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1 February 2016

Consultation paper

on

**EIOPA's advice on the development of an
EU Single Market for personal pension
products (PPP)**

Table of Contents

Responding to this paper	3
Publication of responses	3
Data protection	4
Executive Summary	5
1. Context	7
1.1. Why personal pensions?	7
1.2. Economic rationale for an efficient Single Market for personal pensions.....	11
2. Addressing failings of an inefficient market	14
2.1. Setting appropriate provider governance standards for personal pensions	15
2.2. Information to PPP holders	26
2.2.1 Starting point: overcoming cognitive biases.....	26
2.2.2 Bridging the information asymmetry.....	27
2.2.3 Providing relevant information taking into account the presence of biases .	28
2.3. Distribution of PPP.....	40
2.3.1 Conduct of business.....	40
2.3.2 Distributor's ongoing role	46
3. Single Market for personal pensions - opportunity for greater efficiency gains 47	
3.1. Product regulation	47
3.1.1 Product governance.....	47
3.1.2 Product standardisation.....	49
3.2 Cross-border activities and transfers	58
4. Requirements of a relevant prudential regime	63
4.1. Technical provisions and capital requirements	63
4.2. Investment rules	64
4.3. Supervision	66
5. Conclusions	71
5.1. Appropriate legal framework.....	71
5.2. Attractiveness of the PEPP in the form of a 2nd regime	75
Annex I: Impact Assessment	77
Annex II: Summary of research questions	83
Annex III: Personal Pension Products in the EEA	84
Annex IV: Pillar 1bis schemes	90
Annex V: Cross-border activities	96
Annex VI: Legal requirements and ESA work on conduct of business requirements	102
Annex VII: Summary of selected international standards on provider governance	105
Annex VIII: POG requirements	108

Responding to this paper

EIOPA welcomes comments on the Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP), focussing on:

Q1: Would PPPs benefit from harmonisation of provider governance standards? What should be the basis for provider governance standards for PPPs? Do you agree with EIOPA's proposals?

Q2: Would PPPs benefit from harmonisation of product governance rules? What should be the basis for product governance rules for PPPs? Do you agree with EIOPA's proposals?

Q3: Would PPPs benefit from harmonisation of distribution rules? What should be the basis for distribution rules for PPPs? Do you agree with EIOPA's proposals?

Q4: Would PPP benefit from harmonisation in disclosure rules? What should be the basis of these rules? Do you agree with EIOPA's proposals?

Q5: Are you aware of any differences in prudential regimes that would lead to an unlevel playing field amongst PPP providers? Do you agree with EIOPA's view not to add specific capital requirements for PPPs?

Q6: Are further supervisory powers - tailored to PEPP - necessary? Do you agree with EIOPA's proposals?

Q7: Do you agree with EIOPA's assessment of the policy options' impacts?

Comments are most helpful if they:

- respond to the questions stated above and in annex II, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email CP-16-001@eiopa.europa.eu, by 26 April 2016.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be processed.

Publication of responses

Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents¹.

Contributions will be made available at the end of the public consultation period.

¹ [Public Access to Documents](#)

Data protection

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications if necessary on the information supplied.

EIOPA, as a European Authority, will process any personal data in line with Regulation (EC) No 45/2001 on the protection of the individuals with regards to the processing of personal data by the Community institutions and bodies and on the free movement of such data. More information on data protection can be found at <https://eiopa.europa.eu/> under the heading 'Legal notice'.

Executive Summary

Based on EIOPA's 2014 preliminary report "Towards an EU-Single Market for personal pensions"² and EIOPA's 2015 consultation paper on the creation of a standardised Pan-European Personal Pension product (PEPP)³, EIOPA provides final advice on the development of a 2nd regime product for personal pensions. EIOPA consults on whether and how these recommendations should be applied to personal pensions in general.

The aim of this initiative is to identify how personal pension products (PPP), as described and defined in EIOPA's 2014 preliminary report, and possible EU-wide frameworks for these, can be further developed, so that they can contribute to meeting the challenges of an aging economy, the sustainability of public finances, the provision of adequate retirement incomes and foster increased long-term investment. Hereby, the special nature of pension products, compared to investment products, to provide for future retirement income is highlighted.

EIOPA's 2014 preliminary report set out EIOPA's view that the development of PPPs at European level would need to address principal-agent conflicts and information asymmetries, as shortcomings of an inefficient market. Measures would be needed on promoting better disclosures, improving product comparability and good governance. Success in this could lead to:

- efficiency gains through economies of scale and opportunities for risk diversification as well as for competition and innovation;
- high levels of cross-border activities and reduced obstacles to further the Single Market;
- opportunities for higher replacement rates and for multi-pillar diversification.

The European Commission's recent Call for Advice⁴ seeks to obtain further clarity about these preliminary results and focuses primarily on consumer protection and prudential regulation provisions. It also seeks to further research cross-border activities.

EIOPA's draft advice on the development of an EU Single Market for personal pension products primarily assesses opportunities to improve the current personal pensions market through a Pan-European Personal Pensions Product (PEPP), as publically consulted in July 2015.

In the recent consultation paper on PEPP, EIOPA set out essential characteristics, which should be standardised and mandatory in the PEPP:

- High level investment principles;
- A default investment option featuring either a guarantee or lifecycling strategy with de-risking;
- Limiting the number of alternative investment options (if provided);
- Periodic free-of-charge provider switch.

