DDV PRIIPs-Report 5

Deutscher Derivate Verband

Impact of the final draft RTS requirements on the SRI and performance scenarios for leverage products

As part of the implementation of the PRIIPs Regulation (EU) No 1286/2014, market participants were given the opportunity to provide comments on two Discussion Papers and a Consultation Paper published by the Joint Committee of the European Supervisory Authorities (ESAs). As representative of the structured products industry, the DDV submitted several position papers to the ESAs in this regard. In April 2016, the ESAs then published its final proposal for regulatory technical standards (RTS).

This particular report (5) follows our PRIIPs reports (1), which analysed the proposed methodology in the Joint Consultation Paper (JC 2015 073) underpinning the market risk assessment and (2), which focused on test calculations of the summary risk indicator (SRI) for structured products, bonds as well as investment funds, also taking into account the Credit Risk Measure (CRM). Report (3) contained recommendations for adjustments of the volatility thresholds for assessing the MRM in the Consultation Paper while Report (4) analysed the difference in results for the SRI, taking into account the updated volatility thresholds in the final draft RTS.

This Report (5) analyses the impact of the final draft RTS requirements on the SRI and proposed performance scenarios for leverage products.

MAIN FINDINGS AND CONCLUSION

- **The sample results for the most popular leverage product types show that all relevant leverage products with realistic product characteristics will end up in the highest MRM class (7).**
- **According to these sample results, it should not be necessary to calculate the MRM / SRI for these types of products and we propose a default categorisation in class 7. Due to the speculative nature of these instruments, a default categorisation in the highest risk class is preferred even if the calculated MRM may be lower.**
- **The results for the performance scenarios for these products are (by and large) questionable due to the speculative nature of the products (with high leverage) and the proposed calculation approach (e.g. showing per annum figures for products with short maturities / holding periods).**
- **The main factors driving the unrealistic results are, in addition to the leverage character of the products, the annualisation of the returns and the maturities.**
- **Presenting such dubious figures for leverage products in the KID is of no added value for PRIIPs investors and will result in a high update frequency for the KID of these products.**

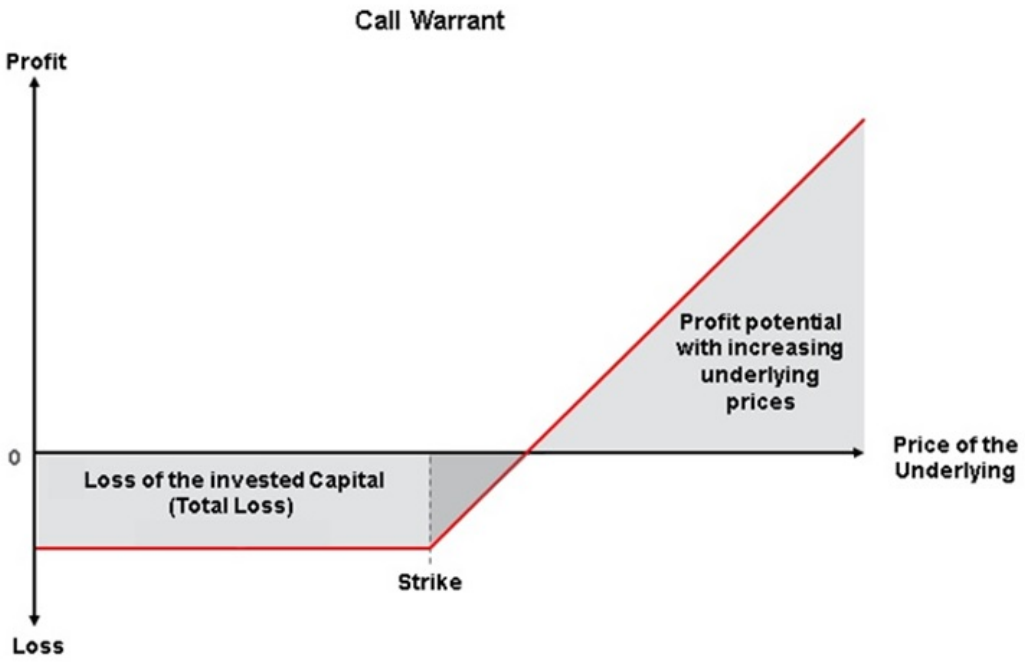
- **In order to address the nature of leverage products as speculative investments that are heavily influenced by even low market movements, we propose providing a more generic KID with generic payoff charts instead of performance scenarios.**
- **A sample payoff chart for a call warrant is displayed after the results table.**
- **This approach would be in line with the argumentation in the final draft RTS for ETDs. As the most popular leverage products offer the same payoffs as ETDs and are very similar economically in this respect, we are convinced that this approach to KIDs for leverage products will be easier to understand for retail investors.**

Type	RHP*	Type / Moneyness**	PRIIPs VEV	PRIIPs SRI	Scenario***		
					Positive	*Moderate*	*Negative*
Warrant	12 Month	Call – 100 %	>100 %	7	340.10 %	-83.78 %	-100 %
		Call – 85 %	>100 %	7	167.76 %	-12.50 %	-100 %
		Put – 100 %	>100 %	7	121.62 %	-100 %	-100 %
	6 Month	Call – 100 %	>100 %	7	1,251.86 %	-99.85 %	-100 %
		Call – 85 %	>100 %	7	383.72 %	-15.31 %	-100 %
		Put – 100 %	>100 %	7	522.36 %	-100 %	-100 %
	3 Month	Call – 100 %	>100 %	7	1,099.02 %	-100 %	-100 %
		Call – 85 %	>100 %	7	1,072.19 %	-11.87 %	-100 %
		Put – 100 %	>100 %	7	3,571.56 %	-100 %	-100 %
Knock-Out Warrant	3 Month	Long – 95 %	>100 %	7	13,909.54 %	42.42 %	-100 %
		Long – 80 %	>100 %	7	698.45 %	16.81 %	-98.16 %
		Short – 105 %	>100 %	7	3,758.01 %	-45.22 %	-100 %
	1 Month	Long – 95 %	>100 %	7	220,202.13 %	-2.36 %	-100%
		Long – 80 %	>100 %	7	2,294.36 %	22.89 %	-100%
		Short – 105 %	>100 %	7	49,153.08 %	-55.02 %	-100 %

Results table for leverage products on EURO STOXX 50 (calculations provided by EDG AG)

* Recommended holding period coincides with the maturity of the product
** Calculation date is 6 June 2016. Moneyness describes the relation of strike level of the product and the underlying price. Products were considered as category 3.
*** Scenario returns are the annualised returns (compounding) for the product for the different scenarios

Payoff chart for a call warrant



Description

The VEV and scenarios are calculated for popular leverage products (Warrants and Knock-Out Warrants) with their typical features. Continuous products (like mini-futures) are currently excluded due to the unclear requirements for the RHP in the RTS for these product structures.

Short product description – Warrant: Warrants are derivatives that confer the right, but not the obligation, to buy (call) or sell (put) a security, commodity etc. at a certain price before (U.S. Warrant) or at the expiration date (European Warrant). The exercise price is the strike price.

Short product description – Knock-Out Warrant: Knock-Out Warrants are similar to plain vanilla warrants with a built in mechanism to expire worthless, should a specified price level (barrier) be exceeded.

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