

Comment

of the German Insurance Association (GDV)

ID-number 6437280268-55

**on the Joint Consultation Paper concerning amendments to the
PRIIPs KID (JC 2018 60)**

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The German insurers welcome the opportunity to respond to the ESAs' Joint Consultation Paper concerning amendments to the PRIIPs RTS. We support the overall objective of the PRIIPs Regulation to enhance consumer protection and improve retail investor confidence in PRIIPs. Moreover, we do agree that improving the transparency of the products offered to retail investors will contribute to this aim.

We understand that the ESAs' rationale for the targeted amendments is twofold: First, to ensure appropriate application of the PRIIPs KID requirements by UCITS. Second, to address some specific issues that have arisen from the application of the RTS. We also understand that the overall review of the PRIIPs Regulation has been deferred. The German insurers welcome the fact that the overall review of the PRIIPs Regulation has been deferred. In our view the postponement of the initial application of the PRIIPs Regulation left a very short period of application at this point. However, it is crucial that consumers, supervisors and providers gain sufficient experience and evidence with the PRIIPs KID before new changes are proposed.

As the ESAs state themselves, the challenging timeframe to which amendments would need to be finalised significantly limits the extent to which new approaches or methodologies can be developed. In our view, the main proposal – the additive inclusion of past performance to the existing future performance scenarios – will not lead to better information for consumers but rather deteriorate the current PRIIPs KID. We understand that under certain limited circumstances the current methodologies for category 2 and 3 PRIIPs lead to performance scenarios which are too positive. This is due to the fact that the performance scenarios repeat the trends in the financial markets seen in the last five years, which were positive for several asset classes. However, including past performance would only reinforce this impression. Furthermore, the German insurers believe that past performance is generally and fundamentally a misleading information for consumers since it encourages pro-cyclical investment behaviour. It is also crucial to notice that past performance does not exist for many types of products including insurance-based investment products, which are individual contracts that additionally offer biometric risk protection. We believe that simulated past performance is a poorly functioning remedy, which will not be understood by consumers. In addition, this information would be less relevant to the consumers and contradicts the fact that the KID should contain only key information on a product. Finally, we understand, that the ESAs could propose further changes to the current methodology for generating future performance scenarios at a later stage. We believe that piecemeal changes increase the risk that consumers lose their trust in the performance scenarios in the PRIIPs KID. Therefore, if the performance scenarios were to be changed, a single overarching in-depth review at a later stage is imperative.

The German insurers agree with the ESAs that the absence of time to test the proposals on consumers significantly limits the extent to which new approaches or methodologies can be developed. We believe that consumer tests, which predominantly address performance scenarios, are indispensable, before any significant changes can be proposed.

We understand that the ESAs have a very short time frame to finalise the targeted amendments in January 2019 which is necessary in order to give the industry sufficient time for implementation. However, it is also critical, that sufficient time is given to evaluate the feedback of stakeholders and to propose genuinely functioning improvements of the PRIIPs KID.

To sum up, we strongly believe that the current proposals will deteriorate the quality of the information contained in the PRIIPs KID. Under these circumstances we urge the ESAs not to introduce any intermediate solutions and encourage the ESAs to conduct an in-depth review at a later stage that is preceded by a consumer testing and thorough consultations with expert groups and stakeholders. Furthermore, we believe that the time line is very challenging due to the European elections next year and time needed by the manufacturers to implement the changes. In our view, this is also a clear reason for the postponement of the review and a withdrawal of the consultation.

Finally, we would like to make clear that German insurers only comment the RTS issues that ESAs addressed in the consultation paper. The short period of time does not enable us to comment on all RTS issues. Therefore, we urge the ESAs to conduct another consultation to collect other possible issues with the PRIIPs KID before the overall review.

1 Do you agree that information on past performance should be included in the KID where it is available?

We urge the ESAs not to introduce any intermediate solutions and encourage the ESAs to conduct an in-depth review at a later stage that is preceded by a consumer testing and thorough consultations with expert groups and stakeholders.

Notwithstanding of the above, the German insurers believe that past performance is in general a misleading indicator for consumers regardless of the type of the product.

