PEPP KEY MESSAGES:
LONG-TERM

The PEPP must be a truly long-term product to deliver high value to EU savers

1 Insurance Europe welcomes the European Commission's strong commitment to linking the future of pensions to its goal of strengthening and diversifying the financing of the EU through its Capital Markets Union's project

Insurance Europe is convinced that the European Commission's proposal for a pan-European personal pension product will succeed in channelling more private pension savings to long-term investment projects only if PEPPs are truly long-term products. This long-term nature is key to allowing the allocation of funds to long-term investments that can deliver good pensions to savers and help fund growth, in line with the Capital Markets Union's objectives.

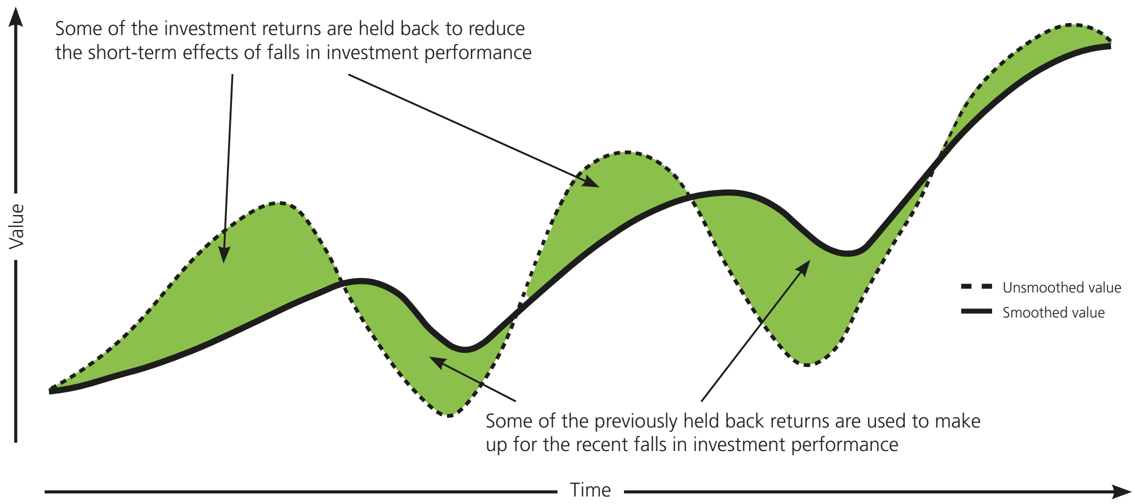
2 Insurance Europe welcomes the proposal that there should be a minimum holding period but warns that it must be balanced against the PEPP's stated objectives

It remains to be seen whether allowing PEPP savers to **switch provider every five years** creates a long enough timespan to allow PEPP providers to invest long-term, particularly given that, based on Article 45, the first switch can occur at any time and it is only each subsequent switch that has to be more than five years after the last.

The possibility to switch providers on such a regular basis will make it difficult for most providers and savers to rely on **traditional insurance techniques** — such as risk-sharing mechanisms and collective pooling — in order to smooth investment returns over time and across a sample of savers.