² EIOPA: Towards an EU single market for personal pensions: An EIOPA Preliminary Report to COM, 2014, https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-029_Towards_an_EU_single_market_for_Personal_Pensions- An_EIOPA_Preliminary_Report_to_COM.pdf

³ EIOPA: Consultation Paper on the creation of a standardised Pan-European Personal Pension Products, 2015, <https://eiopa.europa.eu/Publications/Consultations/EIOPA-CP-15-006-Consultation-paper-Standardised-Pan-European-Personal-Pension-product.pdf>

⁴ European Commission: Call for Advice from the European Insurance and Occupational Pensions Authority (EIOPA) on the development of an EU Single Market for personal pension products (PPP), 2014: https://eiopa.europa.eu/Publications/Requests%20for%20advice/Personal_pension_EIOPA_Anexx_-_CfA_EIOPA.pdf

In addition, EIOPA previously proposed for the PEPP to include the following optional, flexible elements:

- Caps on costs and charges.
- Biometric and/or financial risk cover.
- Choosing a retirement date and forms of decumulation.

In light of the objective of promoting a Single Market for personal pensions, and in particular to conclude on the potential for PEPP, EIOPA carried out a survey amongst its members and received stakeholder feedback through the public consultation, public events and direct industry feedback.

Based on this further research and analyses, EIOPA confirmed its views that a standardised PEPP with a defined set of regulated, flexible elements would be best placed to support sustainable pensions via personal pension savings that are safe, cost-effective, transparent and sufficiently flexible to accommodate the current economic and labour market environment in Europe and to promote a Single Market for personal pensions.

Taking into account further analyses and in particular stakeholders' input, EIOPA now proposes a PEPP that is characterised by the following features:

- Standardised information provision based on the proposals of a KID within the PRIIPs framework
- Standardised limited investment choices and defining one default "core" investment option, which takes into account the link between accumulation and decumulation
- Regulated, flexible, biometric and financial guarantees
- Regulated, flexible caps on cost and charges
- Regulated, flexible switching and transfer of funds
- No specification of decumulation options

Pan-European Personal Pension Product (PEPP)			
Standardised elements	information provision	Flexible elements	guarantees
	default "core" investment option		cap on cost and charges
	limited investment choices		switching

In this draft advice EIOPA considers whether and how these recommendations could be applied to PPPs in general and in that case, whether and which possible adjustments are needed. Comments are requested from stakeholders on these sections; based on that, further analysis could be carried out.

1. Context

1.1. Why personal pensions?

Pensions have been high on the agenda in all Member States, as there have been longstanding concerns about sustainable and adequate pensions in Europe. National pensions systems are challenged by demographic and labour market changes, as well as pressure on national budgets, all aggravated by a challenging economic environment. It is clear that unless more money is saved for retirement, the adequacy of pensions cannot be guaranteed.⁵

The prospects for European pensions are affected by financial instability and low employment rates, as well as by falling asset values and low returns in a low interest rate environment. Obviously, those challenges are not necessarily equally pronounced in all Member States and similarly access to or the ability to save more in supplementary pension savings are not equally available in the EEA. In some Member States there may not even be the need for savings in private pensions due to the specific set-up of statutory pension schemes and occupational pensions.⁶

In addition to public pay-as-you-go pension schemes and occupational retirement savings, personal voluntary pension savings can help secure adequate replacement rates in the future. Some countries have introduced these, but there is still scope for further development of personal private pension savings opportunities in many countries. This would require though that these pension schemes become more attractive to consumers, i.e. potential pension savers, and more cost effective, as well as more compatible with increased mobility of European citizens. Additionally, improving consumer information and protection in voluntary personal retirement savings is necessary to enhance consumers' confidence in those products.

Furthermore, one can expect a noticeable geographical shift of ageing populations from Western to Eastern European Member States by 2060 and may give an opportunity to develop a regime where it does not already exist.

⁵ See European Commission: White paper: An Agenda for adequate, safe and sustainable pensions, 2012, p. 2; European Commission: The 2015 Pension Adequacy report, 2015, p. 1; European Commission: Pension Adequacy in the European Union 2010-2050, 2012, p. 9.

⁶ Note that in some Member States the specific structure and benefits of statutory pension schemes may make supplementary pension savings less relevant, see for example European Commission: The 2015 Pension Adequacy report, 2015, p. 4.

Member States with proportions of over 65s above the EU average in 2010



Member States projected to have proportions of over 65s above the EU average in 2060



Publication: ILC-UK report on Europe's ageing demography, November 2014

The European Commission mentions in its 2014 Call for advice and in its 2012 White Paper on pensions several tools that could be regarded as complementary or supplementary pensions savings - in addition to possible changes to pensions systems - that could address the obvious challenges for sustainable and adequate retirement income in the future.⁷ It mentions the role of occupational and personal pensions, life insurance products and other forms of asset accumulation and other financial instruments, for example reverse mortgages which enable elderly people to convert their equity investments in their homes into annuity-like retirement income.

