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Transparency of Performance, Costs and Fees (Capital markets union action plan)

Position Paper by the EIOPA Occupational Pensions Stakeholder Group

1. Objective

In September 2015, the European Commission (EC) launched its Capital Markets Union (CMU) Action Plan. One of these actions is to ask the ESAs to work on the transparency of performance and fees of long term and pension savings products:

European Commission's CMU Action Plan (page 18,September 2015): « To further promote transparency in retail products, *the Commission will ask the European Supervisory Authorities (ESAs) to work on* ***the transparency of long term retail and pension products*** *and* ***an analysis of the actual net performance and fees****, as set out in Article 9 of the ESA Regulations. »*

The OPSG had identified the disclosure of performance and fees as an agenda item of the work programme of its user protection sub-group, and therefore generally welcomes this initiative from the EC.

Some members of the OPSG believe that the CMU action does not include occupational pensions in its scope, because those are not "retail" products. Other members of the OPSG believe they are indeed in scope as the CMU Action Plan mentions "long term retail and pension products", and as the EU Law governing the OPSG does mention that consumers and other retail users of the IORPs are among the "stakeholders" of occupational pensions[1] (and therefore must be represented in the OPSG). Anyhow, all members of the OPSG agree that transparency of performance and fees should apply to occupational pensions as well, and agree to include occupational pensions in the scope of this position paper.

As of September 2017, OPSG understands that the EC will issue a formal mandate to EIOPA to implement this CMU Action this month.

At the suggestion of EIOPA (26 April 2017 OPSG meeting), OPSG will try to deliver advice to EIOPA on the implementation of this CMU Action at two different stages:

- before the mandate to help frame the issues,
- and once the mandate has been issued for the project development

This paper addresses the first stage.

The OPSG would like to clarify from the outset that disclosure requirements for long-term retail and pension products vary according to the regulatory framework they fall under (e.g. Solvency II, PRIIPs, IORP II). Differences between these rules reflect fundamental differences between these products, which is why it would be challenging to achieve comprehensive and meaningful comparability. Furthermore, some of these rules are yet to be implemented and their combined impact remains to be seen. Therefore, the OPSG calls on the ESAs to refrain from jumping to conclusions and developing common disclosure rules in the sole framework of their work on transparency.

[1] Recital 47 of EU Regulation 1094/2010 establishing EIOPA

The objective of the ESAs' work should be to assess whether products provide value for money, which is a concept that depends on a wide set of elements and the type of products. Therefore, the ESAs should base their work on appropriate methodologies depending on the type of products being considered. The OPSG believes that it would be incorrect to apply a one-size-fits-all methodology that would be inevitably biased towards one type of product. A biased approach would ultimately deny the diversity of long-term retail and pension products and would not acknowledge that they meet consumers' various needs. For instance, it would be wrong to consider a product with protection features from the sole angle of financial performance because it can be assumed they were specifically chosen for these extra features.

Furthermore, the OPSG is of the opinion that attention must be paid when applying the concept of cost. Protection features come at a cost, from prudential regulation alone.

Regarding performance, the OPSG would like to point out that long-term retail and pension products are meant to be long-term. Therefore, showing returns for a short period of time and long before maturity would be irrelevant. This would artificially distort the assessment of the true value provided by some types of products.

In this context, some members also point out that due to their nature as a social contract between employer, employees and social partners, occupational pension products funded through IORPs are missing typical characteristics of consumer financial products and services. Hence, it has to be carefully considered, where such common disclosure rules make sense and where they do not or are just not applicable.

2. Current status of the ESAs work on this CMU Action

The CMU Action refers explicitly to Article 9 of the ESAs Regulations. Indeed this article stipulates that the ESAs must collect, analyse and report on consumer trends:

"1. *The Authority shall take a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services across the internal market, including by:*

(a) collecting, analysing and reporting on consumer trends; …

(d) contributing to the development of common disclosure rules".

To date, the work carried out by the ESAs to fulfill their duties under article 9.1. has not included information on "*actual net performance and fees*" of the "*consumer financial products or services*" under their scope. This is particularly the case of long term and pension savings.

For example, one cannot find any performance and fee information in the "*Consumer Trends*" reports published by EBA and EIOPA. In the "*Trend Risks and Vulnerabilities*" report published by ESMA (ESMA does not publish a report specific to consumer trends), some quantitative information is included for the last five years labeled "*retail investor portfolio's* *returns*". However, these returns are actually blended capital markets returns (stocks, bonds and interbank money market) and not on retail investment products' returns.

