Insurance Europe response to EIOPA consultation on PEPP technical standards

Preliminary comments

Beyond the content of EIOPA's proposals, the insurance industry is particularly concerned that the very short timing foreseen to develop the PEPP level II technical standards will prevent a smooth, transparent and efficient process.

The wide range of issues to be dealt with by EIOPA requires substantial works as it touches upon many technical issues that are completely new at EU level eg. risk mitigation techniques and pricing regulation.

Beyond the PEPP itself, EIOPA's works could set an example, establish a reference, which could have an impact on national pension systems and related regulatory frameworks. We can already witness that some discussions currently taking place at national level are operating under the light of PEPP developments.

Against this background, we urge EIOPA to take the necessary time to deliver on this challenging task. It is indeed important that the development of the PEPP technical standards should be made in one go to avoid unsuitable products being sold to consumers and to ensure that eligible providers are in a position to implement and comply with the PEPP requirements. PEPP contracts tend to be very long-term contracts. Unclear provisions that are not tested properly would expose providers to a unquantifiable level of legal/compliance risks during the whole contract period and even beyond.

We also regret that EIOPA public consultation and consumer testing exercise are taking place in parallel. It would have been preferable for the consultation paper to consider the results of the testing and be provided with more finalized mock-ups for us to provide meaningful and helpful comments.

Furthermore, we would highly recommend always having a 2-steps consumer testing process. Having a first round of testing would allow to fix preliminary proposals based on the feedback received. Then, having a second round of testing would ensure that the new proposals have addressed the shortcomings previously identified and are effectively providing consumers with relevant information.

For EIOPA to meet the deadline set by the level I Regulation (15 august 2020), it would have to submit its technical advice to the Board of Supervisors' approval in the end of June. Therefore, there would be less than 4 months between the end of this public consultation and this internal deadline. Based on the current state of EIOPA's proposals, we consider this would not been enough for EIOPA to provide finalized, fully tested and substantiated proposals to the European Commission.

Most importantly, many crucial information is currently missing from the consultation papers. Therefore, stakeholders should be provided with another opportunity to comment on EIOPA's suggested proposals before being presented to the European Commission.

Last but not least, we would always invite EIOPA to build on existing well-functioning solutions, rather than overengineering this process and introducing new conceptual and complex ideas whose merits are yet to be proven.

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Q1. Do you have any comments on the presentation of the information documents? Do you find the preliminary, illustrative examples of the mock-up PEPP KID and PEPP Benefit Statements are translating well the outlined objectives?

Overall, we welcome EIOPA working on a mock-up basis. We believe this is a useful approach to provide ideas to market practitioners but also to ensure that disclosures requirements are workable in practice. It is very important to work on an "end user-friendly basis" to ensure that complex financial information is translated in lay-man's terms and therefore made accessible to all types of investors.

However, we believe that these illustrative mock-ups still require further works.

First and foremost, it is crucial that these mock-ups undergo **consumer testing** to ensure they effectively bring expected benefits to PEPP prospective savers and members.

Moreover, these mock-ups are not addressing the issue of **information overload and burden**. Information should focus on quality rather than quantity. Receiving too much information could in fact result in savers not saving for their retirement and/or not making the choices that would best address their demands and needs. Against this background, the following elements deserve particular attention:

- Duplication of information should be avoided. For instance:
  - In the PEPP KID mock-ups, in the section "what is the product?" information on portability and on sub-accounts is redundant.
  - In the PEPP KID mock-ups information as to whether it is a basic PEPP is disclosed on 2 occasions: 1) in the general heading "product type" and 2) in the "what is the product?" section 1, "guarantee/risk mitigation techniques" sub-section 3.
  - In the PEPP Benefit Statement mock-up, information in relation to costs would be disclosed on 3 occasions, first in the current balance section 1, then in the breakdown of costs and last in the Reduction in Wealth indicator in section 3.

- Gold plating of PEPP requirements should be avoided and carefully weighted in relation to the added value it brings to consumers. For instance, it is unclear how EIOPA's suggested approach to the disclosure of past performance would be helpful or provide savers with relevant information.
  - The PEPP Regulation does not require a benchmark for past performance. Moreover, the long-term risk-free rate is a tool available to project investment returns. Therefore, it is not suitable for a retrospective, past performance assessment.
  - The PEPP Regulation only requires the 10 years past performance to be disclosed in the KID and the benefit statement. Adding the 5,3 and 1 past performance goes beyond the mandate granted by the level 1 legal text.

- The cumulative impact of legislations should also be duly considered in order to avoid information overload and burden. The different pieces of legislation which are applicable to the PEPP, their distribution and providers will most likely result in inconsistencies, overlaps and duplication. Insurance Europe estimates that an insurance broker selling a sustainable PEPP online would have to disclose between 158 and 202 pieces of information at precontractual stage (depending on how the PEPP second regime lex specialis nature is interpreted).

- The disclosure of two performance tables in PEPP information documents (benefit projections and past 10 years) despite being required by the Level I Regulation would not help consumers understand the product. In contrast, it will result in overloading consumers with further information. Such an overload of figures, obtained through different methodologies (past performance is anchored in actual historical data, while future scenarios show the range of possible outcomes), would only confuse consumers, and not simplify their choice.

- Against this background, digital information can be a useful tool to streamline the quantity of information received as it allows the saver to identify and focus on relevant information only e.g. with the help of visual icons, dropdown menus and tick-the-box approaches. Layering of information in particular, may also help streamlining the quantity of information a saver might need to process (see question 10).

