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Key Policy Issues on the PEPP Level 2 Regulation

Joint Position Paper of EIOPA's Occupational Pensions Stakeholder Group (OPSG) and Insurance and Reinsurance Stakeholder Group (IRSG)

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?

The Stakeholder Groups agree that digital distribution can have a positive impact both for the consumer and the industry. They support the overall principle that information provided to the consumer must be fair, clear, not misleading and in compliance with the law. This is explicitly acknowledged under article 24 of the PEPP regulation.

The Groups have identified young people as a particularly important group, where the demand for digital and online distribution may be higher and may therefore be an incentive for them to consider investing in a PEPP.

The Groups would like to highlight the potential of digital distribution to help better present information to the consumer. This can be achieved through a layering approach and drawing attention to key warnings, as well as using visual icons, pop-ups, drop-down menus and tick-the-box approaches. It is also important to consider that, for young people in particular, mobile devices may increasingly be used to access this information and it should therefore be suitable for use in this case.

The Groups believe that digital distribution could help to reduce costs, which is considered important in the context of the 1% fee cap. Digital distribution could help foster broader coverage, including in cross-border sales.

Some members of the Groups also believe that the use of online or digital comparison tools could be explored. These members highlight the need for any comparison tool to focus on more than just the prices of product offers, not be subject to promoted content and ensuring that any data collected or shared is in line with the General Data Protection Regulation requirements.

Whilst the Groups are in favour of potentially allowing digital distribution without human intervention, they believe there are several key points to consider. Firstly, the technology may not yet be sufficiently developed to allow a fully digital distribution process, although robo-advice has shown potential, but also has not been successful in some European markets. Some members have also indicated that there are examples where on-line distribution does not lead to lower costs and that there can be additional costs incurred, for example in complying with Anti-Money Laundering requirements. A second important issue is to ensure that human intervention is still possible when requested or required by the consumer, this can be particularly important for vulnerable consumers. It should be made clear when the distribution process is taking place without human intervention. A third issue is that most consumers are not mindful of or willing to save early for retirement, or have low trust in providers[1]. Finally, the PEPP is a new product that will compete with local existing pensions and long-term savings products. Therefore, it will require a strong marketing effort largely based on face-to-face meetings or individual calls.

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?

The Groups believe that there are issues with the methodology developed under the PRIIPs regulation and that it cannot be directly used under the PEPP regulation. Some members believe that this methodology can be a starting point and adapted for use with PEPPs, whereas others feel that it must fundamentally be changed. The Group highlights that the time horizon, investment method (e.g. lump sum or regular contributions) and liquidity of PRIIPs and PEPP products are quite different and require these differences to be reflected in the methodology used.

The Groups take note here of the ongoing review of the PRIIPs regulation and regulatory technical standards that is currently underway and will look at the presentation of risk and performance scenarios. There is a general consensus that there are issues with these methodologies under the PRIIPs regulation that need to be addressed in this review.

The Groups also see a number of other challenges and issues to be considered for the presentation of costs, risk and performance scenarios for PEPPs specifically. Several points relate to the long-term investment inherent in a pension product. Here the Groups raise the need to properly reflect the risk and performance of different investment strategies in the context of this longer time horizon.

As a final point, the Groups believe that the information provided should, in any case, be adapted to and suitable for the consumer.

Cost disclosure

Q3: Do you think that the PEPP KID should provide information on the following cost elements: administration costs, cost of investment management, transaction costs, distribution costs, cost of advice, cost of guarantee)?

[1] Page 53, https://ec.europa.eu/info/sites/info/files/mms2017_final_report_-_part_i.pdf

There is a general view that all the costs indicated should be disclosed. There were some views that they did not need to be broken down as set out or could be split under management and distributions costs. One member considers that transaction costs should not be provided as these are incomprehensible to consumers. A number of members consider the cost of guarantee should be reported separately. One member suggests that costs need to be put into perspective with the service provided, in order to enable savers comparing the costs they are effectively paying, with the service they benefit from, and how this ratio (i.e. value for money) meets and serves their expected demands and needs in retirement. It should be clear that this list is of exhaustive character and that there are no further costs associated with the PEPP.

Some members also made the following comments:

- Any deductions from the fund made by the PEPP provider on behalf of and to the tax authorities should be made transparent, to avoid that customers mistakenly think this has been taken by the provider as a cost.

- The costs should not be set out as above: what should be provided is an analysis of costs which are controllable by the customer and comparable in a meaningful fashion with other suppliers and with substitute products/solutions. It would be helpful if EIOPA could set out a taxonomy of costs and standardized definitions in order to allow for consistency as well as cost comparability across different providers. This should be as simple and workable as possible. The starting point for this "taxonomy" can be found in the PRIIPs regulation EU 2017 / 653 of 8 March 2017, Annex VI: Methodology for the calculation of costs - List of costs for investment funds, PRIPs other than investment funds and insurance-based investment products (cf. Recital 38 of PEPP regulation (EU) 2019/1238). These lists are comprehensive, very detailed and pertinent, because especially with regard to insurance-based investment products there already are long-term personal pension products (PPPs like annuities, combined payout options with draw down plans or lump sums) which are very close to future PEPP products (cf. Article 2 (1) of PEPP regulation).

- A guarantee is an add-on policy option which comes at a price. This price is not comparable to the costs of administration, transactions, etc. This price is a premium for an add-on insurance product. It should be disclosed separately, and it should be made clear what kind of add on product it is. What can a consumer expect from it?

- A buyer should know what the expected outcome is at the end of the savings period based on a given contribution/premium flow and an assumed return on assets. This return on assets should be the return before any costs are deducted and the expected outcome is after all costs are deducted. To facilitate a comparison between providers, it would be useful to present at least one common scenario for comparison purposes, showing what the net result would be on a, say 4%, return expectation and assuming a standard investment mix (for example, 50% bonds, 50% equity). Consumers are indeed not so much interested in knowing all the different cost components in detail. What they need is a fair comparison of the costs of different providers and what the amount is that they can expect at the end of the savings period after deduction of all costs.

