BLACKROCK

28 September 2018

Retail Distribution Policy
Strategy & Competition
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Submitted via email to: PRIIPsCfI@fca.org.uk

RE: Financial Conduct Authority Call for Input: PRIIPs Regulation – initial experiences with the new requirements

Dear Sir, Dear Madam,

BlackRock[1] is pleased to have the opportunity to respond to the Call for Input, issued by the Financial Conduct Authority.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this Call for Input and will continue to contribute to the thinking of the Financial Conduct Authority on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

Executive summary

Context and the effectiveness of the consumer journey

BlackRock supports the aim bringing more transparency, competition and choice to retail financial products. The PRIIPs Regulation is an important cornerstone to deliver this ambition by ensuring that retail investors are provided with meaningful and comparable information. With our experience of the UCITS KIID we have seen the value of such standardised disclosures and we remain fully committed to the ambition to develop a clear, meaningful and comparable information for consumers for all savings products. There are a number of issues with the requirements of PRIIPs which hinder effective consumer decision-making which we set out below.

A confusing patchwork of transparency disclosure standards

PRIIPs does not sit in isolation. At the same time as its introduction additional cost transparency requirements were introduced in MiFID2. The practical application of these new standards has presented both market participants and investors with a number of challenges. Crucially, there is no consensus on how to measure the transaction costs that portfolios incur. Across the EU we are seeing different conventions and methodologies emerge depending on the product or service provided. This adds to the confusion, as disclosures are heavily influenced by the markets in which fund managers, distributors, and investors are situated. Within the same jurisdiction, reports can be hard to compare; but across EU markets with differing standards, it becomes nearly impossible.

In this context it is unsurprising that we are receiving ongoing feedback from investors that they do not understand the data in the new disclosure standards. The different approaches permitted under the various regulatory standards create confusion among investors as to what they are paying for, leading to increased distrust of the financial sector, rather than fostering greater trust and confidence.

Key shortcomings of PRIIPs

Our experience of producing the PRIIPs KID shows that there are a number of serious shortcomings in the final rules which hamper consumers when comparing the features of competing retail products rather than helping them to make effective decisions. The areas which cause us the greatest concern include:

- the use of the slippage methodology to disclose implicit costs. This has the downside of obscuring trading costs by capturing underlying market movements which occur after the decision to deal has been made,
- spreading the costs of entering, holding and exiting a product across the recommended holding period rather than showing consumers when these products occur (rather than obscuring these by only showing them spread over the average holding period),
- the use of future performance scenarios in the KID without any reference to historic performance data is likely to mislead and disempower consumers as opposed to empowering them to look at costs and charges in the context of performance delivered by a fund.

Confusion between charges, costs and performance

We note there still continues to be significant confusion from consumers as to the use of transaction cost disclosure. We believe it is important for users to be distinguish transaction costs from product and distribution charges. Transaction costs need to be assessed in the context of the net performance a manager has delivered. The failure to show historic net performance in the KID exacerbates the issue, as there is then no comparable reference point allowing consumers to link transaction costs to net performance.

Moreover, this increases the risk of investors effectively double-counting transaction costs, where they are added on top of measures of net performance (which already reflects the impact of transaction costs) as a separate metric. This practice is commonplace in some, but not all European markets, exacerbating the inconsistency of disclosures and further confusing investors.

Concerns with the use of the slippage methodology for disclosing transaction costs

Transaction cost disclosures should be judged according to their effectiveness in helping investors make better decisions about their investments. For both new and existing portfolios, the disclosures should serve as a tool for assessing how efficiently a fund manager achieves their stated objective. Additionally, disclosures should explicitly state which costs are already included in performance figures to avoid misrepresenting their impact.

We believe slippage metrics are not suited to transaction cost disclosures, given their technical nature, exposure to market volatility, and sensitivity to underlying data, which leads to repeated instances of negative transaction costs even when averaged over the three year period required under PRIIPs. Slippage does represent an important tool for portfolio managers and traders to improve investment performance as part of an analytical toolkit allowing managers to interrogate underlying data sets to assess how trading strategies can be improved. As a single measure of disclosure of costs without access to the multiple underlying trading parameters it provides a misleading view of the costs associated with a single portfolio or fund.

As a result of our concerns regarding the use of slippage we have produced a ViewPoint: Disclosing Transaction Costs –The need for a common framework which provided a detailed analysis of spread methodologies over slippages as an effective consumer disclosure tool with a number of recommendations as to how to improve the data quality when using half-spread methodologies.

Further steps

We welcome the FCA's call for Input as an opportunity to highlight our concerns. The planned review of the application of PRIIPs at EU level in 2019 and the scheduled adoption of PRIIPs disclosure standards by UCITS from the start of 2020 highlight the importance of adopting a consistent and coordinated approach. We believe that action is urgently needed to reach a common regulatory framework for transaction cost transparency which delivers for investors rather than further exacerbating the problems.