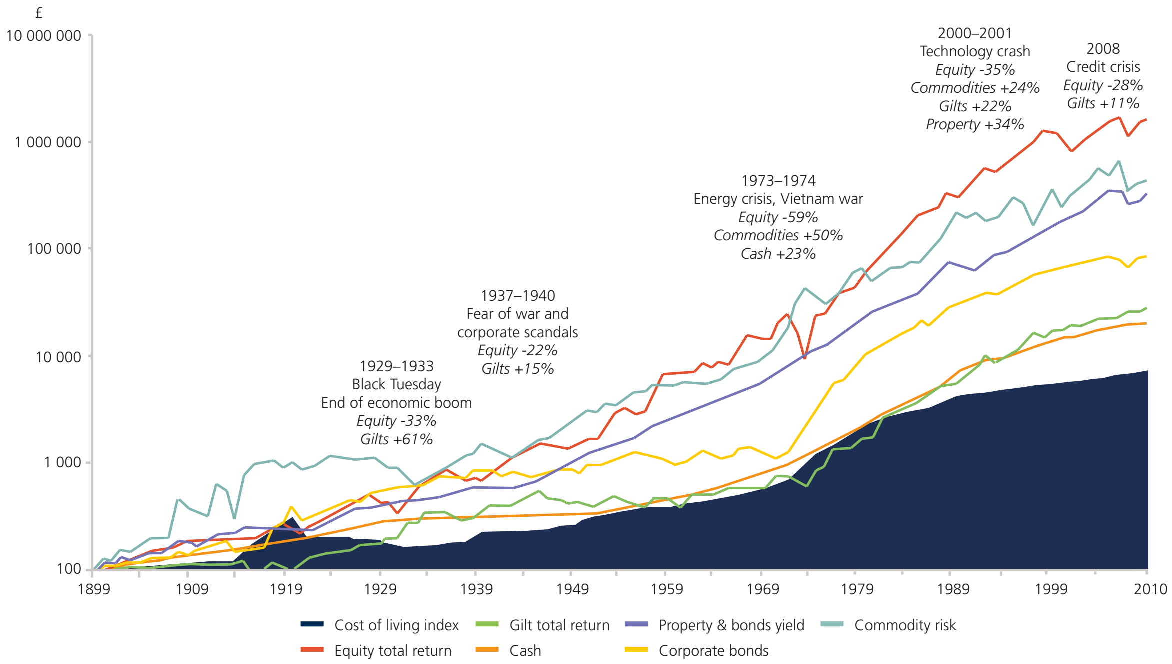
Too frequent switching will also prevent PEPP savers from benefiting from the **long-term returns** generated by investing in illiquid asset classes. For instance, it is a well-known fact that — over the long-term — equities perform better on average than any other major asset classes.

Figure 1: Return smoothing through collective mutualised investment products



Source: Legal & General

Figure 2: UK historic returns of asset classes and inflation — 1899–2010 (£)



Source: AIM, Barclays Capital, Deutsche Bank, Credit Suisse. All assets rebased on 100 31/12/1899. Equity total return is UK equities (Barclays Equity Gilt Study)

Insurance Europe recommendations

With a long track record of tackling demographic challenges, life insurers are major providers of personal pension products that consumers can trust. Based on its long-standing experience, the insurance industry stands ready to work with EU policymakers to make the PEPP a workable and safe tool for EU consumers without any unintended consequences for Europe's pension landscape.

Insurance Europe proposes the following solutions:

- While understanding the rationale behind introducing the possibility of switching, the insurance industry would like to point out that the flexibility offered to PEPP savers must be adequately balanced against the need to give providers a sufficiently long horizon over which to manage investments. Therefore, Insurance Europe believes that for the switching service to be workable, the following considerations must be addressed prior to deciding on a minimum duration:

  Article 37 As regards the **default investment option**, it must be clarified whether "capital protection" entails the provision of a guarantee, and consequently how it is backed up and when it might be due. Insurance Europe's view is that a guarantee must be due only at maturity and not at switching points, as otherwise the PEPP may be overly expensive.

  Article 45 To safeguard PEPP cost-efficiency, the provisions around the **switching service** must specify under which conditions it would take place, meaning that:
  - For PEPPs with guarantees, the transfer of assets between providers should only be possible based on the actual market value of the assets.
  - For PEPPs relying on collective investment techniques, methodologies to calculate individuals' assets should be identified, as well as possible proxies and/or adjustment methodologies, to ensure that the value of the assets transferred does not exceed the value of liabilities taken out.

- Last but not least, Insurance Europe stresses that the PEPP must be subject to solid **prudential treatment** reflecting the nature of long-term liabilities. Therefore, for PEPPs offering a guarantee on the capital invested, the prudential treatment should be **Solvency II**. Solvency II was specifically designed to ensure a high-level of protection for consumers acquiring long-term savings and pension products.

  However, it should be noted that Solvency II is overly conservative, as it exaggerates balance-sheet volatility and therefore results in high capital charges. Solvency II consequently unnecessarily affected pension returns and adjustments are therefore needed.

  Insurance Europe advocates a proper investigation, as part of upcoming Solvency II reviews, of what it sees as a mismatch between the current regulatory approach and how insurers are really exposed to investment risks. Refining Solvency II requirements for long-term labilities would help insurers play an active role in contributing to the PEPP project through the provision of real pension products as well as other long-term savings products.