Several elements presented in the illustrative mock-ups require **further clarification**:

- It is not at all straightforward to reconcile EIOPA's suggested approach as detailed in its draft advice/impact assessment with the illustrative mock-ups. This is, mainly because many crucial information is missing from the consultation paper. For instance, the mock-ups do not reflect the strong stance EIOPA has in favour of digital layered information disclosure.

- Some of EIOPA's suggested approaches are not sufficiently substantiated and explained. For instance, there is no explanation in the draft technical advice and impact assessment to understand the different risk scales (1-4 risk, high/medium/low) suggested for the PEPP KIDs and the Reduction in Wealth cost indicator suggested for the PEPP BS (see also question 8).

- In order to ensure transparency and comparability of information across PEPPs, the insurance industry recommends introducing a distinct, standardised and compulsory section indicating whether the PEPP provides coverage against biometric risks. It is important to stress when such protection is provided. It is equally to stress when this protection is missing and warn against the practical consequences when not covered against financial, longevity, mortality and morbidity risks…

- The presentation of the risk indicator in the PEPP KID example A is not clear either. Does it measure how likely or unlikely a particular PEPP will be to meet its objectives? ie. does category 1 correspond to the lower or the higher risk?

- Suggested language for various narrative is not always accessible to average savers. Also, technical concepts/jargon such as biometric coverage, ESG factors (beyond sustainability), sub-accounts and risk mitigation techniques will require further explanations or alternative wording.

- In the PEPP KID "what is the product section?", suggested narrative on portability (ie. "distributing PEPPs <u>within</u> the majority of member states") does not reflect the level I Regulation requiring PEPP being distributed in "at least <u>2</u> Members States".

- In the PEPP KID "what is the product section?" suggested narratives, there seems to be a confusion between rules applicable to early redemption and switching.
  - 5 years minimum holding period applies to switching.
  - Switching costs are limited to actual costs and capped to 0.5% of current balance.
  - Early withdrawal is often limited at national level to hardship situations.

- In the PEPP KID "what is the product section?" information on retirement benefits should distinguish "fixed-term" annuities from "life-long" annuities as different categories.

- We see limited room in the PEPP Benefit Statement mock-up to embrace the possibility that a PEPP could have several sub-accounts with different contribution levels, different taxation, different costs resulting from providers (ie. in case of partnerships). This aspect needs to consider benefit possibly entailed by layering of information.

- The use of QR codes also triggers practical questions. The management of the PEPP KID database could prove a challenge as these will be revised on a regular basis.

- Monetary disclosures are difficult to implement in a meaningful way most of all when dealing with a standardized pre-contractual information document for a pan-European product ie. the assumptions used in the KID mock-ups (eg. 10k accumulated capital, 100 euros monthly contributions) are not relatable in several EU countries depending on income levels, savings capacity and currency. Also, it does not embrace the fact that a PEPP with several sub-accounts might have to be presented as multi-currency products.

- In the PEPP KID mock-ups, the way costs are being disclosed is confusing and misleading. 95 euros recurring costs translate in 0.95%. First, it seems to imply that the cap requirement does not consider one-off costs. Moreover, costs disclosure consider only the contribution (using the artificial 10.000 euros assumption) but not the projected performance (eg. 92600, 59000 and 39600 in example B). As a matter of principle we strongly believe that costs should not be disclosed in isolation (see question 8), but should always be put into perspective with service provided and projected performance to ensure savers understand what they get from what they pay and how much it impacts the final benefits. Also, cost disclosure should always be annualized to prevent long-term products wrongfully looking more expensive.

Q2. Do you agree to approach the areas of risk/ rewards, performance and risk mitigation for the PEPP in a holistic manner?

<u>General comments on introducing a holistic approach specific to the PEPP:</u>
Yes, the insurance industry supports considering risk, reward, performance and risk mitigations in a holistic manner.

A holistic approach to risk, reward and performance can be achieved with the introduction of a forward-looking stochastic economic model (see also question 4) paired with quantitative criteria (see also question 3).

A PRIIPs-like approach would not be the right approach as it would not be able to capture the effect of guarantees and risk mitigation techniques.

- The PRIIPs deterministic synthetic risk indicator (SRI) would not provide information that is granular enough to reflect the PEPP specific features.
- The PRIIPs' risk approach would also not be suited to the PEPP, as the underlying methodology is anchored in recent historical data, extrapolating the past 5 years performance to project the future expected benefits.

Despite welcoming EIOPA suggested deviations from the PRIIPs framework, in order to embrace the PEPP specificities, the insurance industry believes that there are still too many elements missing from the draft technical advice, the impact assessment and to mock-ups. Against this background, we urge EIOPA to take the necessary time to further investigate the topic before finalizing its technical advice to the EC.

Finally, it is of the utmost importance that the evaluation of PEPP risk and reward is balanced. EIOPA's proposals seem to indicate that high rewards are possible without risks. However, practice shows otherwise meaning that risks usually trigger rewards. Bearing in mind that PEPP requires capital protection, this will have an impact on risks and therefore on rewards.

<u>Specific comments on risk measurement</u>
The insurance industry is extremely concerned that EIOPA's proposals require to **assess risks at individual level**, based on subjective objectives and personal circumstances (page 13: "the main risk of pension product is the risk of not reaching the <u>individuals' retirement objective</u>"). It is indeed unclear how EIOPA's proposals to

"link the riskiness of the investment option to the relative deviation of the projected pension projection from the best estimate" (page 15) could work in practice. The objectives pursued by a saver when purchasing a PEPP will vary greatly. Depending on local and personal circumstances, a PEPP might be purchased either to build up the main source of income in retirement or could more simply be used to top-up other sources of income. Many other factors will also impact individual expectations (standards of living, remaining duration…).

