Institute and Faculty of Actuaries

Joint Committee of the European Supervisory Authorities (ESAs) – EIOPA, EBA and ESMA

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IFoA response to Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs)

General comments

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the ESAs' consultation on Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs). This response has been prepared by IFoA members with experience in the design and marketing of PRIIPs and their accompanying Key Information Documents (KIDs), as well as experience of conducting research into the areas covered in the Discussion Paper.

We are focusing our comments on chapters 3 and 4 because these are highlighted as the most challenging areas of KIDs (see section 1.5). We also believe that risks/returns and costs (especially the former) are the most important issues for most retail investors when they are trying to understand and compare products.

Chapter 2 of the Discussion Paper includes criteria for assessing the presentation and methodology of KIDs – for example that they should be engaging, enable comparisons between products, and be based on robust methods which are practical to implement. We welcome the Discussion Paper's identification of these desirable features and encourage the ESAs to focus on identifying the guiding principles that are likely to achieve these outcomes. However, we note the wide variations between PRIIPs markets in Member States (MS), which leads to similarly wide divergences in the structure of products and the typical objectives of consumers. Given these variations, we would encourage the ESAs not to over-prescribe the detail of KIDs, either in their presentation or the underlying methodologies. Given the heterogeneity of both the product types in scope and the characteristics of products/consumers in different member states, a 'one size fits all' approach may only serve to confuse rather than help customers. Even where such solutions are possible, implementing them would require substantial efforts, which could damage the cost-effectiveness of the proposals and may risk stifling innovation. We would therefore argue that there is strong case for ensuring that requirements for KIDs are delegated to MS as far as possible.

At the same time the IFoA believes that the ESAs would be most effective in establishing guidelines for the types of information that consumers should receive. Identifying those higher-level disclosure requirements would allow NCAs to implement the guidelines in the most appropriate manner for MS.

The Discussion Paper focuses on point of sale documents and many of the products sold will be sold on an advised basis rather than on an execution only basis. The IFoA considers there would be greater benefits from investing in a goals/outcomes based communication and engagement strategy

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that also covers the period after the point of sale, when more information is available, or could be captured, to support this type of approach. We also note that it will be challenging to produce a KID at 'product level' when so many of the key metrics will depend on an individual's ultimate investment choice.

We also believe that consistency between point of sale, post sale and ongoing touch points for the customer is important. Customers will be confused if they see one set of information at point of sale, which does not relate to what they see at year 1, or to the conversation they would have with the provider if they called up (or went online).

We consider that ESAs should support the move to more interactive methods of engagement with consumers, alongside traditional formats such as the KID. Online methods could enable better comparison of options and their relative expected values by means of "plug and play" technology. We believe that "gamification", or learn as you play, would increase engagement and understanding. In particular, interactive functionality could allow investors to specify presentations to reflect their particular investment goals and their expectations of risk and return. Suggested requirements around methodology in the KID – such as balance, robustness etc. - would also have to apply to these apps to mitigate against possible mis-selling of products.

Chapter 3 – what are the risks and what could I get in return?

Question 2: Do you agree with the consumer's perspective on risk expressed in the Key Questions?

The Key Questions are valid and they provide a potential objective basis for comparison across products. It would be desirable if they could also refer to the individual investor's objectives. We would encourage ESAs to consider if it were possible for the KID to link the Key Questions to the broader types of outcome that would be of concern to investors with different risk appetites and objectives. In 2012 an IFoA Working Party published a discussion paper on transforming consumer information[1], in which one of the proposed outcomes was to "Communicate risk and reward by reference to the chances of achieving the consumer's goal".

The uncertainty of returns questions make reference to 'given current market conditions….' If the assumptions underlying the performance scenarios are only refreshed periodically then this could introduce a comparability issue, since different providers may update their assumptions at different times and in different market conditions.

We also believe that the references to "winning" in the Key Questions ("How much can I win? How much am I likely to win?") are not representative of how consumers relate to financial products. We suggest that "win" is replaced with "gain" or "earn".

