Call for Input: PRIIPs Regulation

Urgent action required to prevent KIDs harming consumers

Executive summary

The Association of Investment Companies (AIC) welcomes the Financial Conduct Authority's (FCA) Call for Input on experiences with the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation.

This process should be a catalyst for the FCA to take forward a robust and comprehensive regulatory and policy response to the failures of Key Information Documents (KIDs).

- KIDs are consistently, and significantly, misleading. They overstate returns and understate risk. Higher risk investments, such as Venture Capital Trusts (VCTs), are shown as lower risk. Retail investors relying on KIDs are in danger of suffering serious financial harm.

- KIDs fail to meet the standards the FCA expects of appropriate consumer financial promotions. They include "*important points that are only shown in the small print*" and they promote returns which are not realistic.

- The FCA's review of KIDs should put the needs of consumers first. Whether or not KIDs are technically correct is irrelevant where the information they give is misleading when considered in the real-world context of what information influences retail investors.

- Problems with KIDs are not transitional: the methodology is flawed and will cause problems permanently, in all market conditions. They are not limited: they have the potential to pollute the broader system of fund distribution.

- The FCA should not ignore 'time limited' problems, such as the lack of comparability between the PRIIPs SRI and the UCITS SRRI. In the period between the UCITS and PRIIPs disclosures being aligned it is possible that thousands of retail investors will be misled. This is not an acceptable regulatory position.

- The FCA should engage in Europe to seek the suspension of the KID regime to allow time for the problems to be solved by making changes to the rules.

- The suspension should apply to all products where disclosures are misleading; any suggestion that a suspension should be limited to UCITS must be resisted. If KIDs are unsatisfactory, then all retail investors deserve protection.

- In advance of rule changes at the EU level, the FCA should protect consumers by:

  - setting the terms of the debate; stating its concerns and identifying problems arising;
  - undertaking a major consumer education programme;
  - clarifying options for the issuers of KIDs to qualify these disclosures; and
  - preventing KIDs adversely affecting the broader distribution mechanisms (such as platforms, robo-advice and suitability assessments).

AIC research findings

The AIC has long warned that KIDs are likely to harm consumers. The greatest dangers arise from understated risk and overstated performance illustrations. The AIC recently published "*Burn before reading*". This report sets out the AIC's concerns in detail alongside evidence of the failings of KIDs. Key findings include:

- KID risk indicators for investment companies with equity portfolios show an average of 4. Risk indicators for UCITS funds show an average of 5.1. For investment companies with property portfolios the average risk indicator is 3.8. Risk indicators for open-ended property funds show an average of 5.1.

  Investment companies are consistently shown as being lower risk than equivalent UCITS. This is wrong. Investment companies tend to incorporate a slightly higher level of risk. Consumers using these indicators will be misled over the relative risks of these investment options.

- Over half of investment company KIDs (51%) indicate annual returns of between 0% and 10% in unfavourable markets over the recommended holding period. 11% of investment company KIDs indicate that, in unfavourable markets, an investor might receive between 10% and 20% annually over the recommended holding period. These scenarios reflect the sustained market growth seen since the financial crisis and are far too optimistic. Any consumer using them to inform their decisions will be seriously misled.

- Had KIDs been produced in the past, they would have given investors the wrong message. The report showed 22 moderate performance scenarios (calculated on relevant data from between 2003 and 2013) for an investment company. It compared these scenarios with the actual return an investor would have received had they held the investment for a recommended holding period of 5 years.

  For half of comparisons (11 out of 22) the KID moderate scenario indicated the opposite of the actual investment outcome. That is, the KID indicated an investment gain when the true outcome was a loss. Alternatively, the moderate scenario showed a loss when the true outcome was a gain. Even where the KID moderate scenario was in the right direction (that is, it indicated a gain and a gain was achieved) the differences in the figures were often substantial. These are not minor discrepancies. They are huge failings. Had a KID been available it would have not simply have been wrong: it would have been actively misleading.

- Using the risk indicator in combination with the performance scenario creates even greater risk to consumers.

