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Ladies and Gentlemen,

Subject: PRIIPs Regulation – follow up

We refer to and would like to thank Mr Gentner for the helpful response of the Commission (the "**Commission Letter**") to the JAC letter dated 17 February 2016 (the "**JAC Letter**") on some of the

outstanding and open questions on the PRIIPs Regulation. We are writing a follow up letter to request that the following issues be resolved through further guidance by the Commission and ESMA, as to the construction of certain additional terms of the Regulation.

FX Forwards in deliverable currencies

We highlighted in the JAC Letter a key scoping issue relating to the inclusion of certain derivatives within the PRIIPs Regulation. We understand this issue has also been raised by the German Banking Industry Committee. In order to fall within the scope of the PRIIPs Regulation (1286/2014), a product must be, under Article 4(1), "*an investment…where regardless of the legal form of the investment, the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor*".

In the case of certain FX Forwards in deliverable currencies and other related derivative instruments (including commodity forwards with physical delivery) with similar characteristics, the amounts to be paid by the two parties (the bank or investment firm as one counterparty and the retail investor as the other counterparty) are already fixed at the point at which the agreement is concluded. The amount repayable to the retail investor is not subject to any fluctuations on their return. All parameters are fixed at the point at which the agreement is concluded, with only the fulfilment of the obligations entered into deferred to a later point in time. The only element that may be "*subject to fluctuations*" is the market value of the FX Forward contract itself (much like the secondary market price of a fixed rate security will change due to market conditions even though the amount repayable to investors who hold the security is fixed), not "*the amount repayable to the investor*", which is the requirement for an FX Forward to satisfy the Article 4(1) definition.

For example:

- on 10 June 2016, a retail investor enters into an FX Forward contract to sell USD 1,000 on 10 September 2016;
- the amount of USD the retail investor will sell and the rate at which the retail investor will sell those USD are agreed on 10 June 2016;
- on 10 September 2016, the market value of the FX Forward contract may have changed since 10 June 2016, but the amount repayable to the retail investor on 10 September 2016 is not subject to fluctuations because the terms were agreed at the outset of the contract;
- on 10 June 2016, the retail investor knew the amount he would receive on 10 September 2016.

In addition, in the draft MiFID2 delegated regulation, certain FX Forwards which are either spot or relate to payment obligations in specified circumstances, would not be financial instruments for the purposes of MiFID2 which we believe is an additional justification for their removal from the scope of the PRIIPs Regulation. In particular, such contracts would not fall within the Category 1 PRIIPs class (Annex II, Part 1, paragraph 4 of the RTS) as they would not be a MiFID instrument. Equally, such contracts would also not fall within scope of any of the other categories outlined in the RTS.

A significant number of FX Forwards will be entered into by a wide variety of commercial entities: municipalities, local authorities and many commercial companies. There is a significant risk that by extending the PRIIPs Regulation to include instruments such as FX Forwards (which by definition should not fall within the scope of the PRIIPs Regulation), the availability of such derivatives will be restricted. This, in turn, potentially increases the financial risks to such entities of doing business in

Europe and is in direct contradiction to certain objectives of the Capital Markets Union where financial markets should contribute to financial growth, not constrain it.

Request: In order for firms to properly scope their PRIIPs implementation projects, we would request urgent clarity that certain FX Forwards in deliverable currencies and derivatives with similar characteristics with no fluctuation, are outside the scope of the PRIIPs Regulation and therefore a KID does not need to be prepared for these products. We ask for clarity on this important point prior to the publication of the final regulatory technical standards. We note that this issue is of pan-European importance and understand it is being considered by regulators in a number of Member States.

Generic KID for OTC derivatives

We understand from the Commission Letter that the PRIIPs Regulation does not make any distinctions in relation to the product's intended purpose, such as, for investment, risk management or hedging purposes and, therefore, that KIDs will be required for OTC derivatives.

We believe that, according to the same rationale as for the "special cases" outlined in the RTS, generic KIDs should be permitted for certain OTC derivatives. We foresee great difficulty, if not impossibility, in such a document being completed for OTC derivatives pre-trade and therefore allowing comparability with other products for the retail investor for the reasons set out below.

The existing provisions in relation to performance scenarios require the PRIIP manufacturer to set out the retail investor's potential return in three different scenarios. In order to calculate the return the retail investor may receive, using the formulas set out in the RTS, a PRIIP manufacturer would need to know the price at which the PRIIP was traded with the retail investor. For an OTC derivative, this would not be known until the trade is entered into. Therefore, it would not be possible to provide the retail investor with the completed KID pre-trade.

In relation to the performance scenarios section of the KID, one solution is to allow OTC derivatives to be presented in the same way as exchange traded derivatives – i.e. in a graph format, rather than following the tabular format as currently contemplated, where appropriate.

More generally, a workable solution for firms would be if a form of generic KID were permitted for OTC derivatives and provided to the retail client pre-trade. Bespoke information relating to the specific product could be provided to the client post-trade if necessary. This solution would offer retail clients the opportunity to compare products pre-trade and in good time prior to the proposed trade and allow for an informed investment decision. This two-tier approach is permitted for PRIIPs that offer multiple investment options.

ISDA is seeking to assist with the preparation of a generic KID for certain types of OTC derivatives and has formed a Legal Working Group from within our own Joint Associations Committee on Retail Structured Products, which I chair.

Request: In order for firms to continue with their PRIIPs implementation preparation, we would ask for urgent clarity that a form of generic KID is permitted for OTC derivatives and that in relation to the performance scenarios section of the KID, OTC derivatives may be presented in the same way as exchange traded derivatives – i.e. in a graph format. ISDA would propose to share a form of generic KID shortly.

Grandfathering and ongoing updating

Regarding the matter of existing PRIIPs, we welcome your offer to work with us to provide additional clarity as needed. We also refer you to paragraph 3 of the JAC Letter which discusses "Secondary Trading Issues and Grandfathering".

As noted in the JAC Letter, the requirements of the PRIIPs Regulation should not automatically apply to PRIIPs traded in the secondary market but should instead be triggered where a PRIIP is "made available to retail investors". In accordance with this principle, where instruments (primarily securities) are listed and/or admitted to trading on a relevant exchange, a KID should only be required in relation to any trades (both in relation to PRIIPs issued or entered into prior to 31 December 2016 and for updating purposes), where there is a clear secondary market in the relevant instruments such that buying and selling can and does occur on the basis of firm two way pricing available from the manufacturer (acting as a market maker) via an exchange.

Territorial scope

We thank you for the clarification that where a PRIIP is offered to a non-EU retail investor by a European manufacturer via an intermediary established in a non-EU country, the obligations of the PRIIPs Regulation do not apply and that the PRIIPs Regulation only applies to PRIIPs offered to retail investors domiciled in EEA countries. We understand, therefore, that if there were an EEA manufacturer selling through an EEA distributor to a non-EEA retail client that the PRIIPs Regulation also would not apply as the rationale is to apply the PRIIPs Regulation only in circumstances where there is an EEA retail client.

Yours faithfully,

Alderman Tim Hailes, JP
Chairman, Joint Associations Committee