In line with EIOPA's 2012 advice on occupational pensions⁸, EIOPA fully supports the further development of occupational pensions and the activities of IORPs, in particular with regard to reaping the benefits of economies of scale relating to cross-border activities. Equally, EIOPA acknowledges benefits in standardising and simplifying life insurance products in order to foster additional savings to enhance future retirement income. Though mentioned in the European Commission's Call for Advice, in the EEA there is little research on the suitability of reverse mortgages to complement retirement savings. In some countries such as the US, Australia or Canada some evidence suggests that reverse mortgages pose significant risks to elderly people taking up those instruments, in particular due to their complex nature and quite often poorly understood terms and conditions.⁹

Analysing the personal pensions market in the EEA EIOPA learnt that there is definitely room for third pillar savings in the European market. With 1,089 billion Euro in assets spread over 67 million consumers this shows there is potential demand for

⁷ See European Commission: White paper: An Agenda for adequate, safe and sustainable pensions, 2012, p. 6; European Commission: Call for Advice from the European Insurance and Occupational Pensions Authority (EIOPA) on the development of an EU Single Market for Personal Pension Products (PPP), 2014, p. 3.

⁸ See EIOPA: EIOPA's Advice to the European Commission on the review of the IORP Directive 2003/41/EC, 2012, p. 8, https://eiopa.europa.eu/Publications/Consultations/EIOPA-BOS-12-015_EIOPA_s_Advice_to_the_European_Commission_on_the_review_of_the_IORP_Directive.pdf

⁹ See for example Australian Securities and Investment Commission: Reverse mortgages, 2015, <https://www.moneysmart.gov.au/superannuation-and-retirement/income-sources-in-retirement/home-equity-release/reverse-mortgages>, ; CNBC: will a reverse mortgage be your friend or foe?, 2015, <http://www.cnbc.com/2015/05/27/will-a-reverse-mortgage-be-your-friend-or-foe.html>.

personal pension products, however, this is not equally pronounced in every Member State. Further data is available in annex III.

Additionally, the millions of members joining a first pillar bis scheme in Eastern European markets indicate that a PEPP, as presented in EIOPA's consultation paper on PEPP, might be especially interesting for markets where occupational pensions are less developed. Also in markets which are known to have a strong second pillar such as the Netherlands, significant pensions savings have been made in PPPs. However, the overall amount saved in PPPs is relatively low. It is therefore questionable if the current level of savings will be sufficient to close the pension gap.

It is remarkable that personal pensions were marked last in the European Commission's analysis¹⁰ of market performance of different products. This calculates a Market Performance Index, which assesses to what extent a given market brings the desired outcome to consumers. Similarly, both in the UK¹¹ and in IT¹², studies were conducted on why people do not buy personal pensions. In the UK, 40% of the respondents indicated that they could not afford to sufficiently save to protect their income at retirement. Almost 30% indicated that they did not need it, whilst 10% highlighted that they did not trust insurance companies. In Italy, over 40% of the respondents mentioned that it was too expensive, relating to high costs and fees. Another 30% highlighted that they did not trust the third pillar, mainly because of its many reforms. 20% stressed that they were too young to think about it.

This proves that trust in PPPs and its providers needs to be restored in order to boost savings in PPPs. This goes hand in hand with making the product affordable and increasing transparency, so consumers can make well informed decisions about their retirement.

Similarly, national pension reforms have not yet fully turned around the still dire situation for adequate and sustainable future pensions. EIOPA's 2015 survey on personal pensions shows that out of 25 respondents 22 Member States have personal pensions arrangements in place with over one trillion euro in assets under management. The vast majority of those products are issued and managed by life insurance undertakings. EIOPA notes a stark concentration of asset values in three Member States (NL, UK and BE). The highest number of contracts is issued in Germany - with over 10 million contracts sold.

Pensions are traditionally a national-specific issue, however, due to the ever further integration of economies and societies in the EEA, the effect of national pension outcomes will have repercussions for the EEA as a whole. That makes pensions an issue of European concern.¹³ EIOPA's 2015 survey on personal pensions also looked into current volumes of, and current potential barriers to, cross-border selling of personal pension products. The volume of cross-border provision can be estimated as 10 billion Euros in the EEA, which translates into 4% of the total market in the corresponding Member States. Whilst this is a very small number and indicates that the benefits of a Single Market for personal pensions are not being extensively realised, it is worth noting that in a few Member States (for example BG and MT) the domestic market is actually dominated by cross-border providers. Further analysis of the current cross-border situation can be found in annex V. The barriers to cross-border provision and management of personal pension products are manifold, ranging

¹⁰ See European Commission: Monitoring Consumer Markets in the European Union 2013, PART I, 2013, p. 16, 22.

¹¹ Swiss Re: The Insurance Report 2011: Facing life's responsibilities, 2011.

¹² See COVIP: Convegno COVIP CENSIS, Promuovere la previdenza complementare come strumento efficace per una longevità serena, 2013.

¹³ See European Commission: The 2015 Pension Adequacy report, 2015, p. 3.

from restrictions on investments in foreign currencies, limitations on transferability to taxes and contract law that have also been assessed in EIOPA's previous reports.¹⁴

The pensions systems in the EEA are highly diverse (see annex III). Yet, the conclusions that can be drawn from EIOPA's 2015 survey on personal pensions show that many Member States could benefit from additional individual savings for retirement due to weaknesses in the state pensions and the often lacking access to occupational pensions. Even though these phenomena may not be the same or may not even exist in each EEA Member State, at least in a number of Member States desirable third pillar savings may only be effectively provided through an efficient Single Market for personal pensions, which facilitates cross-border transactions.