  33% of investment companies have KIDs with risk indicators of 3. Risk-averse investors might choose to select only from these options. Were they to also use the performance scenarios to see which might give them an attractive return they would be given overly optimistic expectations. 15% of these investment companies have KIDs indicating that, in unfavourable markets, the investor might "*receive after costs*" annualised returns of between 10% and 20% over the recommended holding period. Investment companies can be excellent investments, suitable for a wide range of retail investors. However, they should only be purchased with realistic expectations about the risks and returns. The information provided by these KIDs is not realistic. If relied upon, it is likely to lead investors to making badly informed, and most likely harmful, purchases.

KIDs are fundamentally flawed. They offer consumers information which is incorrect, misleading about future risks and returns and which is not comparable with alternative investment options. The threat of serious consumer detriment demands an immediate response from the FCA.

Putting consumers first

Consumer needs should be central to determining the FCA's next steps in relation to KIDs.

Overwhelmingly, feedback to the AIC from its members has been concern that retail investors relying on KIDs will be misled. The FCA has been pressing financial service providers to take a broader view of their duties to consumers. It has urged them not to focus just on complying with the letter of the rules. Firms should also have a culture of accountability which prioritises the interests of consumers. The concerns of investment company boards about the consumer risks created by KIDs is an exemplar of these principles in action.

It is disappointing that the FCA's call for input seems to focus on technical and compliance matters rather than considering more fully the real-world consumer perspective.

- **Performance scenarios:** The call for evidence notes "*The presentation of the scenarios, and the accompanying narrative, explains that they are not a forecast of future return, and that they are intended to be illustrative. Even so, there is a risk that a consumer might assume that they are least, to some extent, indicative of the potential return that might be derived from the product and form the wrong impression of potential rewards on offer*" (para 3.35, page 17).

  Stating that the performance scenarios are qualified by an accompanying narrative and acknowledging that there is a risk that consumers may not properly understand the disclosure, does not equate to putting consumer needs first. The FCA would not normally expect an accompanying narrative to be sufficient to protect investors if more prominent figures are misleading.

  The performance scenarios are presented with a (required) text stating that the amounts set out are "*what you might get back after costs*". The notes that explain that these figures are "*estimates*" and "*not an exact indicator*" of returns are much less prominent.

  FCA guidance to consumers on 'how to spot a misleading financial advert' says that financial promotions with "*important points that are only shown in the small print*" should be treated with caution as they may be misleading. The same guidance encourages consumers to spot and avoid misleading financial adverts by asking themselves "*Are the ... returns being promoted realistic?*" The KID performance scenarios fail these consumer-friendly tests. The FCA's guidance on misleading financial adverts suggests that consumers should treat KIDs as potentially misleading.

- **Risk disclosure:** There is a material risk that investors will focus on the risk indicator without appreciating that this not a full summary of all the risks; other risks may arise.

  The risk indicator has the same failings as the performance scenarios. That is, it is qualified by "*important points that are only shown in the small print*". The qualification itself is difficult to assess as, unlike the indicator of market volatility, it is not quantified.

  A consumer reviewing the KID should take note of the FCA's guidance on potentially misleading financial promotions which asks "*What are the risks to my money and is this clear*?". A risk indicator, which is labelled as a summary when it is not, which is then qualified by a narrative explanation, is not a clear statement of the risks of the product.

  Also, the PRIIPs risk indicator looks the same as the UCITS SRRI. It looks comparable when it is not. In the real world, the consumer will not understand the differences.

  The KID risk disclosures fall short of the standards that the FCA would otherwise expect of material included in financial promotions. This should be explicitly recognised in the conclusions the FCA draws from this Call for Input.

- **Transaction costs:** The FCA has placed high importance on the clear disclosure of costs.

  The call for evidence notes that "*Negative transaction costs are not necessarily inaccurate*" (para 3.14, page 13). It is difficult to reconcile this perspective with the needs of consumers. Disclosing 'costs' which do not reduce the value of the assets available to investors is not clear. It is confusing. Negative transaction costs may have some technical merit for some investors in some contexts, but they are not meaningful or helpful to retail investors.

In fundamental respects, KIDs do not address the real needs of consumers. They include disclosures which, while arguably technically accurate, are not clear or comparable.

