



# **Consumer testing services - Retail investors' preferred option regarding performance scenarios and past performance information within the Key Information Document under the PRIIPs framework**

FISMA/2019/016/C

Executive Summary

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## 1. Background and purpose of the consumer test

Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products ('PRIIPs Regulation') and its implementing measures laid down in Commission Delegated Regulation (EU) 2017/653 ('PRIIPs Delegated Regulation') determine the format, content and calculation methodologies of the key information document (KID) for packaged retail and insurance-based investment products (PRIIPs) to be made available to retail investors. These rules apply from 1 January 2018. With the overall aim of improving the effectiveness of the PRIIPs KID, i.e. retail investors' understanding of information provided in the PRIIPs KID as well as product comparison between and selection of different investment products, the European Commission, in close cooperation with the ESAs, has proposed different options for the presentation of performance scenarios within the PRIIPs KID. The Commission requested DevStat's assistance in carrying out a consumer test of the proposed options. The results of this consumer test of performance scenarios in the KID will feed into the ESAs' review of the PRIIPs Delegated Regulation and will be used as important evidence during the review of the PRIIPs Delegated Regulation. Consequently, the **general objective** of this project is to test the effectiveness of different content and formats for presenting information on past performance and potential future performance (performance scenarios) of PRIIPs so that this information can be as useful and as well understood as possible by retail investors.

## 2. Methodology of the consumer test

The consumer test covered 11 example products of three types: funds, structured products and insurance-based investment products (IBIPs). The following four versions of the KID were analysed:

- **Current KID version.** This version includes information on stress, unfavourable, moderate and favourable performance scenarios over three time periods. This version can be applied to funds, structured products and IBIPs.
- **Probabilistic approach KID version.** In this alternative version, the stress scenario is replaced by a minimum scenario. Moreover, the performance information is removed for intermediate time periods, and probabilistic information is given on the unfavourable, moderate and favourable scenarios at the end of the recommended holding period. Probabilistic information is framed as '*XX in 10 chance of doing worse*' than the performance scenario. This version can be applied to funds, structured products and IBIPs.
- **Past performance KID version.** This version includes all the variations introduced in the probabilistic approach version but also adds information on the performance of the product over the last 10 years. This version can be applied to funds and IBIPs.
- **Illustrative scenario KID version.** This version offers all the variations introduced in the probabilistic approach version but also adds specific performance examples to show the rules defining each structured product. This version can only be applied to structured products.

The test was carried out online. The final sample consisted of 7,684 subjects. Participants were those responsible or jointly responsible for the financial decisions of the household. The test covered France, Germany, Italy, Poland and Sweden. This selection of countries guaranteed a balanced representation of Member States covering retail investors from different regions of the EU. Participants were recruited online and were randomly assigned to combinations of example products and versions of the KID, thereby fulfilling quotas by country, sex, age and education level for each combination. The average time to complete the test was 22.7 minutes. The most common respondent profile was employed (50.2%), married (47.9%) and saving for specific goals (74.0%).

After recruitment and random assignment to combinations of products and KID versions, the consumers completed the test questionnaire, which consisted of different tasks. First, the consumers observed a pair of products (of the same type or different types). They then selected one to invest and were also asked to identify products with specific features (*product selection and identification questions*). Next, the consumers answered a series of questions on the features of the product (*understandability questions*). Finally, the consumers completed a sociodemographic questionnaire and a financial literacy questionnaire.

### 3. Main findings of the consumer test

The participants generally made good investment decisions. More than two thirds selected the optimal investment product from pairs of products of the same type <sup>1</sup> for all types of products and versions of the KID. Investment decisions were slightly better for funds (72–75% of participants selected the optimal fund) and IBIPs (71–75%) than for structured products (68–71%).

