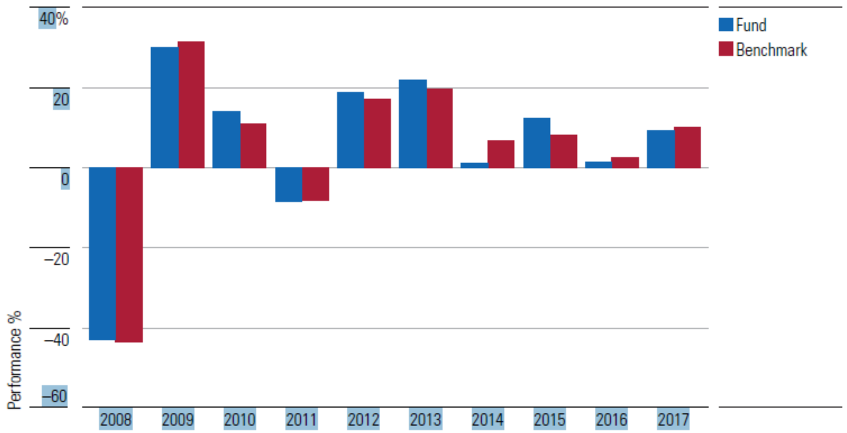
Comments Template for Joint Consultation Paper concerning amendments to the PRIIPs KID (JC 2018 60)		Deadline 6 December 2018 23:55 CET
Name of Company:	Morningstar	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
	Please follow the following instructions for filling in the template: ⇨ 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 empty. ⇨ Please fill in your comment in the relevant row. If you have no comment on a question or a cell, leave the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-18-005@eiopa.europa.eu** **Our IT tool does not allow processing of any other formats.**	
Reference	**Comment**	
General Comments	Morningstar welcomes the opportunity to respond to ESAs Joint Consultation Paper JC 2018 60. Morningstar's primary mission is to help investors reach their financial goals. Because we offer an extensive line of products for individual investors, professional financial advisers, and institutional clients, we have a broad view on the proposals to improve the quality, comparability, and robustness of information available to investors. Much of our response stems from our screening and analysis of data that we have collated on around 50,000 classes of PRIIPs, predominantly category 2. We shall be happy to share more of this data or conduct further analysis on it if it can assist your ongoing work.	

	We would also like to draw to your attention to a Morningstar Policy Research Paper, that examines the requirements of the risk, return and cost component sections of a KID and makes a series of focused recommendations on how they could be improved. The paper is available at https://www.morningstar.com/en-uk/lp/kids-first-term-report. We are cogniscent of the time constraints under which you are operating but are concerned that partial, and largely untested amendments will be sub-optimal. Our concerns regarding performance scenarios are expressed in our comments herein. We have parallel concerns and about the risk and the cost sections of KIDs expressed in our Research Paper, together with recommendations on how they may be addressed. Making piecemeal amendments will result in investors being provided KIDs that may change format and content several times rather than once. Such an approach will extend the education cycle; lose consistency, familiarity and comfort for recipients of KIDs; add cost to the industry; and likely have limited effect in uniting stakeholders across the retail financial services industry in producing disclosures that they believe are helpful and informative to investors. We hope our response to the CP questions is helpful, and we would be happy to discuss any aspects of it with you further. Andy Pettit, Director, Policy Research (EMEA)	
Q1	We agree that past performance information would be a valuable addition to the KID. Unlike performance scenarios, past performance over standard time periods allows investors to assess different products on a level playing field and see how those different products actually performed at different points during a market cycle.	
Q2	It is our view that performance information should be published in the form most relevant and helpful to investors in each type of PRIIP. Where there are challenges of producing past performance for certain types of PRIIPs, for	

<table>
<tr><td></td><td>example, structured products, then it is better to not show past performance information than to manufacture complex simulations of it.

We think that performance scenarios are most helpful for such products, where the possible outcomes are clearly incorporated in the design of each product. Modelling these outcomes can aid investor understanding of the product and help quantify the possible outcomes.</td><td></td></tr>
<tr><td>Q3</td><td>We recommend presenting the performance either in a manner similar to that of the KIID, as illustrated in Exhibit 8 taken from the Morningstar Policy Research paper ‘Your KIDs First Term Report’.

