.107 * \mu_1 / \sqrt{N} + 0.0724 * \mu_2 / N - 0.0611 * \mu_1^2 / N) - 0.5\sigma^2 N]$$

Moderate scenario;

$$\text{Exp} [M1 * N - \sigma M1/6 - 0.5\sigma^2 N]$$

Favorable scenario;

$$\text{Exp} [M1 * N + \sigma \sqrt{N} * (1.28 + 0.107 * \mu_1 / \sqrt{N} - 0.0724 * \mu_2 / N + 0.0611 * \mu_1^2 / N) - 0.5\sigma^2 N]$$



Simplified calculation example for Category 2

		z_α	$(z_\alpha^2 - 1)/6$	$(z_\alpha^3 - 3z_\alpha)/24$	$(2z_\alpha^3 - 5z_\alpha)/36$
Unfavorable Scenario - CV	10%	-1,281551566	0,107062403	0,072494466	0,061060634
Moderate Scenario - CV	50%	0	-0,166666667	0	0
Favorable Scenario - CV	90%	1,281551566	0,107062403	-0,072494466	-0,061060634

RHP	5 years	1 year	3 years
N	1260	252	756
$\sigma\sqrt{N}$	0,257	0,115	0,199
Unfavorable RHP value	0,799	0,881	0,825
Moderate RHP value	1,112	1,022	1,066
Favorable RHP value	1,544	1,183	1,374

Performance – steps Category 3

Performance Annex IV

- How to calculate the intermediate period for a cat 3 PRIIP?
- How to deal with auto-callables?

- The first steps are identical to the steps required for the MRM calculation for Category 3 products. However, Step 4 differs.

Step 4 Compute the return by summing the returns from the selected periods, i.e.

$\text{Return} = E[\text{Return}_{\text{risk-neutral}}] - E[\text{Return}_{\text{measured}}] - 0,5 \sigma^2 N - \rho \sigma \sigma_{\text{ccy}} N$ according to paragraph 16-24 of Annex II Part 1. However 2 adjustments to the calculation shall be made;

- The expected return for each asset or assets shall be the return observed over the period
- The expected performance shall be calculated at the end of the RHP and without discounting the expected performance using the expected risk free discount factor.

See Step 4 of the example

Determining Performance for Category 3 PRIIPs

Step 6 For each set of simulated curves and spot prices, compute the value of the product and sort the resulting 10,000+ values. See step 5 of the example

	Full RHP RETURN	½ RHP RETURN
FAVOURABLE:	1,099	1,049
MODERATE:	1,021	1,010
UNFAVOURABLE:	0,981	0,991

For the unfavourable case: take the 10th percentile result, or the 1000th value in the ordered list of product values.

For the moderate case: take the 50th percentile result, or the 5000th value in the ordered list of product values.

For the favourable case: take the 90th percentile result, or the 9000th value in the ordered list of product values.

Question 7

Are significant risks of loss adequately covered by these scenarios?

NO

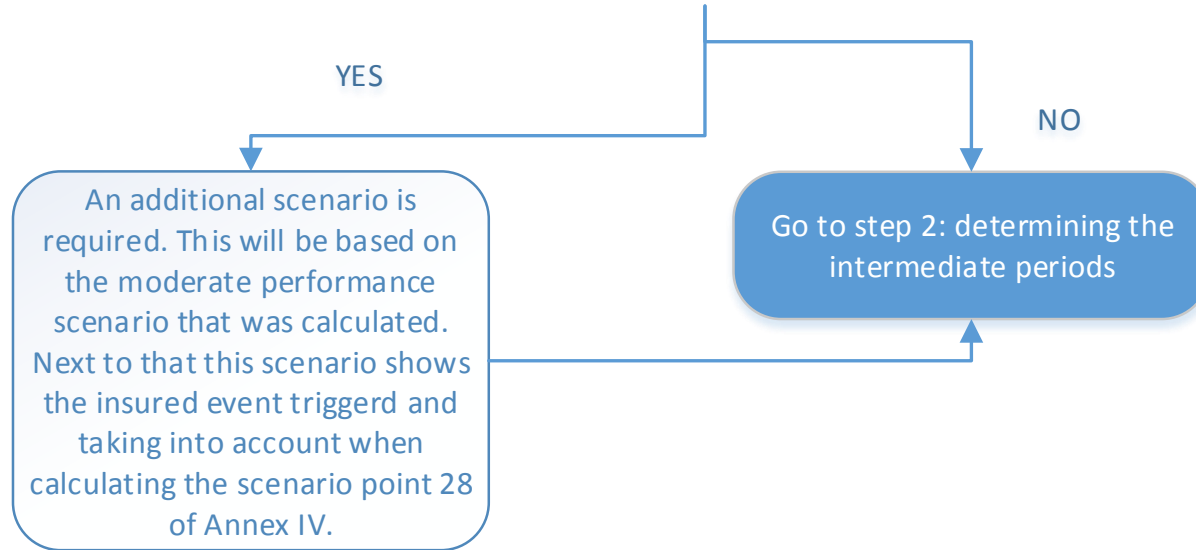
YES

Add an additional scenario covering these situations

Question 8

Is the PRIIP an insurance based investment product?

