



AMIC response: ESAs consultation on PRIIPs RTS
13 January 2020

AMIC welcome the opportunity to comment on the [amendments](#) the ESAs are considering recommending to the European Commission regarding PRIIPs RTS.

For the purpose of this consultation we have decided to focus on the review of the transaction cost methodology (question 43), which is in our view a crucial issue, given the confusion created by contradictory provisions across the EU (MiFID, IDD, PRIIPs and national provisions) and the potential knock-on effect on future EU rules.

We would like to start by stating that, contrary to explicit costs, implicit transactions costs are not a charge to investors but reflect the cost of investing in markets which are deducted from reported fund performance and fully reflected in performance statements. Interests of the end investors and the PRIIP manufacturer are de facto aligned as they are both seeking positive performance, best execution and minimized cost in order to enhance returns. A fund with lower transaction costs will not necessarily generate better performance which is what matters in the end to allow investors to meet their objectives. Given that best execution is already tackled by MiFID, PRIIPs should rather focus on comparability and understanding of investment solutions available to retail investors.

It should also be acknowledged that measuring and interpreting implicit transaction costs are not straightforward: most methodologies (including the slippage methodology currently required under PRIIPs) are prone to technical bias and interpreting results can be extremely challenging. If there is no disagreement over what constitutes explicit transaction costs, it is still impossible to assert that a single methodology can be used to capture precisely implicit transaction costs across all asset classes. Regardless of the methodology used, the PRIIPs KID will provide an estimation rather than a 100% accurate figure. Bearing this in mind and given that this measurement has a limited added value for the end investors, the goal of the ESAs and the EC's prime objective with this review should be to design a straightforward easy to implement framework providing realistic, transparent and meaningful estimates for end investors and which aligns with the MiFID requirements, given that PRIIPs products are predominantly sold using intermediaries.

Furthermore it should be made clear that the current methodology, chosen in 2017, to compute implicit transaction costs (namely the slippage approach), which produces misleading results (i.e. negative and inflated transaction costs) and can be subject to moral hazard as we explain below, is not required by level 1 but was introduced by level 2 measures. Despite the limitations highlighted above, the ESAs have proposed that market movements ("slippage" – i.e. the time between the order and its execution) should be considered a cost and should be added to the market spread. Attributing precise reasons to the change in price between the order and the execution is simply not feasible (i.e. it's impossible to be sure that the price movement is due to the execution of a specific order, so called "market impact"). For these reasons it was decided under MiFID and IDD that underlying market risks" (i.e. market movements) should not be considered a cost.

We welcome the changes proposed by the ESAs in the consultation with the introduction of implicit transaction costs based on half spread but believe that these should be taken a step further, and that the flawed slippage approach should be eliminated for all asset classes, given that it factors in a lot of bias and approximations. Disclosures that are based on the slippage methodology are highly volatile and strongly influenced by many factors: it is dependent on the benchmark price used to calculate the slippage which cannot be harmonized across asset classes and all funds, the trading strategies and timing (limit order, immediate execution, buy-sell vs bull-bear market), which can lead to having the same execution price and therefore the same economic impact but completely different slippage costs. By its design, the slippage approach requires the use of “fallbacks” to cover all the cases where an actual arrival price is not available. These fallbacks have no economic relevance and generate irrelevant implicit transaction cost figures. The slippage methodology does not work without historical data and is inconsistent with all available methods to estimate transaction costs ex-ante, such as the method designed for new PRIIPs in point 21 of annex VI of the delegated regulation. Due to the volatility of the slippage methodology, there is no correlation between the costs estimated ex-ante using the new PRIIPs methodology and the results of the slippage approach. Lastly and more importantly the slippage methodology can produce negative transaction costs, which are counterintuitive and misleading for end investors. The argument in support of the slippage calculation, that with better quality benchmarks the transaction cost reports will become more stable and negative costs will disappear, has been invalidated by several empirical studies. Analysis of large samples of transactions of equity instruments shows that the slippage approach results in negative implicit transaction costs for about 50% of transaction where an actual mid-market prices is available, and creates very volatile transaction costs, which cannot convey any meaningful information to the investors.

Although the proposed draft RTS under option 1 are trying to answer some of the concerns raised previously (data availability for OTC transactions, sample size...) the slippage approach, with its major drawbacks, is kept. The proposal to avoid negative cost is unsatisfactory as it could lead to a false and inflated representation of costs, thus failing to comply with the level 1 text which requires that misleading information must not be provided.

We therefore recommend allowing the use of the spread methodology across all asset classes and trading venues by aligning the PRIIPs RTS with MIFID and IDD. This approach also refers to indirect costs but removes many of the statistical impediments under the slippage methodology and the risk of disclosing misleading negative transactions costs. The spread methodology has the advantage that it is more suitable for ex-ante cost disclosures (and therefore the PRIIPs KID) that provide information about prospective investments.

We welcome the principle of having a simplified approach in the calculation of implicit transaction costs, however we believe that this should be extended to illiquid listed instruments and designed to reduce the burden of calculation where there is little impact on the overall cost disclosure, which ensures that the information communicated to the investor remains of high quality and not misleading.