As pointed out by the CMU Action Plan, this action will enable the ESAs, and EIOPA in particular to better fulfill their legal mandate "*related to consumer protection*" (article 9.1).

3. Proposed product scope of EIOPA's work on the analysis of actual net performance and fees of long term and pensions savings

3.1. Pension savings products

The OPSG proposes to include all funded pension products where pension savers eventually bear all or part of the investment risks:

• Collective Defined Contribution (DC) pensions

• Collective insurance-based DC pensions

• Individual/personal (whether they are insurance – based or not) pensions with or without surrender value, including the future PEPP.

• This criterion should also be applicable to "hybrid" pension products, which mix defined benefit (DB) and Defined Contribution (DC) techniques, although the variety and sometimes complexity of such products may make such an application difficult.

As far as insurance-based pension products are concerned, OPSG and EIOPA could ask the IRSG if it would be involved at some stage.

It is important to bear in mind the characteristics of collective pensions (i.e. the inclusion of employer as well as employee contributions) so as not to distort results.

OPSG believes that the defined benefit (DB) pensions should not be included in the scope, as usually in DB pension plans, the consumer does not bear the investment risk. However, financial returns are also very important for the performance of DB schemes, and therefore for their participants.

3.2. Long term savings products

It is important to mention that the CMU Action not only includes "pension" savings products stricto sensu, but also all "long-term" retail savings products. In fact, EU citizens often use multi-purpose long-term products for retirement purposes, such as:

- Life-cycle investment funds as such, other investment funds, equities and bonds (SMSG scope)
- Life insurance (IRSG scope)

In this respect, in our view, IRSG and SMSG should also get involved asap.

3.3. Costs and fees

OPSG recommends that the ESAs to review the existing definitions of costs and fees in EU law (such as in MiFID, IDD, PRIIPs, IORP, etc.), in order to check if they can be used for this Action, and to use a consistent definition and scope for all long term and pension savings products.

One member pointed out that too high fees take away opportunities from individuals, and suggested to insert a table at the beginning showing the impact of costs; for example after 30 years. One member mentioned as a possible approach the Synthetic Cost Indicator disclosed by Italian pension funds and designed by COVIP, the Italian Supervisor (see brief description attached in annex 1).

4. Proposed information to be collected, analysed and reported

The OPSG reiterates that the objective of the ESAs' work should be to assess whether products provide value for money, which is a concept that depends on a wide set of elements and the type of products. Therefore, the ESAs should base their work on appropriate methodologies depending on the type of products being considered.

The OPSG also insists that the European Public Authorities should only use a consistent methodology applicable to all pension products, so that comparisons are meaningful and accurate.

Nonetheless, the OPSG suggests collecting information:

- by Member State
- by main long term and pension savings products categories by Member State as they vary from one to the other (for example in the Netherlands, the biggest product category is collective pension products, in France it is life insurance)
- over the longest term possible (currently: OECD: 5 and 10 years; Better Finance: currently 17 years wherever data is available)
- following a well-defined, consistent and open source methodology, taking into account the only existing one at the international level: OECD[2]'s (for non insurance-

[2] See for example the OECD « Pensions markets in focus 2016 ». Data are calculated using a common formula for the average nominal net investment return (ratio between the net investment income at the end of the year and the average level of assets during the year). Average real net investment returns are calculated using the nominal investment rate of return (as described above) and the variation of the end-of-period consumer price indexes.

based pension plans only but applicable to other long term savings products) and also used by Better Finance (for a much larger scope)[3]:

- nominal gross return
- minus impact of all fees and commissions including average entry and exit fees, indirect fees (for example the fees charges to the "units" of unit-linked insurance contracts in addition to the contract fees) if applicable and as far as they are borne by the pension savers / participants.
- minus the impact of inflation (very important to eliminate the "monetary illusion" for long term savings; one member whishes to mention that in her view providers cannot manage the inflation risk).
- Taxation has a key impact on the return for pension savers, therefore some members recommend to try to quantify the impact of taxation whenever possible (very challenging in the EU, but this is mandatory in the summary prospectus for mutual funds in the USA). However, other members feel that the impact of taxation should be disregarded because it is too complex, and to avoid distorted results due to diverging taxation systems and rates across the EU. If taxation is included in the calculation of the net return, tax benefits on the contributions have to be included as well.

