



## Executive summary –

# Consumer testing study of the possible new format and content for retail disclosures of packaged retail and insurance-based investment products

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## Executive summary

### Motivation of the study

On 26 November 2014, a Regulation<sup>1</sup> was adopted which requires a new form of short, standardised consumer-friendly information (a “Key Information Document” or KID) to be provided to retail investors when buying Packaged Retail and Insurance-based Investment Products (PRIIPs). The Regulation will apply from 31 December 2016.

Each product’s KID will be drafted by its manufacturer but will adhere to a common format. Article 8 (3) of the PRIIPs Regulation sets out the main sections of the document which will provide answers to the following questions relevant to investors:

- "What is this investment?"
- "What are the risks and what could I get in return?"
- "What happens if the product manufacturer is unable to pay out?"
- "What are the costs?"
- "How long should I hold it and can I take money out early?"
- "How can I complain?"
- "Other relevant information"

The three European Supervisory Authorities (ESAs)<sup>2</sup> have been empowered to develop proposals for detailed rules on what the manufacturers must include in these areas. These proposals should ensure KIDs that are as helpful and meaningful for retail investors as possible. In this regard, the European Commission has initiated this consumer testing study so the particular format for presenting PRIIPs information will be truly helpful for consumers in comparing and selecting the best products for their investment needs. In addition to looking at the best format of the KID, the testing needed to identify how this could best work also for products that offer multiple investment options. This is particularly with regards to the provision of generic information about such products, where such information is provided separate from specific information on the details of each of the investment options offered.

Within the consumer testing study, the ESAs in collaboration with the European Commission prepared “variants” (i.e. different ways of presenting KID materials) for testing. The ESAs also identified the key policy questions they needed the consumer testing to clarify, and the key criteria by which the effectiveness of different variants could be assessed. London Economics and Ipsos designed and implemented fieldwork tools appropriate for answering these questions and assessing the variants against these criteria, and have reported the findings. The process was designed to offer as many opportunities as possible for iterative feedback to allow for subsequent improvements and refinements to the variants.

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<sup>11</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014R1286>

<sup>2</sup> European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA)

## Research methodology

### *Structure of the study*

The study consisted of two phases of research:

- In Phase I, the main elements of the PRIIPs disclosure document (sections on risk, performance and cost) were tested separately.
- In Phase II, full documents (KIDs) were produced on the basis of the Phase I results, and tested.

The reason for structuring the study in two phases was so that Phase I could deliver detailed information about consumers' preferences and understanding regarding the main individual elements of the KID, prior to the design of the overall KID to be tested in Phase II. This allowed for an iterative improvement of the testing variants between the two phases. A wider range of variants were tested in Phase I than in Phase II, so that the number of combinations could be reduced already to those that performed the best – and these best performers could be further improved before the commencement of Phase II. Phase II focused on testing the overall KID so as to test the information on different elements in the context of the overall document and thereby represent more closely how consumers would interact with the document in real life.

Given the importance of the appropriate use of terminology and plain language, translations of all testing materials (questionnaires, discussion guides, variants and overall KIDs tested) were checked with native speakers, both in respect of the accuracy of financial terms and in respect of the use of plain and clear language. In addition, where amounts in currencies were shown, these were put in the official currency of the Member State where the testing took place to ensure that respondents were familiar with it.

### *Analytical methods*

Both phases of research involved two analytical methods:

- Quantitative research, which took the form of a large scale online survey of EU consumers across 10 Member States; and,
- Qualitative research, which was implemented through focus groups in six EU Member States.

In both the quantitative and qualitative research, consumers saw different ways of presenting key information associated with PRIIPs and were asked a range of questions to elicit: (i) their engagement with the material, (ii) their understanding of the material, and (iii) their ability to use the material to make comparisons between products.

The main advantage of using quantitative analysis was that it could test each variant against these criteria in a controlled way and on a representative sample of European consumers. This allowed for easy comparison of each variant against the criteria. Equally, it allowed for statistical analysis to identify where variants performed well in improving the comprehension and the comparison of information for respondents. It was important that the design was precisely aimed to gather information on how well consumers understand and use the variants, and not only on consumer's subjective preferences, as sometimes these do not correlate (e.g. consumers prefer a presentation which they objectively do not understand well, or dislike a presentation which actually communicates better).

