DDV
Deutscher Derivate Verband

Initial analysis of proposed Market Risk Measure (MRM)

As part of the implementation of the PRIIPs Key Information Document regulation, market participants are given the opportunity to provide comments on the recently published Joint Consultation Paper by the European Supervisory Authorities (ESAs). As representatives of the structured products industry, the DDV will be providing detailed comments on the paper.

This particular report is an initial analysis of the proposed methodology in the Consultation Paper underpinning the market risk assessment. According to the paper, the market risk assessment, together with the credit risk assessment, form the summary risk indicator.

This initial analysis tested the proposed Market Risk Measure (MRM) on equities and stock indices. Although these lie not within the scope of the PRIIPs regulation, they were examined for the purposes of simplicity and comparability across products.

MAIN FINDINGS AND CONCLUSION

- **Although all of the equities selected represent <u>blue chip and well-known companies</u> (both bank and non-bank), almost all of them were classified in <u>MRM class 7</u> (the riskiest class). In addition, <u>all major European indices</u> were classified in <u>MRM class 6</u> (the second-riskiest class).**

- **The MRM provides little or no differentiation between high risk products where potential losses could exceed the invested capital (e.g. CFDs) and blue chip investments in the real economy.**

- **We are of the opinion that the current MRM and corresponding classification scheme are not accurate and reliable and do not comply with the overall aim of comparability among financial products which was addressed heavily in Level I of the PRIIPs regulation.**

In addition, page 4 of the Consultation Paper indicates the input of the Consultative Expert Group which the ESAs established for advice on the methodologies for disclosure of risks, rewards and costs of retail investment products. We have doubts as to whether the Consultative Expert Group has agreed to this MRM approach. The potential omission of the input would have a strong impact on the reliability of the MRM.

RESULTS AND METHODOLOGY

As a first step (and for simplicity reasons), results have been provided for well-known equities and corresponding equity indices for various European countries (test calculation for PRIIPs will follow).

Risk indicators were calculated according to approaches proposed for PRIIPs of Category II (approach for linear / delta one products) and Category III (approach for structured products where the evaluated stocks and indices are popular underlyings).

Results for both approaches are similar and result in the same risk class.

Results show almost all blue chips and well-known equities categorized in the highest risk class 7 (VEV>25%) and well-diversified equity indices mainly fall into class 6 (VEV 15%–25%).

Country	Name	INDEX/STOCK	VEV PRIIPs Cat. II *	VEV PRIIPs Cat. III *	MRM class Cat. II	MRM class Cat. III
Germany	DAX	INDEX	20.39%	20.92%	6	6
	Daimler	DE0007100000	30.26%	29.96%	7	7
	Deutsche Lufthansa	DE0008232125	29.95%	31.86%	7	7
	Deutsche Bank	DE0005140008	35.13%	35.25%	7	7
France	CAC 40	INDEX	20.81%	21.24%	6	6
	Airbus Group	NL0000235190	28.85%	31.07%	7	7
	BNP Paribas	FR0000131104	37.01%	38.68%	7	7
	Alcatel-Lucent	FR0000130007	53.51%	51.98%	7	7
United Kingdom	FTSE 100	INDEX	15.95%	15.63%	6	6
	Glencore	JE00B4T3BW64	41.67%	43.80%	7	7
	Barclays	GB0031348658	39.64%	38.34%	7	7
	Burberry Group	GB0031743007	33.52%	33.04%	7	7
Italy	FTSE MIB	INDEX	26.49%	26.50%	7	7
	STMicroelectronics	NL0000226223	38.17%	39.94%	7	7
	Telecom Italia	IT0003497168	34.23%	35.68%	7	7
	Intesa Sanpaolo	IT0000072618	46.28%	45.08%	7	7
Poland	WIG 20	INDEX	18.57%	18.52%	6	6
	Cyfrowy Polsat	PLCFRPT00013	29.08%	30.51%	7	7
	KGHM Polska Miedz	PLKGHM000017	37.76%	37.25%	7	7
	Alior Bank	PLALIOR00045	30.46%	31.40%	7	7
Spain	IBEX 35	INDEX	23.32%	23.48%	6	6
	Banco Santander	ES0113900J37	31.47%	32.50%	7	7
	Arcelormittal	LU0323134006	35.73%	37.56%	7	7
	Repsol	ES0173516115	30.85%	30.95%	7	7
Sweden	OMX Stockholm 30	INDEX	19.67%	19.44%	6	6
	Nokia	FI0009000681	45.06%	46.63%	7	7
	Boliden	SE0000869646	35.64%	35.88%	7	7
	Electrolux	SE0000103814	41.92%	40.05%	7	7

Country	Name	INDEX/STOCK	VEV PRIIPs Cat. II *	VEV PRIIPs Cat. III *	MRM Class Cat. II	MRM Class Cat. III
Netherlands	AEX index	INDEX	17.75%	17.65%	6	6
	ASML	NL0010273215	29.08%	29.19%	7	7
	ING Group	NL0000303600	41.85%	40.04%	7	7
	TNT Express	NL0009739424	47.97%	45.87%	7	7
Austria	ATX	INDEX	21.81%	21.51%	6	6
	OMV	AT0000743059	27.08%	27.33%	7	7
	Voestalpine	AT0000937503	34.04%	36.01%	7	7
	Erste Group Bank	AT0000652011	41.11%	41.35%	7	7
Belgium	BEL 20	INDEX	17.82%	17.83%	6	6
	KBC	BE0003565737	43.31%	46.13%	7	7
	Delhaize Group	BE0003562700	28.46%	28.41%	7	7
	Ageas	BE0974264930	35.63%	35.54%	7	7
Portugal	PSI 20	INDEX	20.90%	21.19%	6	6
	Impresa	PTIPR0AM0000	59.20%	52.04%	7	7
	Jeronimo Martins	PTJMT0AE0001	31.10%	31.08%	7	7
	Banco Comercial Portugues	PTBCP0AM0007	62.00%	55.17%	7	7
Czech Republic	PX	INDEX	16.42%	16.92%	6	6
	CEZ	CZ0005112300	22.02%	21.84%	6	6
	O2 Czech Republic	CZ0009093209	35.98%	55.80%	7	7
	Komercni Banka	CZ0008019106	25.77%	25.88%	7	7

* As opposed to the formula given in the Consultation Paper, the assumption of log normal underlying prices (instead of normal distribution) is used for calculating the VaR Equivalent Volatility (VEV). This approach consistently follows the model prescriptions within the Consultation Paper. VEVs are calculated on the basis of a recommended holding period of 5 years using underlying price spaces.