- The primary purpose for the disclosure of costs should be to allow comparisons between product providers - not to quote a total cost. This is particularly true in a product which proposes to have a cost cap, which reduces the benefit of the total costs being disclosed to ensure providers are not "over charging". On this basis consumers should be able to easily compare whether one product is more expensive than another. From that perspective, the total expense ratio (or reduction in yield) approach could be a good way of doing this.

- It would also be worth considering a more radical approach whereby the TER/RIY would be categorised as Less expensive, Middle Expensive and More Expensive depending on whether the TER was, say, 0%-0.75%, 0.75%-1%, 1%+. Consumers might find this type of descriptive statement more informative than a number.

- Total costs should be disclosed in monetary terms and as a percentage of investment value, followed by a breakdown of the various cost elements (administration costs, cost of investment management, transaction costs, distribution costs, cost of advice, cost of guarantee, etc.).

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?

Members have differing views on this topic. Some members consider that the Reduction in Yield approach is appropriate, as it is the best measure to capture total impact of charges given the long-term nature of the PEPP and there appears no better measure. There are, however, differing views as to whether retail investors found RIY easy or difficult to understand and one suggestion was that consumer testing could be done to assess this.

Some consider that that there should be different approaches to the disclosure of costs at the pre-contractual stage, where RIY might be appropriate, and on an ongoing basis where the actual costs over the last year would be disclosed in the Annual Benefit Statement.

If the cost of the capital guarantee would be excluded from the 1% fee cap, one member considers that the computation of the RIY should integrate the cost of the guarantee to avoid giving incorrect and misleading information to savers.

Some members consider that the RIY approach is not appropriate for the following reasons:

- 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).

- The Reduction-in-Yield (transforming the impact of costs into an estimation of an estimation) is not appropriate as it is not understandable even for professionals and should be replaced by the Expense *Ratio* or the *Wealth-Reduction-Ratio*.

- The Expense Ratio (ER) shows how much fees "ate into" or "will eat into" (represent/weight) the cumulative return of the PEPP at target/maturity date. It would be calculated as the weighting out of the gross compound return of the difference between the real gross compound return and the real net (of fees) compound return.

- The Wealth-Reduction-Ratio, more meaningful for retail investors, would show the decrease in the PEPP saver's income per month due to fees. It would be based on public assumptions (Eurostat) of life expectancy at retirement of the age cohort of the saver and on an equal monthly distribution of the savings, with no further returns on investments.

Another member proposed using the TER approach as there is a convincing criticism from Better Finance on the RiY approach.
https://betterfinance.eu/wp-content/uploads/PRIIPs-Position-Paper-BETTER-FINANCE.pdf (see page 8 et sequ).

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?

There is a general agreement that the underlying methodology that should 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. Most members are of the opinion that the methodology used in the PRIIPs Regulation is not appropriate since it takes, for instance, a time horizon of five years. The investment horizon should be the minimum between the maturity until the retirement age and at least 20 years. It should also be considered the possibility of extended duration beyond retirement age, if the PEPP client has the possibility to stay invested in the same products using drawdown solutions "Flexible Pensions". However, one member disagrees and considers that 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.

One member considers that the length of accumulation period should not necessarily be reflected, but there could be a general mention that longer accumulation periods reduce the impact of short-term fluctuations. Still, a short-term fluctuation can significantly impact the final pension outcome, so the risk is the same at pay-out for very long-term investments.

For one member, the real challenge is to recognise and appropriately acknowledge tail risk and that low risk is not no risk.

Some members are of the opinion that the underlying methodology should recognize the fact that the risk of equity investment is lower in the long run than the risk of cash and nominal guarantees, because equity investment tends to protect savers against inflation, which in general is not the case of cash and nominal guarantees. Hence, the summary risk indicator should also reflect the impact of guarantees in real terms, i.e. after inflation.

One member is of the view that, in order to create a pre-contractual disclosure document that will actually be helpful, relevant and provide added value for the saver, the summary risk indicator must be built on a correct understanding of "risk" for retail investors and must be determined on two parameters that would properly reflect the risk profile of retail pension savers:

- The investment horizon remaining until the target date of the product;
- The market risk (volatility), credit risk (default) and liquidity risk (pay-out limitations).

The summary risk indicator could be presented in a table comprising three dimensions:

- the risk scale based on the number of years remaining until the maturity date of the product; and
- the risk level based on the probability of loss in real terms.

- the risk level based on the magnitude of the potential loss in real terms.

The summary risk indicator could be accompanied by a more generic table, indicating the risk characteristics of the assets in which the product invests (magnitude and probability of loss based on standardized time-horizons, such as 1 year, 1-10 years, and 20 years + per asset class, such as equity, bonds, money market instruments).

A number of members consider that EIOPA should recommend using the use of stochastic model and Monte-Carlo simulations to calculate the probability that savers get back the value of their contributions at retirement, in nominal or real terms. Such tools would also allow to calculate the expected loss and the potential return that savers could expect from the investment strategy under different scenarios.

Indeed, it is not clear if/how a deterministic approach for risk measurement could provide meaningful information to users given the path dependency of the risk mitigation methods (life cycle and smoothing) or allow the relative risks/benefits of one life-cycle approach vs another or a life-cycle product vs smoothing vs guarantee could be captured.

A single stochastic economic model assessing the risk mitigating effect of different investment techniques could allow a consistent assessment of risks for all eligible mitigation techniques. For example, it could provide for all PEPP products a % risk of the customer getting particular levels of returns and therefore

- provide the basis for meaningful risk categories (e.g. 1 to 5 or traffic light approach) to be communicated to the customer
- enable a threshold to be defined for “safe enough” risk mitigation and therefore distinction between the basic PEPP and non-basic PEPPs
- could also allow a principle-based approach for defining each risk mitigation technique and so avoid the need for detailed rules.

Inspiration for such an approach can be taken from countries who have already applied such stochastic economic models in relation to pension savings e.g. Austria, Denmark and Germany.

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?

Some members believe that three scenarios should be given. A number of members have reservations with the use of "best" estimate as being potentially misunderstood and recommend that EOIPA should discuss these scenarios with practitioners to set-up the most appropriate standards to be used by all providers. The objective should be to allow meaningful comparison between providers and avoid discrepancies. It was also suggested that, at a minimum, there ought to be strong warnings and unequivocal links in the KID and PBS to where detailed information on switching and early cancellation costs are to be found. There should also be strong warnings that all scenarios will be based on assumptions that may not necessarily reflect the developments of financial markets in the future.

