How do we get to conducive disclosure?

*We consider the below ideas particularly relevant in the context of **Q10, Q11, Q13, Q15a and c, Q16a, Q18,Q41 and Q42** of ESMA's Call for Evidence.*

Despite the unprecedented levels of disclosure, there is little evidence to suggest that consumers are using or trust the information presented, or feel motivated to invest. So far the regulatory approach has focused on consumer protection taking a rather patronizing approach. But the ideal protection for consumers would be the one that is superfluous because consumers are already empowered to make good decisions. We encourage ESMA and policy makers to review the approach that has been taken so far and investigate new ways forward.

Focus on the consumer perspective

So far the approach has been all about what information product manufacturers need to show, how and when. By contrast, there has been surprisingly little focus on the receiving end, the consumers. Consumer research, e.g. on UCITS and PRIIPs KID focussed on presentational aspects of the disclosures rather than on more fundamental questions, such as:

– Do consumers know that they should read and engage with regulated disclosures?

– Do consumers read and engage with the disclosures and, if so, for how long?

– Do consumers understand these disclosures?

Discussing preparatory work for the Deloitte study on online comparison tools some years ago, some distributors reported that consumers spend an average of two seconds on the KIID/KID (UCITS/PRIIPs). The assumption is that little has changed since then. This means that consumers either do not know they should read the information, aren't interested in the information, prefer the information given in a user-friendly way via the online firms' compliance with MiFID regulation, or the engagement is so minimal that it is practically the same as if not reading the disclosures at all.

Where they do read the disclosures, it seems that consumers do not understand them.

The way forward is to put the client at the centre of the discussion and recognise that disclosure alone is not a guarantee that consumers will engage with or understand what they see, let alone trust and act on it.

➔ **Recommendation: There is need for consumer research, with input from distributors, to gain insights into exactly how consumers interact with disclosures and how.**

Enhance financial engagement

There is evidence to suggest that the levels of financial education and literacy (as means to more financial engagement) are persistently low.[1] Importantly, there is a connection between trust and familiarity-understanding.

Achieving financial engagement would mean that consumers understand that the disclosures via UCITS, MiFID etc. are important in the first place and, by using them, they can take the right decisions for their savings and investments. It is important to bear in mind that financial engagement is not about turning every consumer into a portfolio manager. Rather, it is about motivating people to talk about their investment and financing needs with professionals and making them confident that they follow the conversation and feel comfortable with the decision they take.

➔ **Recommendation: Develop an EU-wide framework on financial literacy, including financial education in primary and secondary education curriculum (via OECD's PISA test?) and for target groups with low levels of financial literacy levels (e.g. low income individuals, women).**

[1] See for example OECD, Financial Education in Europe: Trends and Recent Developments, OECD Publishing, 2016.

Rethink existing disclosure requirements

Richard Thaler, the renowned behavioural economist, has summarised the insights from behavioural economics in one phrase: "if you want people to do something, make it easy". If the disclosure framework aims to help consumers put their savings in retail investment products, two things are needed: disclosure that is meaningful and disclosure that is consistent.

Meaningful disclosure
This is the equivalent of 'fair, clear and not misleading'. We finally need to get the PRIIP KID right, not least because it will eventually apply on UCITS and serves as a model for the PEPP. In a constructive dialogue with stakeholders (both industry and consumer representations), the ESAs have targeted three areas which need to be fixed:

- Amend performance disclosure so that it moves away from misleading, procyclical performance scenarios
- Change the presentation of the cost indicator so that it is consistent with MiFID II and IDD disclosure
- Change the estimation methodology for implicit transaction costs so that it does not result in negative numbers

To properly address all three points, it is necessary to go beyond Level 2. Unless these issues are properly fixed, we face the risk of having new KID versions again and again, certainly not enhancing consumers' trust in the information presented to them.

➔ **Recommendation: Fix the PRIIP disclosure framework at Level 1 and 2 to ensure there is only one set of changes that results in meaningful disclosure.**

Consistent disclosure
Consistent means the same numbers for the same datapoints that can also be cross-referenced with other documents such as (for funds) the annual reports. In this context, a significant inconsistency between the two most important files for consumer protection remains: MiFID II and PRIIPs.

Costs in MiFID, that platforms and advisers must provide, are presented as a percentage of the fund assets, whereas costs in PRIIPs, that fund managers will need to provide, are presented as a reduction-in-yield. This disparity means that for the same retail investment product, investors would see a number for total cost on a platform (MiFID) that is different from that on the fund manager's website (PRIIPs).