As the FCA has noted, regulations to protect consumers should be designed "*around real, rather than ideal behaviour*" (FCA mission: Approach to consumers, page 11). KIDs do not meet this standard. The FCA should recognise this and take active steps to respond to the shortcomings of KIDs.

Problems with KIDs are not transitional

Flaws in the methodology underpinning KIDs are not transitional. They arise from fundamental errors in the approach. Critically, the KID uses data arising from the past performance of an investment to provide an indication of future outcomes.

It presents an indication of risk which is described as a 'summary' (implying that it addresses all sources of risk) when this is not the case. The headline figures which describe the performance and risk of PRIIPs are qualified by explanations set out in the small print. Investors are unlikely to ever pay sufficient regard to these qualifications and caveats.

These problems will not be corrected by the passage of time. They are permanent: hardwired into the way in which the KID rules operate. They must be addressed by rule changes. In advance of this, the FCA should take other steps to prevent KIDs harming consumers (see below for recommendations).

Time-limited risks to consumers are significant

Some problems with KIDs are time limited. This includes, for example, the risks arising where consumers erroneously compare the KID SRI with the KIID SRRI. This problem will end when the disclosures for UCITS are aligned with other investment products at the start of 2020.

It is not appropriate for the FCA to simply accept this position and not act now to address it.

There are suggestions that the KID disclosure should not be imposed on UCITS as scheduled. This reflects concerns that KIDs are not helpful for investors. It is conceivable that this delay for UCITS will be adopted. If so, then this 'time limited' problem may be extended, potentially for years.

Also, purchases of UCITS and PRIIPs, up to the end of 2019, are likely to amount to billions of pounds in value. The KID and KIID will be considered, and compared, by many thousands of investors. Where KIDs and KIIDs are being used to compare products, and possibly filter investment options, there is a risk of significant financial harm.

It is not appropriate to accept this position. Where the FCA does have scope to act independently of the PRIIPs regime, to help address this problem, it should do so.

Vulnerable consumers and the FCA's statutory duties

The FCA has previously found that many consumers do not use the KIID. It is possible that a similar proportion do not pay huge regard to the KIDs. This does not reduce the need for FCA action.

KIIDs do not incorporate the same fundamental flaws as KIDs. Consumers are given a reasonable indication of risk by the SRRI. They are not provided with unrealistic performance scenarios. While KIIDs may not be ideal consumer disclosures they are not actively harmful. The same cannot be said for KIDs.

For the FCA to decide not to act it would have to conclude that it is acceptable for those using the KID to be misled by the risk indicator and performance scenarios. Such a decision is not consistent with the FCA's statutory duties to protect consumers.

This is particularly the case as the KID was specifically designed to be accessible to vulnerable consumers. These consumers are at the greatest risk.

The FCA has stated "*We will act, within the scope of our regulatory remit, where our intervention is necessary to secure an appropriate and proportionate level of protection and redress for consumers across the UK*". (FCA Mission: Approach to consumers. Page 9). The evidence demonstrates that KIDs are misleading. The FCA's statutory duties provide grounds for the FCA to intervene to protect consumers.

The FCA has also stated that it will "*prioritise the needs of the most vulnerable and less resilient groups*" (FCA Mission: Approach to consumers. Page 11). KIDs are potentially very damaging to vulnerable consumers because they have regulatory authority. Their provision and content are mandated. They are delivered to consumers just before they transact. Other marketing communications must not contradict the information contained in the KID, nor can they diminish the KID's significance. The PRIIPs approach has been designed to give KIDs traction in the sales process. Given this, it must be that vulnerable consumers are most at risk of the misleading content of KIDs.

The significant risks inherent in KIDs mean the FCA must observe its duty to have regard to the need for consumers to have information and advice which is "*accurate and fit for purpose*" (Financial Services and Markets Act 2000, Part 1A, Chapter 1, The FCA's general duties, section 1C).

Scope for FCA action

There are constraints on how the FCA can seek to remedy problems with flawed KIDs. The European regulatory framework prevents the FCA unilaterally changing the rules. The FCA is unable to allow firms not to produce KIDs. It must supervise according to the requirements of the rules. That said, there are areas where the FCA should act.

