Key Policy Issues on the PEPP Level 2 Regulation

Background

EIOPA is very interested to receive the views of two Stakeholder Groups on the general approach and priorities on which its advice and draft technical standards should be based.

The joint contribution of the two stakeholder groups will provide further input to EIOPA to finalize the text of its public consultation. So, this is not the last opportunity that will be offered to the stakeholder groups to make observations and that there are elements of the process that are mandatory and there is no point in reopening those issues.

Please consider that the questions are open-ended, in the sense that you can provide any nuances you in your responses even when the questions require a Yes or No answer.

For practical reasons, you are invited to provided your views in this document, and forward it by 31 October at the latest to [...].

Your name: Christian Guelich (BdV)

PEPP Information Documents

Digitalisation

Q1: Do you agree that digital distribution of the PEPP information documents (PEPP KID & PBS) would increase consumers' engagement and facilitate their decision-making process, provided that the information is fair, clear, and not misleading in the sense of the existing EU rules? Do you think that PEPP providers/distributors could offer online without meeting the prospective savers in person?

Your view:

- Yes, I agree. Digital distribution should reduce distribution costs, especially entry fees (commissions etc.). Of course, all legal obligations for the distribution process resulting from IDD and MIFID II (Product Oversight and Governance requirements, disclosure of conflicts of interests and remuneration systems, pre-contractual information duties like test of demands and needs of consumers, appropriateness assessment, Key Information Document etc.) must be respected at same level as for traditional distribution procedures.

Cost disclosure, summary risk indicator and performance scenarios

Q2: Do you agree that the methodology developed in the PRIIPs Regulation for the calculation and presentation of costs, risks and performance scenarios needs to be adapted to take in account the specificities of a personal pension product?

Your view:

- No, I do not agree. PEPP are nothing but a particular category of long-term PRIIPs / IBIPs, focused on pension out- payments. The only fundamental difference are the "compartments" in case of a move to another EU Member State by the saver.
- Notwithstanding the forthcoming changes due to the current PRIIPs KID Review (especially a more reliable use of past performance data), all PEPP specificities with regard to long-term investment phase and longevity risk coverage for the pay-out phase are already - or ought already to be - included in any IBIP pension product which exists right now.
- That is why, in order to ensure a thrustworthy, competitive and comparable PEPP, the calculation and presentation of costs, risks and performance scenarios should be as close as possible to the already existing long-term PRIIPs / IBIPs.

Cost disclosure

Q3: Do you think that the PEPP KID should provide information on the following cost elements (you can reply by yes or no):

Your view:

- administration costs - YES
- cost of investment management - YES
- transaction costs - YES
- distribution costs - YES
- cost of advice - YES
- cost of guarantee – YES (if there are any!)

Q4: Do you consider that, when disclosing the compound effect of costs on the pension outcomes, the Reduction-in-Yield approach is appropriate? Is there an alternative measure that would better reflect the long-term nature of the PEPP?

Your view:

- No, the RiY approach is not appropriate. The underlying yields are just probable "best estimate", but any costs are clearly calculated in advance. This has been shown already in 2011 by an essay of Axel Kleinlein (current BdV spokesman) published in the German journal "Versicherungswirtschaft" (English translation available).
- The minimum criteria for the application of a RiY approach should therefore be that the assumed underlying percentages of the yields will be disclosed in the KID.

- Additionally there should be a cap on RiY.
- From consumer's perspective the best reference parameter for costs are the contributions actually paid by the customers. These amounts are immediately understandable for any customer, what is obvious. This reference parameter is already stipulated in Germany by the law on state subsidized private retirement provision (Kostenstruktur: § 2a Altersvorsorgeverträge-Zertifizierungsgesetz).

Summary risk indicator

Q5: Do you agree that the underlying methodology that will be used for the presentation of the summary risk indicator should reflect, among other things, the impact of guarantees and risk mitigations techniques and the length of the accumulation period?

Your view:

- Yes, I agree. But as pointed out in our comment to Q 2, the underlying methodology for SRI should be as close as possible to long-term PRIIPs and especially to IBIP pension products which are already sold.

Performance disclosure

Q6: In order to reflect the PEPP specific nature in pension benefit projections:

- How many scenarios do you believe are necessary? (e.g. best estimation scenario, unfavourable and favourable scenarios only? stressed and moderate scenario also?)
- What would be the investment horizons to consider? (e.g. maturity only? 5 years switching intervals also?)
- Would it be useful to show the distribution of the value of assets accumulated at retirement using Monte-Carlo simulations?

Your view:

- In order to prevent from information overload only three scenarios should be included: stressed scenario, best estimation scenario and favorable scenario.
- As the time horizons for PEPP savers may be – in absolute figures – very different, the investment horizons to be considered should always be half, three-quarters and end of accumulation phase (e.g..: 20, 30 and 40 years). Switching intervals are not necessary.
- Yes, Monte-Carlo simulations are an useful instrument.

Impact of inflation and fees

Q7: Do you agree that prospective savers should be informed about the expected level of capital at retirement, after deduction of fees and inflation, compared to the total contributions paid to the PEPP?