The main strength of the qualitative analysis was that it allowed for more in-depth examination of specific challenges that consumers might have had with certain variants. For instance, focus group facilitators can probe participants on why they find a certain aspect difficult to understand and ask what improvements they would suggest. However, such analysis of course tends to be limited to gathering stated preferences.

**Participant selection**

The target population for the research was potential investors who are typically in the market for PRIIPs and/or have recently purchased PRIIPs. The target population was selected in a controlled fashion, to ensure its representative nature against key demographic criteria, and so as to allow for higher and lower financial literacy subsamples. In order to target this group in the study, all participants included in the quantitative and qualitative research had to be either responsible or co-responsible for household financial decisions.

**Research findings**

**Phase I results**

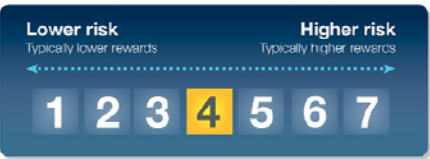
Generally, the results of the quantitative research showed that simpler approaches were associated with better comprehension of key information than more complex approaches. There was support for more detailed information in the qualitative study among some participants. However, increased detail often meant poorer performance on the objective questions within the quantitative testing.

The Phase I results were used by the ESAs, in consultation with the Commission, in selecting the main variants to proceed with. In addition, the results highlighted ways in which the variants could be potentially improved.

For communicating the risk of a product, the best approach overall was a 7 point scale using a simple graphic layout (as shown in Figure 1). A variant showing a vertical scale presentation similar to an energy label did not perform as well. Consequently, the 7 point scale approach was used as the basis for the risk elements of all of the KIDs tested in Phase II. In addition, an alternative presentation of the risk information, which included a multi-dimensional indicator, was found helpful to consumers in Phase I when considering details on different types of risk, such as market risk, credit risk and liquidity risk, though the consumers found these specific forms of risk nonetheless difficult to understand and combine. As a result, there was an effort to improve the format of the multi-dimensional indicator for Phase II.

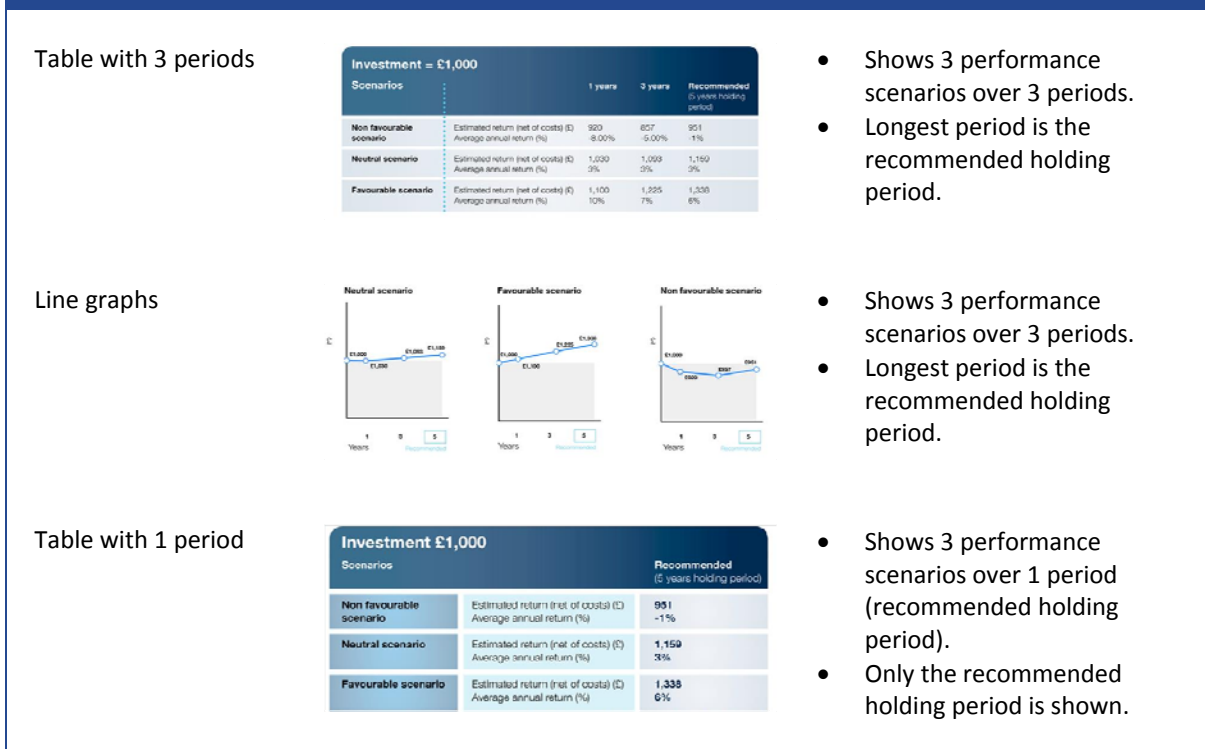
In the qualitative study, although some respondents suggested using colours (red, green) to indicate risk levels, other respondents indicated that using the red colour could be interpreted as a danger warning, yet a higher level of risk might sometimes be appropriate for the investor. Due to this, a neutral colour scheme was kept for the second phase of the research.