One member suggests using just favourable and unfavourable scenarios, whereas another suggested a fourth "minimum" scenario as proposed in the current ESA consultation on PRIIPs.

There were very differing views on the investment horizon, ranging from:

- The investment horizon of maturity is a good indicator, depending on the remaining maturity it can be shown five-years or ten-years intervals additionally.

- 5 yearly switching intervals would seem appropriate. Projections to retirement which exceed this period come with too many health warnings to be trustworthy.

- Investment should be considered to maturity to encourage long term thinking. Given the PEPP long timeframe, the investment horizons to be considered should end up at retirement age to ensure that savers understand well the differences between investing in a liquid investment product or bank account and investing a long-term pension product for retirement.

- Recital (36), Articles 34 & 36 state that "Where projected levels of PEPP retirement benefits are based on economic scenarios, that information should also include a best-estimate scenario and an unfavourable scenario, <u>which should be extreme but realistic, taking into consideration the specific nature of the PEPP contract</u>.". As the PEPP is by nature a long-term investment product, this implies that the unfavourable scenario can't be based on short term market shocks to avoid giving incorrect and misleading information to savers. Even if a subscriber can switch provider every 5 years, the investment horizons to consider should be the minimum between the maturity up to the expected retirement date and at least 20 years.

- Regarding investment horizons, the focus on should be on maturity. Information on what could happen after 5 years could be presented in another layer of information.

- 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).

- Not only are future performance scenarios extremely misleading, but the PRIIPs future scenarios are based on only five years' performances (which, naturally, would be too short time horizon for a pension product). However, if future performance scenarios were to be kept for PEPP:
    - Three scenarios maximum
    - projection calculations based on at least 20 years of historical data.

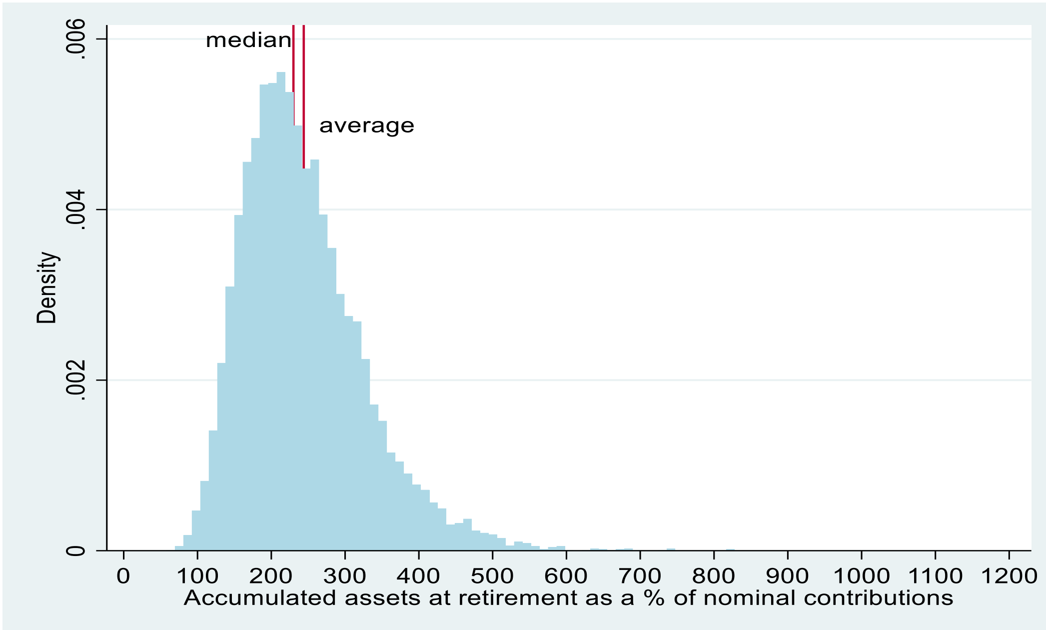
- PEPP performance projections must be comparable, i.e. standardized.

- PEPP performance projections must be long-term, i.e. intermediate points of 5 years, 10 years, 20 years, 30 and 40 years maturity.

- Future performance projections must be coupled with long term past performance disclosure with the performance of the benchmark selected by the provider disclosed alongside like in the UCITS KIID.

- While there are similarities with the PRIIPs discussions in terms of the range of forward-looking performance to be shown to customers, the PRIIPs underlying methodology (e.g. historical data approach) does not work and must be revised, in order to make forward looking disclosures that are appropriate and suited to long-term pension savings.

A number of members support the use of Monte Carlo simulations to present future performance under the form of a distribution of outcomes, as illustrated in the chart below. This approach would allow to inform savers about the average amount of assets they could expect to reach at retirement. Such presentation would also illustrate (i) the potential of accumulating a larger amount than the average and (ii) the risk of getting back less than the nominal value of contributions, or in real value using the ECB medium-term 2% inflation target.



Even if the 3 scenarios are appropriately defined, they could substantially differ from the final outcome at retirement whereas a stochastic model derives uncertainty about returns on investment, discount rate and inflation by assuming random-generating processes for each of the variables (or risks) in question. Therefore, in addition to the 3 scenarios, it would make sense to use a stochastic model to produce thousands of Monte Carlo simulations for savings accumulated at retirement based on stochastic simulations of investment returns in different asset classes, and of inflation. Usually, these models also assume correlations between the different variables when necessary. Each Monte Carlo simulation represents one possible realisation of the world. Using an easy-to-read graphic summarizing the results of these simulations and showing the distribution of the value of assets accumulated at retirement would provide a consistent and robust information to savers.

Considering that the distribution of the value of assets would be useful, EIOPA could consider allowing interested customers “play” with assumptions and positions in distributions. This might support those who are interested in these things to assess what could happen and under which circumstances. Such a gaming-like option must be possible to offer in a digital environment. EIOPA could also propose that all these scenarios be equally applicable for guarantee and life-cycle solutions.