Similarly, MiFID II rules require that where past performance is shown, it should be done on a discrete annual basis (aligned with the UCITS rules) but PRIIPs currently has no past performance and requires the presentation of scenarios instead.

Again, these inconsistencies risk creating serious confusion among consumers.

➔ **Recommendation: Remove confusing inconsistencies between different disclosure requirements.**

Embrace technology

Existing disclosure rules have been designed for a paper-based format. This is, however, 20th century thinking and ignores the global trend to use online means for any type of transaction. Investor surveys show that an overwhelming majority of active investors use technology for choosing and managing their investments, this is also reflected in the rise of trading platforms such as Trade Republic etc.

Consumer testing involved in the development of the UCITS and PRIIP KID was conducted without any consideration of digital delivery, which was simply not a significant issue at the time. But a 3-page pdf of a PRIIP KID is either illegible on a smartphone due to small font size or requires significant enlargement and scrolling in both directions in order to be read (going against the "make it easy" principle).

Already in 2019, EBA requested that *"information should be presented in plain and intelligible language and in a readable font size, which should easily adapt to work on any kind of device"*.

In the same year, IOSCO[2] stressed that regulators need to account for the fact that more people now make their investments in an online environment and that this differs from the, so far, more traditional means of disclosure. However, little has changed since then from a regulatory perspective.

In today's online world, regulation needs to take a more innovative approach to client communication. Digital delivery that engages consumers, not only at point of sale but throughout the holding period, is a huge opportunity to reach consumers where they are, at the right moment in a personalised and customised way, increasing the chances that consumers engage with the disclosure and understand it.

Digital delivery is not a silver bullet but can get us much closer to "making it easy" for consumers. The industry can run such digital tools in parallel to regulated disclosures but the real issue is that if digital tools are actually better than a 3-page pdf document in achieving the policy objectives, policy should switch to this approach.

In this context, the ESAs advice on the review of the PRIIPs Regulation in 2022 was very welcome and we hope that the proposals by the European Commission on the Retail Investment Strategy will soon be adopted, as an important step in the right direction.

➔ **Recommendation: allow digital delivery and interaction with key information that allows personalisation and customisation.**

Be clear about the risks

An important component for empowering consumers to make the right investment decision and for enhancing their trust in the information presented is comprehensive transparency about the risks involved, as well as the link between risk and reward. Consumers need to understand that investing in a fund will involve bumpy periods but ultimately 'riding out' volatility will result in higher rewards.

In considering risks, it is important that product providers are clear as to what the consumer might expect - and what might stop him or her from achieving the outcome they are looking for. While volatility is clearly a factor, there are others – e.g. for some retail products, reliance on the financial health of the institution providing the product or the accuracy of calculations that lie behind the design of the product.

Last but not least, to give the full picture, consumers need clarity on the "risk of not taking a risk": This includes information on how much capital they risk losing when putting money on a bank or savings account given inflation and particularly the potential pension gap consumers are likely facing without proper retirement savings through pillar 2 and 3 products. A "cash benchmark" in the KID would be an important step towards better and more balanced clarity on risks.

➔ **Recommendation: Complement risk disclosures with clear explanations on volatility, product specific risks (incl. savings accounts) and potential pension gaps.**

Speak plain language

Particularly the investment world is full of confusing and very technical jargon. Communicating in language and terms that consumers easily understand is another key to consumer empowerment and building up trust. While UCITS KIIDs and PRIIP KIDs are required to be written in customer-friendly language in order to help inform customers and help them compare investment products, it seems this has been given little attention at EU level. A recent example of a national initiative is the Investment Association's "Fund Communication Guidance[3]" triggered by the FCA's "Asset Management Market Study". The Guidance promotes the use of consistent terminology in communications from fund managers about their funds to help customers make comparisons across different funds. Based on extensive consumer testing, the guidance explains which terms are better understood by consumers (e.g. "shares" vs. "equities") and where descriptions work better than the term itself (e.g. "active", "derivatives"). Notwithstanding that consumers in the EU speak different languages, agreeing on more accessible language would bring consumers closer to investment products.

➔ **Recommendation: work on consumer-friendly language across Member States (ESAs Level 3)**

---

[2] IOSCO, "The application of behavioural insights to retail investor protection",FR05/2019, April 2019

[3] https://www.theia.org/sites/default/files/2019-08/20190218-fundcommunicationguidance.pdf