The AIC **recommends** that the FCA should prioritise:

- **Setting the terms of the debate:** The FCA should clearly state whether, and how, KIDs present risks to consumers. If it does not consider the concerns raised by the AIC and others to be valid, then it should also clearly explain its position.

  Andrew Bailey has previously expressed concern about PRIIPs, but the nature of this concern is not entirely clear. In a recent speech he said that the PRIIPs regime "*carries a risk that it is leading to literally accurate disclosure which is not providing useful context*" (Speech "*Asset management: a regulatory perspective*", 26 April 2018). What this means from the consumers' perspective is difficult to discern.

  The FCA should set the terms of the debate in the UK and in Europe about the risks arising from KIDs and need for reform. It should place the needs of consumers above the potential embarrassment of stating that the genuine efforts of policymakers to create a better disclosure regime have fallen short. Its public stance should seek to galvanise attention to this agenda and support for the FCA's other efforts to resolve the problems with KIDs.

- **Consumer education:** The FCA should publish consumer education materials warning consumers about the deficiencies of KIDs. It should work with the Money Advice Service (and its successor) as well as other financial education bodies to explain issues arising from KIDs.

  These efforts should include highlighting that KIDs are not comparable to KIIDs and the risks of making such comparisons.

- **Clarify options available to issuers of KIDs to qualify these disclosures:** The FCA published a statement in January 2018 saying that it was "*comfortable*" with PRIIP manufacturers "*providing explanatory materials*" to put optimistic performance scenarios in context. The AIC remains uncertain as to what, in practice, this allows KID issuers to do.

  It may be, for example, that the FCA anticipates that issuers could include a general warning or 'signpost' to other documentation in the 'other information' section of the KID. Alternatively, other options may be available. In the absence of clarification, the FCA's statement has limited practical value to issuers or consumers.

  The FCA should also encourage the European Supervisory Authorities to issue guidance on options to interpret the rules in ways which reduce the prevalence of misleading KID disclosures. The current Q&As do not address this matter.

- **Prevent KIDs adversely affecting broader distribution mechanisms:** The recommended FCA policy statement setting out the consumer risks created by KIDs should also make a commitment to ensuring that problems with KIDs do not contaminate other areas of distribution.

  KID risk indicators do not fully represent the risks of products. They do not provide the basis for comparing products. Risk indicators (that is, both the PRIIPs KID SRI and the UCITS KIID SRRI) should therefore not be used by automated systems, such as robo-advice or online platform 'filters' to help filter investment options for consumers. They should not be used in suitability assessments by financial advisers.

  KID performance scenarios should not be promoted in other distribution channels.

  The FCA should also set out its views on whether, and how, performance scenarios and risk indicators used in KIDs should be used in financial promotions.

  In addition to making a headline policy commitment, the FCA should set out its proposals to ensure that the problematic aspects of KIDs are not embedded in the broader distribution environment.

- **European Commission review:** The PRIIPs Regulation requires the European Commission to review the regulation by 31 December 2018. The FCA should press for this review to be undertaken comprehensively and in a timely manner. It should ask the Commission to explicitly consider concerns raised about the risk indicator, presentation of performance scenarios and the cost methodology. It should urge the Commission to take swift action to resolve the problems identified.

- **Suspending the regime and securing rule changes:** The experience of KIDs justifies suspending the PRIIPs requirements until the rules can be changed. The FCA should argue for the KIDs rules to be suspended while rule changes are considered.

  The suspension should be for all investment and insurance products. It should be extended to UCITS if the problems with KIDs are not remedied before these funds are due to be sold alongside KIDs in 2020.

A suspension of the KID regime would not harm consumers. It would remove a source of consumer harm. Consumers would continue to be protected by relevant provisions of MiFID II and the AIFM Directive (which includes pre-sale disclosures and allows Member States to restrict the sale of non-UCITS funds to retail investors). Member States would continue to be able to regulate other financial promotions.

The position for disclosures for the sale of PRIIPs would revert to the situation which applied before KIDs were required in January 2018. This situation persisted for years without significant consumer concerns arising.