Q3 Do you agree that market, credit and liquidity risk are the main risks for PRIIPs? Do you agree with the definitions the ESA's propose for these?
Q4 – Do you have a view on the most appropriate measure(s) or combinations of these to be used to evaluate each type of risk? Do you consider some risk measures not appropriate in the PRIIPs context? Why? Please take into account access to data.

We agree that the definitions of market, credit and liquidity risk are quite broad, and therefore cover many of the key risks for PRIIPs. However, these broad definitions may be difficult to combine into a single quantitative measure. For example, the suggested measures of market risk are based on

[1] Transforming Consumer Information Discussion Paper: http://www.actuaries.org.uk/research-and-resources/documents/transforming-consumer-information-discussion-paper

volatility and Value-at-Risk, both of which depend on historic or forecast returns. A single value of volatility, as an example, may be too crude to capture all the aspects of risk mentioned in the paper, such as inflation, interest rates, currency, and the investment's underlying asset classes.[2]

Many of the measures suggested are potentially calculation heavy and – more importantly – the end consumer is less likely to understand a large amount of technical language e.g. Value-at-Risk, credit spreads.

If the KID document is at product level rather than fund level, and the consumer's investment choices are unknown, it may be more appropriate to use qualitative measures. The provision of context or benchmarking – as proposed by the visual examples in section 3.7 – are helpful, as without this, end consumers may struggle to draw conclusions from the information presented.

If the performance scenarios are to be based on forward looking assumptions, then in our view the risk measures should also be based on these, given the relationship between them.

Question 5: How do you think market, credit and liquidity risk could be integrated? If you believe they cannot be integrated, what should be shown on each in the KID?

We note the interesting discussion of the pros and cons of using a single indicator for risk in aggregate or separate indicators for each risk, and that the PRIIPs Regulation gives scope for some flexibility in this area. However, we would argue that it is mistaken to limit the KID to having a single form of presentation for risk. Instead, the five options identified in the Discussion Paper should be seen as available options for providers. Consumer testing could help them to choose appropriate risk indicators.

For some insured investment products, it would be helpful to have consistency with the SRRI scale in KIIDs, as consumers may be comparing alternative tax wrappers where KIIDs will be available for the underlying funds e.g. Offshore Bond vs Onshore Bond vs S&S ISA vs Pension.

Question 6: Do you think that performance scenarios should include or be based on probabilistic modelling, or instead show possible outcomes relevant for the payouts feasible under the PRIIP but without any implications as to their likelihood?

If more than one scenario is to be included, then we would support having some indication of the likelihood of each.

Regarding performance scenarios in general, our view is the only way to achieve comparability between providers would be to apply a very prescriptive approach to the methodology for the scenarios. Such an approach is unlikely to succeed given the wide range of products and consumer objectives, and therefore there will be a trade off between comparability and flexibility of methods.

Question 9: Do you think that performance scenarios should include absolute figures, monetary amounts or percentages or a combination of these?

We would suggest that performance scenarios should use a combination of all these measures. In particular, providers should avoid using only percentages, since consumer research frequently indicates that consumers struggle with these.

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[2] The IFoA's paper on Transforming Consumer Information (see footnote 1) states (2.3.16): "if the consumer is saving for something in particular in 10 years, the price inflation of that particular item will have a significant bearing on the amount required. Indeed, the risk of long-term returns being lower than expected is much more pertinent to success than the yearly volatility of the investment."

Question 10: Are you aware of any practical issues that might arise with performance scenarios presented net of costs?

We believe that gross performance figures are misleading as they can never be achieved. While there are challenges with presenting net of costs figures, they set more appropriate customer expectations.

Question 11: Do you have any preferences in terms of the number or range of scenarios presented? Please explain.

Informing the customer must be the objective rather than simply providing information. We note the point that too few scenarios could trigger behavioural biases, but equally too many could impede effective decision-making. The optimum number will depend on the product and on the customer's objectives.

Question 12: Do you have any views, positive or negative, on the different examples for presentation of a summary risk indicator? Please outline advantages and disadvantages, and provide any other examples that you are aware of that you think would be useful.

The variety of examples shown in section 3.7 illustrates the benefits of enabling MS to design their own risk indicators. These will reflect the different products and frameworks within each MS. As noted already, for some insured investment products we would encourage consistency with the SRRI scale in KIIDs as consumers may be comparing alternative tax wrappers where KIIDs will be available for the underlying funds.