Likewise, we really wonder how could it be possible to **factor in individual expectations** when disclosing PEPP risks in a standardized pre contractual information requirement and we would invite EIOPA reconsidering the suggested heading in the PEPP KID mock-ups "how likely it is that I will reach my retirement objective?". If different PEPP savers aim different retirement objectives, there is a risk that the same or very similar PEPP products would score differently. Moreover, consumers will not be able to compare different products unless the risk is uniquely measured against the same benchmark.

Also, EIOPA suggested proposal on page 14 is a perfect example of what "over-engineering" is and how it could lead to very few people – if any - being able to understand PEPP risks ("For the quantification of the risk measure the standard deviation from the mean (best estimate) expected outcome per decumulation option available (PEPP KID) or decumulation option chosen (PEPP Benefit Statement) together with the probability of reaching returns in line with the ultimate forward rate is suggested to be used").

We believe it is the **role of advice -** not the one of risk measurement and information disclosure - to assess and ensure that a contemplated PEPP effectively matches the personal and individual circumstances. On the contrary, **risk assessment must remain objective** meaning that it should measure possible risk of losses considering the following elements:

- the PEPP general objectives as set by the Regulation (ie. nominal capital protection only at the end of the accumulation phase),
- the market risk of underlying assets,
- the risk mitigating effect of the investment strategy.

Specific comment on risk indicator

When it comes to the suggested **risk classification**, we understand from the mock-ups that there would be up to 4 categories of risks. However, the consultation paper does not provide sufficient information and the following crucial information is missing:

- First, it should be clarified against which objective the PEPP risk is being measured. We strongly encourage to follow the letter of the Regulation and not to consider individual objectives.
- Then, the presentation of risks should be clarified. Does it measure how likely or unlikely the PEPP will be to meet its objectives? ie. does category 1 correspond to the lower or the higher risk?
- What is the rationale behind having only 3 or 4 risk categories? We see the point of not having the same number than in PRIIPs to avoid wrong comparisons but, the number of categories and the choice between an odd or even number of categories should take into account the results of the consumer testing.
- Would the level of risk be derived from the stochastic modelling? Clarity on the methodology used to quantify risks is necessary in order to be able to comment on the presentation of these risks. However, we have not been provided neither with the economic model itself nor with its parameters.
- If so, what would be criteria applicable to each category? What would be the percentage value for each risk categories? It is important that a single quantitative model is applied to ensure that PEPP risks are consistently classified.

Specific comments on performance/benefit projections.

The insurance industry recommends that EIOPA uses a **stochastic economic model** to generate the investment return assumptions that will be used by all companies.

EIOPA's suggested approach is confusing as it suggests different options/elements (LTRFR, inflation, wages), without specifying whether they should be considered all together or just some of them at specific times. Given the confusing nature of the consultation, it is difficult to provide specific and detailed comments.

However, we can share the following preliminary **concerns/observations**:

- There is a strong concern that EIOPA is creating a complicated and confusing systems for providers, distributors and customers.
- It is confusing how EIOPA refers to and appears to be considering using the UFR. The UFR is a calibration element used for generating solvency II risk-free rate curves. It should not be used directly to generate assumptions for performance/benefits projections.
- Inflation cannot be forecasted by providers. Inflation is the result of a complex set of factors. Although there is a target set by central banks in some countries, in practice the actual rate of inflation is different from that target. Therefore, using inflation to generate either assumptions for projections or benchmark is also problematic. Finally, it should be noted that inflation is not a product-specific feature. Based on EIOPA's proposal, there is an impression that inflation is only relevant for guaranteed products.
- Wage inflation is similarly difficult to forecast in any accurate way and in trying to include an assumption could easily confuse customers more than benefitting them.
- The more elements are to be included in the projections, the more volatile these projections can be and the more difficult to explain and understand.

Disclosures in real terms, despite pursuing laudable objectives, are extremely complicated to achieve in practice, and could prove really confusing for savers. Acknowledging these well-known difficulties, we are aware of only few countries using inflation-adjusted projections disclosures as the primary source of information in a pension context (IE, IT and DK). In other countries, the provision of inflation-adjusted figures appears to be rare, and if provided is presented in personalised annual information documents during the accumulation phase (NL) whose purpose are different ie. nudging – when necessary - savers into increasing their contributions. This might await consumer testing, but in any case, it is important that the PEPP documents do not provide different information from the one provided for other personal pension products available at national level. This could not only be confusing but also make PEPP less or more attractive compared to other options available at national level. Last but not least, we are not aware of any precedent at EU level introducing real term performance disclosures.

We would recommend EIOPA using the stochastic economic model to project PEPP benefits/performance **and using adequate warnings** alerting savers that several factors could impact the value of their future benefits eg. different types of inflation, taxation, evolution of wages (…) Savers could be provided with more educational information (explanation, links and available short-term projections) in a secondary layer of information, should they wish to seek further information.

We welcome EIOPA's suggestion to include a **third favourable scenario**, to add nuance and balance in performance related disclosures. In addition, we support adding a specific warning helping savers to understand the benefits of products offering a guarantee as their added value could not always be captured by performance scenarios. The solution investigated in the context of the ongoing PRIIPs review, the "minimum guaranteed scenario", showing maximum possible losses, could be a valid option to consider for the PEPP.

Q3. Do you agree to measure the risk inherent in PEPP as the dispersion of pension outcomes and to link it to objective of reaching at least the long-term risk-free interest rate?

