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PENSIONS

It takes two

The Level 2 measures will be crucial to the success of the PEPP pan-European pension product

While the full impact of the COVID-19 crisis is yet to be measured, it will most certainly confirm the need for people to better prepare for their retirement, further emphasising the need for good pension products.

Crucially, therefore, EU policymakers' work on a pan-European personal pension product (PEPP) is not just a theoretical initiative at the heart of the EU plan for a capital markets union; if successful, it could be part of the answer to Europe's ageing challenge.

The PEPP, which is intended to complement national pension regimes and be portable between EU states, was agreed on by EU policymakers in early 2019. At the time of writing, it is reaching another important milestone, as EIOPA submitted to the European Commission in mid-August 2020 the Level 2 measures that will flesh out the details of the Regulation.

A lot depends on Level 2

The development of standards specifying the technical details of the PEPP is a real challenge. This is not only because the text of the PEPP Regulation is unclear, but also because such a long list of standards covering many technical issues is required. The fact that some of these are completely new at EU level — such as the definition of rules to apply to risk-mitigation techniques or the introduction of the requirement for a fee cap — makes EIOPA's task even more challenging.

Digital is desirable

In Insurance Europe's recent survey of what Europeans want from their pensions (see p40), there was a clear preference for receiving information about pensions digitally rather than on paper.

67% of all respondents preferred digital information, rising to 70% of 18 to 35-year-olds. The insurance industry believes a digital-friendly approach to distribution and disclosures is therefore essential for PEPPs and that EIOPA's Level 2 measures are a missed opportunity to develop practical solutions to foster digitalised information documents.

There is also concern that the tight timeline for developing the Level 2 measures foreseen by the Regulation is hampering a smooth and transparent process as well as a sufficient degree of quality for the technical standards, not least because it resulted in EIOPA not submitting fully finalised work.

Danger of complex solutions

Insurance Europe is also concerned by EIOPA's tendency to opt for excessively complex solutions that have not yet been tested. For instance, EIOPA suggests introducing inflation-adjusted performance projections and a completely new cost indicator "reduction in wealth" (RIW) in the PEPP benefit statement. The RIW indicator would provide savers with the difference between projected maturity values with and without costs. The concern is that such an approach would result in figures that do not take into account the extent of the service provided, the length of accumulation and the performance achieved, and are therefore likely to discourage people from making additional contributions to their PEPP.

Along the same lines, EIOPA also wants to introduce "return ambitions", requiring that PEPPs outperform the annual rate of inflation with a probability of at least 80% over 40 years. This goes beyond the letter of the Regulation, which requires a PEPP to ensure "nominal capital protection" and raises the practical questions of how to predict inflation over such a long period of time and whether this could be achieved, especially given the current economic environment.

Another key aspect of the measures is EIOPA's work on the economic stochastic model that it suggests using to support its holistic approach to risk, reward, performance and risk-mitigation techniques. Methodologies to measure PEPP risks and performance, as well as rules governing the eligibility of investment options in the PEPP are a key element in assessing EIOPA's proposals. Insurance Europe understands that EIOPA will now continue work on these preliminary proposals. However, all elements must be made available to policymakers before they decide whether to endorse the PEPP technical standards.

Last but not least, the definition of the fee cap's scope is one of the main issues that will determine distributors' ability and willingness to offer PEPPs. EIOPA proposed an all-inclusive fee cap, meaning that all costs and fees — except biometric, switching and guarantee costs — would not exceed 1% of the capital invested per annum.

Insurance Europe strongly welcomes the fact that EIOPA acknowledged the specific nature of guarantees. Guarantees are not a cost, but a price paid for a particular service, and that price is partly driven by sectoral legislation. However, the inclusion of the cost of advice remains problematic, particularly in the early years of the accumulation period, when upfront costs are added on top of ongoing costs and based on the expected level of contributions to the PEPP. An exclusion of advice costs, even if partial and temporary, as well as the possibility to consider average costs instead of annual costs, seem necessary conditions for providers to be able to design and launch high-quality PEPPs on the market.

All in all, the impression is that while the end of the legislative process is in sight, the PEPP discussions are far from over. Insurance Europe appreciates EIOPA's intense work and efforts, and acknowledges how difficult a task PEPP is, but it urges authorities and policymakers to take the time needed to get this important legislation right. Insurers, as major providers of personal pensions products, stand ready to continue to contribute to this.