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

Questions to stakeholders

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

In the beginning, we would like to provide some initial remarks regarding unit-linked as an insurance product. Unit-linked product is significant for the insurance market and consumers since insurance-based investment products (IBIPs) form a considerable part of EU households' financial savings. Long-term and real returns are always actual issues for the unit-linked market, as they often constitute private pension savings. It is fair to mention that in the past misselling episodes happened. These situations, detrimental for consumers, have resulted in many detailed regulations, both national and European. Hence, there is still a need for close monitoring of UL market.

Due to tight distribution and solvency regulations and changing consumer needs, unit-linked insurance is still evolving. However, internal flexibility allows shaping this product according to the needs, changing the size of insurance coverage, that can provide:

- some legal protection and advantageous features, notably in the field of inheritance law and other specificities;
- the insurer's guarantee of the liquidity of the investments, which is not the case for financial assets directly held by policyholders outside an insurance contract;
- the possibility of adapting the investments backing a specific policyholder contract to his specific investment horizon and risk appetite by blending different investment vehicles with the general fund and switching between them.

We believe the unit-linked insurance is here to stay, as it can provide genuine value, thanks to insurance coverage and capital guarantee. That is why IRSG welcomed the EIOPA initiatives to discuss important issues of the European unit-linked market. We find the effectiveness and efficiency of the unit-linked insurance of the utmost importance for consumers and the insurance industry.

Because of the group's composition, there is no unanimity regarding many of the raised topics. Nevertheless, we believe that we are moving toward a better understanding of this complex product while presenting various perspectives.

Coming back to the question 1., members present diverse opinions. Some members present opinions that a single definition can be made to consider the specificities of the EU market, and the POG framework does not achieve its purpose, ie to ensure that the target market is aligned with the demands and needs of the target market clients. Those members who disagree raises that definition would not take into account the specificities of the EU markets. They also underline that the POG framework already ensures that products are aligned with the target markets' demands and needs. Furthermore, VfM would be heavily influenced by the customer's perspective, and a single definition would not capture that.

There was also an opinion that EIOPA should make the definition based on the purpose or features of a product: If the product is designed as an investment or pension product, then the definition should focus on the actual net returns and, implicitly, on costs; if the product is designed primarily as insurance against various risks, then the definition of Value for Money (VfM) should focus on the services and benefits of the products, as indicated by EIOPA.

Some members raise the issue of proportionality. Here there were also diverse opinions. According to particular members, the proposed definition does not consider potential constraints of economies of scope and scale and thus implicitly favours larger over smaller providers or newcomers. This could be seen as a negative positioning towards innovation that typically has to overcome higher initial costs. Therefore, benchmarking against the total market should be reconsidered.

Other members express quite the opposite opinion. While proportionality is an important consideration in relation to much of the regulation we deal with, it does not seem appropriate that on should advise against benchmarking on the basis that some entities are smaller. They still have to compete in the same marketplace, and any disparities in their charges, whether due to size or other factors, should not be hidden from the customer. Furthermore, although innovation costs are high this is not a good reason for seeking to prevent benchmarking. The provider may of course, reference size or innovation as a reason for disparities.

Some members raise that if a value for money is to achieve objective measurement, it should also be required to consider the underlying risk being adopted. For instance, even if charges are considered “reasonable”, it may be that the projected returns on the chosen asset types do not provide a return which, the net of charges, is more significant than risk-free alternatives (such as the deposit rate). In such cases, it would be difficult to argue that the proposition provides a value for money, although potential ranges of returns also need to be considered.

A dilemma regarding the relations between value for money, profitability (for a different market player), and conflict of interest, was also raised.

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

There is no unanimity among IRSG members regarding the assessment of the UL-market, especially in the area of performance and regulations. There are several issues link to performance. First of all, the availability of the market data varies across countries significantly, but in most of them is inadequate. It makes any comparison and deeper analysis almost impossible. UL-market is vast and requires data availability and transparency.

The next issue is somehow connected to data availability. Consumer representatives present estimations of UL-market performance of the French market, (consumer representatives – available in the annexe) which are challenged by some insurance industry representatives (available in the annexe). The difference in assessment was caused mainly by the approach and methodological assumptions. Hence, there is a need for market data, a coherent performance methodology, and an appropriate way of presenting and comparing outcomes for consumers, the insurance industry, supervisors, and regulators.

There is no unanimity among IRSG members when it comes to usage of aggregate data for UL-market. Some of the members find it as an informative benchmark. Other members consider it as oversimplification with limited comparative utility.

Concerning regulations, some members believe that a strongly regulated market, with a range of manufacturers and distributors, with transparency of all charges and obligations to justify advice on product selection to be given to customers, is well placed to deliver value for money to consumers. Such members present the opinion that further limitations and supervision are needed because EU investors are selling a lot and more unit-linked IBIPs. Regulations should allow consumers to compare different options (i.e. IBIPs and capital guaranteed policies), especially an ability to keep purchasing power in the long term.