No, Insurance Europe urges EIOPA to stick to the objectives set by the PEPP Regulation.

The PEPP Regulation requires that all investment options must ensure "sufficient protection for the PEPP saver" (article 42(3)). The Basic PEPP should allow saver "to **recoup the capital invested**" (article 45(1)) meaning the "aggregate capital contributions after deduction of all fees, charges and expenses that are directly or indirectly borne by the savers" (article 2(24)). This capital protection is due at the end of the accumulation phase (article 55). PEPP risk mitigation techniques should ensure that the investment strategy is designed to "build up a stable and adequate individual future retirement income" (article 46(1).

Against this background, EIOPA's suggested objectives as detailed in page 13 of the draft technical advice go beyond the letter of the PEPP Regulation. To quantify the PEPP investment options' riskiness and performance, EIOPA suggests 3 investment objectives which are either not feasible nor suitable in a PEPP context:

- EIOPA suggests that accumulated savings should be protected against **inflation**. This would be extremely challenging — if not impossible — considering inflation's fluctuant nature and the fact that it is not known at the time when the guarantee is issued. Such commitment would result in an unquantifiable promise, most likely not authorised by national supervisory authorities and way too burdensome from a prudential point of view. Otherwise, it would require to exclusively invest in inflation indexed bonds, which are not widely available in Europe and would defeat the investment diversification policy agenda. Moreover, it does not consider the fact that in most EU countries, inflation is higher than maximum guaranteed interest rates set at national level.

- EIOPA also suggests that PEPP investment strategies should at least reach the **Long-Term risk-free rate**. It is not clear why this is a particularly relevant pension savings target and is unlikely to be a concept easily understandable by savers.

- Finally, **limiting dispersion of future PEPP benefits** cannot not be a PEPP investment objective as it would lead to the subjective assessment of PEPP riskiness based on individual expectations. Furthermore, it is not compatible with the general objective set by the PEPP Regulation ie. to recoup the capital invested. The stochastic economic model should measure the risk of loss ie. what are the chances that an investment strategy will not meet the objectives set by the PEPP Regulation (ie. nominal capital protection only).

Q4. To ensure consistency in the application and comparability of the information on past performance, performance scenarios, pension projections, summary risk indicator and to assess the effectiveness of the applied risk-mitigation techniques - do you agree for EIOPA to set the key assumptions and inputs used for the necessary stochastic modelling?

The insurance industry agrees that the assumptions should be somehow standardized at EU level. However, it is not clear whether EIOPA is the most appropriate entity to do so.

The insurance industry recommends EIOPA to investigate the benefits of a forward-looking stochastic economic model applicable to all risk mitigation techniques. A stochastic economic model assessing the risk mitigating effect of different investment techniques by **measuring the probability to meet the objective set by the PEPP regulation** – ie. the risk of losing the capital invested – could be suited to measuring PEPP risks in a consistent manner given its expected diversity.

We believe that the establishment of a stochastic economic model for the PEPP could not only ensure consistency but also:

- Measure the probability that the PEPP will meet its objective ie. nominal capital protection.
- Allow the establishment of minimum thresholds to satisfy to identify if a risk mitigation strategy is safe enough to be sold to the public with the Basic PEPP quality label.
- Derive risk indicators and performance projections to fulfil information disclosures requirements.
- Avoid the need for detailed rules on each risk mitigation techniques and so allow innovation on financial markets while ensuring the Basic PEPP is safe.

There are **proofs of concept** supporting the relevance of stochastic economic model approach Germany, the Netherlands and in Denmark. The OECD is also currently investing the potential of stochastic economic model applicable to life-cycling strategies as part of the ongoing update of its Roadmap for the Good Design of DC Pension Plans.

The insurance industry believes that EIOPA has a role to play in setting the key assumptions and inputs for this stochastic economic model. However, based on national experience, we also see merits in EIOPA being assisted by an **independent third party** to establish, run, monitor and update the economic model on a regular basis.

- For instance, in Denmark, the key assumptions used for the recently introduced pension projections and risk labelling are established by an independent third party called the "Pension Council". This Council is appointed by Insurance & Pension Denmark and Finance Denmark. The expert council is composed of 3 researchers and experts which are appointed for 3 years mandate. To prevent conflicts of interests, experts sitting in the Danish pension council cannot be involved in the daily management of pension companies (board membership is allowed).
- In Germany, the model is run by an independent body called PIA (Produktinformationsstelle Altersvorsorge). PIA's advisory board is composed of scientists, consumer representatives, industry experts, and federal ministries.
- National authorities might also have a role to play as the most likely to be using the results of the model as a basis to assess PEPP registrations.

Last but not least, it is vital that the stochastic economic model is **appropriately calibrated and uses an appropriate range of data**.

- Recent PRIIPs experience has shown that using only the past 5 years historical data has proven suboptimal to project reliable information on future benefits/performance.
- The OECD recent study considers two different data sets to illustrate how the stochastic model would assess probability of getting back capital invested: historical returns (1969-2018) and low returns (1999-2018). Illustrations of the proposed stochastic model have shown very different outcomes depending on which data are being used.
- Further discussions are needed to identify the relevant historical data. This is also why it would be so important to have independent experts involved making calibration decisions.

Q5. Do you agree that PEPP's product supervision requires one set of relevant information to carry out the duties of home and host supervisors as well as of EIOPA?

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Q6. Do you agree with the 'all inclusive' approach to the Basic PEPP's cost cap? Do you agree that the capital guarantee is a distinct feature, which costs should not be included?

