Position Paper

# Response to EIOPA's consultation on a framework to address value for money risk in the European unit-linked market

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| Our reference: | COB-PRI-21-055 | Date: | 16 July 2021 |
| Referring to: | EIOPA's consultation on a framework to address value for money risk in the European unit-linked market | | |
| Related documents: | | | |
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| Pages: | 16 | Transparency Register ID no.: | 33213703459-54 |

**General remarks**

As recognised by EIOPA, unit-linked and hybrid products can offer important benefits for policyholders and the Capital Market Union (CMU). The design, distribution and review of such products are carefully regulated by the Insurance Distribution Directive (IDD), which has introduced solid rules on product oversight and governance (POG), professional advice, distributors' continuous training, suitability/appropriateness/demands and needs tests, transparency requirements and product monitoring.

Consequently, Insurance Europe believes that the existing regulatory framework already offers all the necessary tools to ensure a high level of consumer protection through the whole life cycle of products that — if implemented and supervised diligently — will guarantee that consumers receive products that are tailored to their demands and needs. Therefore, due attention should be paid to supervising the application of the current POG rules, rather than introducing further limitations to the design and distribution of unit-linked and hybrid products based on theoretical considerations such as those proposed by EIOPA in its draft Framework on Value for Money. Furthermore, the general nature of POG in its current application ensures that it applies equally well to very heterogeneous insurance products in different markets.

Unit-linked and hybrid products are vehicles for investment diversification and can provide a long-term savings or pension vehicle for consumers. At the same time, they can offer: risk protection and capital protection; fiscal and estate benefits; high standards of services; flexibility, i.e., the ability to adapt to the changing needs of consumers; sustainability characteristics and objectives; and other distinctive features, all in a single solution.

Meeting consumers' expectations and needs is essential to the success of the insurance industry. Insurers need to maintain a diverse range of products to satisfy the varying needs of consumers across Europe. Therefore, the insurance sector believes that:

- Developing an entirely new system, with new definitions, procedures and tests, will create additional red tape, legal uncertainty and compliance costs, while the IDD and its delegated regulations already provide a solid protection framework.
- EIOPA and national authorities would be better focusing their efforts on the proper implementation and enforcement of the existing rules, in particular the IDD requirements.

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- There is no one-size-fits-all definition of "value for money". The overall adequacy of the product for the client's needs is the most important element. In particular, insurance features are not simple add-ons but core elements of unit-linked and hybrid products.
- It would go beyond supervisors' role to try to limit the number of underlying investment options of unit-linked and hybrid products, thus restricting consumers' choice. In other words, whether or not a product is attractively priced is determined by the customers in a competitive market, not by the supervisors.

Insurance Europe urges EIOPA not to pre-empt the political discussions on the forthcoming review of the IDD, or to act before the outcomes of its report on the application of the IDD and the European Commission's assessment of the current study and public consultation on the functioning of the retail investment market.

| **Q1:** *Do you agree with the definition of value for money presented in paragraph 1.7?* |
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Value for money (VfM) is not defined in the EU insurance legislative framework or MiFID. Although a one-size-fits-all definition as proposed by EIOPA may seem appealing, Insurance Europe believes that:

- **A definition is not necessary**: the POG framework already highlights that product characteristics, including costs, need to be tested to ensure they are aligned with the target market's needs, objectives and characteristics and with the target market's ability to pay and bear losses. The level of costs and charges should not be so high as to thwart the purpose of the product for the target market. Existing rules on POG provide a more than adequate toolkit for national supervisory authorities to monitor and enforce this rule.
- **The objective to develop a single, simple definition is not realistic:**
    - VfM requires the consideration of several elements and is heavily related to individual priorities and circumstances. Clients will value different services and features differently. The same applies to the premiums to cover them. In addition, the economic and financial environment can influence the value for the client.
    - In the "Framework for assessing conduct risk through the product lifecycle" (2019, at p.15) EIOPA states that "*The assessment of value for money is arguably subjective, while several factors influence the perception of "value for money" from a customer perspective. […] From a supervisory perspective, assessing value for money of insurance products may not be within the competencies of NCAs or it may not be feasible to the extent required to infer on the potential level of consumer detriment. Such assessment may require substantial information on the product (e.g. scales of premiums or technical bases) which is not necessarily gathered by NCAs.*"
    - Crucial elements, such as the solidity and reliability of the insurance company, the fiscal and estate benefits, the visibility and accessibility of the distribution network in the territory, the product's sustainability characteristics and objectives, etc. cannot be captured in a single definition.

Further problematic aspects in the proposed definition:

- "*where the costs and charges are proportionate to the benefits (i.e. investment performance, guarantees, coverage and services) to the identified target market*":
    - Dividing insurance-based investment products (IBIPs) into an investment and insurance component does not represent the nature of the product nor does it do justice to what consumers expect to receive as "value" from an IBIP. In many European markets the majority of IBIPs are long-term products that offer protection against longevity risks and market volatility and enhanced protection for surviving dependents. Consumers therefore expect and derive value from the entire package rather than from its individual components.
    - EIOPA seems to refer to benefits offered by the insurance company that are well-known and measurable in advance. However, from a practical perspective, this is only partly true, as the investment performance depends on the overall market performance. Costs can be judged as relatively high when the return of the product turns out to be low due to market

