

Comments Template for Joint Consultation Paper concerning amendments to the PRIIPs KID (JC 2018 60)

**Deadline
6 December 2018
23:55 CET**

Name of Company:	Erasmus University Rotterdam and Tilburg University	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ Do not change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇒ Leave the last column <u>empty</u>. ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a question or a cell, leave the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. <p>Please send the completed template, in Word Format, to CP-18-005@eiopa.europa.eu</p> <p>Our IT tool does not allow processing of any other formats.</p>		
Reference	Comment	
General Comments		
Q1	<p>Although we understand the ESA's reasoning to include past performance information in the KID to shed light on the behaviour of PRIIPS, we stress that academic literature has extensively documented that such information does not benefit (fund) investment decision making. Hence, we do not agree that past performance should be included in the KID where available.</p> <p>Cox, de Goeij and Van Campenhout (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3277502) demonstrate that the addition of past performance histograms to the KID disclosure might even exacerbate suboptimal investment decision making (see Tabel VII, column 4) such as the amount of unnecessary fees</p>	

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	incurred. Their study finds this to increase when disclosure includes past performance information relative to disclosure where this information is absent.	
Q2	Although these matters are not academically investigated in great detail, we note that the academic literature shows that financial illiteracy is widespread and that understanding of basic financial concepts is low. This implies that the effects of the presentation of information are likely to carry over to different types of PRIIPs irrespective of the exact nature of the product. Obviously, we expect that more complex PRIIPs will come with more complex disclosure which increases the risk of information overload and suboptimal decision making (see also Q11).	
Q3	See our response to Q1, we have strong reservations against including past performance in the KID as it actually makes investors worse off compared to not including this information at all (see Cox, de Goeij and Van Campenhout 2018, Table VII).	
Q4	<p>Although simulated past performance does not equal realized past performance, simulations based on realized prices could give valuable insights to the behaviour of a PRIIP. However, it is challenging to adequately disclose that the resulting information is based on simulated performance. We agree with the ESA's that solely the provision of price information on the underlying does not provide an adequate insight into the behaviour of the financial product.</p> <p>In the annex to Cox, de Goeij and Van Campenhout (2018) that has been prepared for the ESA's, a consumer test is conducted among 1200 Dutch respondents where different graphical presentations of past and expected performance are tested. Decision making improves when <i>expected</i> returns are included in the KID compared to the inclusion of past performance. However, the introduction of confidence bounds that demonstrate the uncertainty surrounding future performance does not affect investor behavior.</p>	
Q5	As noted in our response to Q4, it should be clearly marked that the information is derived from simulations and refers to past performance. Moreover, it should be considered whether the use of longer time periods (e.g. 25 years) provides a more accurate insight into the economic behaviour of the PRIIP (see also Q7) than solely relying on more recent periods. Note that investors are sensitive to returns series that appear volatile because they cover a short time period (see Shaton, 2017). Finally, we believe that a simulation of performance should be conducted taking into account the exposure features of the product and not solely the underlying	

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	asset.	
Q6	<p>Although in general we believe that for narrative descriptions it holds that ‘less is more’, the usage of formatting such as bullets, bold or underscored text etc. can help investors to distill the key messages that are communicated.</p> <p>Please refer to the work by Cox and De Goeij (2018) (available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2822212) that the design of investment advertisements is such that the visual saliency of key messages (including those in narrative) is increased. An increasing body of academic research shows that this significantly affects economic behavior.</p>	
Q7	<p>We agree with the discussion in the Consultation paper, although we do not see the benefit of anchoring returns using the risk free rate. Note that the determination of a suitable risk free rate is highly debatable and might lead to additional confusion if different Rfree are used across PRIIPS. The ESA’s could consider calculating future performance scenario’s and require reporting expected excess returns (e.g. returns in excess of Rfree rate) which can also be done for PRIIP’s with a longer holding period.</p> <p>Note that excessively optimistic investor expectations can be combatted by using longer return estimation periods (e.g. 25 years) that are smoother. Such return series will contain multiple bull and bear markets that are informative of how a PRIIP behaves in different scenarios (see also Q8) and exhibit less short term volatility (Shaton, 2017)</p>	
Q8	<p>The ESA’s might consider using longer time periods of data to calculate performance scenario’s in order to inform investor about the (long term) behavior of a PRIIP. Although this has the advantage that multiple bull and bear markets can be included which are informative to investors for risk management purposes, the drawback of the approach is that the maturity of the PRIIP does not always match a long (e.g. 25 years) investment horizon. This mismatch between the calculation horizon and the PRIIP investment horizon can be misinterpreted by investors. This approach might be usefull for long-term holding PRIIPs.</p>	
Q9		

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Q10	With respect to the discussion in section 4.3.5, we refer to our earlier comments regarding the inclusion of past performance information.	
Q11	With respect to the benefits of including past return information, we do not understand how this is relevant to their decision making. Simulation of the return distribution to calculate <i>expected</i> returns would largely eliminate the need to include past performance with its associated drawbacks.	
Q12		
Q13	Yes, the risk of information overload. The costs from information overload are not explicitly addressed although this risk is explicitly mentioned on p. 21 of the Consultation paper. A typical investor evaluates multiple options before reaching an investment decision. This implies that an increase in the complexity or amount of information for a single option raises the risk of information overload and suboptimal decision making. We recommend the ESA's to explicitly take this risk into consideration when evaluating the different options to amend the KID.	