One member has reservations about the use of Monte Carlo simulations, as the evidence of their use in capital budgeting by businesses operating in the real economy (as opposed to the financial economy) remains sparse. If these more sophisticated allocators of capital do not use this tool, what evidence is there to suggest that it would be a helpful decision support to retail investors who hold PEPPs?

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?

The Groups generally agrees that it is important to inform the consumer of the expected level of capital at retirement, after deduction of fees and inflation, compared to the total contributions paid to the PEPP, including to ensure that the purchasing power is explained to the consumer. A number of concerns exist, however, over how this might be achieved including how.

A first potential issue is over how an inflation rate would be obtained and if it would set a standard rate set by EIOPA, Eurostat or the ECB (which aims at inflation rates of below, but close to, 2% over the medium term).

The Groups also raise concrete ideas for presenting the expected level of capital at retirement. A layered approach could be used; first warning that inflation has an impact, then giving more detail in a second layer that is tailored to the type of PEPP (life-cycling, smoothing, guarantees). A graph showing the impact inflation and fees have on the present value of the capital invested could be given to consumers. This graph could show the decrease in time of the value a standard sum of money (€10,000) over 20 years, present the future performance scenarios gross-of-inflation (but net of fees), or in real net terms (inflation adjusted).

There is an underlying need to ensure that the consumer is not overloaded with information and is not disincentivised from actually reading the information document. It should be subject to consumer testing.

Structure of the PEPP Benefit Statement

Q8: Do you believe that the structure established by EIOPA for the IORP II Benefit Statement[2] is suitable for the PEPP benefit statement? Otherwise, what information would you consider missing and important for PEPP savers?

The Groups believe that the IORP II benefit statement would make a good starting point as a basis for the PEPP benefit statement. The Groups do, however, believe several additional points would also be needed in the case of PEPPs. This includes ensuring that it shows how a PEPP performed periodically and generally ensuring that it can be compared with other PEPP products, or IORP products where relevant. There should be a dedicated section on risks with a risk indicator and related risk information. The PEPP benefit statement should clearly and fairly explain and highlight the conditions of any guarantees offered for a PEPP. For other types of PEPPs, the benefit statement should disclose the returns of the underlying assets

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

or products. Where the PEPP includes insurance cover for the risk of disability, the benefit statement should clearly disclose the associated risk premium. This could be part of a section for additional features such as biometric protection. There needs to be a balance as too much information can be counter-productive.

The Groups also believe that the PEPP benefit statement should make use of digital approaches and layering. They believe that further improvements should also be identified through consumer testing and EU-wide studies.

1% Fee Cap for the Basic PEPP

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.

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?

There were very detailed responses and strong views on this question.

A number of members are supportive of the all-inclusive cap, for the following reasons:

- While it is important to reconsider and eventually change position on the inclusion of the cost of advice if the PEPP product has a low take-up, the 1% cost cap with an all-inclusive methodology should at least be tried. Financial innovations such as ETFs make it possible to reduce fees, and the ambition of PEPP is to reduce fees through economies of scale. This chance should be seized via the 1% all-inclusive cap.

- The product providers and EIOPA/NCAs already have 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. A number of members note that Article 45, paragraph 2, of the PEPP regulation clearly and explicitly specifies that “The costs and fees for the Basic PEPP shall not exceed 1 % of the accumulated capital per year.” Therefore, excluding ANY categories of costs from the 1% limit would breach Article 45(2) of the PEPP regulation.

- Such caps have been tested in the past: Several Member States have it in place for their national personal pension products (PPPs), including the UK.

- According to independent studies the average overall fee for the US domiciled PPPS is below 1% and the study on life cycle pensions from Bocconi university is based on a 1% overall annual fee.

- Consumer confidence for the PEPP is very important. They must be assured that 1% means 1%!

- If it is not possible to deliver the PEPP with 1% one could ask whether it is good to buy a PEPP. Within the Basic-PEPP there should be no further differentiation between mandatory and non-mandatory features which could lead to the result that the fee cap does not apply. It should not be allowed to sell a PEPP with higher costs than 1% for whatever reason. If you have specific features with more costs you must choose the non-Basic PEPP.

- There must be some kind of cost pressure on the industry as long as profits are high.

- From the consumer point of view, the PEPP presents serious hope to achieve a vision of sustainable, low-cost financial product offering for consumers. The all-inclusive approach suggested by EIOPA, requiring all of the relevant costs and fees to be included within the cap, is welcome.

- The cap, as negotiated, should not be diluted by ANY type of exceptions. If financial sector players are able to deliver a viable product at 1 percent or below – consumer expectations are fulfilled. If not, in two years' time, a revision is imminent and further changes to the regulatory regime can be discussed.

- It is critical that the cost of advice should be included within the fee cap for the Basic PEPP. Digital distribution of the PEPP product could help future PEPP providers to provide cost-efficient advice to consumers.

- On the contrary, the early exclusion of any types of specific cost classes will destroy the promise associated with the PEPP product. If certain types of costs are excluded from the cap, the race to add another cost element eligible for exclusion will begin. In the end, the very essence of a cap will be destroyed, hopes for a low cost product will be ruined, and, more importantly, public trust of policy makers will be severely damaged.

- The commitment to a low-cost product is a noble one. The lessons from the introduction of the Personal Retirement Savings Account in Ireland do not offer grounds for hope. See for example Maloney, M., & McCarthy, A. (2017). Pension provision by small employers in Ireland: an analysis of Personal Retirement Savings Account (PRSA) using bounded rationality theory, The Irish Journal of Management, 36(3), 172-188. doi: https://doi.org/10.1515/ijm-2017-0018

- A possibility that might be acceptable to stakeholders is to have a permitted variation on a five yearly basis whereby if returns exceed the aggregate of a rate of inflation and a rate of return on a long dated treasury instrument by a set amount, then a higher rate of fee might be acceptable. What would the higher rate be for? If investment markets in aggregate perform well, then the higher fee could well be a windfall gain largely independent of supplier performance.

- It does not bode well if the element of the value proposition that is discarded is the advice element. Suppliers have much cost in their value chain: rents, marketing, administration, fund management, strategy, legal costs etc. It would be good to see some squeeze on these elements using Target Costing and Lean Management principles before discarding the advice component.