Other members believe that markets in Europe assure competition in unit-linked business, together with evolving customer-focused regulation, which has led to an improved value proposition for customers. In addition, non-insurance investment products are being available to consumers assisting the competitive landscape and can give further baselines to advisors on value for money. Such members raise that product design and testing as per POG rules, professional advice, distributors' continuous training, suitability/appropriateness/demand and needs, transparency requirements, and product monitoring already ensure a high level of consumer protection through the whole product life-cycle, with no need to introduce further limitations to the design and distribution of unit-linked and hybrid products. In the past, the European legislators addressed conduct risk by intense cost disclosure (cf. PRIIPs, IDD). The "reduction in yield" approach, supported by the Key Information Document for insurance-based investment products, helps customers to understand the aggregate impact of costs on performance instead of confronting them with a series of isolated numbers.

To sum up this part of the response, we would like to stress that the IRSG as a whole is concerned that customers should and can be assured of value for money in all products, including investment-based insurance products and unit-linked products. However, there is a need to ensure data and work out a coherent performance measurement methodology for unit-linked market.

There are also more specific, individual comments.

- Any fee-related schemes should be disclosed. Retrocession fees paid by asset managers to distributors or manufacturers should be taken into account while disclosing the structure of costs and charges.
- As a concept, the value for money cannot ignore the present regulations, mostly flexibility regarding possible withdrawals.
- While defining poor value for money on an outcome basis, it should be clearly stated that the sources of poor outcomes can be manifold and are not restricted to conduct risk. Particularly in unit-linked life insurance, customers participate to a significant extent in capital markets and are exposed to market risk. Fiscal treatment also affects the customer outcome, e.g., insurance premium taxes depending on the actual holding period or income taxes depending on the payout method (lump sum, annuities, combinations). In practice, conduct risk is not the single source of poor customer outcomes.

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?

There is no unanimity among IRSG members regarding value-for-money as part of POG. Some members express that POG rules are in many cases not respected, and it is tough for supervisors to monitor and assess these processes. That is why there is a need to introduce further limitations to the design and distribution of unit-linked and hybrids at the EU level, as many of these products destroy the actual value of savings, and consumers are not aware, nor can they choose differently due to the lack of bias-free advice. Stricter rules and guidance on the POG consideration are required, particularly concerning the development (design) phase – target market identification – and product testing. At the same time, such an approach will not deliver viable results without close supervision and enforcement. Unfortunately, the POG process (including product design and testing) was explicitly designed to ensure that the value for money related to the target market is delivered. Consumer representatives express an opinion that many years since its application has not been achieved.

Some members underline that there is no need to deliver just another disclosure for consumers, hence not necessarily very effective, especially in particular additional ones (to what is already required) that may have limited effects. Potential disclosure should stick to the following rules: simple; concise; avoiding jargon; using aspects that are key for the investment decision; and at last, disclose the total annual cost per "unit". However, with the lack of adequate and harmonised supervision at the local level, such requirements – although aimed in the right direction – will not deliver their results. That is why more emphasis should be paid to enforcing the existing rules, and if there is a need, a more rigorous framework, the micro-prudential framework within soft law.

In the group, there are members who asses positively and negatively the EIOPA proposal. Some members express the opinion that the framework proposal provides guidelines for clients and supervisors to ensure that the product manufacturer delivers on their promises or contractual obligations, which is currently not easy or very debatable due to the lack of provisions or guidelines.

Other members present an opinion that it is not clear the formal status of the proposed framework, and the Insurance Distribution Directive (IDD) and its delegated regulations introduced to sound and strict conduct rules for the design, distribution and review of unit-linked and hybrid insurance products. Product design and testing as per product oversight and governance (POG) rules, combined with the robust requirements of professional advice, distributors' continuous training, suitability/appropriateness/demands and needs test, transparency and product monitoring already ensure a high level of consumer protection through the exclusive products life-cycle. There is no need to introduce further limitations to the design and distribution of unit-linked and hybrids at the EU level. Insurance undertakings are best placed to enforce the existing requirements through measures and procedures that are proportionate to the level of complexity and risks related to the products and the nature, scale, and complexity of the relevant business of the manufacturer rules. Furthermore, the role of the advisor in ensuring that the products provided are appropriate to the needs of the customer also needs to be addressed as part of these considerations.

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

There are various opinions regarding proposed principles. Some members underline that EIOPA is proposing a very complex framework and risks to create lengthy bureaucracy in the product design and review (e.g. complex internal documentation and additional processes), with excessive compliance burden and costs, which will ultimately be passed down to clients. It also proposes requirements that seem unworkable, especially for smaller companies (e.g. monitoring comparable retail solutions on the market; assessing the most selected options and underlying investment funds while they may vary across distribution channels, depending on consumers' profiles and based on the evolution of the market, e.g. shifts in consumers' preferences, economic cycles and new trends). EIOPA's proposed framework goes in the direction of reducing choice and hindering products' differentiation by supporting product standardisation and reducing the number of options available, which is not in the interest of consumers.