- **Fair treatment of all consumers:** The FCA should oppose any moves to suspend/defer the application of the KID rules for UCITS without also suspending the regime for PRIIPs.

  If the information provided by KIDs is not considered appropriate for UCITS the same conclusion should be drawn for PRIIPs.

These options are available to the FCA even within the restrictions of EU policymaking. They are targeted and proportionate. They should be adopted as a priority.

Questions for feedback

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.

The AIC's members are closed-ended investment vehicles. They are alternative investment funds, AIFs, as defined by the AIFM Directive.

The PRIIPs rules apply to our members insofar as the securities they issue are within the definition set out in the regulation. We have not made a detailed assessment of all classes of security issued by investment companies. That said, our view is that the ordinary shares of our members are likely to be within scope where they are available to retail investors in the UK.

The precise position of individual classes of security will depend on the specific circumstances applying. For example, some debentures which might be issued by investment companies will not be PRIIPs where they do not meet the definition.

Questions have been raised as to whether the PRIIPs rules apply to classes of security issued by UK REITs. The AIC's view is that securities issued by UK REITs are potentially within scope of the PRIIPs Regulation where they are AIFs and available to retail investors.

In making the assessment of whether the PRIIPs rules apply, the tax status of the issuer of the securities is not the determining factor.

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.

The AIC has no comments on this question.

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.

The AIC has reviewed KIDs prepared for investment companies. Our research identified 13 companies with equity portfolios with 'negative' transaction costs. It identified a further 3 with transaction costs of zero.

It may be that the impact of negative slippage costs is far greater than suggested by the number of companies with equity portfolios showing zero or negative transaction costs. Negative costs may also be lowering transaction costs for other investment companies where the total is above zero.

The AIC is sceptical about the 'slippage' methodology. The FCA assumes that calculating the cumulative impact of slippage over all transactions over a three-year period will average out the impact of price increases and decreases to "*approximately zero*". In the absence of evidence that justifies this conclusion, the basis for this position is unconvincing.

Some PRIIPs may have smaller, more concentrated portfolios which trade less frequently. This may reduce the potential for high volumes of trades across the portfolio to average out positive and negative fluctuations.

The securities held by the PRIIP may have characteristics (for example, where they are relatively less liquid) or be traded on markets where it cannot be assumed that price variations during the investment process will necessarily average out to create a neutral result.

The investment style employed by the manager of the PRIIP might consistently involve purchasing securities where the price is falling. This might reduce the likelihood of positive and negative transaction costs averaging over time.

Even if the concept of slippage in relation to transaction costs is reliable, and even if it has some value for certain professional or institutional purposes, it is far from clear that disclosing this amount has any meaning or usefulness for retail investors.

A 'negative' costs suggests, counterintuitively, that the process of buying and selling investments does not result in reduction in the value of a product's assets. This simply does not make sense from a common-sense, consumer-orientated perspective of what a 'cost' is.

The FCA's Call for Input identifies issues which have caused calculation errors. It may be that correcting these matters will improve the calculation of slippage costs in accordance with the methodology. Nonetheless, the AIC remains cautious about the value of this disclosure to retail investors. If a 'correct' calculation can result in a 'negative' cost, or reduce explicit costs, then it is not a helpful consumer disclosure: it is confusing.

Customers or intermediaries using these disclosures may get a distorted impression of a product and how it compares with others. This could lead to them making a poor investment decision. It could distort competition.

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.

Investment companies have been required to disclose 'negative' costs. The AIC does not consider that these disclosures are helpful. It is inherently confusing for a 'cost' to be 'negative'. From a common-sense perspective this is nonsense.

Asking for consumer views on this issue via a formal call for input is unlikely to be the best means to secure an insight into these problems. It seems unlikely that the type of consumer who has been confused, or misled, about these disclosures will respond.

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.

The SRI does not allow the risk of an investment product to be adequately explained to customers. It is a fundamental problem that the headline 1-7 risk indicator is labelled as a 'summary' of risks when it is not. It is a description of one risk measure: historical volatility. Other important risks are explained only in the 'small print'. Unlike the measure of historical volatility, they are not quantified. These descriptions are likely to be less intuitive than the headline number, particularly for less sophisticated, more vulnerable, retail investors.

