EIOPA Public Consultation on 'Framework to address value for money risk in the European unit-linked market'

BdV comments (final version) by 15 July 2021

Please provide your comments to EIOPA by 16 July 2021. Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field.

Q1: Do you agree with the definition of value for money presented in paragraph 1.7?

BdV-comment:

Yes, we agree. It is correctly stated in paragraph 1.6. that "value for money is not explicitly defined in EU legislation". Therefore we stress that with regard to notions like "proportionate" and "reasonable" there should be included reliable references to other EU regulations or decisions of the European Court of Justice in the forthcoming framework of "value for money". This could be a way in order to reduce the undetermined character of these fundamental judicial notions. The principle of proportionality is crucially outlined in the Solvency II regulation. Instead of "reasonable" the notions of "suitable" or "appropriate" could be used, because they are already well established with regard to insurance-based investment products e.g. by IDD and its Delegated Regulations.

Additionally EIOPA should make the definition based on the purposes or features of a product: if the product is designed as an investment or pension product, then the definition should focus on the real net returns and, implicitly, on costs; if the product is designed primarily as an insurance against various risks, then the definition of Value for Money (VfM) should focus on the services ane benefits of the products, as indicated by EIOPA.

The concept of "Value for Money" had already been developed by the British section of CFA (Chartered Financial Analysts) in 2018 by insisting on the four "E": Economy, Efficiency, Effectiveness and Equity.

Source:
https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/3-research-and-position-papers/value-for-money--a-framework-for-assessment.pdf

Q2: Do you share EIOPA's concerns about value for money in certain areas of the UL-market?

BdV-comment:

Yes, we fully agree. Even in a traditional market of life-insurances like Germany, where classical minimum return guarantees played a very important role until recently, due to the ongoing zero interest rate phase the change towards unit-linked or hybrid products (with no or at least less return guarantees) is accelerating.

Following to BaFin's Annual Report in 2020 the new business of life-insurers decreased from 5,1 million contracts (2019) to about 4,6 million new concluded contracts in 2020. 75,5% of these life-insurances are long-term products with a share of 90,9% of annuities. Out of these annuities 12,6% were unit-linked products and even 40,4% were hybrid products. BaFin estimates that the market share of hybrid products amongst annuities will rise up to 50% until 2024 (cf. *BaFin-Jahresbericht 2020*, S. 73 und S. 76, published in May 2021).

But following to the statistics of the Association of German Insurers (GDV) for new business in 2019 the costs of administration and especially of distribution even increased considerably - not in percentage - but in absolute figures (distribution costs: 7 bn Euro in 2018, 7,5 bn Euro in 2019; cf. *GDV - Lebensversicherung in Zahlen 2020*: Tabelle Kostenquoten der Lebensversicherung, S. 31).
Though the new business for all categories of life-insurances decreased from 5,1 million contracts in 2019 to 4,6 million contracts in 2020, the total amount of distribution costs ("Abschlusskosten") only decreased from 7,540 bn Euro in 2019 to 7,529 bn Euro in 2020. The total amount of administration costs ("Verwaltungskosten") even increased from 2,035 bn Euro in 2019 to 2,066 bn Euro in 2020. So the administration costs increased despite the fact that the total number of life-insurance contracts decreased by 1% (from 82,9 million contracts in 2019 to 82,0 million contracts in 2020). All figures can be found in the annual report on life-insurances ("GDV - Deutsche Lebensversicherung in Zahlen 2021")

Source:

https://www.gdv.de/de/medien/aktuell/stornoquote-trotz-corona-krise-auf-historischem-tief-68732

With regard to UCITS costs ESMA came to the conclusion that "retail clients continue to lose out due to high investment product costs". In detail "UCITS costs only marginally declined over time. For one-year investments they were 1.4% in 2019 compared to 1.5% in 2018 on average across asset classes (...) Retail clients pay on average around 40% more than institutional investors across asset classes. A ten-year investment of EUR 10,000 in a portfolio composed of equity, bond and mixed funds led to a gross value of around EUR 21,800 and EUR 18,600 after costs. Around EUR 3,200 in costs were paid by the investor." (ESMA PR of 14 April 2021).