- During the PEPP interinstitutional discussions, the insurance industry has warned against the detrimental impact that a fee cap would have on the PEPP.
- We agree that the guarantee is a distinct feature and possible related costs should be excluded.
- A way should be found to exclude the cost of advice, because without this the PEPP is unlikely to be viable.
- The 1% cost cap should consider average yearly costs.

<u>General comments</u>:
During the PEPP interinstitutional discussions, the insurance industry has warned against the detrimental impact that a fee cap would have on the PEPP.

While supporting the goal of cost efficiency, we believe that pricing regulations would prove a real challenge to implement in practice for the following reasons:

- A 1% fee cap will challenge the launch of PEPP, given its voluntary nature and expected limited scale.
- A 1% fee cap will limit the diversity of PEPP providers and products/features on offer.
- A 1% fee cap will be particularly detrimental to smaller-sized providers as they might not benefit from an existing scale and/or infrastructure as a basis to launch PEPPs.
- A 1% fee cap risks compromising the expected high quality PEPP standards.
- A strict all-inclusive fee cap would also be challenging given the many new features and requirements introduced with the PEPP (mandatory advice on 3 occasions, design and administration of at least 2 sub-accounts, recurring switching, creation of risk mitigation techniques, detailed information disclosures at various stages…). PEPP manufacturers and distributors will need to develop these services from scratch and the corresponding level of fees cannot be fully anticipated at this stage of the PEPP process.
- A strict annual fee cap does not consider the fact that costs tend to decrease over time, especially when measured against the capital invested.

On the contrary, transparency of costs has proven to be a useful tool to enable savers when making an informed choice but also to boost competition and ultimately drive costs down for providers to stay competitive in the savings landscape.

Acknowledging the political agreement, we believe that the scope of the fee cap should carefully consider the following cost items and principles.

<u>Guarantee costs</u>:
First and foremost, the insurance industry does not agree the suggested **definition of guarantees costs** (see question 9).

The insurance industry supports the **exclusion of the guarantee** from the fee cap requirement.
Guarantees are not a cost but a distinct sectorial feature which is different in nature in comparison with other risk mitigation techniques.

- Both "life-cycling" and "pooling and smoothing" leave the risks with the customers (either with customers on an aggregate mutualized basis or with customers individually).
- A guarantee transfers risks away from the customer to the (insurance) company.

The amounts charged for guarantees are also different and go beyond the costs implied by other risk mitigation techniques:

- Insurance companies providing guarantees will have all the same type of costs as those companies providing life-cycling or pooling and smoothing, fund management, asset liability management and transaction costs resulting from the need to buy and sell individual assets and to re-balance the portfolios over time.
- They will also have additional costs and constraints created by the requirements set by Solvency II (valuation of liabilities and solvency capital requirements).

The different nature of guarantees was acknowledged by EU policymakers during the PEPP negotiation and highlighted in the following provisions:

- **Recital 55:** "In drawing up the draft regulatory technical standards, EIOPA should, in particular, consider the long-term nature of the PEPP, the different types of PEPPs and the cost-relevant factors linked to their *specific features,* so as to ensure a fair and equal treatment of the different PEPP providers and their products while taking into account the character of the Basic PEPP" (…) "Within that framework, in order to ensure that *PEPP providers offering a capital guarantee benefit of a level playing field with other providers*, EIOPA should duly take into account the structure of costs and fees".
- **Article 45(3):** "EIOPA shall also assess *the peculiar nature of the capital protection with specific regard to the capital guarantee*"

Advice costs:
The insurance industry also supports the exclusion of the advice costs from the fee cap requirement. The preliminary feedback from market participants indicates that it would be impossible to provide advice under a 1% yearly fee cap for a number of reasons:

- First of all, due to the **definition of advice**. Advice in the PEPP context does not mean guidance but implies a "personal recommendation" (article 2(31)) to be provided on 3 occasions: pre-contractual, pre-mobility and pre-retirement stages (articles 20, 34 and 60). The provision such high-quality/frequent advice will most likely involve human interaction which is a complicated and costly task as it requires to undertake a "know-your-customer" procedure, assessing the savers' demands and needs, assess risk appetite and tax eligibility, and explain the contract details and arrangements, among many other things. A too restrictive fee cap might risk lowering the quality of advice.
- Whilst **robot/automated advice** may appear as a cost effective solution in the future, this does not yet exist, may not exist for some time and when/if available may not be as low cost as some believe due to the costly investment needed to develop it and the need for tailoring to the PEPP optionality, members states' tax, social security. Moreover, it would require high investment costs to establish the necessary IT infrastructure.
- Another aspect to consider **PEPP expected contributions**. We would assume that small and regular amounts will be saved in a PEPP, at least initially and depending on tax incentives granted to the PEPP. It will therefore be extremely difficult, if not impossible, for providers to develop a viable business model on such limited scale. Taking the concrete example of an average moderate earner saving 5% of his 25k gross yearly salary, a 1 % yearly fee cap would mean that providers could charge up to 12.50 euros in the first year. Contributions would accumulate over the years, but these would remain too small amounts, especially considering the switching right every five years, preventing the possibility for providers to amortize related costs over time.
- To put the above figures into perspective, we found evidence that a German federal state-based consumer organization offers 90 minutes retirement planning consultation for 170 euros.

Time horizon of the fee cap:
The insurance industry urges for the fee cap to consider "average yearly costs" for the following reasons:

- It would ease the fee cap requirement, which as it stands would most likely jeopardize the PEPP uptake.
- It would allow to consider costs over the lifetime of the product, irrespective of the timing of the costs.
- It would be suitable to all products with different costs structures, different timing and therefore embracing the expected PEPP diversity.
- It would reflect the standard costs glidepath ie. the fact that costs tend to decrease over the lifetime of a product and therefore allow to mitigate higher costs at the beginning of the accumulation phase.