**Figure 1: Example of the preferred approach for showing risk – Phase I**

Simple risk indicator – horizontal presentation		<ul style="list-style-type: none"><li>• Graphic is a single scale showing overall risk.</li><li>• Information on market, credit and liquidity risks, guarantees and maximum loss in text</li></ul>
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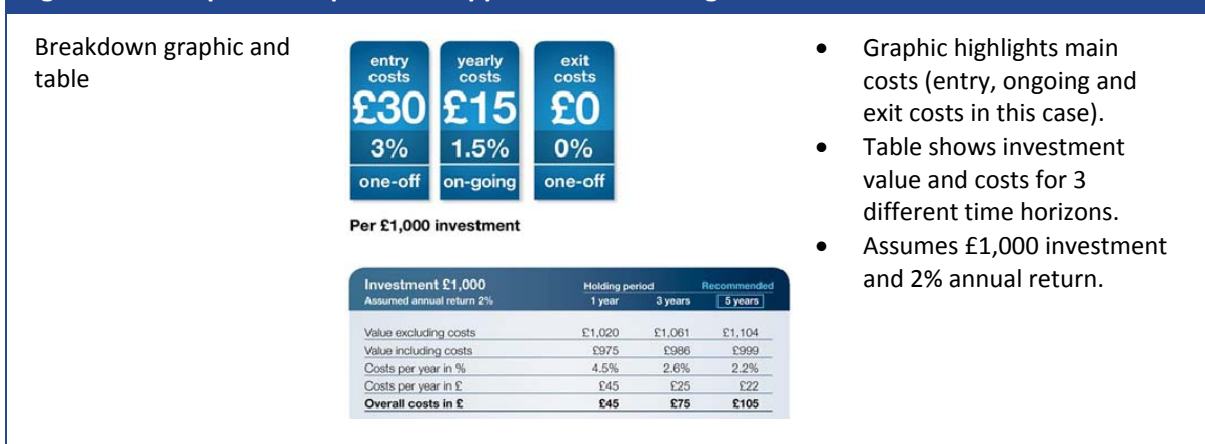
When different ways of presenting performance information were considered, more complex graphical designs (showing a “funnel of doubt” or a “probability histogram”) did not perform as well as simpler graphics which incorporated either a table or a line graph (as shown in Figure 2). Based on these findings, the more complex designs were dropped for Phase II and the simpler graphics were further developed.

**Figure 2: Example of the preferred approaches for showing performance – Phase I**



For the cost section, a combination of a simple graphic plus a table (as shown in Figure 3) was associated with better results than the other approaches, which combined a table with either a bar chart or a more sophisticated graphic. As a result, this combination of graphic and table was used as the basis for the cost sections of all variants in Phase II.