In the context of these draft RTS, our proposal could be achieved by amending option 1 or 2 as follows:

Option 1

8. The aggregate transaction costs for a PRIIP shall be calculated as the sum of the transaction costs as calculated in accordance with points 9 to 29 of this Annex in the base currency of the PRIIP for all individual transactions undertaken by the PRIIP in the specified period. This sum shall be converted into a percentage by dividing by the average net assets of the PRIIP over the same period. **When relevant to accurately reflect the actual ratio of transaction costs, the explicit costs ratio could be measured at a higher frequency (months or quarters, for example). In such instances, the transaction cost percentage shall be the sum of the annualized percentages calculated over shorter periods.**

~~9. Where implicit transaction costs are negative, a minimum of explicit transaction costs shall be disclosed.~~

[...]

15. The actual transaction costs for each transaction shall be calculated on the following basis:

- (a) for each purchase undertaken by the PRIIP, the mid-market price of the instrument at the time the purchase order is **executed** ~~transmitted to another person for execution~~ (the purchase 'arrival price') shall be subtracted from the net realised execution price of the transaction. The resulting value shall be multiplied by the number of units purchased;
- (b) for each sale undertaken by the PRIIP, the net realised execution price of the transaction shall be subtracted from the mid-market price of the instrument at the time the order to sell is **executed** ~~transmitted to another person for execution~~ (the sale 'arrival price'). The resulting value shall be multiplied by the number of units sold.

16. The net realised execution price shall be determined as the price at which the transaction is executed, including all charges, commissions, taxes and other payments (such as anti-dilution levies) associated with the transaction, either directly or indirectly, where those payments are made from the assets of the PRIIP.

17. The arrival price shall be determined as the mid-market price of the investment at the time when the order **is executed**. ~~to transact is transmitted to another person. For orders that are transacted on a day that is not the day that the order was originally transmitted to another person, the arrival price shall be determined as the opening price of the investment on the day of the transaction or, where the opening price is not available, the previous closing price. Where a price is not available at the time when the order to transact is transmitted to another person (due to the order initiated outside market opening hours or in over the counter markets where there is no transparency of intra-day prices for example), the arrival price shall be determined as the most recently available price or, where a recent price is not available, as the opening price on the day of the transaction or, where the opening price is not available, the previous closing price. Where an order is executed without being transmitted to another person, the arrival price shall be determined as the mid-market price of the investment at the time when the transaction was executed.~~

18. Where information about the order **execution** time ~~when to transact is transmitted to another person~~ is not available (or not available to a sufficient level of accuracy), or where information about the mid-market price at that time is not available, it is permissible to ~~use as the arrival price the opening price of the investment on the day of the transaction or, where the opening price is not available, the previous closing price.~~ **calculate the transaction cost as described in point 20.** ~~When calculating transaction costs using data prior to 31 December 2017, intra-day prices may be considered as not available.~~

19. Costs associated with transactions undertaken by PRIIPs and concerning financial instruments that fall within one of the categories referred to in items 4 to 10 of Section C of Annex I to Directive 2014/65/EU shall be calculated in the following way:

- (a) for instruments that are standardised and where there is regular trading in the instrument itself (for example an index future on a major equity index), transaction costs shall be calculated with reference to the instrument itself. The arrival price shall be determined as the mid-price of the instrument;
- (b) for linear instruments that are customised, and where there is no price transparency or regular trading in the instrument itself, transaction costs shall be calculated with reference to the underlying asset(s). The arrival price shall be calculated based on the price(s) of the underlying assets, using appropriate weightings if there is more than one underlying asset. Where the cost of transacting in the instrument is materially higher than the cost of transacting in the underlying asset, this must be reflected in the transaction cost calculation;
- (c) for non-linear instruments, it is permissible to calculate the transaction costs as the difference between the price paid or received for the instruments and the fair value of the instrument, on the basis described in points 36 to 46 of this Annex.

20. By way of derogation from points 13-19 of this Annex for transactions executed on an over-the-counter basis **or transactions of illiquid listed instruments**, the actual transaction costs shall **may** be calculated in the following way:

(a) Where a transaction is executed after bid prices and offer prices have been obtained from more than one potential counterparty, the arrival price shall be taken to be:

- (i) If the best bid price is below the best offer price, the mid-point between the best bid price and best offer price;
- (ii) If the best bid price is higher than the best offer price, the best bid price in the case of a sale or the best offer price in the case of a purchase.

(b) Where a transaction is executed without **a representative set of several** ~~both bid prices and offer price pairs~~ having been obtained, the transaction cost shall be calculated by multiplying the number of units transacted by half the value of the spread ~~between the bid price and the offer price of~~ **calculated for** the instrument. The value of this spread shall be calculated on the following basis:

(i) Where available, from a composite of live market bid/offer quotes; or

(ii) Where live market quotes are not available by reference, to spreads obtained for either previous transactions in assets bearing similar characteristics (e.g. duration, maturity, coupon, call-/ put-ability) and liquidity, using transactions previously executed by the manufacturer or data verified by an independent third-party, or from an independent third-party to value the asset, **or from a standard spread table as defined in point 27.**

21. In calculating the costs associated with orders that are initially entered into an auction, the arrival price shall be calculated as the mid-price immediately prior to the auction.