A strict yearly fee cap would prove a real challenge and be detrimental to the PEPP take-up. For instance, referring to the assumptions used in the mock-ups, a strict interpretation of the yearly fee cap would be detrimental to PEPP with ongoing premiums, which we understand would probably be the most common variant of PEPP:

- For PEPP with 100 euros monthly contributions, providers would be allowed to charge maximum 12 euros for the first year, and about 24 euros for the second year (and so on…)
- For PEPP with a 10000 euros single contribution, providers would be allowed to charge maximum 100 euros in the first year.

The figures used in the mock-ups also illustrate the limits of a strict annual fee cap. The suggested one-off entry costs disclosed for in the PEPP KID mock-ups (administrative and distribution costs in the first year amounting 75 euros) would already exceed by far the 12.50 euros allowed in the first year for PEPP with a 100 euros monthly contribution.

Finally, an "average yearly cost" approach is also in line with the objective displayed in the PEPP Regulation, ie. "to ensure a level playing field" and "equal treatment" between different PEPP providers and different types of PEPP "with their particular cost and fee structure" (Recital 55).

Q7. Which criteria should be added to foster the application and development of superior risk-mitigation techniques? Which research and learnings should EIOPA consider in its further work?

General comment:

We recommend introducing a uniform **high-level principle-based approach** for all types of risk mitigation techniques, combined with a holistic stochastic model and eligibility criteria to ensure consumers' interest are well protected.

A principle-based approach would reflect the fact that the level I Regulation only provides for a non-exhaustive list of Risk Mitigation Techniques (ie. "inter alia") leaving the door open to innovation and new investment techniques to mitigate PEPP investment risks. Furthermore, it would also reflect that a PEPP might combine several risk mitigation techniques.

There is a need to ensure a level playing field between different types of risk mitigation techniques. As it stands, EIOPA's approach to smoothing and pooling (additional disclosures, segregation of assets and equity loan) as well as to guarantees (additional inflation-related disclosures) appears to be much more penalizing than the one for life-cycling strategies.

Also, the eligibility of Risk Mitigation Techniques should be measured against the objective set by the Regulation ie. nominal capital protection.

Life-cycling strategies

We welcome EIOPA's suggested **high-level/principle-based approach** when dealing with life-cycling strategies. Introducing excessively restrictive requirements to frame these techniques could challenge innovation on financial markets and defeat their added value (ie. flexibility) and therefore decrease attractiveness of life-cycling to PEPP savers and providers alike.

However, some safeguards are needed to ensure that these life-cycling strategies meet the objective set by the PEPP Regulation ie. allow the PEPP saver to recoup its capital. This is where an economic stochastic model together with thresholds conditioning eligibility might come helpful (see question 4).

The possibility to extend the last phase of the life cycle beyond the expected end of the accumulation period, which is especially relevant for life-cycling, should not be introduced as a risk mitigation technique. Such **5 years buffer** does not mitigate investment risks and does not shift risk away from the savers. On the contrary, it increases the burden weighing on individual savers, as they will untimely be the one deciding to postpone the pay-out. It is also not in line with the Level 1 Regulation that explicitly requires providing capital protection at retirement (article 55), not 5 years later. Moreover, this corresponds to conditions in relation to the decumulation phase, which are left at the discretion of members states (article 57). Finally, this option would not be consistently available across Europe as it is conditioned to a large extent to national tax, social and labour laws.

Establishing reserves / pooling and smoothing

The "pooling" of individual assets in a collective fund allows providers to benefit from a larger scale and to increase their exposure to a wider range of assets classes. The "smoothing" of returns aim to reduce the direct impact of market changes on the fund investment which means that investors are less directly exposed to rises and falls in the value of their investment over the shorter-term. As a result, pooling and smoothing techniques are available in some countries as an alternative and a less risky way for savers to access certain types of investments while benefiting from the certainty of long-term average returns.

For these techniques to bring their expected benefits (combining the best of both worlds ie. safety and performance), it is important to maintain a rather flexible framework with requirements and details limited to those areas necessary (such as transparency on allocation mechanism) and to not create unnecessary constraints on how P&S can be implemented by companies. For instance, it is important that the **segregation of PEPP assets** does not lead to legal ring fencing. Eligible PEPP providers should be able to use their general account, at least for a certain period of time, to enable the launch of the PEPP product on the market and the accumulation of a certain mass establishing the "reserve". This is more viable than other options discussed by EIOPA such as providers offering a 10 years loan to PEPP savers.

Guarantees

First things first, there is still some uncertainty in regard to the **definition of guarantees** in the PEPP level 1 Regulation. The reference to "guarantees against investment losses" as an example of eligible risk mitigation techniques (article 46(2)(c)) somehow enters in contradiction with general provisions on investment options for PEPP savers (article 42(3)) that distinguish between one and the other. In our opinion guarantees do not only "mitigate" investment risks, guarantees "transfer" the risk of loss away from savers.

Having said that, we agree with the fact that on top of offering protection against investment risks, guarantees are also a powerful tool to nudge more risk adverse savers into saving for their pensions. Insurance Europe has recently run a survey interviewing over 10000 people in 10 European countries. Results have clearly demonstrated that **guarantees are highly valued in a pension savings context** on repeated occasions:

- When asked about their priorities when saving for retirement, by far the highest priority was the security of the money invested (60%).
- When saving for retirement, survey respondents overwhelmingly (73%) chose investment safety over performance.
- The information that respondents were most interested in was about guarantees, both before signing a contract (64%) and once the contract is in force (51%).