There is also a coment regarding the following fragment, "Costs are often not identified, and they cannot be linked to a specific product component, making it difficult to assess the value of each component"- this can be the case, for example, where mortality cost is involved and other guaranteed costs. Under IDD article 29 (1), an itemised breakdown of costs and charges is to be provided where the customer so requests and where applicable, such information shall be provided to the customer on a regular basis, at least annually, during the life cycle of the investment.

Other members raise that principle 2 disregards a holistic, outcome-oriented approach by disintegrating products into single components/features. It is a key characteristic of insurance to pool various items to reach appropriate equalisation. Some features may benefit more than others but are necessary to provide the overall product. Therefore, the holistic outcome should always be given absolute priority over any comparison of individual single feature breakdowns. Some members express doubts about separating the components with defined costs for each component, e.g. mortality cost (usually done by the cancellation of units). Policyholder usually is not aware of the amount of this cost; with-profit related admin cost etc.

Elements of the principles, particularly those relating to detailed disaggregation of charges, add complexity to disclosures and may not add to customer understanding when applied in practice. The addition of complex disclosures would lead to additional manufacturer costs, which would increase product's costs. The complexity involved in translating these principles to real numbers may also drive the difference in interpretation from manufacturer to manufacturer and ultimately lack comparability.

Yet, other members present an opinion that the framework, on the contrary, is designed to reduce costs in the end. It also reduces the choice of toxic products and increases the choice of well-performing products. The principles set out would need to apply to the full savings and investment product range to enable full comparison and establishment of relative value for money across the available universe of products. Furthermore, if benchmarks are to be used in further assessment, a single principle regarding the appropriateness of a benchmark can be added. The benchmark should be objective aligned with the product's investment objectives and should be objective (i.e. not a peer group). If the provider claims to have no benchmarks (i.e. no defined investment objectives), then it should be inflation, i.e. ground zero for the purchasing power of IBIPs and insurance-regulated pension products.

Some members propose that supervisory authorities, including EIOPA, should access independent product databases (with data on cost and returns in particular) to effectively supervise and monitor the products in their jurisdiction and dispose of adequate resources. Cost disclosure (ex-post) should be improved to enable policyholders to quickly and the entire annual cost per unit and compare the returns and costs with other similar products. In addition, the practices at the point of sale must be closely monitored as well.

There is also an opinion that EIOPA must first ensure that the product manufacturers clearly (and correctly) identify the purpose of the IBIP or the IBPP (insurance-based pension product), which must be aligned with the target market. This step is crucial as it gives the benchmark against which VfM can be measured: if the primary purpose of a product – albeit having investment characteristics – is to insure the client against certain risks, then the assessment of VfM will be different to products that are meant as a long term investment or pension product, but also offer on the side (as a “bonus”) insurance facilities.

Some members raise an issue concerning a multiplication of definitions (e.g. value for money, undue costs, product complexity, etc.) and red tape, based on a tick-the-box approach. It is burdensome for insurers, with unclear repercussions on distributors’ understanding and ability to ensure compliance and supervisors when trying to understand companies’ internal documentation during investigations and controls. One avoids red tape and tick-the-box if EIOPA works with principles or guidelines based on which an assessment is done from one product to another.

Some members raise an issue relating to tax relief which may not be necessary on the basis that VfM tests should always be applied only to the money invested. There is an opinion that a requirement for VfM should not be lower because tax relief is available. Tax incentives are benefits granted by national governments to incentivize savings/insurance given the societal benefits associated with it. They are not benefits provided by the manufacturer. As such, the tax benefits should not be taken into consideration when assessing VfM. Unit-linked products should offer value regardless of the tax treatment. Hence when advertising for unit-linked products, manufacturers and distributors should not present this fiscal benefit as a feature of the products but as an element that comes from the legislation and can vary over time and from jurisdiction to jurisdiction.

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

There is no unanimity among IRSG members regarding additional measures. Some members believe that the benefits of unit-linked life insurance products need to be clearly disclosed. Next to the investment component, the protection component differentiates unit-linked life insurance products from other investment products. Unfortunately, the Key Information Document does not provide a due comparison as information on insurance benefits can be simply omitted by the product manufacturer if they do not exist (cf. Art 8 (3) lit c point iv PRIIPs Regulation). Permanently finding information on insurance benefits (such as the insured sum) would enable customers to compare retail investment products. For unit-linked products used as pension vehicles, charges have to be disclosed in the decumulation phase. IRSG notices that local products leave this information out of the KID.

There is also an opinion that product manufacturers must be required to undertake regular reviews and assessments to ensure that a product continues to deliver VfM to its target market, ascertain the product and risk appetite of the policyholder is still matching. It applies to potential tax relief because the product because many ULs are pension products.