- It is widely acknowledged that “History may not be a good predictor of the future.” as the ESAs stated in the discussion paper JC/DP/2014/02. This is particularly true for long-term products such as insurance-based investment products. However, consumers would assume that past performance is relevant for the future gains. Otherwise, why else would this information be included in the key information document?
- Past performance would encourage pro-cyclical investment behaviour, consumers would chase recent returns. The ESAs state themselves in the cost-benefit analysis section of the current consultation paper that retail investors may unduly rely on past performance information and assume it will be replicated in the future (the so-called extrapolation bias).
- Past performance overestimates the true performance due to the so-called survivorship bias. Poorly performing funds close, and therefore, the existing funds are not a representative sample of the true past performance.
- The ESAs argue that past performance is relevant to illustrate the actual behaviour of a product in given market circumstances and to help investors to appreciate the volatility of the returns of the product, as well as the ability of the investment manager. The German insurers disagree strongly: first of all even ten years of past performance will not show the financial crisis of 2008 in the next year. Thus, consumers will see relatively low volatility and too positive returns of the products, an effect which is similar to the current future performance flaw. Finally, past performance does not provide enough information to judge the ability of the investment manager. Observing only one path cannot differentiate between pure luck and skill. Any arbitrary deviation from the benchmark would outperform the benchmark in 50% of scenarios. Thus a large number of modelled scenarios has to be used to judge a strategy. Only if it outperforms the benchmark in significantly more than 50% of the scenarios can ability be assumed.
- We disagree with the ESAs that the proposed amendments will reduce the risk that the meaning of these figures is misinterpreted or that there is undue reliance on them. In our view, the inclusion of past performance can even reinforce the possible current misinterpretations. Even where past performance data exists, it will reinforce the impact of the current trends of the future performance scenarios on consumers thus deteriorating the information even further.
- Finally, an additional inclusion of past performance and respective narratives would exceed the limit of PRIIPs KID of three pages, as ESAs acknowledge in the cost-benefit analysis.

The ESAs mention that trade bodies and stakeholders representing consumers have argued as to the relevance of such information and criticised its absence from the PRIIPs KID. We would like to point out that past performance was initially included in the Commission's proposal for the PRIIPs Regulation. However, both Council and the European Parliament preferred future performance. Thus, it was explicitly agreed in the Trialogue not to include past performance in the PRIIPs KID.

The German insurers agree with the ESAs that the absence of time to test the proposals on consumers significantly limits the extent to which new approaches or methodologies can be developed. The ESAs claim that the results of consumer testing study that was conducted during the development of the original draft RTS in 2015 could be used. However, we would like to stress that this consumer testing only considered different possibilities to show future performance scenarios. Neither did it investigate different methodologies for calculation and how consumers understand them nor did it investigate the interpretation of past performance by consumers.

2 Are there challenges to include past performance information for certain types of PRIIPs?

We urge the ESAs not to introduce any intermediate solutions and encourage the ESAs to conduct an in-depth review at a later stage that is preceded by a consumer testing and thorough consultations with expert groups and stakeholders.

As previously mentioned, we strongly believe that past performance is in general misleading for consumers. Notwithstanding of the above, we welcome that the ESAs recognise that past performance does not exist for several PRIIPs.

The ESAs acknowledge that actual past performance does not exist for some product classes such as structured UCITS or other structured PRIIPs. However, we urge the ESAs to acknowledge that past performance also does not exist for insurance-based investment products for various reasons:

- Biometric benefits are also included in performance scenarios, as the holistic approach is taken in the PRIIPs KID. If projected to the past, insurer would have to include information in the event that the consumer died or became incapacitated in the past. Furthermore, the display of capital guarantees makes no sense in retrospect since in retrospect there is no uncertainty anymore.

- Insurance contracts are individual agreements between insurers and consumers. The contracts offered to consumers change due to further evolution of the products as well as new developments in jurisprudence and legislation. Insurance-based investment products have, therefore, very short products cycles compared to other products. Thus, it is impossible to buy exactly the same product consumers bought several years ago.
- For insurance products, which are individual agreements, past performance and past costs can only be captured at a generalised level. This information might be useful for macroeconomic comparisons, but not as individual information for a single consumer. For a single consumer such generalised information would be misleading.

Moreover, even if past performance values were somehow simulated or approximated, a yearly bar chart display is contrary to the nature of insurance-based investment products. Especially for long-term IBIPs a holistic approach is important so that consumer see the effect of long-term saving and biometric protection. The main question is not how much yield the product produced last year (which would be a rough simulated guess) but rather how does the cumulated gain contribute to my yield in the long-term, for example for retirement purposes and what will happen if the insured event occurs. Investment strategies, profit participation (esp. terminal bonuses) and cost structure are designed with a long term perspective. The returns do not only depend on external factors like the underlying investment but also on the phase of the contract.