We believe that EIOPA's suggested criteria would prevent guarantees to bring their expected benefits to the PEPP. Seeing the **impact of inflation** in relation to guaranteed PEPP only is not only inaccurate but also penalizing. Inflation has an impact on all pension benefits, regardless the type of product, the risk mitigation technique and the asset mix involved. As explained in question 3, guarantees cannot protect against inflation for a certain number of reasons. Shall EIOPA decide to pursue its intention to stress the impact of inflation on PEPP pension savings, it should be done by mean of a general warning alerting the saver, using layering tools to enable savers to seek further detailed information on what might impact the value of their final benefits.

Last but not least, there are well-known concerns that **Solvency II** creates unnecessary barriers for insurers to provide products with long-term liabilities and to take investment risks with the assets backing these liabilities. This also includes the PEPP. Should Solvency II remain unchanged, in a PEPP context, this would have an impact on the performance and diversity of PEPPs on offer, and especially detrimental to guaranteed PEPP.

The insurance industry therefore advocates for a proper investigation by the EC and EIOPA — as part of the 2020 Solvency II review and PEPP-related discussions — of the mismatch between the current regulatory approach and how insurers are effectively exposed to risks relating to long-term products, so that it is feasible for providers to offer such products which ensure an appropriate level of safety for consumers but at the same time, meeting their long-term needs. Improved Solvency II requirements for long-term liabilities would help insurers to provide safe, long-term savings products, including PEPPs.

% quantitative criteria to be satisfied

EIOPA suggests establishing **% quantitative thresholds that** investment strategies must satisfy to be eligible to the PEPP.

To be eligible to the Basic PEPP, we understand that the investment strategy must ensure, considering the results of the stochastic modelling, a 99% probability that the capital invested will be recouped. This probability is lowered to 95% for the alternative investment options and when the PEPP duration is lower than 10 years.

- First and foremost, it would have been preferable to be provided with information on the stochastic economic model itself before being asked to comment on the numbers that will be derived from it.
- Also, discussions on the feasibility of these % thresholds ire at the moment confused by EIOPA's proposals to gold plate the level 1 objectives for example by including inflation. The Regulation defines

that PEPP should ensure nominal capital protection. EIOPA is proposing to deviate from this and it shouldn't.

- Another concern derives from the fact that EIOPA suggested % thresholds are to be met during the accumulation phase (page 32 article xa(3)). Such requirement would be another deviation from the political agreement enacting that PEPP capital protection objective should be met at the end of the accumulation only (article 55).
- We are not sure what would be the merits of lowering the probability threshold when a PEPP has a duration period shorter than 10 years. It would be confusing that savers are entitled different levels of protection when purchasing the exact same PEPP depending on the timing. Plus, we imagine that there will be age restrictions preventing a PEPP to be purchased too soon to retirement.
- We also wonder which criteria will apply to products combining different risk mitigation techniques.
- Provided that all of the above concerns are addressed, then it will be possible to assess whether the 99 or 95 percentage values could potentially be considered a reasonable interpretation of what ensures "capital protection".

Q8. Do you have any comments on the draft Impact Assessment? Do you have any evidence which could further enrich the draft Impact Assessment?

Regarding the suggested cost indicator, we are not sure we fully understand EIOPA's suggested **Reduction in Wealth (RiW) indicator**. The draft advice, the impact assessment and the illustrative PEPP benefit statement mock-up do not provide enough information.

In our view, RiW is not a suitable indicator for the following reasons:

- RIW drastically increases with the length of the holding period making all retirement products look more expensive, even if they are very cost-efficient. Therefore, RiW prevents a fair comparison of PEPP as a PEPP purchased by younger consumers would always look more expensive than a PEPP acquired by more senior ones. Moreover, it will discourage savers from saving for their retirement.
- The suggested indicator is a new one, it has not been tested and has not undergone consumer testing. There is therefore no indication the information provided will be more useful to savers.
- The consultation paper misquotes the study conducted in Germany by ZEW on cost indicators. The study assessed several cost indicators - including the RIW - but ultimately favoured the RIY as the most appropriate and robust cost indicator.
- Finally, EIOPA refers to some criticism on RIY in its impact assessment. However, the arguments apply to an equal if not greater extent to RIW:
  - "RiY approach technically requires assumptions – over holding periods and over returns" – Exactly the same holds true for RIW. Moreover, while RIY varies only moderately depending on the RHP (or not at all), RIW increases rapidly with longer RHP making all old-age provision products look very expensive.
  - "2% lost yield over 40 years represents a significant impact of costs." In general, a cost indicator that comprises all costs into a single figure compresses information. To understand the impact of a reduction of the yield even better, consumers are provided with costs in monetary terms. This is a better solution than making every retirement product look very expensive as the RIW does.
  - "RiY strongly depends on the duration of the accumulation phase" This effect is much stronger for RIW. Furthermore, the recommended holding period (RHP) of a PEPP is fixed, since the product is supposed to be held until retirement.

In general, we support the following principles:

- PEPP costs should not be disclosed in isolation: costs should be put into perspective with the service provided for savers to understand how the product matches their demands and needs ie. "value for money". Costs should also be presented in perspective with the projected performance, for savers to understand how costs impact the final benefits.
- PEPP costs should be considered on an annual basis. We also note that for mortgages, European regulation requires customers to be given the interest rates as a standardized annualized rate in order to be able to compare products. This appears to be an identical approach than reduction in Yield.