Personal pension savings will only deliver on the promise of enabling adequate replacement rates in the future, if those savings are safe - in the sense of trustworthiness -, cost-effective and transparent, as well as sufficiently flexible to cater for an European labour market that is characterised by more and more unconventional careers and heightened mobility of workers.¹⁵ These objectives for personal pensions will require personal pension products to exhibit the following characteristics:

- **Safe products:** regulation needs to address agency conflicts and information asymmetry as shortcomings of an inefficient market. Conflicts of interests need to be acknowledged and the right incentives need to be put in place to facilitate optimised results for consumers. The main tools for doing so are setting the right authorisation regimes, governance, distribution rules, as well as capital requirements, where appropriate, and supervisory powers. Furthermore, provision of relevant information is critical for the endorsement of that regulation. Ensuring this means having a robust regulatory framework in place (covering the abovementioned areas as well as rules on conflicts of interest or product governance). Safe products can also mean some controls and limits on product design, including through product oversight and governance measures.
- **Transparent products:** high complexity is often seen as inherent to the nature of any long-term savings. In order to enable a consumer to make well-informed decisions about taking up and maintaining long-term savings, relevant information on those products need to be provided. Experience shows that individuals cannot necessarily rationalise an estimate of the need to save for pensions and the extent to which additional savings are required. The nature, frequency and presentation of information are crucial in this regard.
- **Cost-effective products:** determinants of administration costs are the level of distribution, information and manufacturing costs, which are intrinsically linked to the complexity of products - or put another way the lack of standardisation. Asset management costs are linked to the size of the asset portfolio under management. Efficiency gains are needed, particularly at a time of low asset returns, to help build a stronger market for personal pensions. Efficiency gains can be sought through economies of scale and risk diversification. A well-functioning Single Market without obstacles to cross-border activities, facilitating healthy competition and financial innovation, would appear to be a condition for realising such gains.

This paper examines how personal pensions might be best regulated to achieve these outcomes and how those outcomes may be optimised through the introduction of a standardised PPP (PEPP). As per the Commission's CfA, EIOPA's preliminary report and

¹⁴ See EIOPA: Towards an EU single market for personal pensions: An EIOPA Preliminary Report to COM, 2014.

¹⁵ See European Commission: The 2015 Pension Adequacy report, 2015, p. 4; European Commission: White paper: An Agenda for adequate, safe and sustainable pensions, 2012, p. 6.

EIOPA's consultation on the PEPP, throughout this paper 'personal pensions' and 'PPPs'¹⁶ are understood as products established on the basis of individual membership and sold on a retail basis. Employers do not play a role in establishing or sponsoring a PPP but may pay contributions to an individual PPP on behalf, or for the benefit, of the employee. Self-employed persons are often seen as potential PPP members.

1.2. Economic rationale for an efficient Single Market for personal pensions

The need to take measures to foster an EU Single Market for personal pensions, highlighted in the European Commission's 2014 Call for Advice to EIOPA, is underpinned by the impact of a number of market failings:

- The personal pensions market remains highly fragmented in the EU, mainly as a result of varying approaches to pension provision. The lack of, or limited, provider access to the whole of the EU market¹⁷ is also evidence of a fragmented and hence **imperfect market** that ultimately prevents PPP providers from achieving both economies of scale and growth potential. On the consumer side, an inefficient Single Market means that EU citizens, who are also increasingly mobile, cannot reap the benefits of wider provider choice, better quality and lower prices due to the lack of EU-wide competition between market players.
- Lack of equality of **supply and demand**: it could be considered whether limited provider access to the whole of the EU market may lead to equally limited access for consumers wanting to save for retirement in personal pensions. That can be assessed as a market failure meaning that the market is unable to adequately provide the supply for all EU consumers that have a demand.
- There are **asymmetric information** issues between providers (so called agents) and consumers (so called principals) where consumers are less well informed than PPP providers and therefore have difficulty judging or comparing the performance and quality of the pension product and/or providers, potentially resulting in less cost-effective and unintended outcomes for PPP holders. This lack of complete and equally shared information between principal and agents reduces trust in PPP providers and may often result in fewer transactions, lower levels of engagement with pension provision, alongside poor decision making by consumers. Whilst greater transparency is a pre-requisite to help address issues of information asymmetry and restoring trust, improving information disclosure will not be sufficient, on its own, to enable consumers to make sound and informed choices. This is because the root causes of asymmetric information are complex and diverse e.g. uncertainty, low financial capability, time inconsistent behaviour, consumer inertia.
- Given asymmetries of information, prospective PPP holders will often turn to distributors and others for advice. However, unresolved conflicts of interest arise due to principal-agent problems. These can also arise between PPP providers and PPP holders, where PPP providers may not always have the PPP holders' interest in long term outcomes in mind. The inverted production cycle of personal pensions, where PPP holders receive benefits only years after their purchase, can make it difficult for PPP holders to monitor financial conditions over extended periods of

¹⁶ As defined in EIOPA: Towards an EU single market for personal pensions: An EIOPA Preliminary Report to COM, 2014, p. 12-16, https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-029_Towards_an_EU_single_market_for_Personal_Pensions- An_EIOPA_Preliminary_Report_to_COM.pdf EIOPA's preliminary report.