Source:
https://www.esma.europa.eu/press-news/esma-news/retail-clients-continue-lose-out-due-high-investment-products-costs

With regard to the risk-reward-relation of unit-linked products EIOPA stressed in its *2021 Cost and Past Performance Report* (risk categories running from 1 to 7 following to the PRIIPs KID regulation) that "hence the reward for the risk taken in the class 7 appears to be worse than for products belonging to classes 5 and 6" (Report, p. 24).

Needless to say that this result severely contradicts the fundamental risk-reward-relation.

Additionally a new study by an independent research company recently showed that performance scenarios often are much too optimistic for unit-linked products, and the differentiation between core and satellite investment is not sufficiently elaborated.

Source: **https://www.asscompact.de/nachrichten/zu-optimistische-zielrenditen-studie-kritisiert-fondspolicen**

In February 2021 the Cologne based rating agency *Assekurata* had published its annual report on benefits of life-insurers. It clearly concludes that hybrid products (with reduced guarantees) do not offer any additional surplus in comparison to classical tariffs.

Sources:

- **https://www.procontra-online.de/artikel/date/2021/02/neue-klassik-negative-rendite-trotz-geringerer-garantien/**
- **https://www.assekurata.de/publikationen/studien/detail/assekurata-marktstudie-zu-ueberschussbeteiligungen-und-garantien-2021/**

In November 2020 the independent public foundation *Stiftung Warentest* published in its monthly journal *Finanztest* the latest comparison of unit-linked products. It was positively assessed that ETFs are offered nearly by all product providers. It was negatively assessed that tax incentives are still used as main argument by intermediaries, but these incentives are useful only under certain conditions (e.g no early cancellation). Product providers differ strongly with regard to administration and distribution costs, which have a severe impact on the real return (Finanztest, November 2020, S. 37).

Conclusion: Due to these various reasons we share EIOPA's concerns about the value for money in certain areas of the UL-market at least in Germany.

Q3: Do you believe that more emphasis on value for money considerations as part of POG, in particular through product testing, will ultimately improve the value propositions in the unit-linked market?

BdV-comment:

Yes, we fully agree. As EIOPA highlighted in the recent analysis on supervision of product oversight and governance procedures that manufacturers must align the design of the product with the needs, objectives, and characteristics of the identified target market. However, with lack of adequate and harmonized supervision at local level, such requirements – although aimed in the right direction – will not deliver their results.

In consequence the crucial importance of product-testing has recently again been underlined by EIOPA’s Approach of Supervision of POG (October 2020): “When carrying out product testing activities, manufacturers are expected to take into account the characteristics and needs of the target market, as the testing should assess whether the product is, and will continue to be over the whole lifetime of the product, in line with the identified needs, objectives and characteristics of the target market” (cf. Chapter 4.2, p. 13). This approach is fully based on article 6 (“Product Testing”) of Del. Reg. EU/2017/2358 and of course on article 25 (1) IDD.

Q4: Based on the framework presented below, do you believe there may be principles you feel are missing? Please explain.

BdV-comment:

Following to the Delegated Regulation (EU) 2017/2358 of 21 September 2017 on POG (based on article 25 IDD) not only the testing and monitoring of new products by the product providers constitutes a crucial part of the POG requirements, but also the information to the distributors and their continuous feedback. That is why the principle based framework should include the activities of distributors at the point-of-sale. Particularly important are the orderly use of the demands and needs test of prospective customers and the documentation of the personal recommendations (based on article 20 (1) and (3) IDD) as well as the assessment of suitability and appropriateness (based on article 30 (1) and (2) IDD) by the distributors of unit-linked products. The fulfillment of these requirements should be an additional principle of the forthcoming value for money framework. Additionally the results of testing and monitoring of new products by the product providers and the continuous feedback given by their distributors should be disclosed publicly for reasons of transparency towards consumers.