Some members find it helpful to examine measures in place in markets where value for money is considered less concern. For instance:

- What regulations have been in place locally that have led to propositions that clearly represent money value?
- A significant part of the costs related to distribution costs. Measures to ensure

transparency of these costs and associated charges are in place in some jurisdictions, and the effectiveness of these measures should be considered.

Other members raise that separate disclosure of the aggregate cost of management of the underlying fund(s) (net of any rebates) could also provide a means of assessing value for money provided by total fund related charges.

Q6: Do you agree that costs and charges need to be due?

The cost issue divides IRSG members. Some members believe the cost indicators provide a more practical and understandable way for consumers to assess value for money than more granular disaggregated figures. Other members underline that within the POG process, the manufacturer already ensures that the product's costs do not frustrate the needs and objectives of the target market. Provided that this is not the case, manufacturers should be allowed to set costs and charges according to their evaluation.

Yet, other members mentioned that apart from the category of costs mentioned in 2.4, there should also be two leading indicators and a reduction in wealth. These can be found in EIOPA's Advice on the PEPP Level 2 Regulation (EIOPA-20-500) of 14 August 2020: "Methodology for the calculation of costs, including the specification of summary indicators" (cf. Annex III, no. 29 and 30, p. 35). It is tough to assess ex-ante whether costs are due, especially considering the uncertainty and lack of reliability of future performance (and, thus) cost estimation. However, EIOPA should consider the following two hypotheses, depending on the case:

- give precedence to using the Reduction-in-Wealth indicator, as is the case for the PEPP; in this sense, we particularly recommend that EIOPA does not make a link or connection to the PRIIPs KID's Reduction-in-Yield;
- Suppose EIOPA decides to implement an approach based on actual cost and returns. In that case, before the product is launched, costs need to be assessed in light of the average cost and returns of the peer group, with an emphasis on decreasing costs where returns are very poor (below 1% in real net terms); after the product is launched, the costs need to be also assessed against the product itself and regularly reviewed.

One member notices that there may also be valid reasons why charges and costs would not align precisely in terms of timing or quantum; for instance, distribution charges are deferred to penalise early withdrawals, but with slightly higher longer-term charges spread among the remaining policyholders.

Q7: Do you agree that for evaluation purposes, costs and charges should be assigned to specific benefits and services?

There is no unanimity regarding this topic. There is an opinion that costs are significant in assessing if the benefit or service would be valued for money. That is why, attention should be paid (in relation to Q13) to where certain costs are assigned to. It can be helpful to supervisors and regulators too.

Opponents underline the principle "partibus summa totius praeeminet" (the whole is greater than the sum of its parts); customers benefit from a bundle of features available under unit-linked life insurance products. In many cases, these features cross-subsidise each other in various ways.

Otherwise, customers could not benefit from some features as these may not be sustainable for product manufacturers on a standalone basis. Details of cross-subsidisation are an essential element of competition and innovation that vary between product manufacturers. Therefore, any product comparison will have to take the holistic “package view” instead of the isolated “component view” that could also trigger anticompetitive effects.

Moreover, it is not always possible to allocate costs and charges straightforwardly to a specific component. Products should be considered as a whole. Transparency of costs allows consumers to be informed. On top of that, any assignment of costs and charges to specific benefits and services would suggest that these may be available on a standalone basis. Typically, such an “à la carte” approach is practically not feasible, so the product manufacturer offers the “full menu”.

The attribution of costs to specific benefits is unlikely to be wholly objective and may be subject to interpretation. This could impair comparability and make the evaluation less effective. Customers should also be able to view the full range of available alternatives through the same lens, so it would be inappropriate to apply this requirement solely to unit-linked products.

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?

There is no unanimity regarding this topic. On the one hand, costs always have a source, and it should not be meant for product manufacturers to disguise certain. However, at the same time, there are some costs or “blame” the dominant feature of it. For instance, costs, mainly linked to a potential conflict of interest (like distribution (such as commissions paid to distributors), should not be assigned to the dominant feature of the product.

Some members believe that EIOPA and national supervisors should clearly define and enforce how a product is designed, i.e., its primary purpose. This facilitates the assessment of VfM and determines the dominant feature of the product directly. For instance, UL or hybrid products are mainly aimed as investment or pension products; thus, biometric risks are additional components. As such, if the dominant part of the premium is not paid for the dominant feature, this leads to mis-selling and consumer detriment by not delivering value for money.

Q9: Do you agree that active investment management involves additional **costs and benefits?**

Yes, however, differences in costs should be justified by better value for the retail investor, assessed in terms of risk and return performance. Some IRSG members underline the cost issue, as high costs could destroy the real value of the contracts for policyholders. That is why the same IRSG members raise that the product manufacturers should demonstrate – in the long term – how active management delivered its promises. Hence, there is a solid need to disclose the real benefits and the additional costs involved.

Q10: Do you agree that each product feature should deliver value for money as well as for the product as a whole?

There is no unanimity regarding this topic. Those who are infavour, in order to strengthen this principle, 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).

