

Workshop on the implementation of the PRIIPs framework

Section II: Costs

Emmanuel Doumas – ESMA / Chair of the Cost Work Stream

11 July 2016

Outline

1. Presentation of the first batch of Q&As on Costs

- a. Estimate of standardized transaction cost
- b. Other Q&As on transaction cost related issues
- c. Other Q&As on costs

2. Questions on Costs received prior to the Workshop

3. Other Questions on Costs?

Presentation of the first batch of Q&As on costs: Estimate of standardized transaction costs

- **Article 21(c) (i) of Annex VI:**

“For the asset classes indicated in the table below, transaction costs shall be calculated as the average of the estimated cost of transaction (based on bid-ask spreads divided by two) for the relevant asset class under normal market conditions. To estimate the cost, one or more reference indexes shall be identified for each asset class. Then, the average bid-ask spreads of the underlying indexes shall be collected”

- **Q&As to specify this methodology:**

- What are the abovementioned “reference indexes”?
- What is the methodology to estimate the corresponding cost of transaction?

Presentation of the first batch of Q&As on costs: Estimate of standardized transaction costs

- **Step 1: Identify the relevant index**

Example:

Asset Classes	Sub Asset Classes	Index
Investment grade corporate bonds	Investment grade corporate bonds	<i>Barclays Euro Corporate IG + Barclays US Corporate IG EURO STOXX 50[®] Corporate Bond</i>

Presentation of the first batch of Q&As on costs: Estimate of standardized transaction costs

- **Step 2: Time period**

Identify the valuation day (the tenth business day of the month) and the time period (the last 12 months)

- **Step 3: Collect the index/indexes constituents** (and their weights for each day of valuation of each month during the time period)

- **Step 4: Collect the closing bid-ask spread** (of the constituents identified for each day of valuation from the source of information identified)

Presentation of the first batch of Q&As on costs: Estimate of standardized transaction costs

- **Step 5: Calculate the estimate cost of transaction of each point in time**

For each day of valuation, the bid-ask spread collected for each constituent is divided by two applying the following formula:

$$\frac{P_{ask} - P_{bid}}{2 * P_{mid}}$$

- **Step 6: Calculate the estimate cost of transaction in normal market condition** (make the average of the estimated cost of transaction of each point in time identified for the last twelve months)

Presentation of the first batch of Q&As on costs: Other Q&As on transaction cost related issues

- **What could be the ‘explicit costs’ and ‘comparable information’ mentioned in paragraph 21 (c) (ii) of the Annex VI of the RTS, and how to estimate these costs?**

“For the asset classes indicated in the table below, transaction costs (including explicit costs and implicit costs) shall be estimated either by using comparable information or by adding estimates of explicit costs to estimates of half the bid-ask spread, using the methodology described in point (i)”

- **In the case an asset manager, being an affiliate entity of another entity, transmits its orders to its trading desk, whereas such trading desk belongs to a sister company or the holding, shall the arrival price be the price at the time the order is transmitted to the trading desk or the time where the trading desk sends the order to the broker?**

Presentation of the first batch of Q&As on costs: Other Q&As on cost

- **Which impact of costs on the investment return is shown in table 2 (composition of costs)?**

The table shows the impact of the different types of costs on the investment return the investor might get at the end of the recommended holding period. The values indicated are the annualized impact on return per year, and more precisely the RIY at the recommended holding period.

- **What should manufacturers do if they do not have the summary cost indicator for an investment in another PRIIP / UCITS? (This will be the case for investments in UCITS during the transitional period)?**

Questions on cost received prior to the workshop

- **Questions on the calculation of RIY**

Ex: *“The RIY shows the difference between returns gross and net of all costs. However, the Costs over Time table is based on the moderate return, which is based on 5 years’ historical prices, which are already net of ongoing charges. How can we arrive at a gross return without somehow adding the charges back into the returns and then deducting all costs to arrive at a net return?”*

- **Questions on transaction costs**

Ex1: *‘How to deal with negative transaction costs?’*

Ex2: *‘In cases where a mid-market price (“of the investment at the time when the order to transact is transmitted to another person”) is not available (para. 14), as is the case for fixed income that is not negotiated on a continuous basis, which price should be used for ‘opening price’ or ‘previous closing price’ (last listing, request for quote from an independent pricing source, other)?’*

Ex3: *‘Calculating transaction costs using data prior to 31/12/2016?’*

Questions on cost received prior to the workshop

- **Questions on list of costs of investment funds**

Ex1: *'Para. 5(b)(v) on securities lending: In order to allow an investor to fully understand both the benefits from and costs of a securities lending programme, the securities lending performance contribution to the portfolio as well as the lending agent's fee share of total revenues should be disclosed. Since lending agents' remuneration is typically a percentage portion of the gross revenues, the current proposal would lead to funds that benefit more from securities lending to appear artificially more expensive for investors, while in fact the fund's higher securities lending contribution adds to performance and reduces costs. In addition, other costs, if any related to securities lending, incurred by the fund, should be disclosed separately'*