Q5: What additional measures could EIOPA facilitate to advance value for money in unit-linked and hybrid products?

BdV-comment:

In order to prevent from possible consumer detriment and to advance value for money in unit-linked and hybrid products markets not only testing and monitoring by product providers, but the pre-contractual practices of distributors of these products and its documentation should particularly be put under „enhanced supervision“ (cf. our comment on Q4). The NCAs should be encouraged to regularly ask for the documentation of distribution procedures by the life-insurers, their agents and the connected brokers.

The German NCA (BaFin) clearly stressed at several occasions (Annual Conference of 21 April 2021 and presentation of Annual Report on 18 May 2021) that it will keep on analysing distribution practices of life-insurers with regard to sales incentives and possible consumer detriment. These researches are based on article 8 of

EU/2017/2359 ("Assessment of inducements and inducement schemes" for IBIPs) and the national insurance supervisory law (§ 48a VAG). Results shall be published in Q4 2021.

Sources: BaFin-Journal, Mai 2021, S. 37; VersicherungsJournal vom 19. Mai 2021.

Q6: Do you agree that costs and charges need to be due?
BdV-comment:
Yes, we fully agree. It is badly surprising that this question is asked at all! Article 29 (1) IDD on „Information to customers" clearly stipulates: „The information about all costs and charges, including costs and charges in connection with the distribution of the insurance-based investment product, which are not caused by the occurrence of underlying market risk, shall be in aggregated form to allow the customer to *understand the overall cost* as well as the cumulative effect on the return of the investment, and, where the customer so requests, *an itemised breakdown* of the costs and charges shall be provided. Where applicable, such information shall be provided to the customer on a regular basis, at least annually, during the life cycle of the investment." (*italics by BdV*)
It is obvious that the information on costs and the costs themselves must be linked to any activities either of the product providers or the distributors. Otherwise the basic principle of causality of costs would be suspended and any kind of arbitrary costs and charges could be introduced.

Q7: Do you agree that for evaluation purposes, costs and charges should be assigned to specific benefits and services?
BdV-comment:
Yes, we agree. Article 29 (1) IDD (cf. our comment on Q6) clearly stipulates that an „itemized breakdown" of the costs and charges of IBIPs can be asked by the customer. Obviously the fulfillment of this request is only possible under the condition that any costs and charges are clearly assigned to specific benefits and services.

Q8: Do you agree that the costs which cannot be directly linked to a specific product component, should be assigned to the dominant product feature? If not, do you have an alternative proposal?
BdV-comment:
Yes, we agree. Nevertheless we see some difficulties with regard to No. 2.5 of this CP (p.8). Unit-linked and hybrid products belong to the insurance-based investment products. So, by definition, the saving or investment component should be the dominant feature. The only biometric risk which may be included is the risk of longevity for the payout-phase.
The inclusion of any other biometric risk like death or disability should be considered as a possible consumer detriment, because it would break the recommended general

rule of separating risk coverage and long-term investment process (for reasons of complexity and transparency). In consequence the dominant product feature should always be the investment part of the premium, otherwise there is a high probability of a mis-selling case. This should clearly be outlined in the framework.

Q9: Do you agree that active investment management involves additional costs and benefits?
BdV-comment:
Yes, we agree. But we stress that the burden of proof must be put on the product providers, especially on the investment fund industry (cf. Better Finance's analysis and warnings of „closed-indexing" funds, PR of 2 August 2019: The high price of closet trackers' plodding performance):
https://betterfinance.eu/article/the-high-price-of-closet-trackers-plodding-performance/

Q10: Do you agree that each product feature should deliver Value for Money as well as for the product as a whole?
BdV-comment:
Yes, we agree. In order to strengthen this principle, we propose to use the analogy of *cross-selling*: „When an insurance product is offered together with an ancillary product or service which is not insurance, as part of a package or the same agreement, the insurance distributor shall inform the customer whether it is possible to buy the different components separately and, if so, shall provide an adequate description of the different components of the agreement or package as well as separate evidence of the costs and charges of each component." (article 24 (1) IDD).