Opponents refer to answers Q4 and Q7. Furthermore, the product is distributed as a whole, and its value should be considered in the POG process. As a core principle, advisors should seek products that provide the best holistic value for money.

Furthermore, for specific product features, e.g., mortality benefits, the ultimate cost of benefit provision is uncertain. There may be different product features such as conversion options, freedom to change premium rates, etc., which may hinder comparison for value-for-money purposes.

Q11: Do you agree that the value for money depends on the target market's characteristics, needs, and objectives?

There is no unanimity regarding this topic, but no further evidence was delivered.

Q12: Do you agree that active and passive investment management have different target markets?

There are two asset management techniques in order to deliver the positive real return net of overall costs over the time horizon of the unit-linked contracts. It is up to the provider or client to choose one or the other or a mix in clients' best interest. Passive investment should be considered as an alternative or option in investment life insurance. One member mentions the emergence of "clean share class" unit contracts in this context.

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 a poor value for money?

There is no unanimity regarding this topic. Those who agree underline that the percentage of the premium does not serve in the best interest of clients. If the costs are charged on the performance of the units, then those are performance fees and should be assessed separately. There was also an opinion that distribution costs, which are charged to the consumer as a percentage of the performance of the units, resembles the pactum de quota litis from other Law domain, and is a carrier of some risks, such as conflict of interest, but also brings into question the access to independent consumer advice and commissions and inducements, issues that MIFID II and IDD have failed to bring to a common denominator.

Those who disagree raise that it would go beyond the role of the supervisor. IDD and Delegated Regulation provide rules to assess whether remuneration is compliant with the obligation to act honestly, fairly, and professionally to serve in the best way the client's interests. Furthermore, specific considerations in the consultation paper seem to overstep the mark of conduct of business supervision. For example, it would go beyond the EIOPA role to discourage certain remuneration practices (e.g. distribution costs charged to consumers as a % of the premium paid) or limit the number of underlying investment options or define the most appropriate number of options product. Insurers' focus should be to ensure the option's suitability to the target market, maintain a diversified offering to respond to different consumers' demands and needs, and adapt to consumers' changing needs over the product life-time.

There is also an opinion that the transparency of commission charges in point 5 enables the client to evaluate the value of the advice provided. It is common practice, especially where full disclosure applies, to apply tiered commission levels with lower proportionate costs and charges on larger amounts of premiums or fund values or move to a flat fee structure.

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?

There is no unanimity regarding this topic. Some members believe, that the aim is to achieve break-even as early as possible, even for pension-related unit-linked products. But, it would be easier and more effective to ban toxic products, toxic being defined as having very little probability of delivering flat or positive net real returns over the recommended holding period.

Other members underline, that the development of future yields cannot be predicted. However this should not limit the offering of unit-linked and hybrid products, as long as they are designed, distributed, and monitored in full compliance with the IDD and PRIIPs rules. Regultions aim to ensure a high level of consumer protection. Reasonable return can be assumed based on maximum projected returns for particular asset category.

Some members reflect discontent with the EIOPA for specific reasons:

- First, these concepts are challenging to estimate accurately, the reason for which the expected return and break-even points are achievable, and not always because of the VfM – manufacturers can argue that it was the market's performance that precluded the product from reaching its break-even point.
- Second, disagreement with the assumption given to life cycle products that these can have a late break-even point: it is a perilous strategy, and the break-even point should be assessed throughout the entire life of a product: although it is not necessary to reach this theoretical point at any period, manufacturers should "raise the alarm" if the performance of the product diverges (negatively) significantly from the break-even point at any given period.

Q15: Views on other criteria / ways to assess reasonableness are sought:

A model to better define what reasonable costs are is unnecessary, and a list of criteria may not be comprehensive or simple to comply with.

Q16: Do you agree that manufacturers have a duty to review costs and charges, performance, and services offered on a regular basis?

Yes – this is the fiduciary duty (acting in the client's best interests), which should be strengthened, is more prominent in the framework of VfM and more closely supervised by regulators.

Q17: Do you agree that policyholders should expect returns that are in line with market returns over the long run?

There is no unanimity regarding this topic. Consumer representatives raise what factors pension savers should consider when analysing long-term and pension savings, most strongly the real net returns (over 20 years minimum for pension products).

Those who disagree underline that insurance protection has a scope and benefits that do not measure the returns provided by purely financial products.

There was also an opinion that while customers may expect that returns on unit-linked funds are in line with "market" returns, there may be justifiable reasons for the divergence of returns from "market". For example, in case of ctive funds, an investment philosophy drives an investment strategy that diverges from the underlying market or, for geographically dispersed funds, different fundings of the fund to underlying indices. Such differences, and the impact of these differences, should be required to clarify customers in communications.

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

In general IRSG members agree, that actively managed funds should be compared to their benchmarks, and customers should be given a periodic statement with this information. But when it comes to details there are various diverse opinions.

Some members consider this specification unnecessary and not always straightforward to apply.