circumstances, but this does not mean the costs were excessive. The same applies to the insurance component or the service: neither the insurer nor the client knows in advance whether the insured event (e.g., death) will materialise during the recommended holding period (RHP) and whether some services (e.g. 24/7 post-sales assistance) will be used by the client.
    - The value of a product cannot be based solely on investment performance, leading to expectations that if the product does not lead to overall gains (which cannot be guaranteed due to uncertain market developments) then it has failed. In a unit-linked product, the market risk of poor investment performance is primarily borne by the policyholder and therefore the role of advisors is important for consumers. There are many external factors that affect investment performance, outside the control of providers.
- "*… in comparison to other comparable retail solutions on the market*":
    - Insurers, including small and medium-sized companies, would need tools that can compare a constantly updated range of unit-linked and hybrid products offered by other insurers in the market.
    - This monitoring would be highly demanding, not always possible or accurate, and would not necessarily ensure an objective assessment of the market. The mix of costs and benefits of every product is unique and designed around the target market and distribution strategy identified by the company.

As a company is not supposed to know the target market and distribution strategy identified by competitors, the current POG principles seem more adequate, focussing on the appropriateness of the product for the target market *per se*. A product may well be compatible with the needs and objectives of the target market but still have higher costs than other retail solutions.

**Q2:** *Do you share EIOPA's concerns about value for money in certain areas of the UL-market?*

No. Offering value in all products to all consumers is key for insurers. Product design and testing as per POG rules, professional advice, distributors' continuous training, suitability/appropriateness/demands and needs tests, transparency requirements and product monitoring already ensure a high level of consumer protection through the whole life cycle of a product, with no need to introduce further limitations to the design and distribution of unit-linked and hybrid products.

Insurance undertakings are best placed to apply the existing POG requirements through measures and procedures that are proportionate to the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the manufacturer (article 4 Delegated Regulation (EU) 2017/2358).

A key element of the current POG provisions is the flexibility to apply them to a broad range of very heterogeneous products, whereas the new considerations proposed by EIOPA would be very restrictive.

National competent authorities (NCAs) are already equipped with the appropriate powers and tools to supervise the effective enforcement of the existing rules, including the IDD solid conduct of business framework and the high level of prudence that regulates these products under Solvency II. If necessary, NCAs can take efficient action in their own market and cooperate with EIOPA. Product intervention powers can also be used as a last resort. For example, NCAs already conduct interviews and investigations that lead to the fine-tuning of a company's compliance and a NCA already used the product intervention powers foreseen by the PRIIPs Regulation for specific, national risks.

In addition, Article 29 (1) IDD requires comprehensive information "*with regard to all costs and related charges*" for insurance-based investment products. This information has to be provided "*in aggregated form to allow the customer to understand the overall cost as well as the cumulative effect on the return of the investment*" including, where the customer so requests, an itemised breakdown of all costs and charges. Non-compliance with these rules is subject to substantial sanctions by the respective NCA.

Finally, EIOPA's consultation paper highlights some potential COVID-related risks that have not been observed by Insurance Europe members so far (e.g., lapses and surrenders).

**Q3:** Do you believe that more emphasis on value for money considerations as part of POG, in particular through product testing, will ultimately improve the value propositions in the unit-linked market?

Insurance Europe believes that VfM should not solely focus on costs, neglecting the wide range of different qualitative and quantitative features of unit-linked and hybrid products.

POG rules have been implemented since October 2018 and, while companies continue to fine-tune their internal processes based on their experience, the rules have shown a positive impact. On top of that, extensive guidance has already been provided by EIOPA — through supervisory statements, Q&As, etc. — clarifying the POG rules and how to implement them.

Existing requirements under POG have already resulted in an increased focus on tailoring products to the needs of target markets and created obligations to assess and record a number of conduct-related elements, not just for unit-linked and hybrid products but for all regulated products. There are already compulsory requirements for the identification, assessment and monitoring of the target market, initial and ongoing disclosure requirements and periodic statements.

In order to ensure the best outcomes for consumers and for the overall European market, NCAs should focus on the effective enforcement of the existing rules at national level and intervene only when necessary, as more detailed supervisory provisions are not an adequate remedy if the existing ones have not been exhausted first.

**Q4:** *Based on the framework presented below, do you believe there may be principles you feel are missing? Please explain.*

No, the effective enforcement of POG and IDD rules, coupled with active and pragmatic supervision by NCAs, is already sufficient to ensure that customers receive products that are suitable.

The proposed framework based on a single definition may not be sufficiently flexible and seems unnecessarily bureaucratic, complex and costly to implement with no clear benefit for consumers. Given the heterogeneity of the European markets for unit-linked and hybrid products, the different saving habits, the diverse risk appetite of consumers and the specific characteristics in a product linked to fiscal regulations or other national requirements — to name but a few — it would not be realistic to devise one single set of detailed principles to fit all available products.

The robust supervision of the current POG rules, and the lack of evidence of flaws, indicate that no further intervention is needed.

**Q5:** *What additional measures could EIOPA facilitate to advance value for money in unit-linked and hybrid products?*

No further measures can be facilitated by EIOPA given the heterogeneity of the market. The effective enforcement of POG and IDD rules, coupled with active and pragmatic supervision by NCAs, is already sufficient to ensure that customers receive products that are suitable.

It is important to ensure that unit-linked and hybrid insurance products continue to be widely and easily available to consumers.