¹⁷ Including restricted access to EU-wide personal pension value chain.

time and put effective market pressure on PPP providers. The inverted production cycle of PPPs combined with the issue of widely dispersed PPP holders¹⁸ who are unable to effectively monitor providers both stress the need for designing an efficient supervision regime whereby a supervisory authority acts as a "tough" and sophisticated claimholder to protect dispersed PPP holders.

- A truly well-functioning Single Market for Personal Pensions would provide a means of unlocking **positive externalities** which have yet to be fully utilised at EU level - especially in the current challenging low interest rate environment - by easing the access to both new and additional cross-border investment opportunities, accessible at lower cost. This would crucially unlock the potential of the personal pension market in Europe to contribute to a flourishing CMU, directed to long term rather than short term investment goals that can multiply real economy benefits. This would, in turn, help achieve optimal risk diversification and multi-pillar diversification¹⁹, thereby enabling PPP holders to save for the long term²⁰ in a robust manner. There is also scope for generating further positive externalities by supporting EU labour mobility, addressing consumer confidence issues^{21,22} and taking into account relevant cognitive and behavioural biases that hinder consumers' ability to make sound and informed pension decisions²³.

In light of the abovementioned market failures and building on previous EIOPA work²⁴, the policy options available to develop a truly successful EU Single Market for Personal Pensions should be appraised against a set of criteria directly derived from EIOPA's key strategic objectives (1) to ensure transparency, simplicity, accessibility and fairness across the internal market for consumers and; (2) to lead the development of sound and prudent regulations supporting the EU internal market. Based on these objectives, EIOPA has developed two combined criteria for policy option appraisal which can be summarised as follows:

(1) Develop and strengthen the regulatory framework for the benefit of protection of consumers - addressing consumer needs and incentivising good pension outcomes:

¹⁸ See Plantin & Rochet: When Insurers Go Bust: An Economic Analysis of the Role and Design of Prudential Regulation, 2007.

¹⁹ Especially since consumers are increasingly bearing risks, notably with the shift from Defined Benefit to Defined Contribution occupational pensions, they will also need to increasingly take greater personal responsibility for their retirement through supplementary private pensions as a result of the ageing of the European population.

²⁰ European Commission: An agenda for adequate, safe and sustainable pensions, White Paper, 2012.

²¹ The last position of the investment products, private pensions and securities market in the Commission's Consumer Scoreboard is a testimony of poor performance in the EU private pensions market, also characterised by very low scores in the ease of comparing goods or services on offer, consumers' trust in providers to comply with consumer protection rules and consumer satisfaction. Source: European Commission: Consumer Markets Scoreboard Market, 2015,

http://ec.europa.eu/consumers/consumer_evidence/consumer_scoreboards/market_monitoring/docs/consumer_market_monitoring_2013_part_1.pdf

²² Improving consumer confidence will ultimately increase the demand for PPPs which will be beneficial to both consumers and PPP providers as the former are no longer deterred from purchasing PPPs.

²³ When faced with uncertainty, risk and complexity, three attributes inherent to private pensions, consumers do not always behave rationally as defined by standard economic theory. They will often avoid or postpone decision-making even if it is in their best interest. When prompted to take pension decisions, they will unintentionally make mistakes, which may adversely impact on their future retirement outcomes, potentially with irreversible consequences. They also tend to be loss averse and will therefore go out of their way to avoid losses relative to making gains. Source: EIOPA: Consultation Paper on the creation of a standardised Pan-European Personal Pension Products, 2015, annex 2:

<https://eiopa.europa.eu/Publications/Consultations/EIOPA-CP-15-006-Consultation-paper-Standardised-Pan-European-Personal-Pension-product.pdf#search=PEPP%20consultation%20paper>

²⁴ EIOPA: Towards an EU single market for personal pensions: An EIOPA Preliminary Report to COM, 2014.

- Balancing simplicity for the majority of EU consumers but allowing choice for the significant minority who want the latter
- Improving product comparability, information transparency and confidence in PPPs
- In doing so, the approach should be consumer driven rather than product focused by seeking to protect PPP holders against risks of fraud, conflicts of interest, market abuse by helping them to overcome key cognitive and behavioural biases.²⁵

(2) Improve the functioning of the EU internal market in the field of pensions and insurance through appropriate regulatory market intervention:

- Encouraging fair and open competition between all market players
- Facilitating financial innovation
- Harnessing existing and creating new cross-border opportunities throughout the EU PPP value chain
- Reducing barriers to market entry
- Enabling efficiency gains through economies of scale and lower costs
- In doing so, the approach should mitigate any potential risk of regulatory arbitrage and ultimately benefit EU consumers so that it pays to save in PPPs

The development and assessment of policy options consider both criteria in an equal and mutual manner to achieve a balanced assessment of the overall impact and fine tune conclusions for each policy option. For instance, an appropriate policy option should be one that is simplest for consumers but also seeks to mitigate any risk of hindering innovation through overly prescribed requirements. Likewise, a suitable policy option that promotes a level playing field and stimulates competition and innovation should also go hand in hand with encouraging the provision of simple, fully transparent, comparable and trustworthy PPPs to consumers.