Other members agree as, this is a long-term position 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 a peer group of products, but the market itself or at least a low-cost tracking option that reflects the market). There is also an opinion that, if actively managed underlying funds have failed to reach their investment objectives over their recommended holding period or longer, they need to be urgently reviewed.

Part of members, referring to 2.16, raises it is not just the investment costs that are charged on an ongoing basis that are the most significant contribution to the reduction in yield, but also high initial charges, for example, the bid/offer spread. These charges affect changes affect the initial capital invested, and so the loss of compounded returns. Such charges are even applied to one-off lump sums added by consumers over the investment term. Not to mention the high charges of transfer to another qualifying scheme of another provider. Some even charge monthly policy fees on top of these charges.

There is also an opinion that even if a policyholder chooses specific funds, he/she is not knowledgeable enough to switch them according to his/her life cycle or the market's current performance unless he is specifically advised to do so. Customers are not aware that they need to manage these funds themselves. Although companies are obliged to provide any annual review meetings with customers in general life companies, often, policies are not actively managed as there are no choices for this unless the policyholder chooses in-house funds. This is detrimental to the performance of the policies. If the policyholder chooses in-house funds, the asset manager should be obliged to keep this managed, compare its performance to a similar benchmark, and show it to the policyholder.

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

There is no unanimity regarding this topic. One group agrees, but only if the target market is identified correctly. For any target market, the options available should be explained clearly to individuals in that target market, with clarity around how options meet needs and fit the risk appetite. In general, too much choice kills choice: UL products with hundreds of units please the distributors but not the clients. EIOPA's assessment and proposals regarding the product governance control over a product's complexity and suitability for the target market, where we also highlight the need to define and implement the concept of toxic products, i.e. products that destroy the value of the capital invested (e.g. a product-based on money market funds which costs more than the interest rate on the money market itself!). There should be a specific control of the quality of the funds used or proposed as the underlying investments and the relationship with the total costs.

Opponents raise that a limitation of several options would mean going beyond the role of insurance supervisors. Moreover, limiting the number of options can practically translate into a limitation of competition and innovation as this indirectly reduces the market access of investment fund providers that generate significant volumes via unit-linked life insurance.

Q20: Do you see alternative measures to mitigate the risks associated with a high number of options?

Generally, a regular transparent advice process and needs analysis taking into account risk appetite is required. However, two perspectives are presented by IRSG members. On the one hand, regular annual reviews should be imposed on providers of unit-linked products, but, as the clear evidence so far that this has not happened the reason for which EIOPA is proposing this framework. On the other hand, product oversight and governance, coupled with the suitability test, the appropriateness test or a demands and needs test (that is, any case performed) already ensure that the right product is offered to the right client, under intense IDD conduct of business rules and appropriate information to consumers.

Q21: Do you agree that UL products require a high degree of financial literacy for consumers to understand?

There is no unanimity regarding this topic. Some members agree that UL products are complex products for the vast majority of EU households, given their level of financial literacy and the complexity and opacity of these products. In general, they are more complex than other IBIP solutions, such as capital guaranteed contracts (misnamed as "on-profit policies" in the UK and unfortunately used by EIOPA), particularly from the point of view of costs and functioning. In this light, we underline the negative impact aggressive marketing or selling practices can have on financial literacy (as it is currently the place where most financial education for adult savers occurs), in particular, "non-independent advice" (MiFID concept), which is the norm in the EU except in the Netherlands, in particular in the life insurance area.

Those who agree with EIOPA's assessment also raise that the target market should be more granular and must consider the additional complexity and risks when dealing with products with a higher degree of complexity. However, aggressive marketing/selling practices can limit the impact of financial literacy.

Those who disagree raise that the relative transparency of unit-linked products in terms of the composition of investment options and the charges available makes them more amenable to understanding than more opaque products. This, in turn, enables different propositions to be made available to suit different risk appetites. Furthermore, IDD is in place to protect consumers from mis-selling and already provides sound rules on distribution, advice, transparency, and prevention of conflicts of interest.

Q22: Do you agree that products with many different options carry additional conduct risks?

There is no unanimity regarding this topic. Those who agree raise that there is a challenge to monitor risk is higher for, let say, 400 option product than for three options. In other words, there is an additional inherent risk, but advice and POG regulation should effectively lower the residual risk.

Opponents believe that the number of options is not connected to higher risks as long as IDD rules are applied and consumers are appropriately informed.

Q23: Do you agree with the variables to be taken into account to determine product grouping? Or do you believe more/less variables should be taken into account?

Agree, but others should be considered. A model with a fixed number of criteria may not appropriately capture the specificities of the products sold in various EU markets.

Q24: For each of the variables identified, we provide views on the options which EIOPA should consider:

Some IRSG members point to the importance of 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: besides the POG process, this is one of the most critical steps as, ultimately, the intermediary that is best placed to assess whether a product is aligned with a particular client and can deliver value for money (as an additional safeguard for EIOPA's framework, which essentially circles back to POG) is the unbiased financial advisor.