Generally speaking, implementation and compliance costs are ultimately passed on to customers. Yet the cumulative economic impact of the various pieces of legislation on consumers as the final recipients of insurance services seems to have been overlooked: the Solvency II Directive, the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation, the IDD and the General Data Protection Regulation (GDPR) are estimated to have brought a 250% increase in the number of disclosures to a customer at the precontractual stage when selling an IBIP. The number of disclosures was increased even more in March 2021 with the new Sustainable Finance Disclosures Regulation (SFDR) and it will be further increased once the SFDR and the Taxonomy Regulation disclosure framework is finalised.

Obviously, complying with all these disclosures means more expense for insurance companies, increasing the cost of insurance products that is ultimately borne by consumers.

To ensure that regulation is cost-effective and does not increase the costs of products unnecessarily, thus undermining their value, there should be a more balanced approach when preparing legislation or guidance, taking into consideration all the above parameters.

**Q6:** *Do you agree that costs and charges need to be due?*

The question is whether it is necessary to match the cost borne by each customer with the actual cost of the service provided. Such an approach would be contrary to the principle of mutualisation that is at the basis of insurance, creating a community of insureds. The same logic applies to other components of the insurance contract, e.g. for biometric guarantees where everyone pays a small premium but not all policyholders will report a claim.

The unique characteristics of insurance products, which differ from other types of investment products, must be maintained. The possibility of pooling costs is what make them so valuable and effective, to the benefit of the majority of policyholders and society as a whole.

As part of the POG process, the manufacturer already ensures that the product's costs do not frustrate the needs and objectives of the target market. Provided that this is not the case, manufacturers should be allowed to set costs and charges as they deem fit. There may be national regulation in place that requires certain processes or calculations that do not necessarily match with the proposal in the consultation paper (e.g., in Germany, by law, the premium calculation has to be sufficient to enable the life insurance undertaking to fulfil all its long-term liabilities). Therefore, insurers must calculate carefully, include security margins and are obligated to return realised surpluses to customers according to fixed profit-participation rules. This is a big difference to funds that can adjust the costs each year depending on circumstances. The insurer must prove to the supervisor that the costs calculated in the product are adequate and sufficient for the entire term of the product (Article 209 Solvency II Directive). Insurance Europe does not believe that these factors can be reflected in a model that aims to suit all European products.

Comparability may not always be straightforward, and a product appearing more expensive than a competitor's could still serve the needs and objectives of the target market. Indeed, POG requires products to be in line with the objectives and needs of the target market. However, a requirement to offer products at a similar price to those offered by competitors would go far beyond POG. In fact, it would run counter to the basic principles of a competitive market.

Under IDD and Delegated Regulation (EU) 2017/2358, distributors and consumers receive transparent disclosures of the costs of a product. In the view of European insurers, it is not the task of the supervisory authorities to replace the judgement of the market with regard to the pricing of products.

Furthermore, according to EIOPA, due costs are those that "*can be clearly linked to services rendered or expenses made, and which are proportional to the efforts and expenses incurred by the manufacturer or distributor*". Some expenses cannot be directly connected to a contract or product (e.g., salaries, training, overhead expenses, rental fees, IT or call centres costs, etc.) and the costs charged to the client not only cover the manufacturer's or distributor's expenses, but are meant to ensure a business profit. There are also other costs that need to be considered, such as capital, maintaining the framework of regulatory controls and those related to financial innovation, which are necessary in a market with high competition and regulation. To preserve fair competition, the level of business profit cannot and should not be the same for all manufacturers. Furthermore, a company is not supposed to know the design of the product, target market and distribution strategy identified by competitors.

Other issues include the fact that the aim of IBIPs is often to address gaps in old-age provision. In this regard, professional advice itself is already an added value. However, this does not take place at product level, thus it cannot be assigned to an individual product, but is rather part of an overall package that provides added value for the client.

As for products sold previously, adjusting costs and premiums is often not possible and a value for money comparison with a new product would not work, as it would not consider the circumstances under which the sold products were on the market. Products sold previously need to be out of scope: complying with domestic laws is sufficient, as they can also take local circumstances into account.

There are more factors that play an important role for consumers than mere quantitative comparison of costs and benefits. Consumers' decisions also depend on qualitative elements: it is important for consumers to have trust in their insurers and to engage with confidence in financial decisions. As mentioned, some components (i.e., identification of gaps in old-age provision and determining the optimal product or combination thereof) cannot even be attributed to a single product and are part of the entire package offered to consumers.

**Q7:** *Do you agree that for evaluation purposes, costs and charges should be assigned to specific benefits and services?*

It is complex and artificial to assign each cost and charge to specific benefits and services. In many cases, costs that cannot be directly linked to a specific product component would be assigned to the dominant product feature, as suggested by EIOPA, which is highly misleading and will distort the functioning of the product (see answer to Q8).

Costs and charges for unit-linked or hybrid products cannot always be allocated according to a precise scheme: the various costs borne by the insurance company (including and not limited to payroll, IT tools, infrastructure, cost of regulatory developments, cost of capital, etc.) do not align directly with specific items.

It is the product as a whole that is distributed to the consumer and, thus, it is the product as a whole that should be considered in the POG process. If the product is suitable for the target market, manufacturers should be free to calculate the costs as they see fit.

Moreover, the breakdown of costs and corresponding benefits or services in multi-option products is often not possible due to the feature of offered options and investment services (e.g., life-cycle approach, options composed of unit-linked and with-profit components, etc.).