We support the overall policy objective of ensuring that all retail investment products are subject to standardised cost disclosure standards. But until the issues we and others across the industry have identified with the PRIIPs disclosure requirements have been resolved, it is premature to replace the current investor information requirements in the UCITS KIID. We call on policy makers to extend the current exemption of UCITS from PRIIPs disclosure standards beyond the current expiry date of December 2019 until concerns about the underlying methodologies have been resolved. This will have the key benefits of delivering improved disclosure to investors while also minimising the number of changes investors have to assimilate.

Responses to questions

Q1. Are you experiencing problems with clarifying the scope of the PRIIPs Regulation? Please provide examples of product types where you believe there is uncertainty as to whether they are in scope.

We have not experienced issues with the scope of PRIIPs.

Q2. Have you tried to resolve this uncertainty and faced difficulties in doing so? If so, please provide details and examples of the difficulties you have faced.

NA

Q3. Have any of your calculations of transaction costs under the slippage methodology led to negative, zero or unexpectedly large transaction costs? If so, please provide examples, together with the full calculation of how the output has been obtained, and explaining any assumptions that have been made.

We have a number of examples of negative and volatile transaction costs in the funds which we manage. We will provide separately the underlying transaction cost analysis.

We have also conducted empirical analysis using the slippage methodology to assess whether better quality benchmarks, the transaction cost reports will become more stable and negative costs will disappear. We used a large sample of BlackRock's equity trades in 2018 to assess this argument empirically. We purposefully chose equities as an example as it allows us to conduct the analysis on the richest possible data.

The variation of the slippage cost, measured by its standard deviation, reduces by about one third but it remains very high even over the full three year calculation period required for PRIIPs. This is most clearly seen in the proportion of negative slippage costs. With a previous close benchmark for Slippage measurement, we observe about 47% of negative slippage costs. This reduces to 44% when we move to intraday data at time of broker instruction. Accordingly, better data does very little to eliminate negative transaction costs.

The key reason why we still observe a high incidence of negative transaction costs –despite better quality intraday data –is due to the structure of equity markets. Electronic trading in equities has flourished due to changes in regulation and advances in technology, resulting in low transaction costs for investors. Most orders are managed algorithmically, split into smaller sizes and traded over time in order to more seamlessly or subtly interact with liquidity displayed in the order book. The duration of these trades introduces market movement into the slippage calculation that cannot be stripped out even with more accurate benchmark data. This produces high variability and negative slippage outcomes.

Based on our findings we expect fund cost disclosures, as they stand, to continue exhibiting highly variable transaction costs that confuse investors. We set out the results of our finding in our ViewPoint: Disclosing Transaction Costs –The need for a common framework. We will be happy to share the results of our underlying empirical data with the FCA.

In our ViewPoint we make the following recommendations to provide investors with more relevant data for making informed and effective investment decisions, leading to smoother implementation of both PRIIPs and MiFID 2:

1. Purpose of disclosures: Transaction cost disclosures should be judged according to their effectiveness in helping investors make better decisions about their investments. For both new and existing portfolios, the disclosures should serve as a tool for assessing

how efficiently a fund manager achieves their stated objective. Additionally, disclosures should explicitly state which costs are already included in performance figures to avoid misrepresenting their impact. This approach highlights the importance of consistency and comparability in the metrics used.

2. Optimal methodology: There is no one simple formula that can adequately represent the costs of trading across multiple strategies and asset classes. Instead we recommend fund managers use a modified spread methodology as the concept most suited for providing transaction cost disclosure to investors; when well executed it delivers the highest degree of consistency and comparability. Existing spread methodologies should be enhanced by incorporating relevant factors that influence trading costs.

3. To ensure full accountability and transparency to investors, fund managers should have appropriate governance and oversight controls in place overseeing fund transaction cost reports. Investor disclosures should include information of the material factors and assumptions used when reporting on transaction costs. We recommend fund managers adopt a governance and supporting disclosure framework based on the recently enhanced MiFID II best execution rules.

4. Supplementary information: End-investors would benefit from clearer attribution of costs which identifies the recipients of any charges and costs they pay (for example, fund managers, brokers, distributors, other intermediaries such as platforms, and tax authorities). Transaction cost disclosures could also be improved by providing separate information on the frequency of trading and cost of trading separately

5. Transaction Cost Analysis: Slippage metrics are not suited to transaction cost disclosures, given their technical nature, exposure to market volatility, and sensitivity to underlying data, which leads to repeated instances of negative transaction costs even when averaged over the three year period required under PRIIPs. However, they are an important tool for portfolio managers and traders to improve investment performance.

