19 February 2015

OPSG Meeting, March 2015

Questionnaire on gathering input for the EIOPA Consumer Trends Report

Background

1.1 EIOPA is required under its Regulation to collect, analyse and report on consumer trends[1]. The term "consumer trend" is not defined in the EIOPA Regulation. EIOPA therefore devised the following working definition:

"Evolutions in consumer behaviour in the insurance and pensions markets related to the relationship between consumers and undertakings (including intermediaries) that are significant in their impact or novelty"

1.2 The term "Trends" must therefore be understood in a broad sense; it means, for example, evolutions in volume, evolution in the way the relationship between customers and undertakings/intermediaries is determined, but also evolutions on certain practices or types of plans or products that are only emerging in the market and which can play a significant role in the future.

1.3 To date, EIOPA has produced three Consumer Trends reports, which were primarily focused in the insurance sector. As the EIOPA Regulation does not limit the scope of the trends report only to the insurance sector, the objective of the present exercise is to identify consumer trends also in the private pension sector, including both occupational and personal pensions. The analysis of consumer trends serves as a source for identifying possible issues leading to consumer detriment that may arise from such trends. Positive trends shall also be identified and highlighted.

Consumer Trends Methodology

2.1 The trends methodology, which includes the collection of consumer trends information from National Supervisory Authorities (NSAs), was adopted in 2012 and revised in 2013 in order to produce more robust consumer trends reports. As identified in one of the steps of the methodology, stakeholders' input, including input from both the IRSG and OPSG is also being sought.

2.2 New in the methodology last year is an additional source of data from BEUC, the European Consumer Organisation who contributed trends information via their members. In addition, EIOPA staff conducted 8 country visits to NSAs to

[1] Article 9(1)(a), Regulation 1094/2010 establishing EIOPA

discuss not just consumer trends data gathering but also how consumer protection activities are carried out.

Questions to the OPSG

3.1 For the next EIOPA Consumer Trends Report, we would like to request the OPSG to provide informal input to the work on the Consumer Trends Report. Therefore, we would like to know the views of the OPSG on the following topics:

(a) **Top three financial innovations** in the private pensions sector in 2014.

Financial innovation may follow a variety of stimuli. Government policy, technological change, changes in tax law, changes in consumer type and consumer behaviour for example. In this reply concentration has focussed on the innovations from the past 12 months. Not surprisingly this will have led members of the OPSG to consider them in terms of salience. Unlike the IRSG which has covered a significantly wider suite of products our focus is quite narrow.

1. Government decisions facilitating or mandating innovation

The removal in the UK of compulsory annuitisation at retirement is a major liberalisation of decumulation policy and creates the opportunity for innovation to replace traditional products. The removal of compulsory annuitisation at retirement and more flexibility in withdrawing assets from the pension pot is a major development.. This may exacerbate the consumer protection issues because the freedom & flexibility come in one point in time possibly after years of personal inertia, and consumers have not been prepared for this major change in managing their retirement income. But it also has created the ground for industry to create new types of products to meet consumer demand. It is probably too early to be precise what might emerge in this space.

Financial innovations in Sweden in the private sector during 2014 has mainly been driven by the decision of the Swedish parliament to abolish tax deductions for private pensions savings, starting from 2015. The financial sector has developed other savings instruments, not clearly linked to retirement savings, and offered those to the customers instead. Most pension managers have stopped new payments to their already existing private pension products, so consumers have been forced to either stop saving for their retirement, or starting a new savings account in a new kind of product. - A general conclusion from this experience could be that where types of products are tax driven, a whole type of savings can be obsolete if the politicians decide to change the tax rules. Private savers lose out from having different accounts and products. Retirement savings are long term products, and rely on stable rules, including taxation.

Austria might follow other Member States in introducing tax occupational pensions according to the EET system which would make the second pillar much more attractive than it is currently.

In France, there is an ongoing law proposal that will impose a lifecycle fund as the default option in the DC occupational pension savings plans. This is a major change in legislation and is a response to the fact that a number of employees are still invested in monetary supports despite the low interest rates.

2. Information changes

Information to be delivered in more customised and tailored ways (trend; also see EIOPA's Max report). In the Netherlands for example this will be obligatory for IORPs as of January 2016.