The presentation of a headline risk indicator which is then caveated by a narrative explanation does not meet the standards the FCA normally expects of a financial promotion or advert. This issue is discussed in more detail in the section, 'Putting consumers first', above.

The required wording for the narrative explanations is also likely to mislead consumers.

The AIC has identified:

- 129 investment company KIDs with an SRI of 3. The mandated narrative is that these are "a medium-low" risk. Also, that the potential losses from future performance is at a "medium-low" level and that poor market conditions "are unlikely" to impact the capacity to pay you.

- 9 investment company KIDs with an SRI of 2. The mandated narrative is that these are "a low" risk. Also, the potential losses from future performance is at a "low" level and that poor market conditions "are very unlikely" to impact on the capacity to pay you.

These statements are seriously misleading. Investment companies can be excellent long-term investments for many retail investors. However, they should only be purchased with a proper understanding of the risks.

Retail investors (particularly more vulnerable consumers) should not be given the impression that investment companies should be considered 'low' risk. They are traded on the stock market and, like most other funds, would normally be considered at least a medium risk investment. Yet the SRI ranks many of these companies as below the mid-point on the spectrum of risk (that is 3 or 2). It then states that "***poor market conditions***" (emphasis added) are unlikely, or very unlikely, to affect returns.

It is not credible to conclude that these disclosures are not misleading. The AIC invites the FCA to consider how it would view financial promotions which included similar indications of the risks of holding investment company shares. Our expectation is that such disclosures would, at least, have to be withdrawn. They could attract more serious penalties. This consideration alone should be sufficient to encourage the FCA to act swiftly to address problems raised by the KID description of risk.

A further, more technical, problem is that the narrative assumes that the return to the investor represents a 'payment' by the PRIIIP manufacturer. This does not properly reflect the nature of holding and selling shares traded on the stock market. This is a secondary concern in comparison with the fundamentally misleading indication of the risks involved. However, the deficiency of this wording does illustrate another problem with imposing an inflexible narrative which does not recognise important differences between different types of investment. It is a barrier to promoting consumer understanding of the type of investment they may be considering.

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.

VCTs are conventionally considered to be higher risk products. They invest in smaller, unquoted companies without a lengthy track record. Like other investment companies, VCTs can be a good investment for many retail investors. However, before buying shares, purchasers should understand the risks. KIDs do not help this process. They provide a misleading indication of the true level of risk.

A common-sense assessment of the VCT sector would be that their risk indicators would be at least 5 or 6, that is among the highest-risk investments available. 70% of all VCT KIDs show a risk summary ranking of 3. The KID rules identify a product ranked at 3 as "medium-low" risk. This is highly misleading for the unwary consumer.

The VCT average risk summary ranking is 3.4. Despite the risks inherent in VCTs, according to the KID they are the lowest ranked of all investment company sectors.

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.

The AIC's fundamental concern is that the performance scenarios are based upon past performance. The KID methodology purports to provide indication of what investors "*may get back after costs*" in different market environments. The presentation gives investors an inappropriate expectation that past performance should be taken as an indication of future performance. This is a dangerous message.

The actual information KIDs present is also problematic. Too often they overstate likely performance. The AIC's report "*Burn before reading*" explores the flaws with the KID in detail. The AIC has identified:

- 198 investment company KIDs with performance scenarios indicating that, in unfavourable markets, they provide might annualised returns of between 0% and 10% over the recommended holding period;

- 44 investment company KIDs with performance scenarios indicating that, in unfavourable markets, they could provide annualised returns of between 10% and 20% over the recommended holding period; and

- 1 investment company KID with a performance scenario indicated that, in unfavourable markets, it could provide an annualised return of 25.8% over the recommended holding period.

Were these disclosures not mandated by the PRIIPs rules it is inconceivable that the FCA would not consider them to be misleading financial promotions. It would take steps to have such disclosures withdrawn.

The FCA would be unlikely to accept the caveats included in the narrative explanation accompanying these disclosures (that is, the statement that these numbers are "*not an exact indicator*") as sufficient to make such disclosures not misleading.