**Figure 3: Example of the preferred approach for showing cost – Phase I**



## ***Phase II results***

In both the qualitative research and subjective questions in the quantitative research, respondents' reactions in Phase II towards the KID were generally positive. Participants appreciated the document's structure, as well as the fact that it included images.

It was clear from the quantitative research that the KIDs tested varied in terms of which parts performed well or less well. This suggests that elements of the different KIDs could be combined to create the best overall format (as presented in the next section).

Between the quantitative and qualitative research, it was possible to identify a number of specific areas of continued confusion among participants:

- Understanding capital guarantees. In general, the concept of guarantees and at the same time the possibility that the guarantees might fail or have limits, was difficult for participants to grasp. Many participants who saw a product with a guaranteed return failed to understand fully what was guaranteed and what was not.
- Understanding the likelihood of performance scenarios. Respondents often wrongly assumed likelihoods when shown performance scenarios even where these purposefully did not include information on how probable they are, yet on the contrary respondents also made mistakes when provided with information on the probability of the scenarios. There appeared to be a clear motivation to find information on how probable the scenarios are, but some problems using the information where they were given it.
- Understanding that the cost figures were not exact. A minority of participants understood that the costs shown might not represent the actual costs an investor would have to pay.
- Understanding the cost figures in general. In general, there was poor performance on the questions relating to cost in the quantitative survey, compared to the questions on performance and risk. There were difficulties with many of the cost questions, including comparing overall costs and cost components between products, identifying the different cost components and how they apply, and estimating costs where there is an early exit.

When participants saw KIDs for products offering multiple investment options, they faced two additional challenges:

- Understanding the representation of multiple investment options. Two approaches were tested, in various combinations, for including information on the investment options in the generic KID for such products:
  - Showing the range of values (e.g. risk ratings) for the underlying options, from the lowest to the highest;
  - Showing the information for an example investment option (e.g. the "typical" underlying option most often chosen by investors), and noting that other options exist that are different.

There was some evidence that participants who saw the values associated with a typical option tended not to understand that these would only apply for the option shown. For this reason, investor understanding may be improved if information in the generic KID focuses on showing the range of choices for multi-option products.

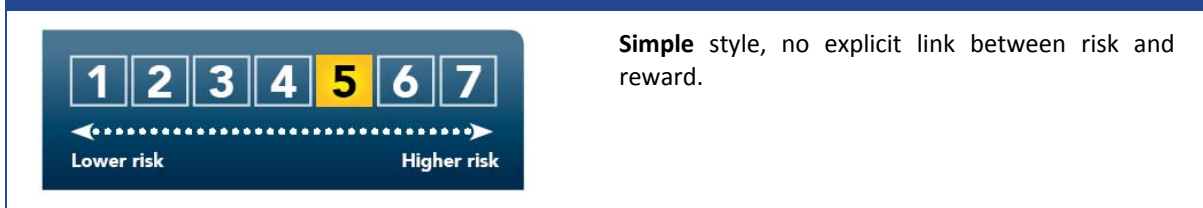
- Understanding the combination of the generic KID and more detailed information on the investment options. The generic KID for multi-option products would be accompanied by more detailed information on each of the different investment options offered. To gather feedback on this, a sample ‘fund guide’ which contained such detailed information was prepared for the qualitative testing. Most participants did not spontaneously understand how the two documents (KID and fund guide) worked together, though with some prompting the combination was found useful. However, focus group participants typically mentioned that they would have preferred having all the information in one document, rather than separately.

## Conclusions and recommendations

Based on the results of the quantitative and qualitative testing in Phase II, it is recommended that the KID should ideally combine elements from a few variants tested in order to take advantage of the variants’ relative strengths:

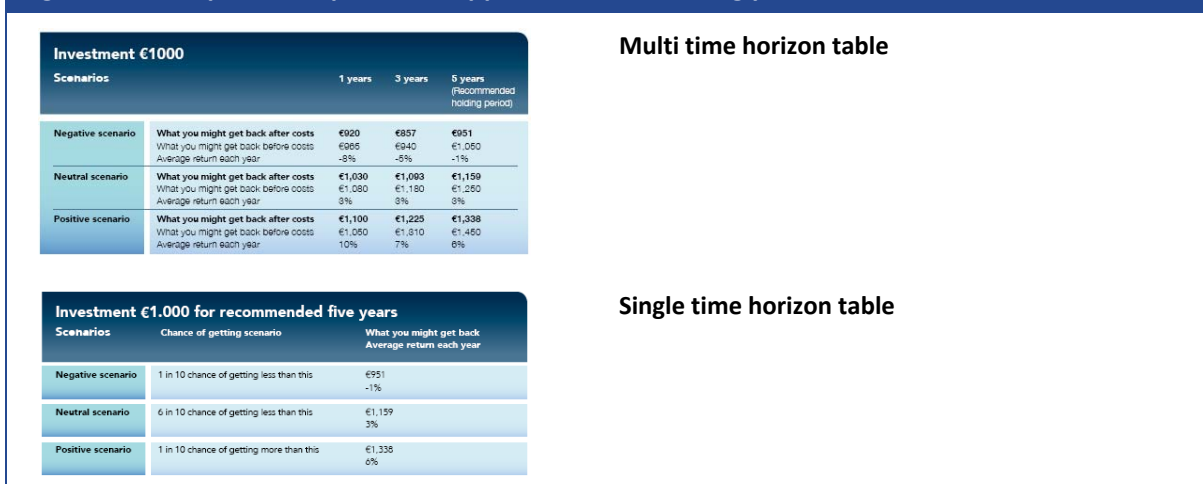
- A single 7 point scale risk graphic which uses a simple graphic layout, and without any explicit link between risk and reward.

**Figure 4: Example of the preferred approach for showing risk – Phase II**



- A performance graphic in the form of a single or multiple time horizon table (similar to the approaches in Figure 5 below).

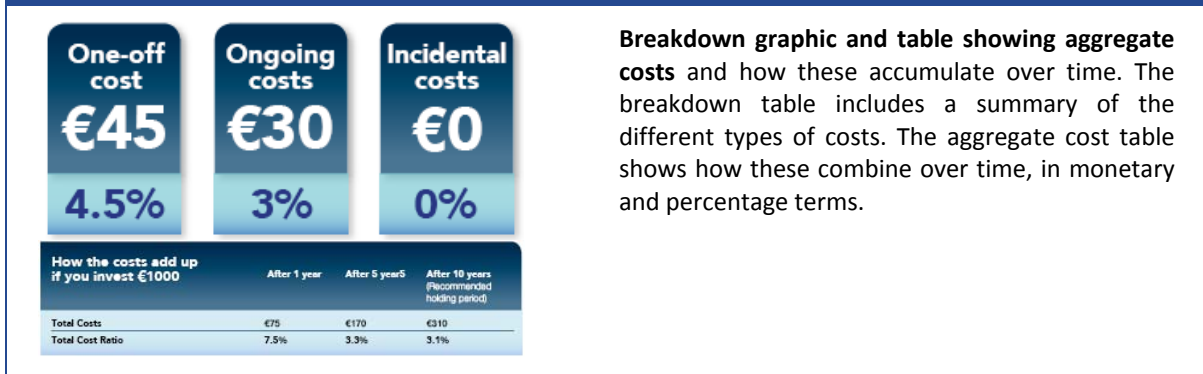
**Figure 5: Example of the preferred approaches for showing performance – Phase II**



- A cost graphic which highlights key information (one-off, ongoing and incidental cost) using a breakdown graphic and uses a table to show aggregate costs in percentage and money terms across three time periods (similar to below although improvements are needed).



Figure 6: Example of the preferred approaches for showing cost – Phase II



For multi-option products, the findings suggested that the generic KID should be showing ranges of possible values, rather than the values associated with a typical option.

The findings also suggested some detailed improvements, such as:

- Only showing net returns in the performance scenarios, as including both gross and net figures confused participants;
- Simplifying the cost information as much as possible, for instance by including less information (as participants had difficulties with many of the cost questions);
- In relation to the costs, avoiding the use of acronyms or abbreviations as far as possible, and using clear and consistent terminology.

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