In Sweden the discussions on a ban on commission is driving the market to more internet-based solutions

In 2014 in Austria a state pension statement was introduced which provides a forecast of how much individual pension can be expected in the first pillar. This was a wakeup call for many Austrians realizing that just by relying on the state pension they will not be able to maintain their living standard. Therefor an increased interest on the second pillar can be expected.

In Sweden the state owned social security company (that is responsible for the social security payments, for sickness) together with Insurance Sweden and the largest trade-union owned non-life insurance company in Sweden (Afa) has started a website, "ersattningskollen" that is open for everyone where they can put in their salary and their benefits and get information about what they will receive. Since this is a cooperation between the insurance industry, the state-company that is responsible for social security and the largest non-life insurance company it has received awards etc. for doing a very good thing for consumers.

3. Decumulation changes

While the UK has shaken up the concepts this is likely to have an impact elsewhere possibly through adoption of variants. Already consumers worry about how to develop a functioning annuity market in particular when the prevalent system is DC. Innovation where liberalisation has not occurred may take place.

Top three consumer protection issues in the private pensions sector in 2014

Introduction

At a general level trust is a key issue and appears in decline in all areas of financial services.

The need for transparency in pillar one should be emphasised in order that pillars two and three are understood in context. For consumers retirement saving is by a series of building blocks and pillar one is the foundation.

Consumer detriment in financial services historically is a feature of weak demand side pressure making competition ineffective and/or limited or inadequate regulation and supervision is in place. Logically looking at personal pensions from this perspective is the starting point, and solutions lie with mitigating poor competition and regulatory failure if it exists.

Consumer understanding is not high in the personal pensions market and current or future protection needs to start from the significant issues that create sub optimal consumer outcomes, and may dissuade future contributions to pension saving. Improving financial understanding may be one route to follow but it, in itself, has limitations.

1. *Costs, Charges and returns*

Pension charges may be hidden, difficult to calculate and will have an impact on the final return for a consumer. It can be accepted that consumers may not appreciate or understand the impact of costs and charges, and may not be in an effective position to have any control over them. This represents real detriment and poses a significant challenge regarding consumer protection.
But even when consumers become interested, disclosure rule are not adequate. Annual statements may not provide a complete picture of the costs and charges and may not be presented in the most user friendly format.

It is asserted that even the national and European supervisors don't know how costs and charges really work despite article 9.1 of the ESAs Regulation. In that context more research, greater standardisation, and supervision may well be necessary.

Arguably the impact of costs and charges, reducing as it does the net yield of investments, and thus final retirement incomes is the most crucial issue of consumer detriment. The impact of relatively modest AMC charges when considered over a lifetime have dramatic effects.

The low interest rate environment is detrimental for savers as opposed to borrowers and consumers are savers when saving in an occupational or personal pension plan. This detrimental aspect of the current European monetary policy receives insufficient attention from policy makers. Very low/negative interest environment in combination with the cessation of negative correlation between equity and fixed income is the new norm. This poses new dilemmas and issues for supervisors and consumer protection.

2. Inadequate disclosure, advice and poor financial capability

Disclosure standards are designed to enable consumers to make informed decisions at different stages of the pension journey. The majority of consumers may not be engaged but documents received by consumers may focus too heavily on legal aspects; information is not easily comprehendible by the average consumer, or essential information may be missing. Complexity and opacity of insurance regulated pension products make consumer choice difficult. The proposition is that product disclosures should be intelligible for the category of people it is targeted at and this should be effectively enforced.

The balance of information, and information mandated, however may lead to potential over-load. Different legislative acts create new information requirements which need to be understood in a holistic manner. If the requirements for advice and information requirements are onerous, there is a risk that consumer need/asks for advice on private pension related questions will not be adequately met. However the starting point should be to create the information solutions that meet the consumer need. An evidence based approach to policy making, and robust action to follow, is key to that.

Consumers need to particularly understand longevity risk especially in a DC world and appreciate market risks over the long term, compound interest, etc. There is a risk that consumers will make inappropriate decisions as a result of inadequate information and knowledge. The UK liberalisation at decumulation may offer a real demonstration over time of this risk.

3. Inadequate competition and poor governance

In the private pension market effective competition between providers may be surprisingly weak as the consumer demand side is weak. Information asymmetries do not benefit the consumer. The incentives for consumers to use demand side switching of pensions are not great at least partly because of low financial capability, and partly because of opaque products. Providers may compete for distribution channels rather than the consumer and the incentives that drive product positioning, features and costs are not necessarily benefits for the consumer. There needs to be an alignment of financial sales and marketing incentives with the direct needs of consumers.