The moderate performance scenarios are also very problematic:

- 143 investment company KIDs incorporate 'moderate' performance scenarios indicating annual returns of between 10% and 20% over the recommended holding period;

- 38 investment company KIDs incorporate 'moderate' performance scenarios indicating annual returns of between 20% and 30% over the recommended holding period;

- 3 investment company KIDs incorporate 'moderate' performance scenarios indicating annual returns of between 30% and 40% over the recommended holding period;

- One investment company KID incorporates a 'moderate' performance scenario indicating annual returns of 44% over the recommended holding period.

Giving retail investors any expectation that these are likely returns is inherently misleading. These figures are based on returns achieved by the investment company sector in a period when markets were recovering from the historic lows experienced during the financial crisis. Investors should not be led to consider that this represents a 'moderate' performance.

Markets are inherently cyclical. Using past performance data in the way mandated ignores the likelihood that, at any one time, the market may be recovering a cyclical downturn or upturn.

The approach means that, after the next market correction, performance indicators remain misleading. Instead of being too optimistic they are likely to be too pessimistic. Again, this is a dangerous message for consumers who may choose not to invest and therefore forgo the benefits of long-term exposure to investment.

The 'practical difficulty' with the performance scenarios included in KIDs is that they use past performance to give an indication of future returns. This is a fundamentally flawed approach which should be abandoned.

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

This question assumes that respondents will have a specific insight into the views of a non-advised investor. That the reader of a KID understood that attractive performance scenarios are unrealistic. Also, whether a specific investor would have understood the nature of the information the 'scenarios' are supposed to provide. It is unclear that this Call for Input will be able to secure views of this nature.

From a more general perspective, there is evidence that a significant number of performance scenarios are far too optimistic and potentially misleading. The AIC has published *Burn before reading* which includes an analysis of investment company performance scenarios. Findings set out in response to question 7 (above) show that investment company KIDs include performance scenarios which are too optimistic. They are based on performance achieved as markets have recovered since the 2008/9 financial crisis. These market conditions are not likely to be repeated. The KID provides no indication of this.

What investors make of these disclosures is difficult to tell. It is likely that some, particularly vulnerable consumers, will erroneously see these disclosures as having authority. KIDs are a regulated document. Investors must receive them before they purchase an investment.

It is unconvincing to conclude that investors, particularly more vulnerable purchasers, will have read the small print describing the nature of the scenarios. Even if they do, the narrative that these figures are not an "*exact indicator*" of what they might receive is insufficient to give them adequate warning.

The AIC's report also compares KID performance scenarios with pension projections (*Burn before reading*, page 20). The differences between the FCA's projections and the level of return shown by KIDs are striking. They exemplify how irresponsible the KID scenarios are.

The AIC has also modelled the returns KIDs would have indicated had they been calculated in the past. It compared these with the actual return five years later, that is, after the typical recommended holding period (Burn before reading, pages 22 -25). This analysis shows that placing reliance on KID performance scenarios would have been actively misleading, for both PRIIPs and UCITS.

It also shows that the scenarios would have been very wrong consistently over time and in all market conditions. The paper includes 22 examples of a moderate scenario calculated at six-month intervals for one investment company. It also shows what the investor would have, in reality, received five years later. On 11 occasions, the KID would have indicated a return that was the opposite of the actual outcome. That is, it would have shown a loss when the investor would have made a positive return. Alternatively, the KID would have shown a positive return when the investor would have actually lost money. Even where the scenario return was in the right direction (that it predicted a positive return and a positive return was achieved) the differentials were sometimes significant. These are not minor discrepancies. They are huge failings.

Whether or not this Call for Input solicits specific examples of KID performance scenarios creating issues for consumers, they are highly misleading. The concept and methodology is fundamentally flawed and these scenarios should be withdrawn.

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.

The AIC has no comments on this question.

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

Providing consumers with a short description of the product they are considering has some value. However, as a description of the product is already made available in other materials, such as factsheets, the positive benefit of the KID is negligible. The benefit of this disclosure is massively outweighed by the inclusion of the flawed summary risk indicator and performance scenarios. The cost disclosures also cause problems.

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