In order to provide a response to the Commission's Call for Advice, EIOPA has mainly carried out an appraisal of the following policy options on the feasibility to develop:

- A "2nd regime"²⁶ that creates a standardised Pan-European Personal Pension Product (PEPP) through new EU rules that do not replace national rules but are instead an optional alternative to the latter. EIOPA has publicly consulted on a PEPP in summer 2015.
- Common EU rules set out in a Directive to enable cross-border activity of personal pension schemes through the harmonisation of national PPP supervisory requirements. EIOPA has not consulted on this until now and it seems premature in places to reach definitive conclusions hence why that policy option is subject to this consultation.

²⁵ The most appropriate policy option should take into account consumers' cognitive and behavioural biases with respect to personal pensions. It should therefore focus on the consumer rather than the product, especially since personal pensions, which require consumers to actively exercise choice (e.g. purchase, switching, fund choice) are hard to sell due to issues of low confidence in PPPs.

²⁶ Sometime also referred to as a "29th regime".

2. Addressing failings of an inefficient market

To effectively drive benefits from a Single Market in personal pensions, EIOPA believes it is important, when tackling systemic market failings and inefficiencies, to take into account relevant lessons from behavioural economics.

Due to the long-term nature, its inverted production cycle and complexity, many consumers consider that PPPs are too abstract with multiple complicated features (e.g. charging structures) that are not properly understood, especially in contrast to other more ordinary products²⁷. Due to individuals' self-bounded rationality, PPP decisions will often be perceived as too complex because:

- They require the individual to assess risk and uncertainty
- They involve trading off between the present and the future
- They require dealing with ambiguity

Behavioural economics teaches that consumers tend to have a strong preference for certainty and they will therefore seek to avoid ambiguity. Due to a present bias and lack of self-control, they will tend to swap their preference from long-term to short-term gains (i.e. hyperbolic discounting) which often translates into consumer inertia (e.g. do not start/postpone retirement saving to a later date) and infrequent decision-making (e.g. periodical retirement planning reviews).

When prompted to make active choices, where procrastination is not an option, they will try and simplify decisions. Using mental shortcuts (so called heuristics), simple rules of thumb and reference points based on their own past experience, and if not, on how others like their peers behave. This leads to decisions, which exhibit systematic errors and ultimately lead to sub-optimal outcomes.

Consumer decisions can also be emotional. In the context of PPPs, these may be strongly influenced by a fear of making losses (so called loss aversion) and/or running the risk of regret later on, especially when the consequences and outcome are only revealed after a long period.

Individuals have been proven to manifest undesirable behavioural conduct based on errors of cognition (bounded rationality, framing bias) or emotional influences (status quo bias, regret aversion bias). Very often financial studies have demonstrated that suboptimal choices are made in the context of lack of information and lack of perfect knowledge. In the case of personal pensions, consumers find it difficult to make optimal choices when confronted with a complex, exhaustive, difficult to understand and multiple choice system that has a utility beginning in the distant future (triggering an inner conflict of opting for a long term goal in favour for short term gratification). A well developed, straightforward, easy to understand and transparent personal pension product would, in this situation, make a notable difference for the future of consumers and personal pensions systems alike.

In contrast, in the area of occupational DC pensions, many of the cognitive and behavioural traits outlined above are being addressed by taking some of the complexity in decision-making away from individuals. For instance, mandatory and semi-mandatory second pillar pensions tend to entrust the choice of pension product to the sponsor or collective who may also set scheme contribution levels, if not

²⁷ For instance, where consumers easily comprehend what they are getting and paying for.

defined in national law. Likewise, the institution and hence persons effectively running an occupational DC pension typically take decisions on the investment strategy on behalf of and in the best interest of the scheme members. Consequently, membership in second pillar DC pensions does not necessarily equip consumers to be self-sufficient, sophisticated investors in third pillar PPPs since the persons running occupational DC pensions through the governance structure take on complex decision-making (e.g. investment strategy) and should communicate what members need to do/know (e.g. number and nature of investment options if member choice is available).

Therefore, implementing robust governance in addition to simplifying both information and choice should constitute some of the key learnings from second pillar DC pensions for furthering the development of PPP to help address, at least partly, consumers' cognitive barriers and behavioural biases²⁸.

2.1. Setting appropriate provider governance standards for personal pensions

EIOPA considers it essential in building consumer trust in PPPs that sufficiently high standards always apply regarding the organisational and governance arrangements in place at the level of the provider, and in some cases the distributor. This is particularly important in view of ensuring PPPs are well designed, and suited to the markets for which they have been prepared.

Some or all of the governance elements discussed here already apply to some types of providers through the applicable sectoral prudential regulation. However, **it is stressed that any governance standards would be subject to a much more detailed analysis providing further clarity and insights before a final policy stance can be taken. However, for the purpose of this section, it is assumed that the governance measures for the success of possible future PPP are needed.** "Success" here means establishing a market for safe and reliable products with desirable features for the consumer. **The remainder of the analysis below should be read with this caveat in mind.**

The purpose of governance measures is to align the level of product security with the consumer's risk appetite in relation to retirement income needs. This "equation" does not contain a dependence of the latter on the type of provider, and therefore no dependence on the regulatory concept this provider is subject to.

