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European Commission

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Criteria for the inclusion of the comprehension alert

The DDV welcomes the approach taken by the European Commission in its letter to the ESAs dated 10 November 2016. This attempts to clarify some of the significant uncertainties with respect to the PRIIPs regime, in particular by proposing the provision of criteria in the Commission Delegated Regulation to facilitate a consistent use of the comprehension alert in the KID. In this context, however, the DDV is of the view that the European Commission and the ESAs need to focus on technical elaboration of the criteria already defined by the European legislator in Recital 18 of the PRIIPs Regulation, rather than on expanding the underlying concepts.

In light of Recital 18 of the PRIIPs Regulation, the DDV feels that the criteria for the inclusion of the comprehension alert in a KID as outlined in the European Commission's letter to the ESAs dated 10 November 2016, as well as the response by the ESAs, will contravene the text of the PRIIPs Regulation and even jeopardise the aim of the PRIIPs Regulation to enhance (retail) investor protection.

The comprehension alert aims to clarify for retail investors that it might be difficult for them to understand the PRIIP. Such an alert is intended to raise awareness that retail investors might need a longer time horizon to consider the information contained in the KID.

Following the proposal of the European Commission and the ESAs, referring in this context only to complexity either as specified in point 10 of the ESMA Opinion on MiFID practices for firms selling complex products, or in Article 25(4)(a) of Directive 2014/65/EU, ignores the

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fact that even products classified as non-complex according to the respective classification approach may be difficult for retail investors to understand. This holds in particular true, since any PRIIP is (by definition) "packaged" and might, as a result of this, already be difficult for retail investors to understand. In contrast, complexity as such, in particular when mitigating potential risks (e.g., of currency rate fluctuations), does not automatically result in a PRIIP being difficult for retail investors to understand.

The approach proposed by the European Commission to even expand the criteria for the inclusion of the comprehension alert in a KID will, however, result in almost every structured product on the European market having to be labelled with the comprehension alert. If almost every structured product on the European market were labelled with the comprehension alert, the warning function for retail investors intended by the use of the comprehension alert would not only be reduced, but even be rendered entirely redundant. The more PRIIPs are labelled with the comprehension alert, the less investor awareness is actually achieved. It seems obvious that retail investors will no longer be able to recognise the importance of the comprehension alert for an individual PRIIP, in particular when comparing it with other PRIIPs (all being labelled with the comprehension alert), and that the comprehension alert will consequently lose its warning function entirely.

In order to enhance the warning function of the comprehension alert and to effectively attract retail investors' attention, the DDV is of the view that the European Commission and the ESAs need to focus on technical elaboration of the criteria already defined by the European legislator in Recital 18 of the PRIIPs Regulation (rather than expanding the underlying concept to the point of meaninglessness). The DDV also takes the view that any approach for these RTS not linked to Recital 18 of the PRIIPs Regulation would not be covered by the legal basis for imposing the RTS.

Based on Recital 18, the criteria for the inclusion of the comprehension alert in a KID should be the following:

- the PRIIP invests in underlying assets in which retail investors do not commonly invest;
- the PRIIP uses a number of different mechanisms to calculate the final return of the investment, creating a greater risk of misunderstanding on the part of the retail investor; and
- the investment's pay-off takes advantage of retail investor's behavioural biases, such as a teaser rate followed by a much higher floating conditional rate, or an iterative formula.

Providing clear and objective guidance on the above criteria (i.e., on the underlying assets or the number of different mechanisms), and also on the potential legal implications, if any, for a PRIIP labelled as "difficult for retail investors to understand" under further European investor protection regulations (e.g., the MiFID II regime), would not only allow for practical and efficient implementation of the PRIIPs Regulation and improve transparency for retail investors, but would also avoid the serious risk of inconsistent implementation of this element in the KID across the European Union. The DDV would be happy to assist the European Commission and the ESAs in clarifying the above-mentioned three cases, based on its work on their practical application over the last months.

If the European Commission and the ESAs were, nevertheless, to expand the criteria and to also require a comprehension alert for any complex PRIIP, undertakings for collective investment in transferable securities (UCITS) that might be "difficult for retail investors to understand" should be also labelled with the comprehension alert.



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