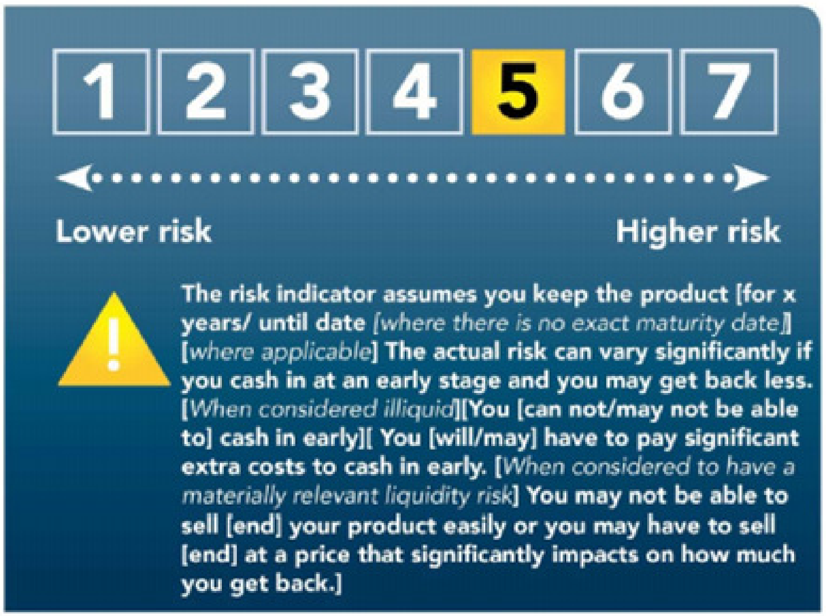
We are also concerned that the requirement for investment companies to include borrowing costs in isolation gives a distorted cost picture and makes cost comparisons with open-ended funds confusing for investors. We would recommend including an offset for the income derived from the investments made with the borrowed capital or an explanation that this cost is a consequence of an investment decision.

Q4. If you are an investor (or represent investors), what has been your experience with disclosures of transaction costs? Have you found these disclosures helpful in making your investment decision? Conversely, have you come across disclosures of costs which you found difficult to understand, or which you felt unable to rely on? Please provide supporting examples and evidence.

Our experience from the variety of client queries received is a lack of understanding of the purpose of published transaction costs. To help our client-facing staff meet the number of queries from distributors we have produced high-level and detailed explanatory guides/notes setting out why we have adopted the PRIIPs methodology not only for PRIIPs but also as part of MiFID 2 reporting as well as providing detailed explanations of how slippage works and why it delivers volatile results.

Q5. Please provide your views, supported by evidence, on the SRI and on the extent to which the required and optional sections of the risk narratives enable the risks of a product to be adequately explained to consumers.

We have particular issues relates to the application of the PRIIPs KID on closed-ended funds as an ELTIF. We understand that we are required to use the wording as provided verbatim in the PRIIPs RTS (where applicable). However, this wording is not always appropriate for the relevant product structure. For example, the narrative within the blue box below makes multiple references to cashing in early where a product is considered illiquid or to have material liquidity risk. This causes challenges for the ELTIF, as this would not be deemed a liquid product and by the very nature of the ELTIF rules investors are unable to redeem for 10 years. Cashing in early is not an option for investors and including this wording ends up misleading investors.



Q6. Do you have any examples of products where the prescribed methodology for assessing and presenting risk leads to a counter-intuitive or potentially misleading SRI? If so, please provide examples.

No additional comments

Q7. Have you experienced any practical issues with the calculation and presentation of performance scenarios in the KID? If so, please provide details so that we can identify any further practical difficulties not fully contemplated in our statement of January 2018.

We have no additional comments above those already raised by both the AIC and the Investment Association.

Q8. Have consumers who are using KIDs to make investment decisions encountered any issues with the performance scenarios presented to them?

We have received feedback from some distributors that transaction costs are being used as driver for fund selection as they are unable to isolate these costs in the fund performance scenarios.

Q9. Are there any other experiences with the implementation of (and compliance with) the PRIIPs legislation that you wish to raise with us? Please include evidence to support the points you make.

We support the overall policy objective of ensuring that all retail investment products are subject to standardised cost disclosures. Nevertheless, until the issues we have identified with the PRIIPs disclosure requirements have been resolved we believe that it is premature to replace the current investor information requirements in the UCITS KIID. We call on policy makers to extend the current exemption of UCITS from PRIIPs disclosure standards beyond the current expiry date of December 2019 until concerns about the underlying methodologies have been resolved. This will have the key benefit of delivering improved disclosure to investors while also minimising the number of changes investors have to assimilate.

Q10. As a user of the KID what is your overall experience of the information provided? Please provide examples of where the information received is useful in informing investment decisions.

No further comments.

Conclusion

We appreciate the opportunity to address and comment on the issues raised by the Call for Input and will continue to work with the FCA on any specific issues which may assist in improving the outcome for consumers.