Q25: Do you think there may be other criteria to be followed when grouping products?

In our opinion, customer's risk, appetite, and life cycle are also important considerations. A model with a fixed number of criteria may not appropriately capture the specificity of the products sold in various EU markets.

Q26: Considerations on the model are sought:

Some members of IRSG present the following statement. First, the initiative of EIOPA is timely and essential for EU individuals, nonprofessional investors, and policyholders as the performance of UL and hybrid products can and must be improved. At the same time, it will constitute an important and necessary tool for closer supervision by EIOPA and national regulators, which is very much needed.

Second, to be viable and not circumvented, the framework for VfM must identify what it aims to deliver and, ultimately, prevent mis-selling of products. Suppose the framework (and the concept itself of VfM) is loosely defined. In that case, it may generate the countereffect of labelling a product as delivering VfM (as per the guidelines of EU and national authorities); when this does not occur, UL products should disclose and specify their long-term objectives (already manufacturers of "units" have to do that in the UCITS KIID and the PRIIPS KID).

Last, having clearly identified the purpose and target market of a product, VfM must deliver good results in line with its purpose, e.g., a UL product, which is essentially an investment product, must aim to deliver decent actual net returns over the long-term, as this is their dominant feature.

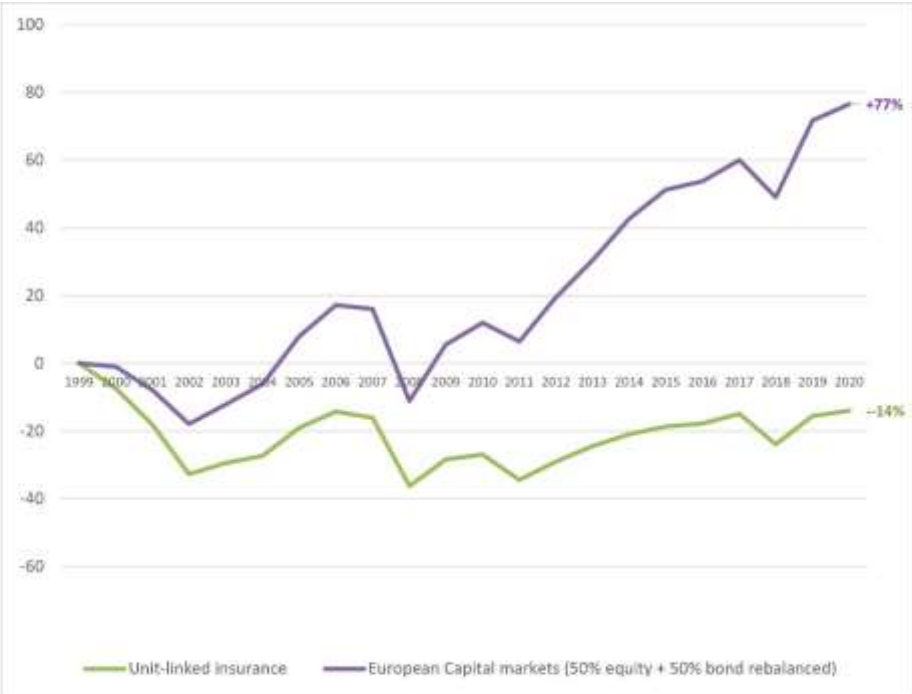
Annex

Data on unit-linked insurance long term returns

To BETTER FINANCE's knowledge, there are only BETTER FINANCE (since 2013) and EIOPA (since 2019) who are publishing market performance data, not the industry, except the French trade association FFA for the French market.

1. French Federation of Insurance (FFA) and BETTER FINANCE data 1999-2020

Net real (net of inflation) returns



Main sources: FFA (nominal returns), Eurostat (inflation), Stoxx (equities), Barclays (bonds)

Considering the more than € 400 billion French unit-linked insurance market:

- over the past 21 years, European capital markets (into which most of UL insurance premiums are invested) returns have been very positive, delivering a gross compound real (after inflation) return of +77%,
- whereas unit-linked IBIPs net real returns have overall been negative, reducing by 14% the real value of savings invested at the end of 1999.

2. EIOPA data 2015-2019

According to **the EIOPA**'s 2021 Cost & Past Performance Report, which covered 57% of EU UL market in terms of gross premiums (GWP) and provides an overall - however incomplete - picture, the median nominal return for UL in the EU in 2019 was **11,4%**. In the timespan 2015-2019, the median return was **2,7%.**