3 Do you agree that it is appropriate for this information on past performance to be based on the approach currently used in the KII? If not, please explain your reasons and if an alternative presentation would be more appropriate and for which types of PRIIPs?

We urge the ESAs not to introduce any intermediate solutions and encourage the ESAs to conduct an in-depth review at a later stage that is preceded by a consumer testing and thorough consultations with expert groups and stakeholders.

Notwithstanding of the above, a yearly bar chart covering performance over the last 10 years as currently used in the UCITS KII is contrary to the nature of insurance-based investment products. Prevalent number of IBIPs are long-term products. For these products a holistic approach is important for the consumer, that shows the effect of long-term saving and biometric protection. The main question is not how much yield the product produced last year (which would be a rough simulated guess) but rather

how does the cumulated gain contribute to my yield in the long-term, for example for retirement purposes and what will happen if the insured event occurs. Investment strategies, profit participation (esp. terminal bonuses) and cost structure are designed with a long term perspective. The returns do not only depend on external factors like the underlying investment but also on the phase of the contract.

4 Do you think that information on simulated past performance should be included in the KID where actual past performance is not available? If not, please explain your reasons.

We urge the ESAs not to introduce any intermediate solutions and encourage the ESAs to conduct an in-depth review at a later stage that is preceded by a consumer testing and thorough consultations with expert groups and stakeholders.

Notwithstanding of the above, the German insurers welcome that the ESAs recognise that actual past performance information does not exist for some types of PRIIPs. Especially for insurance-based investment products which are individual contracts between insurer and consumer, past values of the same agreement do not exist. Moreover, it is not possible to show biometric benefits in the past.

The aim of the PRIIPs Regulation is provision of information necessary for consumers to make an informed investment decision and compare different PRIIPs. Therefore, the PRIIPs KID should contain information which is comparable, that is, in the first place the information should exist. Thus, it is deeply worrying that the ESAs nevertheless consider developing methodologies for such products by introducing artificial simulated values without any empirical evidence that they enhance consumers' understanding and are comparable to "real" past performance. In ESAs' view, due to unsolved technical issues of using past performance for products where it does not exist, the inclusion should be done in two stages. This would particularly mean that artificial assumptions will be needed to produce these values.

We do not understand why one-size-fits-all approach seems to be more important than comprehensibility for consumers. We believe that simulated past performance will not be understood by a consumer who also applies heuristics and rules of thumb. Furthermore, as the ESAs acknowledge themselves that it can be argued that this information is of less relevance to the investor. We agree that if consumers are provided with sufficient information and understand what simulated past perfor-

mance means and how it works, they will find the information irrelevant. In our view, this contradicts the fact that the KID should contain only key information on a product. Additionally, as we argued previously that past performance does not necessarily show real volatility or the ability of investment managers, this would be exacerbated for simulated past performance. Therefore, it is of utmost importance that if such approach was taken, it should be thoroughly examined in the consumer testing. Before any decision is taken it should be tested what consumers understand by simulated past performance. In those tests consumers should be made aware that the values are not real and be provided with explanation of how the simulation was achieved.

Finally, we believe that a two stage approach of first including past performance for products where it exists could lead to confusion at a later stage. We believe that piecemeal changes increase the risk that consumers lose their trust in the performance scenarios in the PRIIPs KID.

5 If you think that information on simulated past performance should be included in the KID, what approach do you think should be used to simulate the past performance, and how should this be presented in the KID?

We urge the ESAs not to introduce any intermediate solutions and encourage the ESAs to conduct an in-depth review at a later stage that is preceded by a consumer testing and thorough consultations with expert groups and stakeholders.

Notwithstanding of the above, we believe that simulated past performance is neither comprehensible nor useful for consumers, see our answers to Q2-Q4.

6 Do you consider these amendments to the narrative explanations to be an improvement on the current performance scenario approach?

We agree with the ESAs that the performance scenarios intend to show the spread or range of outcomes, and not give undue certainty to these outcomes. Therefore, we welcome ESAs' efforts to make the current narrative even more comprehensible for consumers. Although we welcome possible improvements, we believe that the possible implementation should come within a single review at a later stage. It would also give the ESAs opportunity to conduct consumer testing to assess the impact of the improvements.