This methodology implies to also assess and evaluate **the overall average level of fees & commissions for these product categories**

Regarding fees, whenever possible EIOPA should break them down by fee category (management, administrative, custody, etc.), and identify any fees or parts of fees that are related to additional services provided other than long term returns, such as:

- services to insure long term and pension savers against longevity risk
- services to provide some minimum return protections, provided they generate real value for pension savers[4]
- other services such as long term care, etc.

Some members point out to a limitation to the breaking down of fees into very granular categories if and when some of those are covered by a confidentiality agreement at the request of the pension service provider.

[3] There seems to be no methodology to be found in EU Law for disclosing past performance, except for the Key Investor Information Document of UCITS investment funds, but this Regulation 583/2010 will be abrogated soon by the entry into force of the PRIIPs delegated Regulation, which unfortunately eliminates all disclosures of past performance.

[4] For example, for pension products, a nominal capital guarantee at retirement has very limited interest and is misleading for pensions savers who are subject to "monetary illusion": over 40 years, even with a low average inflation rate of 2% per year, this (nominal) capital guarantee means in reality that only 45 % of the real value (purchasing power) of the pension savings is guaranteed.

The categorisation of pension products should also take these additional services into account in order to avoid comparing “apples and oranges”.

One member points out that performance and costs disclosures require a higher degree of transparency and publicity for PPPs compared to collective pensions, and also points out to the mandatory performance disclosure and methodology applicable to Croatian pension funds (annex 2).

EIOPA would also benefit from investigating what data and methodology the ECB, Eurostat, etc. could be using in this field.

EIOPA could also begin collecting individual data in a more granular way. For example, the ESA could start using its Pan-European product data base (insurance and pensions), as it is already done by some NCAs. This will certainly improve the accessibility of retail investors and financial services users to a more transparent data.

Annex 1
Italian pension funds – The Synthetic Cost Indicator

The Synthetic Cost Indicator (SCI) is an indicator aimed at easily communicating all the costs charged on a pension fund member (over the accumulation phase) in percentage of the assets of his individual account. The SCI is calculated as the difference in the real return of the pension scheme compared to a hypothetical similar scheme where no costs are charged to the members.

The SCI is meant to be a tool for consumers to be able to compare the costs of different pension schemes, based on a standardized methodology which doesn't take into account any cost relief accorded to specific categories of consumers. Therefore it has to be noted that the SCI is not an indicator of the real cost the consumer pays for the enrollment in the pension scheme but is only an indicative value.

Indeed, the SCI is calculated according to a methodology defined by COVIP, which is common for all the different kinds of pension funds and has to be done for all different schemes/investment options offered by a pension fund and for four different time horizons (2, 5, 10 and 35 years). The calculation is referred to a "representative" member who accumulates assets in his/her account according to the following hypothesis:

- contributions annually paid: 2500 euro (at the beginning of each year);
- assets: annually revaluated by a constant rate of return (4%);
- charges: all direct (e.g. enrollment charges) and indirect charges (e.g. management fee) paid by the member upon joining and during the accumulation phase.

The SCI of each scheme/investment option has to be displayed on the Key Information Document to be made available to members (*Informazioni chiave per l'Aderente*), on the *Nota Informativa* (Informative Note) and on the COVIP website.

In particular, the Key Information Document should display a chart, showing for each scheme/investment option and for the four different time horizons:

- the SCI calculated for the specific scheme/investment option;
- the average SCI calculated for a comparable pension scheme/investment option (open-ended pension funds, closed-ended pension funds, insurance third pillar pension schemes);
- the minimum and maximum SCI calculated for a comparable pension scheme/investment option (open-ended pension funds, closed-ended pension funds, insurance third pillar pension schemes).

Data on the minimum, maximum and average SCI for each scheme/investment option category is available on the COVIP website (http://www.covip.it/Indicatore).

Annex 2

Croatian pension funds – performance disclosure

The calculation used for performance is prescribed by the local pension bylaws. The calculation is quite simple, it is a percentage difference between the value of units on the last and the first day in a year.
Using this method, fund performance comprises fees and cost which can be paid from funds assets.
Besides nominal rate of return, pension funds are obliged to publish real rate of return.

$$R_{real} = \left(\frac{100 + R_{nom}}{100 + CPI} - 1\right) * 100$$

Variables like entry and exit fees, taxes, are excluded from funds' performance, and to get net return the member should use pension calculator, available on the funds' web page.