- Stakeholder pensions were originally introduced with a 1% fee cap. This did not include the cost of advice. Following industry pressure, the cap was increased in 2005 to 1.5% for the first 10 years of saving, 1% thereafter. It will be difficult for providers to meet the 1% cap if the cost of advice is included. The only way this can work is if advice is online and automated. However, excluding the cost of advice from the cap may mean that people who buy a PEPP early on are disadvantaged if the cap later includes advice.

Another group of members consider that that the 1% cap is not viable, for the following reasons:

It will be extremely difficult, if not impossible for providers to develop a viable PEPP business model if the 'all inclusive' approach is adopted. If EIOPA adopt a "all inclusive" approach it will be difficult for potential providers to establish viable business models to distribute PEPPs, and it might have unintended consequences to clients, since a cheap product does not necessarily mean a good investment or the best choice.

This group of members also considers that Article 45(3) of the Regulation requests that EIOPA develop draft regulatory technical standards specifying the types of costs and fees that should be covered by the fee cap in order to ensure a level playing field between different PEPP providers and different types of PEPPs. If an "all inclusive" approach is taken, there is a huge risk that there will be no level playing field because there will be no PEPP market. Under this scenario, the PEPP will share the same fate as the European Long-Term Investment Fund (ELTIF).

There are a number of reasons why an "all inclusive" fee cap, including the cost of advice, would prevent the development of the PEPP market.

- Small amounts will be saved in the PEPP, at least initially – this is because the tax incentives are likely to be modest. It will therefore be extremely difficult, if not impossible, for providers to develop a viable business model. For a moderate earner saving 5% of a gross salary of 25,000 euros, a 1% fee in the first year equates approximately to 12.50 euros which is used to pay for the product, including advice. Over 5 years, the total fee collected would be €200. These are very small amounts, especially in view of the fact that the provider will never know whether the saver will decide to switch to another provider after 5 years.

- Providing in person, high quality advice is a complicated and costly task - what is required by the Regulation (on three occasions (PEPP regulation articles 20, 34 and 60) is not a guidance but a personal recommendation, which will involve undertaking a know-your-customer procedure, assessing the savers' needs, risk appetite and eligibility for the tax benefits, providing a personalized recommendation, and explaining the contract details and arrangements. It should also be taken into account:

  - ✓ Most consumers are not mindful / willing to save early for retirement
  - ✓ They often have no idea on what they have in their existing pensions schemes
  - ✓ The PEPP is a NEW product and will compete with current local pension saving products
  - ✓ As the current level 1 regulation doesn't define precisely the actions covered by the mandatory advice, it is likely that NCAs would refer to the MiFID2 standard when they would label the PEPP. Our compliance departments could also refer to this Delegated regulation (EU 2017/565)

  Whilst robo/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 every market's tax, social security, etc systems.

  Therefore, offering the PEPP will require a strong marketing effort based mostly on face to face meetings, which are likely to take at least 1.5 – 3 hours for basic cases and longer more for complex cases.

  For this reason, providing advice is unfortunately costly. By way of illustration, a study from Strategic Insight shows that the average fee paid by investors to get some professional advice in the United States ranged from up to 1.5% for small investment accounts (below $100,000), down to approximately 1.0% for investments around $1 million and less for less for multi-million dollar accounts.[3]

[3] See Strategic Insight (2017): "Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios: a Canada – U.S. Perspective 2017 Update". Available here.

- There are different distribution strategies across Member States (direct selling, through banks, digital platforms …), and the PEPP Regulation requires PEPP providers or PEPP distributors to provide advice before the conclusion of any PEPP contract, establishing the possibility of doing it "in whole or in part through an automated or semi-automated system", which, may be charged directly to the PEPP saver or consist in a portion of the management fee that is paid by the PEPP. It is unclear how such arrangements could be put in place without creating competitive distortions in the market. Crucially, a further factor will depend on the remuneration of the advisers offering a non-PEPP alternative personal pension product (PPP). If the PPP allows advisers to receive a higher remuneration, there will be a bias against the distribution of the PEPP.

- The PEPP is a personal pension product, not a workplace pension - default investment strategies in workplace pensions in the UK are subject to a 0.75% fee cap which according to some policy makers has provided a justification for the 1% fee cap. However, an occupational plan based on auto-enrolment has a very different cost structure from a third pillar pension product such as the PEPP, which is subject to different distribution costs and mandatory advice. Hence, the ability of UK providers to supply workplace pension products within the 75bps cap is not be a good guide to a third pillar product in the more fragmented European market, where the cost of customer acquisition is likely to be quite high. Overall, the UK experience on the 75bp charge cap shows that while costs have gone down, the impact on investment has led to lower levels of diversification and a desire to minimize investment costs, regardless of the possible impacts on members' outcomes.

  To put it another way, investment strategies following the reform are being constructed from a starting point of lowest cost, rather than the strategy which has the best chance of delivering good outcomes for members. It is also useful to look at the fee structure of two Australian pension funds (Table 1 and 2 below): the QSuper, which is a profit-for-member superannuation fund and one of Australia's oldest and largest funds, and Rest, which is a very large superannuation fund offered to retail employees. The total cost of the four different life-cycle funds offered by QSuper, excluding the cost of advice, are shown in the table below. The cost of the fund falls with the age of the saver, as the share of equity decreases as the saver is approaching retirement. For savers under 40, the cost is 0.93%. In the UK the average cost of advice is in the region of 3% initial and 0.7% ongoing (Data included in the Financial Advice Market Review – Baseline Report from June 2017). The total cost of the core strategy offered by Rest is 0.90% for accounts of $50,000, and 3% for accounts of less than $6,000. This cost does not cover advice.

Table 1 (QSuper)

QSuper fees breakdown

The cost of managing your account is split into administration fees, investment fees, and indirect costs. We calculate and take the fees out before we declare the unit price, every working day.