Exhibit 8 KIID Past Performance Display



<table>
<tr><td>−43.1</td><td>30.1</td><td>14</td><td>−8.5</td><td>19</td><td>22</td><td>1.2</td><td>12.5</td><td>1.5</td><td>9.4</td><td>Fund %</td></tr>
<tr><td>−43.7</td><td>31.6</td><td>11.1</td><td>−8.1</td><td>17.3</td><td>19.8</td><td>6.8</td><td>8.2</td><td>2.6</td><td>10.2</td><td>Benchmark %</td></tr>
</table>

Past performance is not a guide to future performance and may not be repeated. The value of investments may go down as well as up and you may not get back the amount you originaly invested.

Source: Morningstar Direct. Data as of 1 August 2018.</td><td></td></tr>
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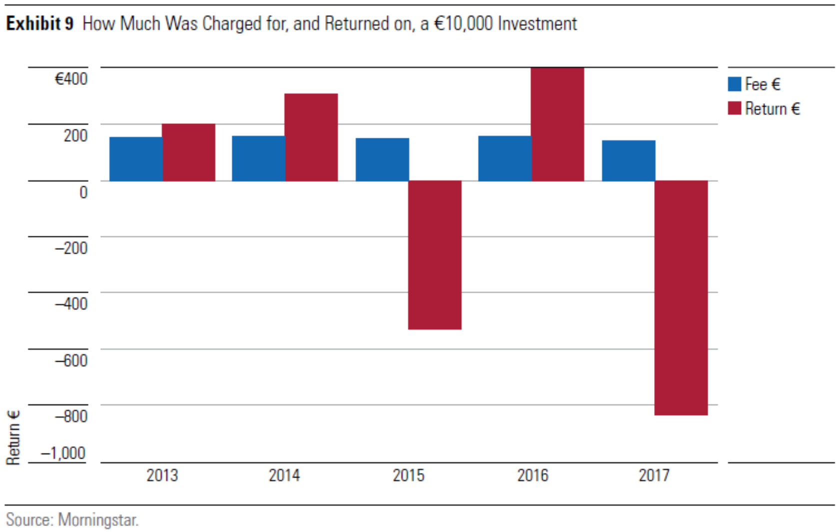
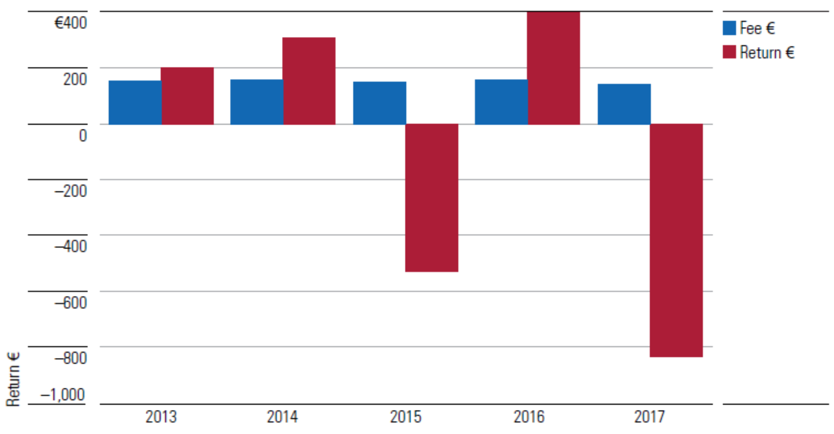
	Alternatively, we see an opportunity to succinctly combine performance and cost information in a clear and simple manner as illustrated in Exhibit 9 taken from the aforementioned Morningstar report.  A further option is to include information about the maximum gain and maximum loss experienced by a product over a given time period. This would provide investors with the best and worst case experience had they been fortunate or unfortunate enough to have bought at the low point and sold at the high, or vica versa.	
Q4	Generally we do not support the illustration of simulated past performance, except in four clearly defined circumstances: - 1. A new share class of a pre-existing product 2. Predecessor – Successor situations, for example, where a product is redomiciled, or	