However, consumers seemed to struggle to identify a product based on its specific features and to answer the understandability questions correctly. With few exceptions across all KID versions and product types, less than half of the respondents were able to identify the product with the most unpredictable returns, the product with the highest expected return or the product that guaranteed a positive return or guaranteed investors their money back. This low proportion of correct product selection was observed when comparing products of the same type and of two different types. Moreover, with few exceptions, less than half of the participants correctly answered the understandability questions.

#### 3.1 Impact of the probabilistic approach (funds, structured products and IBIPs)

##### 3.1.1 Selection and identification of financial products

The percentage of consumers who selected the optimal investment product from a pair of products of the same type was similar when the information was presented with the current version of the KID and with the probabilistic approach version of the KID.

It is not possible to identify an objectively optimal investment decision when dealing with two products of different types. However, it is possible to assess how the probabilistic approach affects the correlations between the features of the selected investment product and the risk preferences of the consumers. Although this analysis reveals no general trends, some interesting individual findings should be highlighted. For funds and structured products, use of the probabilistic approach version seemed to make identifying investment products based on their volatility more difficult than with the current version. However, probabilistic information seemed to aid the participants' understanding of the probability of losses when comparing funds with IBIPs and structured products with IBIPs. No conclusion may be drawn regarding the impact of skewness preferences.

The probabilistic approach version of the KID improved the identification of the products based on their specific features when comparing products of the same type or of different types. The probabilistic approach version of the KID helped participants identify the product with the most unpredictable returns when comparing a fund and an IBIP and the product with the highest expected returns when comparing two IBIPs. Crucially,

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<sup>1</sup> When participants were asked to select an investment product from a pair of products of different types, it was not possible to identify which was the optimal selection, given that there was not an objectively better product.

the probabilistic approach version of the KID included information on the minimum performance scenario. The level of understanding of this information can be assessed through consumers' selection of products in terms of the guaranteed returns at the end of the recommended holding period. Table 1 shows that the identification of the correct product in terms of its guaranteed conditions was 7 or 8 percentage points higher for funds when the probabilistic approach version was used. A statistically significant, but weaker, impact was observed for IBIPs. Moreover, the probabilistic approach never had a negative influence on the proportion of participants who correctly identified a product.

*Table 1. Impact of the probabilistic approach version on product selection in terms of guaranteed returns at the end of the holding period\**

Question	Type of product	(1) % of correct answers with the current KID	(2) % of correct answers with the probabilistic approach KID	Percentage point difference in the % of correct answers with each version (2) – (1)
<i>QT1.4. Looking at the information sheets above for Product A and Product B, in your opinion, with which product are you guaranteed that you get...</i>				
<i>QT1.4a. ...a positive return at the end of the recommended holding period (i.e. an amount in addition to what you invested)?</i>				
QT1.4a	<b>Funds</b>	<b>23.75</b>	<b>30.94</b>	7.19
	Structured products	25.06	27.47	2.41
	<b>IBIPs</b>	<b>22.71</b>	<b>28.23</b>	5.52
<i>QT1.4b. ...back the money you invested at the end of the recommended holding period?</i>				
QT1.4b	<b>Funds</b>	<b>23.99</b>	<b>32.31</b>	8.32
	Structured products	24.07	27.28	3.21
	IBIPs	42.25	40.45	-1.8

\*Bold numbers for statistically significant differences with  $p$ -value < 0.05.

### 3.1.2 Understandability questions

In the probabilistic approach, one of the key changes with respect to the current version of the KID is the inclusion of probabilistic information on the likelihood of the unfavourable, moderate and favourable performance scenarios at the end of the holding period. A clear way to assess the level of understanding of this new information is through analysis of the understandability questions on the number of times out of 100 that the value of the investment will be above the favourable scenario. The introduction of the probabilistic information increased the percentage of correct answers by 11 percentage points for IBIPs, 9 percentage points for funds and 4 percentage points for structured products.

The current version of the KID includes information on the stress scenario, which is not included in the probabilistic approach version. The understandability question for the stress scenario was correctly answered by only 26% and 29% of participants for funds and structured products, respectively<sup>2</sup>.