Notwithstanding the above, we believe that an additional explanation, e.g. that market developments in the future cannot be accurately predicted, is of added value for consumers.

7 Do you have any comments on the analysis set out in this Section of other possible options to improve the future performance scenarios?

We understand that there were two reasons for the ESAs to modify the performance scenarios: future inclusion of UCITS in the PRIIPs Regulation and possibly unrealistically positive performance scenarios for some products. However, we believe that the current suggestions do not improve the RTS in this respect but rather deteriorate them.

In our view the flaws of the current methodology lie in the fact that the performance scenarios repeat the trends of the last five years and are, therefore, misleading for consumers. An addition of past performance will only reinforce this effect. In our view the quality of future performance scenarios could be improved if a forward-looking stochastic simulation approach based on realistic and consistent long-term market expectations is used instead.

Future performance scenarios anchored in the risk-free rate of return

The risk-neutral calculus is normally used as a mathematical tool to calculate the fair price of derivatives. The sole reason for using an artificial risk-neutral pricing is the simplicity of the risk neutral world. However, the values of performance scenarios which are obtained using risk-neutral values do not have any meaning in the real world. They are artificial values with no meaning and, hence, useless for consumers. Instead, consumers are interested in real-world values of performance scenarios.

Furthermore, future performance scenarios anchored in the risk-free rate of return do not fit the basic PRIIP requirements of comprehensibility and comparability. If calculations are based on the risk-free rate, there will be no return for risks taken. Thus, consumers will not understand that there is a trade-off between risk and return. The results of a risk-free rate approach will indicate that the product with the lowest risk and lowest cost has the same average return as products with higher risks. Products with higher risks will just show a higher volatility. As this approach does not help to illustrate the distinctions between products with different risks as the ESAs acknowledge in the cost-benefit analysis, it will impede comparability. Consumers literally live in a “real world scenario” not a risk free one.

Amended approach and presentation for future performance scenarios to highlight the range of outcomes

Showing just two performance scenarios could easily be misinterpreted by consumers: The values might easily be mistaken as upper and lower bounds of possible outcomes. Something like this should not be included without proper consumer testing.

Furthermore, it should be noted that the stress scenario is produced under different assumptions and under a different methodology than the other three scenarios. A presentation of optimistic scenario together with the stress scenario would not be consistent. Furthermore, in some cases the stress scenario lies above other scenarios. If the product performed poorly in the last five years it can also happen that the stress scenario lies above the optimistic scenario. This is highly misleading for consumers.

Extend the historical period used to measure performance

Extending the historical period does not mitigate the basic issues. Market cycles sometimes last longer than ten years as can currently be observed. It would be preferable to use forward looking models that are not directly dependent on the current market cycle.

8 Do you have any views on how the presentation of the performance scenarios could otherwise be improved?

We urge the ESAs not to introduce any intermediate solutions since we believe that proper improvements need time. We encourage the ESAs to conduct an in-depth review at a later stage that is preceded by a consumer testing and thorough consultations with expert groups and stakeholders. Notwithstanding of the above, in our view the quality of future performance scenarios could be improved if a forward-looking stochastic simulation approach based on realistic and consistent long-term market expectations is used instead.

9 Do you agree with the proposals described in this section?

The German insurers appreciate possible improvements of the RTS. We believe that the Q&A is a good place to address these supplementary changes. If the changes of the RTS should be necessary, we urge the

ESAs to implement these changes after a thorough review of the RTS is conducted at a later stage. It would also give the ESAs opportunity to conduct consumer testing to assess the impact of the possible improvements.

Market risk measure (MRM) calculation for regular investment or premium PRIIPs

The German insurers welcome the inclusion of a methodology for the calculation of market risk for products with regular premium. Most of long-term IBIPs are regular premium products and, therefore, functioning methodology is needed for these products.

The industry has developed two methods which can be applied for regular premium products and which are regarded as equivalent. These can be found in the comfort European PRIIPs template (CEPT V1.1) [published by Insurance Europe](#) and EFAMA (field 31050_Lump_sum_or_regular_premium_indicator). We believe that the current ESAs' proposal corresponds to the method 2. However, the German insurers are worried that the current description might be not comprehensible for all manufacturers. In particular, concrete formula for the VEV calculation should be added.