Biometric and investment protection are core and integral parts of IBIPs and not simple add-ons. Therefore, a holistic approach is necessary. The cost structure proposed by EIOPA neglects some insurance characteristics. For example, the biometric risk premium consists of net premium and biometric costs as defined in the PRIIPs Regulation. Only the latter should be regarded as costs.

Transparency of cost disclosures ensures that consumers receive appropriate information on the total costs and how they affect the expected returns of the product, although the focus should remain on the importance of streamlined and meaningful information. An itemised breakdown of the costs and charges is also provided on request as per article 29 of IDD.

**Q8:** *Do you agree that the costs which cannot be directly linked to a specific product component, should be assigned to the dominant product feature? If not, do you have an alternative proposal?*

In general, it is complex and artificial to assign each cost and charge to specific benefits and services. Assigning costs that cannot be directly linked to a specific product component to the dominant product feature is a practical solution for a tick-box compliance exercise, but it brings no real value in terms of cost analysis. For insurance products, several components can be significant, and assessing a dominant feature may distort how the product is presented. In particular, artificially attributing costs to one product feature will inflate that feature's costs while making other features seem less costly. Insurance Europe would like to reemphasise the need to treat entire products as one item.

In addition, the specific characteristics of insurance are not suited to a systematically association of costs with a specific service/advantage. The management of insurance contracts also requires a financial burden that would not be evident from such specific associations. Another concern is the possible introduction of controls over the prices set by insurers; if too granular standards of costs and charges within the framework of these definitions were to be set, this would reduce an undertaking's freedom of action and, more broadly, negatively influence healthy competition between insurers.

Individual components within one product can also differ significantly depending on each customer's needs. Linking the costs to a specific item without properly taking that into account could result in costs being linked to one component in one case and to another component in another, with different results for a single product sold to different customers.

The concept of benefit should be clarified. If it is related to the performance of the product, it could mean that if the contract is undervalued then the cost must be reduced or non-existing. However, the performance of a product is strongly linked to the evolution of financial markets, which is not controlled by the product's manufacturer and thus cannot be taken into account in the analysis of the value for money.

**Q9**: *Do you agree that active investment management involves additional costs and benefits?*

Yes, as active investment management may involve additional work (e.g., analysis, decision-making, approval process, etc.) and, therefore, additional costs.

Besides, depending on the product, unit-linked and hybrids are not only characterised by asset management, but also by liability management; guarantees, financial protection or death benefits can bring additional benefits whose value would be higher than the costs needed for active asset-liability management.

For insurers, the different asset management methods play a role in the choice of the underlying funds. In the end, it is the consumer's decision which funds they choose. Therefore, transparency in the PRIIPs KID and the IDD is key.

**Q10:** *Do you agree that each product feature should deliver Value for Money as well as for the product as a whole?*

The product as a whole is distributed to the consumer and should be considered as such in the POG process.

The product's correspondence to the target market's demands and needs should prevail over trying to keep the price and the compliance burden of implementing further requirements and controls low (e.g., through more exclusions, lower limits of cover, lower capital guarantees level, less diversified funds, fewer services, etc.).

There are fully adequate insurance solutions in which a part of the product could be wrongly seen as providing "poor" value, as the value of each component of the contract, taken individually, can be difficult to assess. Some options may be evaluated only in connection with others, or even increase their value as a result. Examples may be minimum guarantees in the event of death, or a unit-linked product where biometric charges are deducted directly from the fund. When only the net return on investment is assessed, the result is lower than that of the stand-alone comparable investments. However, it should be considered together with the benefits of the risk (biometric) part of the contract.

Since the components of an IBIP interact with each other in order to satisfy the target market's needs, a holistic perspective is needed to understand the overall suitability of the product. It may not be possible for each feature to deliver against the definition of value for money and it should be viewed in the context of an alternative, e.g., where a new policy needs to be taken out that would incur additional costs, or against the much higher social costs of a protection gap or advice gap. The life insurance contract must be seen as a whole; the contract offers the possibility to diversify investments and change the composition of the investment, providing additional guarantees (in the event of death, use of a mortality table, etc.) and financial services for managing investments. This goes beyond the simple ability to invest in underlying funds.

**Q11:** *Do you agree that value for money is dependent on the target market's characteristics, needs, and objectives?*

Yes, the overall product's suitability for the target market's characteristics, needs, objectives and their evolution over time is the first priority. IBIPs, for instance, are long-term products and they are sufficiently flexible to adapt to the changing demands and needs of consumers.

For instance, in a target market with a low risk appetite, a guarantee has a high value, even if it could mean higher costs and lower expected returns than a product without any financial protection that would be more suited to a target market of customers with a high risk appetite. The current POG rules already require insurers to robustly assess a target market, including the distribution channels. The product's suitability for the target market can be ensured and supervised based on existing IDD rules, without the need for additional, bureaucratic requirements trying to artificially dissect the offering and assess each element in isolation.

Finally, the value of a product to a consumer depends not only on quantifiable aspects (such as risks, performance and costs, about which consumers are well informed via the PRIIPs KID), but also on qualitative aspects such as being insured well, trusting  the service provider, having peace of mind.

**Q12:** *Do you agree that active and passive investment management have different target markets?*

Insurance Europe does not agree. It depends on the overall product design and target market to which the product as a whole is addressed, as well as on the risk-return appetite of the consumers, the overall product type/benefit and the sophistication of the investor.