Question 13: Do you have any views, positive or negative, on the different examples for presentation of performance scenarios? Please outline advantages and disadvantages, and provide any other examples that you are aware of that you think would be useful.

We support some form of benchmarking for the performance scenarios although this is potentially difficult to achieve. A balance needs to be struck between finding an engaging presentation that is simple enough for the majority of consumers to understand without it being misleading. For example, the '3 line graph' on page 43 is potentially misleading as, without proper explanation, consumers may think that they could receive one of the straight lines.

Question 14: Do you have any views on possible combinations of a summary risk indicator with performance scenarios?

The IFoA notes with interest the discussion of different presentation formats that may be used for summary risk indicators, performance scenarios and combinations of the two. This analysis is very useful in highlighting some of the principles that should guide the choice of presentation in practice. However, our view is that the most appropriate presentation format cannot be defined in advance, and that this is likely to vary for different member states. To achieve comparability between providers within each MS, the appropriate format would need to be prescriptively defined at an appropriate level.

Chapter 4 - Costs

We believe that the paper could be clearer in distinguishing between the amount of costs and value for money. Additional costs may be regarded as providing value for money by some groups of consumers, but not by others. Too much focus on costs may distract from a broader view that focuses on the customers' outcomes. Costs should not be separated from the previous section on risks and reward and are definitely not distinct from customer objectives.

It would be particularly helpful for the PRIIP requirements to be consistent with disclosure requirements proposed for other product types e.g. for QWPS workplace pensions (where the notion of a value for money assessment is also being introduced).

Question 16: What are the main challenges you see in achieving a level-playing field in cost disclosures, and how would you address them?

As many of the costs are investment related and will therefore be dependent on an individual's investment selection, we are unclear how this will be represented at the KID level. There may be a risk that product level disclosures are made based on the assumption of selecting the 'cheapest' investment option available.

Question 18: Do you have any views on how implicit costs, for instance costs embedded within the price of a structured product, might be best estimated or calculated?

We believe that the nature of indirect costs, particularly in structured products, will be almost impossible to bring together in a key document across the EU. While it is desirable for providers to strive to make such costs as transparent as possible to consumers, any attempt to standardise the description of these costs would inevitably cause customer communication difficulties.

Question 19: Do you agree with the costs and charges to be disclosed to investors as listed in table 12? If not please state your reasons, including describing any other cost or charges that should be included and the method of calculation.

We do not have specific comments to make about the costs and charges listed in table 12, but we would note in general that there should be a balance between providing sufficient transparency and causing confusion by providing too much information.

Question 20: Do you agree that a RIY or similar calculation method might be used for preparing 'total aggregate cost' figures?

If the customer knows the impact of costs e.g. a RIY percentage, in our view this is generally more useful than a detailed breakdown of the constituent parts. We would caution, however, that percentages are not generally well understood. Adopting an ongoing charge/TER approach could help improve comparability across different product types with different disclosure requirements e.g. KIIDs.

Question 23: How do you think implicit portfolio transaction costs should be taken into account, bearing in mind also possible methods for assessing implicit costs for structured products?

Transaction costs are not always readily identifiable. It would therefore be helpful to understand the extent to which the KID needs to recognise these costs. We would encourage the ESAs to have a general aim of consistency across product types and regulatory frameworks, both in terms of what is to be disclosed to consumers and also the methodology to be used by investment managers to calculate these costs. There needs to be clarity about the position of product providers who request the relevant information from investment managers but where this is not provided.

Question 25: What do you think are the key challenges in standardising the format of cost information across different PRIIPs e.g. funds, derivatives, life insurance contracts?

The products are fundamentally different so can have very different charging structures.

Question 26: Do you have a marked preference or any objection for any of the presentation examples? If so, why? Please provide any alternative examples which you believe would be useful.

We believe that consumer testing is needed to inform this. Some of the examples provided are quite complicated.

Question 27: In terms of a possible breakdown of costs, are you aware of cost structures for which a split between entry or exit costs, ongoing costs, and costs only paid in specific situations or under specific conditions, would not work?

No.