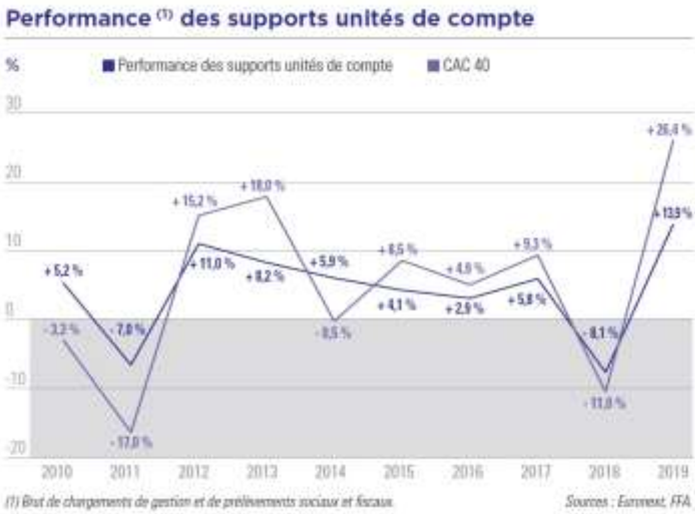
The BETTER FINANCE research (based on non-audited insurance industry data of the French

Federation of Insurers) covers 100% of French UL market, based on total assets (mathematical reserves). The average (more relevant than the "median" one) nominal return in 2019 was **12,8%** (net of contract fees)**.** In the timespan 2015-2019, the average nominal net return was **3,1%**.
The BETTER FINANCE figures are net of most fees (see below section 3 on data sources and computation), including of the annual contract fees.
A specificity of the French UL market is therefore that its average net returns seem higher than the European median ones. And despite these higher returns, they reduced the **real** value of their clients' savings over the last 21 years by 14%.

3. <u>Sources and Computation of net real returns of EU UL products</u>:

Sources: to BETTER FINANCE knowledge, there are only BETTER FINANCE (since 2013) and EIOPA (since 2019) who are publishing data, not the industry, except the French trade association FFA for the French market.

- BETTER FINANCE:
  - based on weighted average mathematical reserves
  - up to 21 year track record: end 1999 to end 2020;
  - Uses the annual nominal returns published by FFA (French Federation of Insurers):



  - Net of all fees and commissions publicly available on an aggregate average level (so still excluding some important annual charges on assets, in particular the charges for the growing delegated management – "gestion déléguée, sous mandat, profilée" in French - service, typically an additional 0,30% or more).
  - Net of inflation: real returns, not nominal ones;
  - By country where available.

Sources: always mentioned at bottom of tables and graphs
Method : [Annual research report on the real returns of long term and pension savings in Europe](), in particular pp. 35-39, 210-211, 217

- EIOPA:
  - According to EIOPA methodology, for UL IBIP net "*The net return* [is] *adjusted for all the costs not included in the NaV in order to be able to compute a net return*" – p. 53

EIOPA report). It is not specified if it is the NaV of the contract or of the aggregated units themselves.

(p. 53 EIOPA Report "*The net return computations is based on the NaV YoY change as unit value, to prevent possible fluctuation due to submission/redemption or dividends*")

- o 5 year track record an time horizon : end 2014 to end 2019 (much shorter than the actual average holding period)
- o Nominal returns, not real ones
- o No country level data disclosed

Computation of net real returns of French UL insurance

Sources:

- No aggregate data published by the NCA (ACPR)
- Only long term series of published aggregate data available: published by the insurance industry, and not audited: FFA (French Federation of Insurers) : table FR8 page 217 of BETTER FINANCE above-mentioned 2020 Report, 1st column ; 2019 nominal return released by FFA only in October 2020 : +13,9% -versus +14,7% estimated by BF in August 2020 before report release - adjusted after FFA release for the 2021 graph).
- For 2020 (FFA not yet available): estimate from research consulting firm GoodValueforMoney.eu

Method:

- FFA :
  - o Overall aggregate nominal returns: 1st column page 217
  - o Returns gross of management fees on the UL contracts themselves

- BETTER FINANCE net real returns : 2d column p.217

  Adjustments to FFA figures:
  - o Real returns: deduction of inflation (Eurostat France)
  - o Returns net of all publicly available aggregate average fees:
    - ▪ Deduction of average UL contract annual management fees
    - ▪ Deduction for the first year (1999) of the average entry fee.

*

These data are difficult to get. It would be indeed very useful if the insurance industry would also provide the underlying data for the other major UL product markets in Europe, as the French industry organization does for the French one.

Remarks of insurance industry representatives regarding computation of net real returns of French UL insurance

We would like to draw attention to the fact that any comparison between gross market financial indices and aggregated performance derived from registered unit-linked financial results across all insurers and their unit-linked insurance contracts can only be understood as an **illustration** as it bears numerous limitations. The unit linked financial results at market aggregated level are the outcome of performance across all insurers and contracts and policyholders and are primarily impacted by asset mix choices, risk appetite and market timing of investments and divestments.

Performance comparison can only be made at unit-linked level on the basis of the documentation provided by insurers on their units which contain benchmarks and historical performances.

It should also be noted that services and guarantees are provided within unit linked insurance contracts and these bear no direct comparison with a financial index although they should be valued. An insurer also provides a legal secured context with third party stipulation. An insurer also secures the liquidity of the assets for the client and is a reliable partner.

Illustrative graph based on pure CAC price return index