It is also important to note that unit-linked and hybrid products act as a “wrapper” for underlying investment choices. This means that the same wrapper (product) can be used to hold active or passive funds or a combination of the two. As IBIPs are long-term, the preference of consumers can change over time, thus they need flexibility within the same product.

The impact of the time horizon must also be considered. These considerations strongly overlap with the target market assessments required under POG. Therefore, the definition of different target markets should not be forced and the focus should rather be on providing adequate information to consumers on the applicable mechanisms.

**Q13:** *Do you agree that distribution costs which are charged to the consumer as a percentage of the premium paid or the performance of the units can create a risk of being poor value for money?*

No. First, Insurance Europe would like to emphasise that distribution and advisory processes are services that create added value for consumers and, thus, naturally come at a cost. Although this added value is provided before a concrete product is chosen, it must still be considered in the product calculation. In some cases, the service is even used without a product being purchased afterwards.

With regards to components of a product that add value for the consumer, the performance of underlying assets is only one of the factors that can provide value. In the case of IBIPs, other components are equally important factors in adding value (e.g., providing advice, biometric and investment protection in the accumulation or decumulation phases).

Distribution costs should be compensated for according to the strategies of the insurance company. It would go beyond the role of supervisors to discourage strategies for compensating for distribution costs through additional compliance burdens. Customers should be free to receive advice, choosing between fee- or commission-based advice, or to take out a policy entirely without advice. Additional regulatory intervention would bring the risk of putting established remuneration models at a disadvantage.

The IDD as well as the Delegated Regulation (EU) 2017/2359 provide rules on the detection and prevention of conflicts of interest and already set out the criteria for assessing whether a remuneration or remuneration scheme complies with the obligation to act honestly, fairly and professionally in accordance with the best interests of customers. These rules are already enforced, as are, where applicable, some stricter national requirements. This already protects consumers by preventing possible conflicts of interest that might result in poor value for money.

There are different ways to charge distribution costs — such as advice and marketing — to consumers. One possibility is to charge a commission that is based on the sum of the premiums payable by consumers. Other possibilities are fee-based advice and a fixed salary. However, none of these options is superior to the others since all of them have advantages and disadvantages.

For example, a front-end-loaded acquisition commission can compensate for the higher initial time and knowledge investment of the distributor, which is most often proportional to the premium (dependent also on the duration of the contract or on the expected total premiums), with ongoing commissions to compensate for distributor’s administrative costs over the year, for example through a small percentage of paid premium or some per mills of accumulated assets. These proportional commissions distribute the charges between contracts more evenly than flat (fixed) commissions, which are not necessarily linked to a higher product quality or better advice. With proportional distribution costs, customers who can only afford a lower premium are offered the same proposition as customers who can afford higher premiums. Otherwise, the fixed costs per contract would be higher, making the offer less attractive and accessible to customers who can only afford lower premiums.

A further element of most of the commission systems is the presence of commission claw-back: i.e., a time-proportional part of the (acquisition) commission should be paid back by the distributor in the case of early lapses or surrenders and this amount can also be used for customer compensation. Other components defining concrete cost deductions could depend on agreed extra services provided by the distributors to the customers.

From the consumer's perspective, it is important to understand the overall impact of these costs on returns and to be protected from mis-selling. Insurance Europe believes this is already ensured under the existing rules.

Distributors are required to provide the total costs in monetary and percentage terms under the PRIIPs Regulation, allowing customers to understand the implication of charges on yield (i.e., RIY). And on request, under IDD Article 29 (1), they must provide additional information detailing any cost of distribution that is not already included in the costs specified in the key information document to enable the customer to understand the cumulative effect that those aggregate costs have on the return on investment.

**Q14:** *Do you agree on the assumptions to be made when assessing the reasonableness of the expected break-even point and of the expected returns?*

In order to assess the VfM of the investment component, manufacturers should test at which point in time a product becomes valuable for consumers. However, this is already an integral part of the POG applied by the manufacturers. It would be impossible to integrate all the aspects insurers need to consider in establishing the reasonableness of costs and assumed return in a model that functions even if the products are granularly grouped.

It is not clear how EIOPA proposes to assess the break-even point. There are also several assumptions that do not appear to be applicable in determining a reasonable break-even point and expected return:

- The quality, depth and comprehensiveness of the advice provided fall within the exclusive competence of the distributor and constitute an obligation of diligence for the distributor. This is also information of a subjective nature that does not constitute quantitative data allowing objective consideration in the measurement of a reasonable return.
- The quantitative consideration of incentives (including commission retrocessions) seems complex to isolate. Moreover, these incentives are already accounted for in all the costs of the underlying funds to determine the net return. Incentives can also be assessed qualitatively, when studying the referencing of the supporting fund, in order to avoid the risk of conflict of interest.
- The management type of an underlying solution — active or passive — should not necessarily lead to the determination of different target markets (see Q12).
- The criteria defined by EIOPA (investment horizon, liquidity needs and client investment objectives) would be difficult to integrate objectively into a stand-alone estimate of a break-even point.

The implementation of a standard model and methodology might not take into account the product's specific characteristics and those of the underlying funds.

We believe that it is not possible to define a break-even point in a way that works well in different market circumstances, is particularly stable over time — as required for pension products — and can be uniformly quantified.

There is a relationship between customer objectives, the expected risk/return offered, costs and other characteristics of insurance products and a break-even point is correlated to those characteristics. However, Insurance Europe believes a unit-linked or hybrid product requires a holistic approach, in view of the various options and qualitative benefits provided by such products.