Furthermore, method 1 should also be added as a possibility to calculate the MRM for products with ongoing premiums since it produces generally comparable results. Since it is a simple method it provides a useful alternative to method 2.

Narrative for performance fees – composition of costs table

First of all, we would like to point out that the line “Incidental costs” is not included in the KID or the generic KID of an insurance-based investment product since insurance-based investment products do not have those costs (see Q&A on the PRIIPs KID, 20 November 2017, question 2 on page 41) However, the question is still relevant for insurers: if the underlying investment option has performance fees, performance fees will be included in the specific information on the underlying investment option. Therefore, we welcome the added flexibility, which enables manufacturers to capture different types of performance fees. Although insurance-based investment products have no performance fees, the flexibility of the text enables insurers to display true performance fees of underlying investments within a MOP.

Growth assumption for the reduction in yield (RIY) calculation

We agree with ESAs assessment that the current methodology is not ideal for products with negative or low moderate performance. However, we strongly disagree with current proposal. Using 3% percent for all RIY cal-

culations is an unnecessary oversimplification. As RIY usually depends on the yield (depending on costs structure) the RIY shown in the KID should match the yield from the moderate performance scenario. First of all, if products have higher performance than 3%, the calculation with 3% would significantly lower the total costs in monetary term (e.g. total costs in EUR). Thus, the current approach punishes products with lower risk (and potentially lower reward) and gives an advantage to products with higher risk class (and potentially higher reward). If performance and costs are shown as unconnected this might mislead consumers as this is generally not true. The consultation paper does not make it clear why a general use of 3% is considered consistent. Using a typical yield for the product makes the cost disclosure in KID much more consistent to the product.

10 Do you have any comments on the proposed approaches in relation to the analysis and proposals in this section?

We understand that the scope of Section 4.3 of the consultation paper is only restricted to the UCITS funds. These additions seem to be necessary for the inclusion of the UCITS funds in the PRIIPs Regulation. We would like to add that in our view there is no need to apply these additions to other products.

11 Do you have any comments on the preliminary assessment of costs of benefits?

The German insurers do not agree with the ESAs that the amendments not necessarily lead to additional burden for manufacturers since they have to review the PRIIPs KID at the beginning of the year anyway. The amendments will have to be implemented additionally in all processes, including IT tools, distribution process, data exchange with providers of underlying investment options etc. These changes would not be necessary for ordinary PRIIP KID reviews.

Adding further information and especially further indicators might substantially hurt the transparency and comprehensibility of the KID for the average consumer. It was intentionally designed as a concise information document. Information overload is a serious problem for the average consumer.

Finally, even if the changes introduced do not concern insurance-based investment directly, they will still lead to implementation costs since insurers have to implement and produce documents for the underlying investment options (if UCITS KIIDs are not used directly). Furthermore, the in-

formation delivery standards (e.g. the European PRIIPs templates EPT/CEPT) and the IT will need to be adopted.

12 Are you able to provide information on the costs of including information on past performance for different types of PRIIPs?

In our view, including past performance on top of future performance would reinforce the trends seen in the future performance scenarios. Furthermore, the German insurers believe that past performance is in general misleading information for consumers regardless of the type of the product. Moreover, past performance does not exist for many types of products including insurance-based investment products, which are individual contracts that additionally offer biometric risk protection. We believe that simulated past performance is a poorly functioning remedy, which will not be understood by consumers. In addition, this information would be of less relevance to the consumers and contradicts the fact that the KID should contain only key information on a product. Last but not least, we believe, that the ESAs could propose changes to the current methodology for generating future performance scenarios at a later stage. We believe that piecemeal changes increase the risk that consumers lose their trust in the performance scenarios in the PRIIPs KID.

Finally, adding past performance would take up valuable space to the detriment of the depth of other disclosures. Especially some of the descriptions and narratives would have to be shortened in order to stay in compliance with the three page limit. As the addition of past performance is of questionable value for consumers this appears to be a bad trade.

13 Are there significant benefits or costs you are aware of that have not been addressed?

If methodology is changed too often, consumers might lose their trust in the information contained in the PRIIPs KID. We urge the ESAs not to introduce any intermediate solutions and encourage the ESAs to conduct an in-depth review at a later stage that is preceded by a consumer testing and thorough consultations with expert groups and stakeholders.

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