Your view:

- Yes, I strongly agree. From consumer's perspective the best reference parameter for the expected level of capital as well as for costs are the contributions actually paid by the customers. These amounts are immediately understandable for any customer, what is obvious (cf. our comment on Q 4).
- There should be a warning/alert with regard to the long-term impact of inflation, but nothing more. This is a difficult question, because there are strongly divergent historical experiences amongst the EU Member States with regard to inflation. In MS in which inflation was low since the 1950s, the fear of inflation may be used for mis-selling cases: the distributor may insist on increasing the premiums continuously (a kind of premium "dynamic"), what in certain cases will more increase the commissions than the payouts.

Structure of the PEPP Benefit Statement

Q8: Do you believe that the structure established by EIOPA for the IORP II Benefit Statement[1] is suitable for the PEPP benefit statement? Otherwise, what information would you consider missing and important for PEPP savers?

Your view:

- Yes, I agree. If any guarantees are given, they must clearly be highlighted and fairly explained (what kind of minimum guarantees and under which conditions, i.e. only at maturity)? If no guarantees are given, the underlying percentages of returns should be disclosed. If risk coverage for disability is included, this special premium should additionally be disclosed.
- The main task of PBS is to inform about the status quo of my savings. Secondly it shall inform about the most probable out-comings. Any deeper reasoning on possible pension gap or on even better planning of retirement shall be the prevailing part of independent advice.

<u>1% Fee Cap for the Basic PEPP</u>

EIOPA proposes to apply an "all inclusive" approach which would cover all costs and fees, except the costs and fees directly linked to the guarantee on the capital. This position can be explained by the fact that the political agreement reached on the PEPP Regulation is that savers should be offered a low cost PEPP; this is the reason why the co-legislators imposed a 1% fee cap on the Basic PEPP. Hence, the room to exclude some costs is limited. This being said, the impact of the 1% threshold on the PEPP offering has not been tested and it is unclear that potential PEPP providers (insurers, asset managers, IORPs, banks) will be able to develop a viable business model if all costs are included.

[1] https://eiopa.europa.eu/Pages/News/EIOPA-news-13-11-18.aspx

Q9: Do you believe that potential providers will be able to develop viable business models to distribute PEPPs meeting the 1% “all inclusive” fee cap as detailed above? What do you think of the idea of excluding the cost of advice from the fee cap and recommending EIOPA to revisit this question during the first review of the fee cap percentage value, which is foreseen two years after the date of application of the Regulation? What other options could be considered to ensure that the Basic PEPP is a low-cost product?

Your view:

- First I clearly have to reject the idea of excluding the cost of advice from the fee cap and of postponing them to a later review. This question is strongly mis-leading! Article 20 IDD clearly stipulates that for insurance distribution there are only two way of practicing: “Advice, and standards for sales where no advice is given”. Consequently distribution or sales may be done with or without advice, but in any case there are costs resulting from distribution or the sales activity. These distribution costs have obligatorily to be disclosed in the KID. If not, this exemption would constitute a severe breach of all stipulations with regard to disclosure of conflicts of interest due to remuneration systems fixed in IDD, MIFID II and PRIIPs regulation.
- Otherwise I agree that the “all inclusive” cost approach is realistic. This has been proved by the PRIIPs regulation EU 2017 / 653, Annex VI: Methodology for the calculation of costs - List of costs for investment funds, PRIPs other than investment funds and insurance-based investment products. These lists are already applicable regulations, and – again - there should not be any difference between PEPP and PRIIPs / IBIPs for reasons of comparability and competitiveness.
- The product providers and EIOPA / NCAs have already concrete and practical experience with cost calculation and cost disclosure based on the PRIIPs Regulation. These cost structures may efficiently be used for PEPP as well - with the exception of additional costs for any national “compartments”. Any new cost structures, calculations and disclosure rules will be more costly than the consistent application of the already existing one, because – again - PEPP is not a completely new pension product category, but it is fundamentally based on already existing long-term PRIIPs and IBIPs.
- In order to be a low-cost product the most important issue for the Basic PEPP is to be a SIMPIFIED product: straightforward investment/accumulation structure, online distribution, and reliable understandable pay-out options. There must not be any “hidden” distribution, administration or management fees! From consumer’s perspective it has become obvious that the disclosure of calculations of costs and of returns is only a first step. If products are too complicated, even customers with high level financial education will not be able to understand them, and therefore effective consumer protection is impossible.

Q10: What are your views on EIOPA's proposal to exclude the cost of the guarantee on the capital? Do you agree that the differences between the two types of Basic PEPPs considered in Article 45, i.e. PEPPs offering a guarantee on the capital and PEPPs using a risk-mitigation technique consistent with the objective to allow the PEPP saver to recoup the capital, form a good basis to treat differently the cost of the guarantee and the cost of the risk-mitigation technique?