Basing the value of products on break-even periods is highly dangerous from a consumer perspective, as it may lead to consumers opting for unsuitable investment options because high-risk products could seem better value for money.

The situation becomes even more complex and shows the appropriateness of POG if we take into consideration the fact that regular premium saving products have the additional benefit of having consumers pay regular amounts and thus accumulate capital that they would perhaps otherwise not save.

The current economic and demographic environment creates different challenges for consumers, distributors and insurance companies in the life insurance sector. Due to extremely low interest rates, highly volatile equity and forex markets, soaring regulatory requirements, reaching the financial targets of customers while generating sustainable long-term growth is increasingly challenging.

**Q15:** *Views on other criteria / ways to assess reasonableness are sought.*

A model to better define what reasonable costs are is not necessary. No list of criteria can be fully comprehensive and even the definition of some principles would generate lengthy bureaucratic requirements during the product design and review phases in order to explain how the insurer has considered and applied the principles in each case. This would not improve the service offered to the client and could lead to higher compliance costs ultimately being passed on to the client. Alternatively, consideration could be given to further enhancing the clarity of cost disclosures to customers.

Insurance Europe believes that the list of aspects named in 2.14 is very extensive. However, the assumptions made by each manufacturer will be different depending on local legal, tax, social law and market conditions. Therefore, it would be very difficult to integrate such aspects into a European model.

**Q16:** *Do you agree that manufacturers have a duty to review costs and charges, performance and the services offered on a regular basis?*

Under Article 7 of the Delegated Regulation (EU) 2017/2358, manufacturers should continuously monitor and regularly review insurance products they have brought to the market and assess whether they remain consistent with the needs, characteristics and objectives of the target market. This is sufficient to ensure that, if some product features do not comply, remedial action is taken. In cases where costs are not in line with the market or services are no longer deemed of value, manufacturers can consider whether to change the options or services or to stop selling the product.

It seems that, according to EIOPA, the review should include the items listed below. Insurance Europe believes that these are excessively burdensome, especially for small and medium-sized insurance companies:

- Comparing the costs and charges to similar options in the market: see obstacles explained in Q1.
- Assessing the most selected options and underlying investment funds: the most commonly selected options may vary from distribution channel to distribution channel, depending on consumers' profiles and based on the evolution of the market (e.g., shifts in consumers' preferences, economic cycles and new trends). The focus of insurers should be on ensuring the suitability of the option for the target market, maintaining a diversified offering to respond to different consumers' demands and adapting to consumers' changing needs over the lifetime of products.
- When offering underlying funds managed by affiliated entities, monitoring the value for money of comparable funds on the market: it would be complex and excessively costly for insurance companies to continuously monitor and assess the value for money of competitors' products.
- Comparing performance against benchmarks: it is currently clear which benchmarks should be used.

As the process of continuously monitor and regularly review insurance products is already a requirement under POG, it should be noted that to introduce potentially duplicative requirements under a separate framework would be contradictory to the principles of Better Regulation which aims to design EU policies and laws to achieve objectives at minimum cost, to avoid overregulation and administrative burden and to apply the principle of proportionality as defined in Art. 5 TEU and set-out in Protocol No. 2 annexed to the Treaties.

**Q17:** *Do you agree that policyholders should expect returns that are in line with market returns over the long run?*

Not necessarily. If the product provides insurance protection, it has a return on investment that is different to funds sold without insurance.

European insurers have already been forced to partially move away from traditional products with guarantees due to:

- Excessive Solvency II requirements in terms of:
  - excessive capital requirements; and
  - excessive and artificial volatility caused by the flaws in the measurement of liabilities.
- Deteriorating profitability caused by prolonged ultra-low interest rates

Limiting the possibility to offer consumers unit-linked and hybrid products would significantly restrict the options available to consumers in a time of low interest rates or low risk options, notably in terms of protection against certain risks (e.g., longevity risk).

Unit-linked and hybrid policies offer a diversified investment vehicle that can provide a better return on investment over the longer term based on thoughtful, sound and sensible risk management. They can reduce consumer's risk exposure through access to diversified investment solutions, compared to investing directly in individual stocks and shares. They may offer higher returns than interest on deposits that are at risk of becoming negative. They represent a middle ground for retail consumers who are in a position to save more over and above instant access accounts but are not experienced in direct stocks and shares. Unit-linked and hybrid products represent an attractive opportunity for general private pension savings, contribute to the resilience of many people against old-age poverty and, often, mitigate additional risks, e.g. biometric risk. Furthermore, they represent a meaningful and comparably less risky vehicle for retail customers to participate in capital markets. Therefore, these products can constitute a significant contribution to the European Union's objectives under the CMU.

Moreover, it is necessary to consider the other benefits to the customer, for which a specific return may be more difficult to quantify, i.e. other insurance covers, active management, fiscal and estate benefits, the services provided to the client and other aspects that cannot measure against "market returns". Performance should be in line with the client's appetite for risk, liquidity and/or collateral needs and objectives, and investment horizon.

Furthermore, for many assets held by insurers there is no benchmark since, for instance, the daily market prices are not available (e.g., for long-term illiquid assets). Therefore, the returns cannot be measured against a satisfying, quantitative benchmark.

If policyholders are satisfied with the overall consumer experience, they continue to rely on the same insurance company for their savings and insurance needs and promote the brand within their network. This is the decisive factor and the first interest of the insurance company.