Good governance to protect the consumer and control conflicts of interest is a key factor in reducing the possibilities of consumer detriment. They are not always robust and fail to manage conflicts of interest that drive poor outcomes for consumers, or maximise efficient and affective administration and performance.

An example from France was cited; In November 2014, COREM, a French private pension product decided to reduce the annuities of its 110,000 oldest participants by another 33 % after failing to revalue these annuities since 2002 (adding a purchasing power loss from 2002 to 2014 of 16 %), and after having already reduced those annuities in 2001 by close to 20 %

4. Miscellaneous National changes in regulation and statute

In France, there is an ongoing law proposal that will impose a lifecycle fund as the default option in the DC occupational pension savings plans. It will be a major change in the legislation. This proposal is a response to the fact that a lot of employees are still invested in monetary supports despite the low interest rates.

Changes in what were considered as guaranteed right, even if in law not so. Changes in the Netherlands could fall into that category.

UK changes in decumulation may result in consumers spending their savings in advance of retirement creating personal and collective long term poverty. Poor products and scams may part consumers from their cash.

In the Netherlands, the four topics of the national pension debate have been freedom of choice, collectivity, solidarity and responsibility/governance. They will remain key in further developing the pension system. The Secretary of State responsible for pensions earmarked 5 issues:

1. *Less complexity and more transparency (trend; communication)*
2. *More flexible labour market and the position of (increasing number of) self employed (trend)*
3. *Freedom of choice and tailoring pensions to these needs*
4. *Pressure on (intergenerational) solidarity (trend) and the way to tailor this best*
5. *Differing views on role of stakeholders/actors (government, social partners and individuals).*

In the UK there are more circumstances mandated through regulation. Where financial advice is compulsory in a range of circumstances safeguarded benefit.

When responding to the above questions, please explain how you decided about the importance of such financial innovation or consumer protection issue. Please also explain as well why you think such financial innovation or consumer protection issue has occurred.

3.2 In addition, we would also like the input from the OPSG on the following:

(a) The level of financial literacy amongst European citizens is reported as low in several Members States. This problem seems to be compounded by increasing complexity or innovation of financial products. Although recognised as a cross-sectorial issue with the rest of the financial services market, what specific **financial literacy/capability initiatives** do you think could be effective in the private pensions sector?

The typical retail consumer does not display great interest in financial products, nor high levels of financial capability. This places great onus on regulatory actions to safeguard the consumer and remove exploitative actions. Knowledge however is required at the moment of deliberation and choice where that is required e.g. where contribution levels are a matter of personal discretion.
There is some evidence that harnessing inertia with opt outs of a pension, rather than opt in, is more successful in maximising participation in savings and delivering good outcomes. Automatic enrolment as in the UK is designed to achieve that where decision making can be minimal. However where choice is required creating simplicity and straightforward choice must assist. Practical, understandable information that can help consumers to find answers to key questions and give clear indication on where he can find further information on a specific topic at the right moment is important. Educational and informational websites set up by national authorities or consumers associations may be useful in this area.
A simplification and standardisation of private pension products is favoured with a KID for those that enables easy comparison.
Retail financial intermediaries and employers could provide more training to their clients / employees to assist capability.

The OPSG has already given opinion on information to members to EIOPA and this should be considered alongside this response. One particular area of difficulty for consumer capability is ***risk awareness and calculation of risk. Due to the range and complexity of insurance products and providers, it is important that any financial education on insurance includes a component of risk awareness and calculation. With a move to DC provision this is particularly relevant.***

There are already some examples of Member state initiatives in financial literacy and aiding financial capability. In the UK the Money Advice Service, funded by industry levy, has responsibility for national strategy and coordinating efforts on "financial capability". In Sweden there are several state initiatives about giving consumer information, from different authorities in Sweden. This is required because in Sweden the responsibility for investments in the state pension is put on to the individual. Every person is individually responsible for the decision on choosing funds for their own state pension, and has to choose between 800 different funds (although there is a state-alternative for those that do not make their own decision)