Ex2: *'Para. 5(m) & (n): At what level do you do look-through for funds of funds? We presume that, as for UCITS, you look through only to the KIDs or KIIDs of the underlying funds, as those KIDs/KIIDs will pick up any further layer of underlying.'*

Ex3: *'Provisioned fees for specific treatment of gain and losses" [Annex VI, I, 5(d)]. Please provide an example of such provisioned fees'*

Questions on cost received prior to the workshop

- **Questions on list of costs of PRIIPs other than investment funds (including structured products)**

Ex1: *'Para. 32-34 (section on recurring cost) do not mention look through, whereas the investment funds and the insurance products sections both include it as a requirement. We are assuming that look-through will be required for all PRIIPs alike.'*

Ex2: *'Could you clarify that although the FV of the product needs to be "in line with accounting standards", it can't be equal to any accounting Fair Value as accounting standards generally allow for provisions and adjustments to the FV which are at book or portfolio level, rather at transaction level'*

Ex3: *'Fair Value concept is not unambiguous: Greater specificity is necessary on the valuation of that implicit cost under the criteria of fair value; To the extent that (i) the standard indicates that it should be assessed under the criteria of fair value in the same way that the institutions do in their own accounting; (ii) but in their own accounting there are products that do not go to fair value, what should be done with these discrepancies?'*

Ex4: *'Should hedging costs be included in the summary cost indicator?'*

Questions on cost received prior to the workshop

- **Questions on list of costs of insurance-based investment products**

Ex1: *'Should the cost part of biometric risk premium be included in the cost section of the KID?'*

Ex2: *'Annex VI para. 53 of the RTS: Can you confirm that this provision applies inter alia to unit-linked insurance products in which the capital provided by investors is invested in UCITS, AIFs or other PRIIPs?'*

Annex VI para. 53 of the RTS: *'Where an insurance-based investment product invests a part of its assets in UCITS or AIFs in a PRIIP other than UCITS or AIFs or in an investment product other than a PRIIP, points 5(l), 5(m) and 5(n) of this Annex shall be applied respectively.'*

Questions on cost received prior to the workshop

- **Questions on the presentation of costs**

Ex1: *'The second table does not show both summary indicators and compound effect (as required per Level 1 Art. 8(f)). Investors will not know the size of any entry cost and will not be able to tell which costs he/she faces at early redemption, due to costs being calculated over the recommended holding period and shown only as the extent to which they reduce return'*

Ex2: *'Incidental costs are in many cases not applicable for traditional endowment insurances. Should the cell row Incidental costs still be included in the table with 0% or deleted?'*

- **Any Other Questions on costs**

Ex1: *'Annex VI in RTS para 13: "The (...)the costs are assessed on an 'all taxes included' basis. Since the manufacturer cannot know at the time of preparing the KID what taxes (direct or indirect) shall apply depending on the place of distribution, customer type or personal circumstances, clarification is requested of whether it is referring to concepts such as registration fees and the like or, otherwise, to which concepts it is referring'*

Ex2: *Estimations for new PRIIPs (Annex VI point 85). Does this point allow to use an estimation for every category of costs: incidental, other recurring and transactions?*

Presenting costs

Cost over time and the composition of costs

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 recommended holding period]
Total costs	[]	[]	[]
Impact on return (RIY) per year	[]%	[]%	[]%

This table shows the impact on return per year

One-off costs	Entry costs	[]%	The impact of the costs you pay when entering your investment. [This is the most you will pay, and you could pay less]. <i>[AND/OR where the costs are embedded in the price, for instance in the case of PRIPs other than investment funds]</i> The impact of the costs already included in the price. [This is the most you will pay, and you could pay less]. <i>[Where distribution costs are included in entry costs]</i> This includes the costs of distribution of your product.
	Exit costs	[]%	The impact of the costs of exiting your investment when it matures.
Ongoing costs	Portfolio transaction costs	[]%	The impact of the costs of us buying and selling underlying investments for the product.
	Insurance costs	[]%	<i>[Where full biometric risk premium presented]</i> The impact of the amount you are paying to buy insurance protection. <i>[Where cost part of the biometric risk premium presented]</i> The impact of insurance costs (the amount you are paying for insurance cover which exceeds the estimated value of insurance benefits)
	Other ongoing costs	[]%	The impact of the costs that we take each year for managing your investments.
Incidental costs	Performance fees	[]%	The impact of the performance fee. We take these from your investment if the product outperforms its benchmark [y by x%].
	Carried interests	[]%	The impact of carried interests. We take these when the investment has [performed better than x%]. [A payment of y% of the final return will take place subsequently to the exit of the investment.]