Investment option	Administration fee p.a.[1]	Investment base fee p.a.[1]	Investment performance-based fee p.a.[1]	Indirect cost ratio p.a.[1]	Total fee p.a.[1]
Lifetime Outlook (age under 40)	0.16%	0.33%	0.33%	0.11%	0.93%
Lifetime Aspire (age 40 to 49)	0.16%	0.27%	0.26%	0.10%	0.79%
Lifetime Focus (age 50 to 57)	0.16%	0.23%	0.22%	0.07%	0.68%
Lifetime Sustain (age 58 and over)	0.16%	0.17%	0.13%	0.04%	0.50%

Source: https://qsuper.qld.gov.au/our-products/our-fees/fee-details

Table 2 (Rest)

How your fees might look

If you're in the Core Strategy (and you'd be in pretty good company as most of our members are in this investment option), and have a balance of $50,000, your annual fees will look like this.
And if your account balance is less than $6,000, the amount of administration fees, investment fees and indirect costs that you'll pay each year is capped at 3% of your account balance.

Investment fee	0.60% of your balance per annum	$300
Plus administration fee	$1.30 per week, plus 0.1% of your account balance at the end of each month (capped at $800 per annum)	$67.60 plus $50 per annum
Plus indirect cost ratio	0.07% per annum	$35
Total*		$452.60 per annum

* If your account balance is less than $6,000 at the end of financial year, or if you leave Rest, the total combined amount of administration fees, investment fees and indirect costs charged to you is capped at 3% of your account balance for the year (or the period until you left).

Source: https://www.rest.com.au/member/products/fees-and-charges

Some members are also of the view that transaction costs should be excluded from the fee cap as these costs relate to the payment of a broker on the purchases or sales of securities and the payment of taxes and levies to Governments and/or regulatory bodies or exchanges. The brokerage fees are paid to invest contributions received or meet withdrawals and to achieve positive performance. The higher return expected from the purchases and sales of securities is good news for savers. The inclusion of transaction costs in the fee cap would create an to invest in passive investments away from investments in SMEs and infrastructure, as desired in the CMU initiative. This would translate into missed opportunities to make gains or limit losses and would therefore be detrimental to PEPP savers. Furthermore, it is extremely unclear how to cap a cost that would include implicit elements of the investment process such as the bid-ask spread. In the case of these transactions, there are indeed no fees paid by anyone and the calculation of implicit transaction costs would probably be inoperable.

Against this background, a number of members propose that EIOPA structure the fee cap in a way which focuses on the cost of manufacturing and administration and excludes advice and distribution costs. Once the dynamics of the new PEPP market are more clearly established, a review of the fee cap structure could be considered.

It would also be useful that EIOPA clarifies what personal advice means and its current cost and investigates the possibility of allowing a transitional measure to allow for the temporary exemption of these costs until the review of the fee cap, foreseen two years after the implementation of the PEPP Regulation in order to further examine this issue.

In the meantime, the transparency of costs, already foreseen, will be a useful tool to enable savers to make an informed choice but also to boost competition and ultimate drive costs down for providers to stay competitive in the savings landscape.

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?

The Groups have split views on this point. One part of the Groups believes that the guarantee should be included under the costs considered for the 1% cap. This part of the Groups believes that if the cost of the guarantee is borne by the consumer it is important to include. These members also believe that not including the cost of the guarantee would create a competitive disadvantage for asset/fund managers offering a life-cycling option and would incentivise providers offering a guarantee to shift other costs into the cost of the guarantee. A point was made here that the inclusion of the guarantee would be consistent with the Solvency II capital requirements provisions on investment management costs. If no guarantee is offered the cap could be reduced to 0.3% - 0.5%.

Another group of members believes that guarantees as distinct in nature from other risk-mitigation techniques and believes that they should be excluded from the cost cap. These members believe that this would consistent with the level 1 PEPP regulation text outlining the scope of the regulatory technical standards, as well as to ensure a level playing field between providers offering a guarantee and those using other risk-mitigation techniques, given that it requires significant levels of capital. This group of members believes that the easiest way to show the cost of the guarantee would be to base the cost on what the provider charges to the customer for the guarantee and require this to be made transparent. Another way that could be considered is to base this on the methodology specified by Solvency II calculations. These members believe this could be done by including the option value of the guarantee, as required under Solvency II for the valuation of technical provisions, as well as including the cost of providing Solvency II capital to back the guarantee based on the risk margin methodology.

Another group of members believes that guarantees should be presented and priced separately. These members believe that, in the case of a pure nominal "capital guarantee" on the capital net of accumulated fees at maturity, there must be a prominent warning that the guarantee does not cover accumulated fees and inflation and may therefore result in a severe loss of the purchasing power of the PEPP at maturity. This part of the group believes that it is important to also ensure that the costs of the guarantee are not used to cover other costs such as distribution costs if it is excluded from the cap.

Some members also consider that EIOPA closely monitor guarantees, in particular in the context of the low interest rate environment. In this context, EIOPA could establish a European level dialogue to assess guarantees.

Risk-Mitigation Techniques

Guarantees

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

The Groups propose the following diverse measures to boost the performance of guaranteed PEPPs:

- Improvements to Solvency II, leading to more appropriate and lower capital requirements for long-term products.
- Review solvency rules to allow insurers to invest much more in listed and unlisted equity to cover long term liabilities.
- Widening of the asset classes available for investment.
- Pooling of exceptional investment results (both upside and downside, e.g. 97% and 3%) in a common buffer.
- Issue of suitable securities by the public and private sector.
- Better linkage of bonds available and guarantees offered.
- Improved fund management performance.

- More benign fiscal policies involving public capital programs.
- Stronger governance and market discipline in capital markets.
- Low cost providers.
- Leaner value chains.

Some members of the Groups believe that a solution rather lies in ensuring that life-cycle investment strategies are available as part of the default PEPP options, or that PEPP savers should be allowed to invest directly in simple cost-efficient products, such as listed shares, ETFs or listed bonds. The point is made here that sectorial legislation only concerns own-risk insurance products and does not affect the defined-contribution investment component of a PEPP. Solvency II, MiFID II and other legislation do not confine investors to certain limits or mathematical provisions.