The probabilistic approach (with or without additional information on past performance or an illustrative scenario) generally had a positive influence on understandability for funds and IBIPs. For both types of products, all alternative scenarios that included such information increased the accuracy of answers to the understandability questions.

<sup>2</sup> This question was not answered for IBIPs.



## 3.2 Impact of the information on past performance (funds and IBIPs)

For funds, only one past performance version of the KID was considered. This version, referred to as *past performance with two elements*, included the annual percentage of losses or gains over the last 10 years against a benchmark index. In the case of IBIPs, two different past performance versions of the KID were tested. The first, referred to in this report as *past performance with two elements*, presented information on past performance over the last 10 years in terms of the minimum annual bonuses and the return on government bonds as a benchmark. The second version, referred to in this report as *past performance with three elements*, included over 10 years the investment returns of an underlying fund, the minimum annual bonuses and the return on government bonds as a benchmark.

### 3.2.1 Selection and identification of financial products

#### Selection of an investment product

Presenting the product information using the current version of the KID or the past performance version of the KID did not have a statistically significant impact on the selection of optimal investment products of the same type.

For products of different types, the impact of the past performance information can only be assessed through analysis of the relationship between the features of the selected product and the risk preferences of the consumers. Although this analysis revealed no general trend, it is worth noting some individual findings from the comparison of funds and IBIPs using past performance KID versions. First, the percentage of risk-averse consumers who selected the product with the highest volatility was lower for the past performance versions (31–38%) than for the current version (49%). Second, when the past performance versions were used to present the features of both the fund and the IBIP, 29% to 39% of consumers with high loss aversion selected the product with the higher loss probability; in contrast, when the current version was applied, this percentage was 55%. These results suggest that using the past performance versions of the KID may help consumers select funds and IBIPs according to their risk and loss preferences.

#### Identification of a financial product based on its features

As shown in Table 2, the percentage of correct identification of a fund guaranteeing a positive return and guaranteeing that investors would receive their money back was higher when applying the past performance versions (30–31%) than when applying the current version (24%). However, the impact of the past performance versions of the KID on the selection of a product in terms of its guaranteed conditions was mixed for IBIPs, since it improved the identification in terms of the guaranteed positive returns but not in terms of getting the invested money back.

For the specific case of IBIPs, the inclusion of past performance information with three elements reduced the percentage of consumers who identified the optimal investment product by 4.5 percentage points with respect to the probabilistic approach version. Similar reductions were observed for the identification of the product with the highest expected returns (5.3 percentage points) and identification of the product that guaranteed investors that they would get their money back (4.5 percentage points).

Table 2. Impact of past performance versions on product selection in terms of guaranteed returns at the end of the holding period\*

Question	Type of product (KID version)	(1) % of correct answers with the current KID	(2) % of correct answers with the past performance KID	Percentage point difference in the % of correct answers with each version (2) - (1)
<i>QT1.4. Looking at the information sheets above for Product A and Product B, in your opinion with which product are you guaranteed that you get...</i>				
<i>QT1.4a. ...a positive return at the end of the recommended holding period (i.e. an amount in addition to what you invested)?</i>				
QT1.4a	<b>Funds (past performance)</b>	<b>23.75</b>	<b>30.64</b>	6.89
	<b>IBIPs (past performance with 2 elements)</b>	<b>22.71</b>	<b>32.21</b>	9.5
	<b>IBIPs (past information with 3 elements)</b>	<b>22.71</b>	<b>29.86</b>	7.15
<i>QT1.4b. ...back the money you invested at the end of the recommended holding period?</i>				
QT1.4b	<b>Funds (past performance)</b>	<b>23.99</b>	<b>29.83</b>	5.84
	<b>IBIPs (past performance with 2 elements)</b>	<b>42.25</b>	<b>37.09</b>	-5.16
	<b>IBIPs (past performance with 3 elements)</b>	<b>42.25</b>	<b>35.93</b>	-6.32

\*Bold numbers for statistically significant differences with p-value < 0.05.