~~22. By way of derogation from points 13-21 of this Annex, where a product undertakes fewer than [250] transactions in a three-year period, or where the total consideration for all transactions undertaken over~~

~~3 years is less than [25%] of the net asset value of the product, the manager may calculate transaction costs using the methodology described in point 20.~~

22. By way of derogation from points 13-21 of this Annex, the manager may calculate transaction costs using the methodology described in point 20, provided that at least one of the following conditions are met:

- i. the total consideration for the transactions benefiting from this derogation is less than [10%] of the total consideration for all transactions undertaken during the calculation period;
- ii. the total transaction costs calculated using the methodology described in point 20 for the transactions benefiting from this derogation is less than [2 basis points] or less than [5%] of the product total recurring costs.

Option 2

12. In addition, other charges, which are not explicit costs, impact the overall performance of the PRIIP when acquiring or disposing of underlying assets. These are deemed implicit costs and shall be disclosed by the manufacturer of the PRIIP to demonstrate how transactions are executed on terms that are most favourable to the client.

13. Implicit costs shall be calculated as the sum of such individual charges incurred by the PRIIP over the ~~previous three years~~ calculation period for all individual transactions undertaken by the PRIIP. ~~This sum of implicit transaction costs shall be converted into a percentage as specified in point 8. They shall be calculated in the base currency of the PRIIP, and averaged over one year. Where these figures are negative, implicit costs shall be deemed to be zero such that the level of transaction costs cannot be less than the amount of explicit costs.~~ When relevant to accurately reflect the actual ratio of transaction costs, this conversion into a percentage may be performed at a higher frequency than the transaction costs calculation period (e.g. daily, monthly, quarterly). In such instances, the transaction cost percentage shall be the sum of the annualized percentages calculated over shorter periods.

14. Any and all processes developed by the PRIIP manufacturer to manage, mitigate and measure implicit costs shall be fit for purpose and documented in a clear and sufficiently detailed manner. ~~For all asset classes and trading venues, implicit costs shall be identified by comparing the execution price recorded for a specific transaction with a suitable reference price such as the mid-market price of the investment when the transaction was executed. For instruments where mid-market price is not available or not representative, the implicit transaction cost should be assessed using an alternative methodology, such as implicit transaction costs from similar representative transactions, or standardized spread tables.~~ The identification of a suitable reference price shall be duly recorded and follow the approaches set out in points (a) and (b) in a manner that is consistent with documented internal procedures of the PRIIP manufacturer to manage, mitigate and measure implicit costs, applied consistently across transaction types.

OTC transactions

15. Where the manufacturer has obtained **two-way** executable prices from multiple counterparties or where live executable prices are available, implicit transaction costs shall be measured by reference to such prices. In any such case, the number of units traded shall be multiplied by either the reference price of the instrument subtracted from the execution price for each purchase undertaken by the PRIIP or the

execution price subtracted from the reference price of the instrument for each sale undertaken by the PRIIP;

16. By way of derogation from points 14 and 15, where the manufacturer is able to demonstrate that the transaction data used is statistically meaningful, sufficiently granular and proper governance and controls are in place to ensure that the data is sufficiently representative of the actual trade, implicit transaction costs shall be measured by reference to prices obtained for previous transactions in assets bearing similar characteristics (e.g. duration, maturity, coupon, call- / put-ability) and liquidity, using transactions previously executed by the manufacturer or a third party or using available indexes.

~~This derogation shall apply in all cases where a manufacturer undertakes fewer than [250] transactions in a three-year period for an individual PRIIP, or where the total consideration for all transactions undertaken over 3 years is less than [25%] of the net asset value of the product.~~

This derogation may apply when at least one of the following conditions are met:

- i. the total consideration for the transactions benefiting from this derogation is less than [10%] of the total consideration for all transactions undertaken during the calculation period;
- ii. the total transaction costs calculated using the methodology described in point 20 for the transactions benefiting from this derogation is less than [2-5 basis points] or less than [5%] of the product total recurring costs during the calculation period.

For transactions negotiated on platform,

17. implicit transaction costs shall be measured as set out in paragraph 14, or:

- by the reference to the mid-market price of the instrument at the time the order is transmitted by the portfolio manager or the trader executed;
- if justified by the manufacturer on the basis of the asset type or liquidity or availability of market data, by reference to a relevant intraday mid-price available for the day of the transaction;
- by reference to the opening or previous closing price for that security where relevant a relevant half spread.

In any such case, the number of units traded shall be multiplied by either the reference price of the instrument subtracted from the execution price for each purchase undertaken by the PRIIP or the execution price subtracted from the reference price of the instrument for each sale undertaken by the PRIIP.