Because consumers are likely to find PPPs and associated decisions difficult, providers, distributors and financial advisors should seek to remove, to the extent possible, some of the complexity when developing, marketing and advising on PPPs and many consumers are therefore greatly reliant on these entities especially if they are likely to be overwhelmed by too much complex information (the next section provides more detail on the cognitive barriers and behavioural biases with respect to pension information). "Sub-contracting" decisions to providers implicitly requires putting in place robust governance requirements that foster trust and confidence and provide reassurance given consumers' tendency to be loss averse and to fear that their decisions will turn out to be wrong in hindsight. This relates both to measures at the level of the provider and how they organise themselves, and measures at the level of the processes the provider follows to ensure the products they bring to market are sound, well understood by the provider and their distributor, and targeted at the right consumers. In this paper, we examine these two aspects of governance separately.

²⁸ Due to both the voluntary and contract-based nature of third pillar PPPs, PPP holders have to deal with complexity by themselves relative to occupational DC members, unless they have "contracted out" the latter to financial advisors notably at the point of purchase, albeit at a cost.

In its Call for Advice, the Commission highlighted that the following governance requirements related to the provider should be further explored in the context of PPPs:

- Fit and proper management
- Functions for risk management, actuarial tasks, internal control, compliance and audit
- Remuneration policy
- Risk self-assessment and documentation
- Depositories (appointment and responsibilities)
- Outsourcing
- Other aspects of the overall governance system (if any)

In EIOPA's view, the governance requirements listed above constitute essential elements when considering setting good governance standards on providers of PPPs. In addition, a comparison of the various legal acts set out immediately below has shown that these governance topics reappear in varying combinations across the sectoral legislation, hence supporting this assertion. EIOPA welcomes the views of stakeholders on this point.

EIOPA has considered both EU and international measures and standards. Seven European Directives in the financial services area address governance: Solvency II Directive²⁹, IMD³⁰/IDD³¹ (latest consolidated version), CRD IV³²/CRR³³, UCITS³⁴, MiFID II³⁵, European Commission's proposal on IORP II³⁶, and AIFMD³⁷.

The question of whether or not, a common governance approach can be taken for all types of personal pension products seems to depend therefore at least to some extent on the associated costs and their differential impact on existing providers in view of how close or far a new approach would be to existing sectoral measures. As governance measures impose costs on the provider, they will be taken into account when the decision about entering or staying in the market is taken. These costs are also inevitably passed on to the consumer in the form of higher charges which reduce the value of their eventual pension. A higher governance level, on the other hand,

²⁹ Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), OJ L 335, 17.12.2009, p. 1.

³⁰ Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation, OJ L 9, 15.1.2003, p. 3.

³¹ Proposal on Directive of the European Parliament and of the Council on insurance distribution (recast); Directive to be published at the time of writing; the latest consolidated version can be found under <http://data.consilium.europa.eu/doc/document/ST-10747-2015-INIT/en/pdf>.

³² Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, p. 338.

³³ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L176, 27.6.2013, p. 1.

³⁴ Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depository functions, remuneration policies and sanctions, OJ L 257, 28.8.2014, p. 186.

³⁵ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance, OJ L 173, 12.6.2014, p. 349.

³⁶ European Commission: Proposal for a Directive of the European Parliament and of the Council on the activities and supervision of institutions for occupational retirement provision (recast) /* COM/2014/0167 final, 2014, <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52014PC0167>.

³⁷ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, OJ L 174, 1.7.2011, p. 1.

should provide for a higher level of product security and thereby greater consumer trust in their retirement savings product, which in turn fosters demand. This may be particularly important in the context of new entrants or products. Both benefits and costs should be borne in mind.

Different governance requirements for different types of providers could also be considered as appropriate in view of the different risks faced by these providers. Firms such as a bank or an insurance company as PPP providers can usually be expected to have more developed processes and greater own resources than, e.g., single fund managers, but the variety of their other activities may also raise challenges that need addressing to avoid contagion impacts for PPP holders.

Fit and Proper management

EIOPA's analysis notes that fit and proper (F&P) requirements are common in EU Directives. When applying this to providers of PPPs it is necessary to determine who is subject to these requirements (scope) and the specific requirements to render the person or group fit and proper (substance). With regard to the scope, it seems adequate to require proof of F&P requirements for the full production chain of the PPP. This includes shareholders and members with qualifying holdings in the financial institution providing PPP products; holders of key functions in the management of the financial institution; third parties to which substantial tasks have been outsourced or sub-outsourced (e.g. depositories and asset management); and distributors, mediators or brokers selling PPP products to consumers.

The reason why the F&P scope should be so comprehensive is that more expertise along the production chain can increase product quality, thus increasing the probability of good consumer outcomes and mitigating mis-selling risks, while delegation arrangements can quickly lead to a circumvention of the intention of regulations if they are not also covered. A clean track record for PPPs in general should be aimed at, as the whole product class could severely and persistently suffer from mis-selling scandals. As costs for F&P checks are mainly one-off, but contribute to sustainable product quality, they are justified.

The substance of the F&P requirements hinges on the person on whom the requirements are imposed. In this regard, it seems the role of distributors is crucial for the success of future PPP products on the demand and supply side. Therefore, the application of F&P requirements at this level would also be crucial: to be fit for marketing PPPs, distributors should provide sufficient education and training to adequately assess the needs of a potential client and tailor the features of a PPP according to those needs. This will also be addressed separately below when examining conduct of business measures related to distribution.