	changes legal structure 3. Parent – Child situations, where, for example, an established product is cloned in another form or territory 4. Master – Feeder situations, where, for example, a new feeder fund is created to an established master fund Full details are available in the Morningstar Extended Performance Methodology Paper - http://corporate1.morningstar.com/ResearchLibrary/article/766326/morningstar-extended-performance-methodology-europe-asia-africa/. Morningstar provided specific input on this topic to CESR working group meetings on UCITS Key Information Document Disclosures in 2009. The work was reflected in CESR's Technical Advice to the European Commission on 28th October 2009 - https://www.esma.europa.eu/sites/default/files/library/2015/11/09_949.pdf This is refelected in Article 19 of Commission Regulation (EU) No 583/2010. In our view, other types of performance simulations are based upon subjective assumptions and are of limited to no use in providing meaningful information to investors.	
Q5	Where any of the situations described in our answer to question 4 are reflected in a KID we advocate that a footnote describe the related product that the performance information is based upon.	
Q6	In the event performance scenarios continue to be a requirement, we agree that the proposed amendments to the associated narratives are an improvement. The example paragraph on page 16 of the CP makes reference to the scenarios being 'an indication of the range of returns'. We think this could be interpreted such that the scenarios provide the upper and lower bounds of possible future performance and should be amended to clarify that it is not the case. However, we do not think that performance scenarios are useful for investors in many types of	

	PRIIPs. The nature of the scenario calculation formula results in similar characteristics for most of the approximately 36,000 PRIIPs on which we have collated performance scenarios, in that: - In the moderate scenario, the annualised return is virtually the same for each of the three time periods - In the favourable scenario, the annualised return is greater over the half recommended holding period than for the full recommended holding period - In the unfavourable and stress scenarios, annualised returns are greater over the recommended holding period than those over half of that period. For an investor looking at a selection of KIDs and seeing that most products indicate a higher annual return over ½ RHP than over RHP is not reflective of reality. We find no statistical evidence to support that this pattern is necessarily a likely outcome. Indeed, taking the constituent funds of the UK Equity Income Morningstar Category, we looked at the three- and five-year annualised returns to the end of August 2018. Of the classes, 162 had a five year annualised return greater than their three-year annualised return and 214 classes showed the reverse situation —a much more evenly balanced outcome (43% versus 57%). If performance scenarios continue to be produced we think these findings are worthy of further analysis to establish why the exceptions do not exhibit the same scenario patterns. For example, is it due to the nature of their returns; their recommended holding periods; the nature of their charges; a change of investment strategy; how newer PRIIPs have completed the necessary data set; or different interpretation or execution of the calculations.	
Q7	**Future performance scenarios anchored in the risk-free rate of return**: We do think there is potential for exploring risk-adjusted returns. It is an area we investigated when analysing the KIID SRRI in the context of minimising the effect of market movements upon the risk level of a product. The analysis can be seen here - http://www.morningstar.co.uk/uk/news/67549/how-does-market-volatility-impact-risk-measures.aspx	

	A downside however is that using risk-adjusted returns can add a layer of complexity for investors and illustrate returns that are not actually achievable by anyone. The proposed approach of using a risk-free rate would likely make the return scenarios less extreme, but would introduce challenges in terms of defining a risk-free return rate appropriate to the type of product, where and what it invests in and the location of the investor. We agree that any such changes would require considerably more development and testing time than is being outlined in the CP. **Amended approach to highlight the range of scenario outcomes**: We see benefits to minimising the amount of performance scenarios. We think it would be easier for investors to consume and negate having to try to explain differences between the four current types of scenario. Also, due to the analysis that we cite in our response to question 6, in terms of the formulaic pattern of returns over the different time periods, they are of little value. With regard to the drawback mentioned in the CP about Category 1 PRIIPs we reiterate our view that it is most valuable to only present information that is meaningful and relevant to investors in each product type, rather than trying to manufacture all information for all product types regardless. We believe this view is consistent with the CP proposals to introduce past performance only for products where it is readily available. Similarly, for the drawback related to structured products, we recommend continuing the current scenarios which are suited to reflecting the different pay-offs and thereby add clarity to investors. **A graph approach**: Graphics can be considerably easier to understand. We would refer to the Exhibit 9 simple example that we believe convey more useful information more clearly to investors than scenarios.	