**Q18:** *Do you agree that actively managed underlying funds should be reviewed in relation to their performance against that of their related benchmarks?*

Insurance Europe believes that parts of the requirements outlined in points 2.17 to 2.20 do not adequately reflect the role of the supervisory authorities. European insurers agree that the supervisory authorities should monitor and enforce compliance with the applicable regulation. This includes the manufacturers' duty to act in the customers' best interest in terms of distribution. It also includes their duties under POG, which require them to ensure that their products match the needs and objectives of their target markets. While these requirements provide effective protection against products that are not in line with the target market's needs, objectives and interests, they do not oblige insurers to offer the cheapest products on the market. It is of the utmost importance to stress that whether or not a product is attractively priced and whether or not the underlying options offer attractive investment yields is determined by the customers in a competitive market, not by the supervisors. This includes the selection of funds offered as part of unit-linked insurance products. Therefore, Insurance Europe does not agree with the obligation to review as stated in Q18.

There are other qualitative criteria that could be important for consumers with regard to the additional features an insurer offers such as flexibility and software support (e.g. apps or website for self-service), transparency and comprehensibility beyond legal requirements, as well as communication.

Under Article 7 of the Delegated Regulation (EU) 2017/2358, manufacturers should continuously monitor and regularly review insurance products they have brought to the market and assess whether the insurance products remain consistent with the needs, characteristics and objectives of the identified target market. This is sufficient to ensure that if some product features do not comply, remedial action is taken.

It is true that in some cases, such as "absolute return" strategies, the benchmark corresponds to the target return. In any case, what is specified in Article 7 is already a sufficient safeguard for the customer.

In addition, there are no clear benchmarks for multi-asset funds, which are the most popular choice in some markets, for instance in Ireland.

Besides, the comparison with a reference index may not be sufficient to assess the quality to price ratio of an underlying fund; some specific funds — including some new united-linked product (in particular unquoted ones) — do not have a representative index and the assignment of a "general" reference index would not be relevant. The ESG criteria is an example of this: the company selection practices that are specific to each management company can lead to disparities that could distort the comparison. Therefore, it seems necessary to have other elements of comparison to judge the performance of a fund to ensure that the comparison is in line with the management implemented.

Furthermore, in order to have good performance a benchmark is not necessary. A hybrid product that balances guarantees and performance in funds will not have a benchmark by construction. An insurer's general fund also has no benchmark due to the lack of daily market data.

Finally, it is not clear which benchmarks should be used for long-term products.

**Q19:** *Do you agree that mass marketed UL products should provide a limited number of options?*

No, and it would go beyond supervisors' role to limit the number of options or define the most appropriate number of options for a product. The focus and responsibility of insurers and supervisors should be to ensure the suitability of the option for the target market, maintain a diversified offering to respond to different consumers' demands and adapt to consumers' changing needs over the life of the product. European insurers do not agree with the term "options". Biometric and investment protection are core elements of an insurance product and not add-ons. Furthermore, the products need to be sufficiently flexible in order to be able to adapt to changing circumstances in consumers' lives.

As regards underlying investment options, consumers can change the underlying funds if their risk appetite changes, which can happen during the long term of an IBIP or, as noted before, a unit-linked or hybrid product can be used in some cases as a "wrapper" around funds. Allowing access to a wide variety of funds for different risk appetites is one of the main benefits of a unit-linked product. Consumers have a variety of objectives for their investments to match their circumstances, so restricting the choices available arbitrarily would be detrimental.

A product with multiple options can be customised to offer solutions in line with a client's demands and needs, and can be adapted during the life of the contract by switching from one option to another. As a result, a multi-option unit-linked or hybrid product allows the customer to change investment choices without bearing the costly fiscal and operational disadvantage of exiting one investment and entering into a new one when they decide to modify asset allocation. A positive aspect of unit-linked policies is that there are usually no upfront charges for the funds and a change of the underlying fund does not result in any new upfront costs. Furthermore, similar non-insurance-based product solutions (e.g., direct investment products) allow clients to invest in mutual funds, bonds, shares, etc., so limiting this access within unit-linked insurance products unfairly disadvantages this type of vehicle and causes an unlevel playing field.

In several markets, consumers appreciate and demand the possibility to choose between a large number of underlying investment options. Keeping customer satisfaction in mind, it would not be efficient to reduce the products that satisfy the market demands, while it is crucial to clearly communicate the options to the customer.

Target market assessments as part of the product design and approval process (as well as assessment in post-sale reviews) already mitigates risk. However, the focus should be on clear explanations and the transparency of the product. It is important that the intended market can easily access and understand the information and features of the product.

Insurance Europe sees no connection between a large number of underlying options and high costs and charges. As an example, Swedish unit-linked products usually have a very large number of underlying options. However, looking at EIOPA's cost and performance report 2021 (p.32), Sweden is one of the countries that combined lower costs and higher net returns for unit-linked products. This example demonstrates that there is no connection between high charges and a large number of options, as the market probably offering the highest number of underlying investment options in the EU is also the market that provided the best combination of lower costs and higher net returns in 2019.

The whole idea of a "complexity assessment" and "complexity scales" based on assumptions such as the number of calculation formulae and number of underlying funds goes beyond the IDD definition of "complex" products in Article 16 and the EIOPA guidelines. Furthermore, calculation formulae are not connected to the complexity of products, since they might be necessary to reduce risks for consumers and increase comprehensibility. They may also lead to confusion in terms of practical application. Several products would need to be taken off the "mass market", which is another concept not clearly defined by EIOPA.