Members of the Groups supporting changes to Solvency II in the context of the 2020 review highlight that it does not correctly measure long-term business and investment risks and as a result is overly conservative and volatile. These members believe that this unnecessarily and adversely affects the cost and availability of long-term products such as pensions, as well as the ability of providers to select an optimal asset mix. They believe that improved Solvency II requirements for long-term liabilities and for investment risks would help insurers to provide safe, long-term savings products, including guaranteed PEPPs at lower costs to customers.

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?

Many members support a principles-based approach, at least ex ante with the possibility of some NSA/ESA oversight ex post. Some felt a principles-based approach would allow providers flexibility based on market conditions, possibly with sufficient conduct of business regulatory heft to make the enforcement of the principles operable rather than aspirational.

Some members support a principles-based approached but with some rules or standards in place. One member considers that simple and understandable rules (rather than principles) such as the new French one for its own PPPs should be used.

As of today, life-cycling strategies are mainly market practices. This means that in most countries, these strategies are not falling under any regulatory or supervisory frameworks (except French PACTE model and Polish PPK model recently introduced). This results in a high diversity of approaches revolving around different parameters: starting and ending assets allocation, investment glide path as well as length of accumulation and levels of contributions.

Introducing excessively restrictive requirements to frame these techniques could challenge innovation on financial markets and defeat their added value (i.e. 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, i.e. allow the PEPP saver to recoup its capital.

Against this background, there would be merits in considering risk mitigation techniques discussions together with risk measurement under the PEPP information key indicators. A single stochastic economic model assessing the risk mitigating effect of different investment techniques could result in a consistent assessment of all eligible mitigation techniques. It could provide % risk of losing or gaining certain amounts but also allow the information to be presented in different categories (1/5 or traffic light approach). This risk measurement could also prevent too detailed rules and enable a distinction between RMT eligible to the basic PEPP and alternative investment options, establishing different minimum thresholds to be satisfied in terms of risk reduction.

Inspiration could be gleaned from countries who have implanted such stochastic economic model in relation to pension savings, e.g. Austria, Denmark and Germany.

A principle-based approach in line with the prudent person principle could assure enough security and flexibility at the same time. Furthermore, good risk management could be rewarded with the possibility to take (slightly) higher risks.

There is sufficient evidence from the UK, the largest private pension sector in the EU at present, that there are recurring cultural difficulties within the sector. It is a precondition therefore that the NCAs must demonstrate early on their commitment to robust enforcement so that the cost of breaches does not become a cost of doing business within the sector. This would reward the principle led practice and bar from the market those firms and individuals unable to abide by them.

As Mackintosh (2016) remarks, a common narrative among the community of technical actors has a direct impact on policy outcomes. (p125)(See Stuart P Mackintosh, (2016) The Redesign of the Global Financial Architecture: the return of State Authority, Routledge, UK).

The Bocconi study and many other researches have highlighted the power of the switching mechanism as an effective risk-mitigate tool over a saver's lifetime that can deliver good outcomes. The governance processes used by fund managers are strong and demonstrable and include fiduciary duties, protection of assets, limited balance sheet risk, independent oversight, organizational requirements, risk management process, suitable products, regulatory regimes, transparency and reporting.

EIOPA should not propose a rigid approach to life-cycling with a prescribed set of asset allocation guidelines. This is because quantitative limitations would have some major drawbacks:

- They would reduce the potential for risk and return diversification of a PEPP portfolio.
- It would be hard to determine whether the restrictions would be too severe or too flexible.
- This approach would require defining a taxonomy of assets according to their risk levels.
- The restrictions would limit the possibility of financial innovation.
- Market conditions could make them quickly ineffective or even counterproductive.

This being said, there may be a role for some specific requirements to ensure that PEPP providers can demonstrate to customers and regulators in a consistent and robust manner how their investment process is consistent with the risk profile of the corresponding investment option. The most promising approach would be to require PEPP providers to calculate the probability of a given investment strategy recouping the capital invested at the end of the accumulation period. The calculation of this probability could be made using a stochastic model to simulate a distribution of investment returns.

Under this approach, PEPP providers should be allowed to design the asset allocation and the de-risking strategy as they see fit as long as the risk level of the investment strategy is consistent with an agreed objective.

This approach would have the following advantages:

- The calculation of the risk takes into account the distance to retirement of individuals and the life-cycling approach to investment.
- It would strike a balance between risk and reward by avoiding focusing on short-term risk and losing sight of the potential return.
- It could form the basis for the disclosure of risk in the KID and for the presentation of the performance scenarios and the range of possible future returns.
- It would allow to differentiate the Basic PEPP from alternative investment strategies by imposing different minimum probabilities of recouping the capital invested.
- In particular, this approach would allow to determine that a Basic PEPP based on life-cycling is a low risk strategy by imposing that it should comply with a relatively high probability of recouping the capital invested.
- This approach could also be used to calculate the level of risk of a Basic PEPP designed on the basis of a guarantee on the capital.

It is also important that there must be enough flexibility for providers 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.

The issue of flexibility was raised in another response. Art 34 1. States that “Prior to the conclusion of a PEPP contract, the PEPP provider or PEPP distributor shall specify, on the basis of information required and obtained from the prospective PEPP saver, the retirement-related demands and needs of that prospective PEPP saver, including the possible need to acquire a product offering annuities”.

As stated in Recital (30), this implies providers to answer to the individual demands and needs of each PEPP saver not only during the accumulation phase but also during the decumulation phase. Moreover, these individual demands and needs could change over the long-term horizon of the PEPP.

This requires providers to offer personalization and flexibility.

Imposing minimum/maximum thresholds per asset classes at different points in time will limit the needed:

- Flexibility to design the most appropriate individual glide path for life cycle strategies
- Innovation for this new product.

Hence, the importance of flexibility for individuals. If for one consumer the PEPP would constitute the most important element in his pension savings than a strategy that indeed would aim something like less than 0.5% probability would make sense. But, if the PEPP for another consumer is just for that little extra, it might be perfectly acceptable that the strategy would be riskier than for the first consumer. There are examples of such a tailor-made approach. Robert Merton (the Nobel prize winner) was one of the first architects of such an individualised approach. Nowadays, more providers are exploring this territory.

One member supports the principles-based approach provided that there is a solid risk indicator. Otherwise, it would need to be regulated based on minimum requirements relating to the investment allocation.

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?