### 3.2.2 Understandability questions

The past performance version improved the understanding of the products in term of the likelihood of the future performance scenarios.

The test included specific questions to be asked for each past performance version. The responses to these questions indicate that participants used past information with caution and, therefore, the presentation of past and future information together does not seem to raise issues. Around two thirds of the respondents considered that it is not possible to predict the likelihood of future returns accurately because the future may differ from the past (66% for funds; 63% - 64% for IBIPs). However, when we asked more specifically about the relevance of the past performance for future outcomes, responses were more varied and a significant proportion of participants indicated that they made a connection between past performance and the potential future performance.

### 3.3 Impact of illustrative scenarios (structured products)

The inclusion of additional information on illustrative scenarios did not seem to be processed or used by consumers when dealing with structured products. This finding is perhaps also a consequence of the higher complexity of structured products.

#### 3.3.1 Selection and identification of financial products

##### Selection of an investment product

The percentage of consumers who selected the optimal structured product for investment (68–71%) was slightly lower (although not statistically significantly) with the illustrative scenario version than with the current version of the KID or the probabilistic approach version of the KID. No general trends were observed regarding the impact of the illustrative scenario version on the selection between a structured product and a fund or IBIP.

## Identification of a financial product based on its features

There were no differences in product selection between the illustrative scenario version of the KID and the current version of the KID. The only exception was a small difference in the percentage of participants who selected the structured product that guaranteed investors that they would get their money back (24% of correct selections with the current version versus 29% of correct selections with the illustrative scenario version).

### 3.3.2 Understandability questions

The illustrative scenario version of the KID had no statistically significant impact on the accuracy of the answers to the understandability questions as a whole. The only items for which the percentage of correct answers was statistically significantly higher for the KID version with illustrative scenarios than for the current KID version were the questions on the likelihood of the performance scenarios. Because the KID version with illustrative scenarios also included probabilistic information, the improvement in these answers may be attributed to the inclusion of the probabilistic information rather than the illustrative scenarios.

## 4. Conclusions

Although the results of this consumer test suggest that the final investment decision is not affected by the KID version, the results show that the design of the KID can play an important role in aiding consumers' understanding of the features of retail investment products and in contributing to better informed financial decision making. The test provides empirical evidence to answer three main research questions:

**Question 1.** *Does the probabilistic approach version of the KID perform better than the current version of the KID?* Although only a small segment of consumers seemed to understand the probabilistic information on the likelihood of different scenarios, the inclusion of this information in the KID increased the percentage of correct answers to relevant questions on product selection. Therefore, it may be beneficial to incorporate in the KID features from the probabilistic approach. However, because the percentage of consumers that seemed to understand the probabilistic information presented in the KID was small, it may be advisable to consider alternative ways of framing this probabilistic information.

**Question 2.** *Is it helpful to add information on the past performance of funds and insurance products?* The application of the past performance version of the KID, which also included probabilistic information, improved the level of accuracy of the answers with respect to when the current version of the KID was applied. Moreover, participants seemed to distinguish between past and future performance of the products and understand that future performance cannot be accurately predicted from information on the past. However, the impact of past performance was not tested independently of the probabilistic information, which makes it difficult to discriminate between the relative contribution of each type of information. The test provides evidence that the inclusion of past performance information has no negative effect regarding funds and, when the simpler (two-element) version is considered, regarding IBIPs. However, the addition of more complex past performance information (i.e. past performance with three elements regarding IBIPs) may have negative implications, probably because of the increase in the cognitive load placed on respondents.

**Question 3.** *Is it helpful to add illustrative scenarios for structured products?* The test provides no significant evidence to support the inclusion of illustrative scenarios. Despite some improvements in consumers' understanding of product features when the KID version with illustrative scenarios was applied, these improvements could reasonably be attributed to the probabilistic information also included in this version of the KID.

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