Swedish second pillar (occupational pensions) is generally DC and the individual can choose his or her provider. The employer pays the contribution to a "clearing house" that delivers the premium to the manager that has been chosen. To make this feasible, trade unions do a large amount of neutral, basic information campaigning, including basic financial training for regular trade union members In addition, tens of thousands of trade union members are elected by their colleagues to serve as "insurance and pensions advisors" to their colleagues at the workplace. These trade union elected people get training to give information about occupational pensions and insurance schemes, including neutral facts about what kind of choices you have to decide upon (what kind of savings product you desire, whether you want to use part of the premium for a life insurance to cover your family's needs in case you pass away before retirement age etc.) They do not give advice about what provider to choose, but neutral information and knowledge =

financial literacy training from one worker to another. LO Sweden organises blue collar workers in all kinds of professions and all sectors. The information about occupational pensions is financed by a collective agreement between LO and the Confederation of Swedish Enterprise. Generally the role of organised labour to help equip is a positive in improving capabilities.

In Denmark the Shareholders Association are designing a number of different seminars "The investor school": A basic seminar on investing, special seminars on different investment strategies, seminars focussing on shares or bonds, a special seminar on pensions. It might be possible to develop these in a cross industry/consumer manner.

To improve consumer knowledge policy makers should embrace new technologies such as apps, social networks, and websites. Such an approach is more likely to appeal to younger citizens and it is important that communications and learning strategies are grounded in evidence of what works for the receiver. Not to do so is to miss the opportunity of making information and education relevant.

It has been suggested that there should be a European Day of Financial Education that would allow policymakers, consumers, the financial sector, education providers, social partners and the media to come together to share best practices and discuss future approaches to financial education and literacy at national and European level.

In the longer term, financial literacy may be improved by introducing financial education classes in schools. Member states need to consider whether such should be a core part of school curriculum or an optional extra.

In conclusion

It is very important to focus information on key points of time for the consumer. Each consumer should be clear on the level of benefits provided by mandatory pension systems to allow people to plan for their retirement and to decide if they should save for retirement or not.

As far as private pension systems are concerned financial capability is aided by an understanding of;

- ***what the contributions paid are: amount of employers contributions, voluntary or mandatory employee/individual contributions***
- ***characteristics of financial options : risk/performance, costs and charges***
- ***options at retirement***
- ***where to get information and advice***
- ***who protects the consumer and where to complain about misconduct or mis selling***

(b) In the private pensions sector it has been observed a certain **shift from DB to DC** pension plans and products. From a consumer protection perspective, what are the advantages and disadvantages of this shift?

Disadvantage for consumers:
These often relate to the transfer of the risk to the consumer and the requirement for more active knowledge and engagement not perhaps backed by capabilities.

- *consumers are expected to make more choices or rely on defaults e.g. different investment strategies without adequate financial capability is a problem. DC puts more onus on the individual to make choices as there may be less decisions made by and guarantees offered by the employer sponsor of a DB scheme*
- *consumers are paying contributions without knowing the precise future benefits as the investment returns are unlikely to be fully guaranteed if guaranteed at all*
- *risk is transferred to the consumer to consider investment risk and gauge longevity risk*
- *in Luxembourg there is the example where the supervisor requires that employers include an investment fund with capital guarantee. In practice, a majority of employees choose this capital guarantee, but this it is suggested leads to poor results, and as a consequence to low pensions*
- *the average duration of the investments is being greatly reduced and this reduces significantly the average return bringing the expected final accumulated amount to a fraction of the equivalent actuarial value of the pension that would have been reached with the same contributions under a DB plan.*

Advantages for consumers
These tend to concentrate on the ability of a consumer to exercise personal choice and freedoms not available in DB but again require capability to do so.

- *potential for the development of simpler and clearer products through new product design, governance and fees*
- *greater portability of pension portfolio by the consumer and the option of personal management of the pension aligned with other assets held*
- *personal control of personal portfolio risks which are not possible in a DB scheme. Here risk exists of company failures compromising the DB offer, which fail to meet their supposed promises unless underwritten by a 100% guarantee from the Member state*
- *direct relationship in DC (other than collective DC schemes) of contributions being kept in a personal identified pot giving consumers the benefits of ownership and control*
- *with changes in work patterns there may be a more direct way, without waiting periods or lower limits on payments, for contributions to begin. This could mean overall more contributions for those with particularly fractured work patterns. Short term contracts and part time contracts give rise to pension rights in relation to the amount of wage earned rather than delay periods or surrenders for short term service.*
- *Switching to a personal pensionplan enables the consumer to selectthe providers and managers best suited to their needs*

General comment
In the transition from the world of pure DB and pure DC the option of a more hybrid world which can combine both worlds is being developed and needs to be monitored.