Q11: Do you agree that value for money is dependent on the target market's characteristics, needs, and objectives?
BdV-comment:
Yes, we agree. Testing and monitoring by product providers as well as sales activities by distributors have clearly to be focussed on the necessary „granularity" of the possible target markets and – in consequence - on the assessment of suitability and appropriateness of the recommended unit-linked or hybrid product for the customer (cf. especially article 5 („target market") of Del. Reg. EU/2017/2358 and chapter III (articles 9 to 19) of Del. Reg. EU/2017/2359 on the assessment of suitability and appropriateness). Additionally we refer to EIOPA's Approach to the Supervision of Product Oversight and Governance, October 2020, chapter 3: Target Market Assessment. We stress that the assumptions on the target markets by the product providers should be disclosed publicly for reasons of transparency towards consumers as well.

Q12: Do you agree that active and passive investment management have different target markets?
BdV-comment:
Yes, we agree. This difference refers to a kind of bet: active management implies higher costs, but the bet is that the returns will be higher nevertheless. Passive management (like by ETFs based on indexes) have lower costs, but – by their nature - they do not pretend to achieve better results than the market average. In consequence investment funds with active management are only suitable for those target markets which are less risk averse and have a greater ability to bear losses ("appropriateness", cf. our comment on Q 11).

Q13: Do you agree that distribution costs which are charged to the consumer as a percentage of the premium paid or the performance of the units can create a risk of being poor value for money?
BdV-comment:
Yes, we agree. Any contractual agreement establishing a direct link between the amount of the premium to be paid by the customer and the amount of the distribution costs, especially of the commissions to be received by the distributor, inevitably creates the risk of poor value for money. That is why the *„Assessment of inducements and inducement schemes"* based on article 8 of Del. Reg. EU/2017/2359 has strictly to be applied.

Additionally the German Association of Insured (BdV) had recently asked again for a general cap of commissions for IBIPs / life-insurances (PR of 19 April 2021).

> Source:
> **https://www.bundderversicherten.de/presse-und-oeffentlichkeitsarbeit/pressemitteilungen/regierung-will-hohe-provisionen-fuer-restschuldversicherungen-festschreiben**

This request is mainly based on the fact that usually German life-insurers use the method of "Zillmerisation" for the calculation of distribution costs. "Zillmerisation" implies that the distribution costs are deducted from the total sum of gross premiums of the entire contract duration, and in consequence the investment part of the gross premiums is very low. Therefore the law of compound interest is strongly reduced which entails a strong detrimental effect on the payouts for the policyholders.

Q14: Do you agree on the assumptions to be made when assessing the reasonableness of the expected break-even point and of the expected returns?
BdV-comment:
No, we do not agree – particularly with regard to the assumption being made for life-cycling strategies seeking pensions and therefore assuming a possible *late* break-even point (cf. No. 2.14 of CP, p. 10). The necessity of reaching the break-even point

as soon as possible must be valid for all life-cycling or investment strategies. Only under this condition the law of compound interest for long-term saving plans can be used as much as possible. The only parameter being acceptable under this perspective and which has a „reasonable" impact on the realization of the break-even point (its delay or volatility) may be the risk awareness of the policyholder. The risk awareness and the risk tolerance of the policyholder must already be identified in the pre-contractual phase following to article 30 (1) IDD and to the PRIIPs KID (section: "What are the risks and what could I get in return?" - based on article 3 of Del. Reg. EU/2017/653).

Q15: Views on other criteria / ways to assess reasonableness are sought.
BdV-comment:
The only parameter being acceptable under this perspective and which has a „reasonable" impact on the realization of the break-even point (its delay or volatility) may be the risk awareness of the policyholder. The risk awareness and the risk tolerance of the policyholder must be already be identified in the pre-contractual phase following to article 30 (1) IDD and to the PRIIPs KID (section: "What are the risks and what could I get in return?" - based on article 3 of Del. Reg. EU/2017/653). Cf. our comment on Q14.