Your view:

- EIOPA should have presented an inequivocal definition for costs of guarantee. At first glance they should be part of investment management costs and – for insurers – based on Solvency II capital requirements. If this is the case, they should not be excluded and obligatorily be part of the "all-inclusive" 1% cap of costs.
- If no guarantees are given, the cap of costs should be lowered to 0,3% - 0,5%.
- In many of the already existing IBIP pension products there is included a "0% minimum return guarantee of premiums" at maturity (in Germany: "Beitragsrückgewähr"). This guarantee may be costly for the policyholders in terms of lower returns due to higher risk aversion – especially in the long run. Primarily this interdependence ought to be explained by the product providers to the customers.

Risk-Mitigation Techniques

Guarantees

Q11: Given the prolongated low interest rates and the constraints stemming from sectorial legislation, what measures do you believe could boost the performance of guaranteed PEPP?

Your view:

- In order to be a low-cost product the most important issue for the Basic PEPP is to be a SIMPIFIED product: straightforward investment/accumulation structure, online distribution, and reliable understandable pay-out options. There must not be any "hidden" distribution, administration or management fees! From consumer's perspective it has become obvious that disclosure of calculations of costs and of returns is only a first step. If products are too complicated, effective consumer protection is impossible (cf. our comment on Q9).

Life-cycling

Q12: Do you believe that life cycling investment strategy should be regulated:

- Based on a principle-based manner with the overarching understanding that the strategy should offer a sufficient high degree of protection?

- Based on a minimum requirement approach regulating the investment allocation e.g. minimum/maximum thresholds per asset classes at different points in time like in the French PPP?

Your view:

- Yes, I agree. There must be enough flexibility for the provider in order to be able to react adequately to changing capital market conditions. The main issues are the information duties of product providers towards the customers in case of strongly volatile markets and consequently the necessary or possible changes of investments strategies and their costs.
    - For example in case of the sudden “crash” of regional or even world-wide capital markets, are customers rapidly informed about any necessary changes of the investment strategy of their PEPP?
    - Or in the opposite case: if there is a constant bull market for shares, but the PEPP saver has already reached the last phase of this PEPP contract, in which he usefully will be invested in bonds. But bonds do not follow the bull market of shares. May the PEPP saver nevertheless change his investment strategy without too high costs?
- For both cases information duties and any additional capital investment costs should obligatorily be disclosed.

Q13: Do you agree that the investment objective should be clear and that the strategy should be based on a clearly defined methodology and definitions in order to ensure consistency and facilitate comparability?

Your view:

- Yes, I agree. This has clearly been stipulated by the PEPP Regulation itself (EU) 2019/1238, especially article 41 (1) on investment rules. Additionally I refer to article 25 of this regulation on Product Oversight and Governance (POG) requirements as well as to all articles on the pre-contractual information duties of the product providers (articles 26 to 34 of this regulation).

Establishing buffers/reserves

Q14: How can PEPP providers using buffers/reserves to achieve smoothing based risk mitigation and ensure fair treatment of savers? How could the following issues be addressed in level 2:

- Ensuring the necessary smoothing will be available at all times
- Transparency
- Segregation of assets

Your view:

- It must clearly be stipulated that the PEPP savers will be benefit from any buffers or reserves in the long run on the same level as PRIIPs or IBIPs savers. In many Member States there are legal provisions on national level, how PRIIPs or especially IBIPs savers have to benefit from any capital buffers / reserves (so-called “hidden reserves”). In German legislation there is the difference between “Garantie dem Grunde nach” (principle-based guarantee) and “Garantie der Höhe nach” (guarantee of exact amount).
- Consequently the Level 2 Regulation for PEPP should clearly stipulate that all existing national provisions with regard to the Prudent Person Principle and fair benefit participation of beneficiaries, Product Oversight and Governance requirements, pre-contractual information duties, PBS, and NCA’s product intervention powers resulting from the relevant former EU regulations (mainly Solvency II, MIFID II, IDD, PRIIPs KID and IORPs II), have to be applied without any restrictions to the PEPP providers. Only in this way it will be assured that PEPP savers will benefit from the same level of consumer protection as any other long-term savers.

Views on other issues

If you want to share your views on other issues, please use to space below.

Linking accumulation and decumulation phase:

- One of the major issues for PEPP to become a true success story is not only the real return at the end of the accumulation phase, but focus must be laid on the actual amounts of the pay-outs during the decumulation phase as well. The example of the Riester Pension plans in Germany show that despite a strong and severe regulation of the accumulation phase (with high state allocations and tax incentives), this type of private pension plans is in stagnation for years now. This is mainly due to low pay-outs during the decumulation phase. PEPP must not repeat this mistake!
- Therefore the Level 2 regulation of PEPP should include these two provisions with regard to the decumulation phase:
  - If an annuity is offered for the decumulation phase, it must be assured that the mortality tables used for the calculation of the longevity are realistic. Any benefits resulting from a necessary “prudent” calculation of mortality should be shared with current beneficiaries as well (and not only with future beneficiaries).
  - For the Basic PEPP there must be an “all-inclusive” cap of costs of 1% for the decumulation phase in the way as for the accumulation phase. Otherwise despite of good returns at the end of the accumulation phase, the total capital actually used for pay-outs and annuities might in advance be diminuished too strongly.