Determining Performance for Category 3 PRIIPs



- Finally, the performance scenarios should be displayed as (i) an amount and (ii) a percentage compared to the prescribed calculation amount.

Step 2: Performance for the intermediate periods

Question 1:

Does the PRIIP only reference or invest in one underlying, and is the PRIIP a value of a monotone function of this underlying price (i.e. when the underlying price increases, the PRIIPs value is either always non-decreasing, or always non-increasing)?

NO

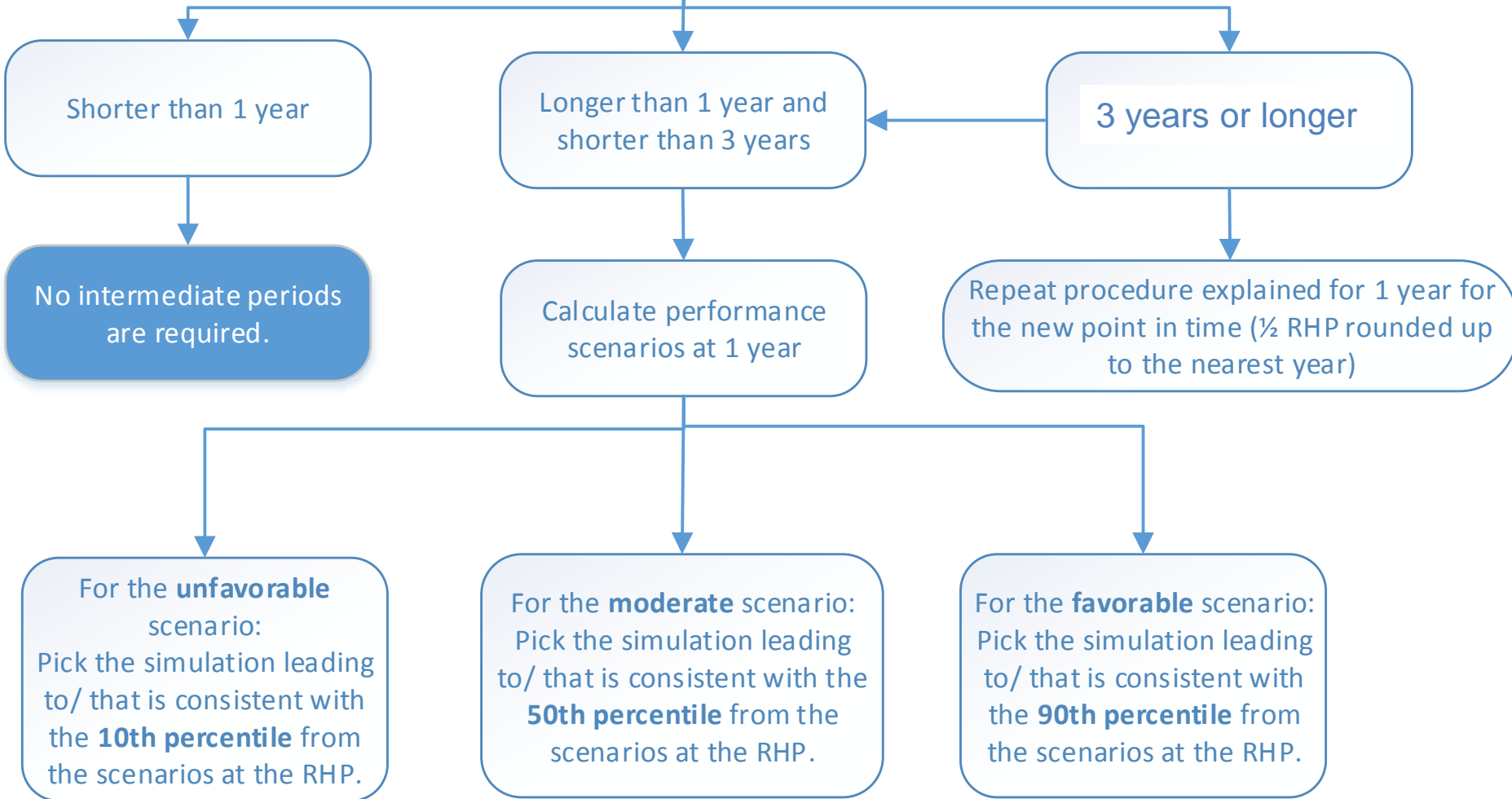
Question 2:

Does the PRIIPs count several underlyings' investment/exposure?

If yes (point 19c of Annex IV), on each intermediate date, select three simulated paths of the underlyings' distribution run as per MRM calculation, and evaluate the PRIIPs value on those three chosen sets of underlyings prices. The paths must be selected to give results which are consistent with (but not necessarily equal to) the percentile of value of the PRIIPs on those intermediate dates

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).

Question 3:
What is the term of the Recommended holding period?



Performance and derivatives

Performance and derivatives

- Is it allowed to amend the text below the performance scenarios?
- Is it allowed to use cash flows instead of payments?

Other topics

Other topics

- Is it required to provide intermediate periods for illiquid PRIIPs?
- Should entry- and exit fees be reflected in the performance scenarios?

Questions...