The Groups fully agree that the investment objective should be clear.

One Member suggests that Accountants and Actuaries have professional standards for measurement with respect to financial and other data within the sector. Similarly, there are professional lawyers who specialize in pensions. Collectively these together with their investment counterparts, Chartered Financial Analysts, Treasury and Risk Professionals should be able to provide the appropriate tools and terms in this domain.

A standard glossary should be used. In the Pharmaceutical industry, standard operating protocols are widespread. Common measurement, terminology, and quality conceptualization are part of industry practice with wide acceptance. This should be as simple and workable as possible.

Suppliers need to be judged by their sustained commitment to good practice. Their brand image should benefit accordingly.

Other members believe that consistency and comparability are very important to ensure a level playing field amongst providers. It is therefore important that savers get clear information about the nature of the de-risking strategy offered by life-cycling strategies. This could be done by presenting in the KID a description of the glide path put in place by the provider. Another suggestion was that comparability of results is important and can be achieved by using clearly defined (stochastic) methods for the ex-ante assessment of the investment objective and how it could work out for a consumer.

Another member considers that this has clearly been stipulated by the PEPP Regulation (especially article 41 (1) on investment rules). Article 25 of the 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 the regulation).

One member considers that investment objectives should be clear but there is no need for clearly defined methodologies provided that there is a clear and consistent stochastic risk measurement applicable to all risk mitigation techniques.

Similarly, another member agrees that the investment objective must be clear and the strategy must be based on a clearly defined methodology and definitions, actual, quantifiable objectives (with a benchmark whenever possible), allowing the corresponding section of the KID to be meaningful and understandable for the retail saver. A clearly defined methodology, including definitions, should be developed by EIOPA.

The only qualified response was that as long as this does not go at the expenses of the risk-return outcome, i.e. some discretion may be better than none.

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

The Groups agree on the need for transparency and to ensure that consumers are properly informed of smoothing based risk mitigation and how fairness is ensured for all savers.

Some members believe that pooling and smoothing techniques are an alternative and a less risky way for savers to access certain types of investments while benefiting from the long-term average returns. They believe that a PEPP based on this approach can offer attractive returns and lower risk than if the customer invests directly. They highlight that this is largely a type of product offered by mature insurers with significant general accounts and smoothing capacity. For these companies this group believes that it would be important to find a way can to allow the consumers to make use of the general account smoothing capacity. For a new company wanting to start a smoothing based PEPP sufficient capital would have to be lent or allocated to the PEPP and which could be replaced overtime with the funds own smoothing capacity. This part of the Groups also see the need for obligations on the consumers to invest for a long term, only allowing them to access the lower value of the funds invested in case of early redemption or switching.

These members of the Groups believe that there would need to be a way for allocation of premiums paid in, the assets they are invested in and the returns earned over-time on those assets to be allocated to the consumer. They believe that the allocation requirements should not be overly restrictive as this could limit the ability for insurers use of their general accounts for such products. They indicate that in other areas of insurance regulation, legal ring-fencing has been avoided because of the constraints it creates and other mechanisms to ensure the necessary segregation have been found.

Concerns were, however, raised by other members of the group on the past experience of smoothing that has led to significant discrimination between generations of pension saver as a result of this technique being used. Some of these members consider that the use of some practical, flexible and low cost technics such as the possibility of postponement for surrenders and the use of flexible drawdowns could be used to mitigate short term unexpected market adjustments. Some members also have concerns over the possible pro-cyclical effects if capital and a buffer are invested in the same way in case of negative performance.

Some members also consider that all existing national provisions with regard to the prudent person principle, fair benefit participation of beneficiaries, product oversight and governance requirements, pre-contractual information duties, pension benefit statements and competent authority product intervention powers resulting from relevant EU regulation (mainly Solvency II, MIFID II, IDD, PRIIPs and IORP II), should be applied without any restrictions to PEPP providers, to ensure that consumers will benefit from the same level of protection as any other long-term savers. In many EU member states there are legal provisions at national level on how consumers investing in a PRIIP or an IBIP in particular must benefit from any capital buffers or reserves.

Views on other issues

Members were asked if they had any views on other issues. The responses are reproduced here as given by those members but there has been no attempt to get views on those issues from the other members.

View 1

The prospective benefits should be comparable to those of pension plans, so that pension tracking systems can provide the full information to the plan members / PEPP customers.

View 2

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 diminished too strongly.

View 3

As a general remark, I believe a PEPP provider using a non-Solvency II guarantee is not required to hold buffers at all. In The Netherlands exists experience in the prudential framework when the risks involved are shared between the participants of the PEPP, and not the PEPP provider. This is derived from article 15(1) IORP II, which reads:

The home Member State shall ensure that IORPs operating pension schemes, where the IORP itself, and not the sponsoring undertaking, underwrites the liability to cover against biometric risk, or guarantees a given investment performance or a given level of benefits, hold on a permanent basis additional assets above the technical provisions to serve as a buffer.

More information can be read here:

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3354549

The reasoning in this paper applies mutatis mutandis to PEPP providers which do not cover the biometric risks or guarantees themselves!

View 4

Policymakers might usefully consider the analysis, perspectives arguments and evidence presented by Froud Tischer and Williams (2017) in considering whether the business models currently operated in the sector are capable of fulfilling the policy goals in this domain. While this article focuses on the banking sector, some elements may be relevant for personal pensions also.

See Julie Frouda, Daniel Tischer, Karel Williams, (2017) It is the business model: Reframing the problems of UK retail banking, Critical Perspectives on Accounting Vol 42, pp1–19.

Similarly de Jager's (2017) view that EU legislators would be well served by promoting an acceptable level of trust and by implication an appropriate level of distrust in the financial sector. Some friction may be necessary to maintain a degree of friction that enhances competition, performance, innovation, value delivery and progress towards socioeconomic goals.

See C. E. de Jager (2017) A Question of Trust: the Pursuit of Consumer Trust in the Financial Sector by Means of EU Legislation, Journal of Consumer Policy Vol 40,: pp 25–49.

View 5

The prospective benefits should be comparable to those of pension plans, so that pension tracking systems can provide the full information to the plan members / PEPP customers.

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