Q16: Do you agree that manufacturers have a duty to review costs and charges, performance and the services offered on a regular basis?
BdV-comment:
Yes, we agree. This has clearly been stipulated by article 25 (1) IDD: „The insurance undertaking shall understand and regularly review the insurance products it offers or markets, taking into account any event that could materially affect the potential risk to the identified target market, to assess at least whether the product remains consistent with the needs of the identified target market and whether the intended distribution strategy remains appropriate." This ongoing review of products is specified and enhanced by article 4 („product approval process") of Del. Reg. EU/2017/2358 and by chapter 4 („product testing") of EIOPA's Approach to the Supervision of Product Oversight and Governance, October 2020.
Additionally the results of this product review by the product providers should be disclosed publicly for reasons of transparency towards consumers (cf. our comments on Q 4 and Q 11).

Q17: Do you agree that policyholders should expect returns that are in line with market returns over the long run?
BdV-comment:
Yes, we fully agree. It is badly surprising again that this question is asked at all! The "low for long" interest rate phase cannot be used as an "excuse" for low returns by the product providers, especially if inflation becomes a more serious problem as

expected. The main duty of professional and valuable capital investment strategies and of strict cost-efficiency by the product providers cannot be reduced at all even under these more difficult general conditions of the financial markets. The annual report of Better Finance on "Pension Savings – The Real Return" clearly shows to which extent sufficiently real returns are necessary for the European pension savers in order to achieve an adequate income at retirement.

Source: **https://betterfinance.eu/publication/pension-savings-the-real-return-2020-edition/**

Q18: Do you agree that actively managed underlying funds should be reviewed in relation to their performance against that of their related benchmarks?

BdV-comment:

Yes, we agree (cf. our comment on Q9). This is a long-term position and recommendation of BETTER FINANCE: a product must be assessed against a benchmark (long-term, at least the past 10 years), which must be an objective comparison (i.e. not peer-group of products, but the market itself or at least a low-cost tracking option that reflects the market). The burden of proof must be put on the product providers, especially on the investment fund industry (cf. Better Finance's analysis and warnings of „closed-indexing" funds, PR of 2 August 2019: The high price of closet trackers' plodding performance):

https://betterfinance.eu/article/the-high-price-of-closet-trackers-plodding-performance/

Similar to the IDD POG disclosure procedures the results of this benchmark assessments by investment product providers should be disclosed publicly for reasons of transparency towards consumers.

Q19: Do you agree that mass marketed UL products should provide a limited number of options?

BdV-comment:

Yes, we agree with the fundamental analysis made in the paragraphs 2.21 to 2.31 of the CP (POG controls of product's complexity and of adequacy for target markets). With regard to the investment part of the premium there should be implemented a specific control of the quality of the investment funds being offered (e.g. are there any ETFs included for reasons of cost-efficiency, and is there an ongoing quality control of the actively managed investment funds?). With regard to the biometric risk coverage we clearly advocate an independent advice stressing the priority separation of risk coverage and long-term saving processes (cf. our comment on Q8).

Q20: Do you see alternative measures to mitigate risks associated with a high number of options?
BdV-comments:
Cf. our comments on Q 8 and Q 19.