	Exhibit 9 How Much Was Charged for, and Returned on, a €10,000 Investment  Source: Morningstar. **Extend the historical period to measure performance**: We agree that this option does not bring any material improvements.	
Q8	In our view, the challenges of explaining to investors what the figures mean, the broad range of possible returns and limited comparability, coupled with the complexity and cost of calculation, do not justify the inclusion of performance scenarios for category 2 PRIIPs such as collective investment funds. Exhibit 13 illustrates the type of extremes and meaningless results that can come from applying the same rules to very different types of investment product. The exhibit is taken from the performance scenario section of an leveraged exchange-traded commodity fund that quotes a recommended holding period of one day, which generates possible outcomes that stretch from losing the entire investment through to making a 5,532,045,700% gain.	

We recommend that such products not be classified as retail products (as explained further in this Morningstar article https://www.morningstar.com/articles/271892/warning-leveraged-and-inverse-etfs-kill-portfolios.html). If such products continue to be classed as a PRIIP, the performance scenarios should be suspended.

Exhibit 13 Live Performance Scenarios Taken From a Leveraged ETC KID

Investment 10,000 USD Scenarios		(Recommended Holding Period) 0.0027397 Years
Stress scenario	What you might get back after costs	7,094.94 USD
	Average return each year	–100%
Unfavourable scenario	What you might get back after costs	9140.28 USD
	Average return each year	–100%
Moderate scenario	What you might get back after costs	9986.46 USD
	Average return each year	–28.92%
Favourable scenario	What you might get back after costs	10,733.11 USD
	Average return each year	5,532,045,700%

Source: Morningstar Direct. Data as of 1 August 2018.

Generally, showing the equivalent scenarios for the benchmark of each product may provide some further context for an investor.

Q9

Narratives for the summary risk indicator: The current free-form text afforded to product manufacturers can result in different explanations of the same risks by different manufacturers. Some may contain more jargon than others. Some will catalog every conceivable risk, however remote.

We think that these other risks could be better and more consistently explained to investors. This might be via a standard list on each KID, with those relevant to that product being ticked, or, alternatively, a set of standard short descriptions of each type of risk from which each product copy and pastes those relevant to it.

Either approach would make it much easier for investors and advisors to screen products that are exposed to particular risks rather than having to read and interpret the documents of many different products.

Narratives for performance fees: We support measures that increase the level of disclosure about the terms of performance fees and aid investors understanding of how and when they will apply.

Ideally, we'd like performance fees to be structured as fulcrum fees. That is, fees should go up if a fund outperforms, but they should also go down by an equal proportion when the fund underperforms. Whilst they unfortunately apply to a small proportion of funds, the narratives should cater for explaining them.

Growth assumption for the RIY calculation: We are supportive of measures that aid consistency and comparison for investors. This proposal is a step in that direction. We think it would be even more helpful to show the cost of purchase and cost of sale separately from the effects of the annual running costs and any additional performance fees, as shown in Exhibit 16.

Exhibit 16 Simplified Illustration of Costs and Investment Return

Investment of €10,000 Scenarios	1 year at 3% growth pa	5 years at 3% growth pa
Value if there were no annual running costs	€10,300	€11,592
Value after annual costs and any performance fee	€10,200	€11,040
Additional cost of purchasing the investment	€0	€0
Additional cost of selling the investment	€ 510	€0

Source: Morningstar.

Going a step further and including a negative growth scenario would highlight to investors that money could be lost and that there will still be a charge.

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Q10	**4.3.1** Creating a situation where a UCITS KIID may be supplied to professional investors, and a PRIIPs KID to a retail investor in the same product (whether it be the same or a different share class thereof) should be avoided. Apart from creating extra cost for each product, and in turn, for investors in those products, it creates a situation where retail investors are provided different information to professional investors for no logical reason.	
Q11		
Q12		
Q13		