As an alternative, the insurance industry believes that **Reduction in Yield (RiY)** is a robust, realistic and accurate cost indicator which could also be suitable to the PEPP because it takes into account the impact of i) cost structure, ii) cost timing, iii) product duration on the internal rate of return (yield). Furthermore, RiY works equally well for single and regular premium payments. These properties are particularly important to properly represent long term products and products with ongoing premiums, which we understand would correspond to the majority of PEPPs.

Q9. Do you have any other general comments to the proposed approaches?

In relation to **costs disclosures**, the introduction of a harmonized taxonomy breaking down PEPP costs is a challenge, given the pan-European nature and the diversity of frameworks applicable to PEPP. Moreover, despite being explicitly requested by the Level 1 Regulation, such a detailed breakdown might be confusing and overload savers.

Suggested definition of the **costs of guarantees** are particularly worrying:
- In the PEPP context, the only relevant and useful figure is the amount charged by the company to the customers for the guarantee.
- We note that under PRIIPs, the total amount charged to the customers including the guarantee are already fully transparent. Therefore, in the PEPP context there are no new charges, only a question to define how to split the total charges between those related to the guarantee and the rest.
- We strongly oppose the suggested definition of the costs of guarantees on page 20 as corresponding to the full premium charged. The cost element of a guarantee is only one part of the explicit premium. This cost element corresponds to what a product manufacturer is gaining from providing the coverage, whereas the total premium corresponds that savers are effectively paying for the service. Similar discussions already took place in the context of PRIIPs, where it was acknowledged that biometric premiums are not a cost. Therefore, EIOPA suggested definition correspond to the "price of guarantees".
- The reference to "opportunity" costs in relation to guarantees costs on page 32 of the draft advice is wrong. Opportunity costs have nothing to do with what is charged to savers but correspond a posteriori to what could have been achieved when doing something differently eg. investing at higher rate and therefore is not related to a certain product feature such as a guarantee.
- In some cases, it may be straightforward to identify charges that companies make specifically for the guarantee. This could be the case for instance with third party guarantees. For some profit-sharing products with a guarantee, for example in Germany, the equity-share can be seen as a compensation charged to savers for providing a guarantee.
- For other products and in other markets, splitting the additional guarantee costs can be less straightforward. Guarantees are most of the time not a simple add-on but an inherent feature of the product.
- Any available methodology that we are aware of (Solvency II option value, PRIIPs fair value) has its own limitations and care should be taken to avoid artificial/indicative figures. Some methodologies could measure the theorical economic costs, which do not correspond to actual costs paid by savers.
- Therefore, the only feasible approach would be to require each PEPP provider to submit their proposed methodology to calculate the costs charged for the provision of a guarantee to the national competent authority as part of the PEPP registration process.

Q10. Do you have any views on the opportunities for PEPP in a digital environment, for example regarding digital information provision and online distribution?

Digitalisation, in general, is a powerful tool to **improve accessibility** to pension savings and increase **readability of pension information**. Therefore, it can help fostering broader coverage of private pension savings, increasing outreach to different cohorts of the population including the youngest one.

Insurance Europe has recently run a survey interviewing over 10000 people in 10 European countries. Results from the survey have clearly demonstrated that there is a clear appetite for digital disclosures. 67% of survey respondents preferred to receive information on pension products digitally rather than on paper. This preference is even higher younger survey participants (18-65 years old) amounting 70%.

Digital information may allow savers to **streamline their decision-making process** because they would be able to easily identify relevant information e.g. with the help of visual icons, dropdown menus and tick-the-box approaches. Layering of information in particular, may also help streamlining the quantity of information a saver might need to process.

Having worked on a mock-up basis, we would welcome the opportunity to be provided with **digital layered mock-ups** at a second stage to illustrate how EIOPA's suggested approach would work out in practice.

Inspiration could be gleaned from the Dutch pension 1-2-3 template, consisting of 3 layers:

- The first layer gives the most important information (readable in 5 minutes).
- Layer 2 offers more detailed information on layer 1 (readable in 30 minutes).
- Layer 3 provides links to other means of information available.

We also welcome EIOPA's suggested approach to highlight in the first layer the PEPP key features, as well as the **benefits entailed by long-term investments and protective features** (eg. guarantees and biometric coverage). A recent pension survey conducted by Insurance Europe revealed that guarantees are deemed the most relevant piece of information both at pre-contractual stage (61% of respondents) and during the contract (54% of respondents). We believe it is important to stress protection offered but also and most importantly the practical consequences that might arise when not benefiting from such features using warnings on possible exposure to financial, longevity, mortality, morbidity risks…

Finally, for digital information to bring its expected benefits, there is a need to **ensure legal certainty** establishing the extent of providers' liabilities when providing information in different layers. Clear indication as to whether PEPP providers are liable for certain/all layers is needed, to avoid legal uncertainty and litigation to arise on the ground that a saver has not effectively received certain information, which was made available in the second of third layer. Therefore, we recommend EIOPA proceeding as follows:

- EIOPA could specify in a comprehensive and exhaustive way what should be in the **first layer**.
- EIOPA could specify the minimum information to be disclosed as part of the **second and third layers**, leaving the flexibility for providers to possible provide additional information.
- EIOPA to clarify that providers are only liable for what is explicitly required.

Online distribution of PEPP is possible, and already a standard practice in several European markets depending on local rules and customs. However, online distribution of PEPP will indeed need to consider the mandatory duty of advice applicable to the Basic PEPP as required by the PEPP regulation.