**Q20:** *Do you see alternative measures to mitigate risks associated with a high number of options?*

What is more important for the consumer is to receive appropriate information and be protected against mis-selling. Insurance Europe believes this is already ensured under the existing rules, and consistency with the target market is the best way to mitigate this risk. Furthermore, the manufacturer/distributor can offer valuable monitoring services, periodically updating the client about financial results and, if appropriate, proposing additional services, e.g., changes in asset allocation based on the advice or on predetermined triggers.

The level of diversification inherent in unit-linked and hybrid products works to reduce investment risk and a high level of financial literacy is not required for consumers to be able to understand and make an informed decision, particularly when supported by a financial adviser.

Insurance Europe would remind EIOPA that products are criticised for complexity when consumers incur losses because they do not understand the risks or because there are hidden costs. Products that provide protection against the risk of losses and that disclose all costs are, on the contrary, consumer-friendly and are not complex from a consumer's point of view. Therefore, pan-European personal pension products (PEPPs) that might include sophisticated risk-mitigation techniques are regarded as simple: these techniques help consumer to smooth the return and reduce the risk, thus making the product itself easier to understand. Complexity is defined in the IDD and EIOPA even produced guidelines on this issue. EIOPA should therefore follow the guidelines and not redefine complexity in this consultation paper.

**Q21:** *Do you agree that UL products require a high degree of financial literacy for consumers to understand?*

Not necessarily. The IDD rules provide a robust consumer protection framework in terms of product design and distribution, professional advice, transparency, and prevention of conflicts of interests and mis-selling. Moreover, common unit-linked and hybrid products are well understood, especially when customers receive professional advice.

For example, in the German market, products that combine a savings period with annuities are common and well known to customers. There is no marked difference between whether the savings period is based on investment funds or based on investment in a collective pool. Guarantees or risk protection do not increase complexity. In fact, when products are criticised for complexity it is due to consumers incurring losses because they did not understand the risk or because there are hidden costs. Guarantees, on the contrary, reduce the complexity of products for consumers and they are easy to understand. For this reason, a PEPP, for example, is regarded as simple although it could apply sophisticated risk-mitigation techniques.

Furthermore, when consumers buy products from an insurer, they expect to be offered insurance-specific features and not just plain investment in funds. Often, insurers add protection that smooths the product's performance and reduces the risk, making it easier for consumers to understand, for instance, the underlying risks. This does not require a high degree of financial literacy.

Furthermore, according to the PRIIPs Regulation, complex products need a comprehension alert so that consumers are informed that they are not easy to understand.

**Q22**: *Do you agree that products with many different options carry additional conduct risks?*

Insurance Europe does not believe that any potential conduct risks with unit-linked and hybrid products are connected to the number of options, as long as the client is advised on them and the options offered shape an offer in line with the client's situation, objectives, savings capacity, investment horizon and risk profile. A lack of options can also result in a product that is less suitable for the customer. Therefore, it can be argued that the risk is not in the product, but in the features of the products not being appropriately explained to the consumer. This could lead to the consumer not making an informed choice and selecting a product that has an option/feature that they cannot use or that is not necessary for their goals/objectives.

The IDD requirements are sufficient to ensure that the selected options are suitable for consumers.

**Q23:** *Do you agree with the variables to be taken into account to determine product groupings? Or do you believe more/less variables should be taken into account?*

A predetermined model based on a “closed” number of factors would not be useful. Such a model would result in a burdensome and costly compliance exercise based on complex matrixes.

European insurers doubt that it would be possible to develop a predetermined model at European level that would be flexible enough to capture all the characteristics of unit-linked and hybrid products for different European markets and yet produce meaningful results, even if products are grouped. A single model could prove to be unsuitable and would drive some sound products towards negative results in testing, thus restricting and making the offering more standardised.

Furthermore, EIOPA’s proposed model would contain different assumptions for the evaluation of the reasonable break-even point and reasonable underlying asset returns taking into consideration different product groupings. As explained in the previous answers, the concepts of a reasonable break-even point and reasonable returns are both very difficult to define in an objective manner.

**Q24:** *For each of the variables identified provide views on options which EIOPA should consider*

See answer to Q23.

**Q25:** *Do you think there may be other criteria to be followed when grouping products?*

The approach of setting a predetermined list of variables risks leaving out certain insurance characteristics, especially when considering qualitative features. For example, the reputation of the insurance brand is difficult to consider a benefit or a service with a corresponding cost, as are the several facultative and flexible choices the client has over whether to activate a coverage, whether to choose an annuity payment or whether to switch to other investment options.

Insurance Europe believes that even if the products are grouped, it would be impossible to specify a feasible model for heterogeneous European products.

It is the product as a whole that is distributed to the consumer and, thus, it is the product as a whole that should be considered in the POG process, with no need for sub-grouping.

**Q26:** *Considerations on the model are sought*

See answer to Q23.

Since the market for unit-linked and hybrid products is very heterogeneous, it will be impossible to generate a meaningful quantitative model that fits different products even if these are put into different groups.

European insurers also believe that it would be helpful in general to assess the costs of such projects vs. whether they fulfil the intended purpose before embarking on further IT projects. Therefore, Insurance Europe encourages such an impact assessment, given the sophisticated IT systems required to comply with regulatory requirements.