Q21: Do you agree that UL products require a high degree of financial literacy for consumers to understand?
BdV-comment:
Yes, we agree – especially with paragraph 2.30 of the CP: "For products with a higher degree of complexity, the target market should be more granular and identified with more details, taking into account the increased risk of consumer detriment associated with such product." But having said this, it must be clear that even the best financial literary cannot compete with the ongoing and ever more enhanced complexity of the products themselves. This "race between the rabbit and the hedgehog" cannot be won by the customer.
Therefore we refer to Gabriel Bernardino who - in his last speech as EIOPA Chair at the EIOPA Annual Conference of 4 February 2021 - had stressed the need for a "new approach to consumer disclosures": "Profound re-assessment is needed to replace all existing information requirements stemming from a range of legislative contexts (e.g. Solvency II, IDD, PRIIPs) with a unique set of information that consumers will actually use."
This is even more important, since in some markets the value for money is often linked to a surplus fund (like in Germany or UK mainly due to "smoothing"-mechanisms). At the same time this surplus fund is crucial for the solvency of these companies. In consequence any customers may believe that there is a high chance of receiving a "reasonable" value for money due to the surplus fund, while at the same time the company is not able to transfer any "appropriate" sum from the surplus fund to the customers because of a lack of solvency (cf. recent study on SCFR 2021 of European life-insurers by BdV and Better Finance).

> Source:
> **https://betterfinance.eu/publication/the-body-mass-index-of-the-life-insurance-industry-a-close-look-at-the-sfcrs/**

It may seem that the use of a surplus fund is not relevant for UL-products. But most of these UL-contracts include some kind of participation of surplus of costs, of biometrical risk coverage and/or of smoothing-mechanisms. These profit participations are usually based on such a surplus fund system and are added to benefits of the mere unit-linked investments.

Q22: Do you agree that products with many different options carry additional conduct risks?
BdV-comment:
Yes, we agree (cf. our comments on Q 8, Q 19 and Q 20).

Q23: Do you agree with the variables to be taken into account to determine product groupings? Or do you believe more/less variables should be taken into account?
BdV-comment:
Yes, we agree (no changes).

Q24: For each of the variables identified provide views on options which EIOPA should consider.
BdV-comment:

- Advice: we stress the necessity of a comprehensive documentation of the mandatory "personal recommendation" by the intermediary (based on article 20 (1) IDD), including the demands and needs test and the suitability and appropriateness assessment for IBIPs. Additionally we stress the importance of independent or bias-free advice (a goal of the EC in its current CMU Action Plan), which is almost non-existent within the EU except in the Netherlands.
- Dominant Feature: Unit-linked and hybrid products are by definition IBIPs, in consequence the possibility that the investment feature is not the dominant one due to a particular contract conclusion, must comprehensively be documentated by the intermediary.
- Product Features: the feature "length" does not make any sense for IBIPs. If "recommended holding period" (RHP) is meant, which does not make any sense either for insurance contracts, the appropriate judicial notion should be "fixed contract duration".
- All the other variables are sufficiently outlined in the CP.

Q25: Do you think there may be other criteria to be followed when grouping products?
BdV comment:
We agree with EIOPA's proposal that "the protection component of the products should be unbundled from the investment component. All the costs and benefits linked to the protection module should be excluded from the model." (p. 15) But we stress at the same time that this exclusion of biometric costs must be applied only to death or disability risk coverage. With regard to the payout-phase the costs of longevity must be included as strong criteria, because it has exactly to be taken into consideration, if these biometric costs are "reasonable" or over-calculated by the product provider.

Q26: Considerations on the model are sought.
BdV-comment:
Unit-linked and hybrid life-insurances fully belong to IBIPs. Therefore all EU regulations with regard to IBIPs (mainly IDD including POG and PRIIPs KID) on levels 1, 2 and 3 (directives, regulations, delegated regulations, communications by the Commission, guidelines, opinions, Q&A etc. by the ESAs and particularly by EIOPA) have fully to be applied. It must be clarified that already existing regulations will not be "softened" by the proposed framework of "Value for Money" like with regard to the necessity that "costs and charges need to be due" (Q &) and to the expectations of real returns by retail clients (Q 17).
Under these conditions the proposed framework of "Value for Money" constitutes a necessary additional tool for "enhanced supervision" by EIOPA and the NCAs with regard to the ongoing product approval processes of the product providers and of the current sales practices of their distributors.
We additionally stress that the market share of unit-linked products and of hybrid products taken into consideration for *EIOPA's Annual Reports of Costs and Past Performances* should still be increased (only 57% of the European unit-linked market in 2020; cf. Report 2021, p. 16).