(c) Different initiatives, both from the public and the private sector, have recently looked into the **costs and charges** structure (i.e. administration costs, investment costs, transaction costs and distribution costs) in the private pensions sector, which are a key issue when considering the value for money or affordability that occupational and personal pensions may deliver. Do you believe that consumers are, in general, sufficiently aware of the volume of such costs and charges? What is the impact of these costs and charges in the accrued benefits or calculated contributions?

Understanding and calculating costs and charges is a highly debated issue at this moment in many Member States. It is asserted by some commentators that even professionals do not fully understand costs and charges and if that is the case then it is highly unlikely that a consumer will understand them.

- ***The questions must include what are the costs and charges to be considered?***
- ***Are any costs and charges not disclosable?***
- ***Are explicit and implicit charges calculable and disclosable?***
- ***Can they be calculated for the past and the future?***
- ***Are they fully and accurately disclosed in the most user friendly way (percentages and actual currency)?***
- ***Are they comparable between schemes?***
- ***Are they validated by an independent authority?***

To compare the costs of different schemes a common indicator for all the schemes and all the indicators should be available on the website of every national authority.

National supervisors do not track, analyse and control these fees particularly if they do not see themselves as economic regulators. A view needs to be taken whether consumers benefit from Member states having discretion to adapt the definition of such costs to their local pensions systems and products or whether in a more harmonised pension world this creates consumer confusion.

Using a National example in Romania; there are hidden charges, which are impossible for a member to understand. For example, pension funds invests in UCITS funds and some of the UCITS funds invest in other UCITS funds. Each time, the savers are charged with management fees, which means a consumer is charged multiple times for the same amount invested. Currently, in Romania, there is no mandatory requirement for providers to disclose a synthetic cost indicator, so consumers are unable to compare the charges of different pension schemes.

(d) In order to address today's increasing labour mobility, in some Member States the so-called "**pension tracking systems**" have been developed to enable consumers track their different pension savings along career. What are the challenges faced by these pension tracking systems?

The advantage of any tracking service is to help a consumer aggregate all their sources of pension income to allow informed decision making. To that end the more comprehensive, accurate and up to date the information, and projections the more useful the exercise.

There are no examples of cross border tracking which have been identified. 11 Member states are understood to have a national tracking service and more are under development. Cross border tracking systems may have to be regulated at EU level and the different pension systems across the EU add significant complexity and hurdles to this. However it may offer benefits to consumers. This is an area which will require further consideration.

Showing all of the pension benefits at retirement age for an individual has obvious merit but will this be sufficient? Information to be useful needs to be at current value but to be comprehensive needs to offer projections to retirement and that requires the agreement of standard assumptions. Consumers to use this information require it to be in a standardised form and will need advice about the interpretation of the data. Information about cost and charges for staying in a scheme or leaving a scheme (transferring to another system) must be clear.

At national level it is complex if the three pillars (state/general social security pensions, occupational and personal pensions) are to be included in one account. This should however give the consumer a more accurate projection of their total retirement income.
There are issues of:

- ***availability of historic data***
- ***data protection - the sharing of data without explicit consent may undermine a tracking service.***
- ***concern about savings disclosure for tax reasons***
- ***seeking to create a single picture for a consumer with a mix of DC and DB***
- ***generally aggregation of data may be difficult between different types of schemes and complicated sometimes by guarantees and sometimes without.***
- ***with different retirement ages in different Member states and differing rules a single cross border tracking service that offers interpretation may not be possible***

With respect to pension tracking services looking to the Netherlands the TTYPE project. PGGM was involved in a consortium (TTYPE) that developed a design for a European tracking service. Challenges faced were:

- ***Diversity (200,000 providers, 250million users)***
- ***How to converge different views from providers and users?***
- ***Transition from paper to digital communication***
- ***Appropriate identification***
- ***Privacy, data storage and other legal issues.***

Next steps

4.1 The OPSG is invited to provide input to EIOPA on the above questions and on any additional observation that they would like to rise **by 30 April 2015 cob**.

4.2 The informal input provided by the OPSG will be taken on board in the data collation and analysis together with data collected on consumer trends information from Member State authorities and other sources, for identifying trends.