At the same time, the backbone of the product is a sophisticated asset management function that is capable of generating growth and income by efficiently investing collective funds in sufficiently diversified investments in keeping with the risk profile being sought. The returns on these investments have to match the expectations and optimised returns arising from the provider's PPP portfolio on a long-term basis, thereby ensuring, for those providers offering guarantees, the going concern of the financial institution. Thus, the asset manager of the PPP provider has to have sufficient skill set, knowledge and experience, e.g. in asset liability management and long-term investment strategies.

These are just examples of the correspondence of "fit" requirements to the role of the person or group of persons on whom they are imposed. These examples illustrate the issues that need to be considered for other activities and functions in the PPP value chain. Furthermore, the eligibility of a person for a specific role or function must be

viable on a continuous basis, meaning that ongoing training and professional development is also essential.

In addition, each relevant person has to be of good repute and integrity, and should at all times be able to demonstrate that he or she acts in the best interest of the clients. The maximum number of concurrent management positions held by a given person exerting the function/role in question should be limited.

For PPPs, EIOPA thinks that the scope for the fit and proper requirements must be defined in the first place. The person or group of persons effectively running the business, ultimately bearing the responsibility or holding a key function in the value chain, and should therefore possess sufficient skill, knowledge and experience to carry out the role(s). With regard to scope, MiFID II, UCITS and AIFMD provide some insight into rules covering outsourced activities. General definitions of the scope of fit & proper requirements are contained in Solvency II and CRD IV/CRR. Once the scope has been defined the specific requirements that must be fulfilled in order for a particular person to be regarded as fit and proper to bear the responsibility of his or her tasks in a PPP provider's value chain have to be determined. These requirements depend on the individual tasks that the position holder must carry out. IDD for example provides some requirements for distribution posts (sufficient training and education among others). UCITS describes prerequisites for eligible tied agents, market operators and data providers, where Solvency II and CRD IV/ CRR set out the requirements on an abstract level. Good reputation and integrity, as well as being able to demonstrate that the person can act in the best interest of the clients are basic features every candidate should exhibit (see e.g. AIFMD). CRD IV/ CRR require that the holder of a position that is within scope of the fit and proper requirements must devote sufficient time to perform their duties and accordingly sets limit e.g. on the number of contemporaneously-held directorships.

Functions for risk management, actuarial tasks, internal control, compliance and audit

It is immediately clear that the range of features of PPPs offered by a provider determines the key function set-up and responsibilities that have to be assigned to individual persons (members of a management, administrative or supervisory board) or the management body as a whole. The development, supply, management and distribution of even a comparatively simple savings product brings certain risks (e.g. liquidity, market, credit, operational risks) on the providing institution, such that a risk management function should be a mandatory part of the set of required key functions.

Consistently, if options and guarantees or similar commitments are part of the PPP contract, actuarial modelling, valuation and actuarial support is mandatory in order to provide a product that adequately takes into account the associated risks (insurance risks incl. calculation of technical provisions, biometric risks). The actuarial support becomes a key function, once the PPP comprises such life insurance elements. This shows again, that the set of (key) functions and tasks must be commensurate with the design of the particular PPP product. The conceptual approaches of Solvency II and IORPII on key functions are quite advanced and could therefore be used as a starting point. Additional input on the extension of the scope of certain functions to outsourced tasks can be taken from AIFMD. CRD IV/ CRR provide an indirect approach whereby the supervisor is required to ensure that the supervised entity has the

necessary assignment of key functions in place, together with the appropriate processes.

A balance must be struck. Operational and other types of risk cannot be managed without a minimum level of compliance, internal control and audit. Nonetheless, proportionality is recommended as a guiding principle for specific obligations with regard to all of these elements, as the establishment and maintenance of the required management and organisational processes, as the scale and nature of the risks, vary according to the PPP provider and their business model. While costs related to measures in these areas are justifiable in view of the potential consequences of failures, these costs should be proportionate to the risks generated by specific PPP providers and their business models.

If a key function is not assigned to a particular person, but jointly to a group (e.g. management board), there is a risk that sharing of responsibilities could lead to a lower level of awareness, accountability and commitment. Thus, the assignment of key functions to designated individuals could contribute to better management and thereby to more reliable products being offered on the market. As reliability is a key factor in the introduction of a new product class, especially considering the long-term nature of pension products, there is a compelling argument for using the individual person approach.

Another consideration is the segregation of certain functions in order to avoid conflicts of interest. If several functions are carried out by the same person, or if a person carrying out a function is subordinated to another person who is responsible for a second key function, this could give rise to conflicts with the first key function. Where the number of persons effectively running the institution is large enough, the allocation of tasks to an appropriate number of people is feasible. If the institution or type of institution is not endowed with a sufficiently large team of managing individuals, the assignment may pose problems. In such cases there may be scope to group roles with strict segregation to ensure that conflicts of interest are avoided. As it has been argued that IORPs often are small and have lean management structures, specific rules have been included in the legislative proposal by COM. Presumably, these rules could be used as a model more widely. Conflicts of interest measures in other EU instruments also demonstrate a regard for ensuring effective measures even in cases where there are no possibilities for a complete separation of functions.

Existing international standards and recommendations applicable to pension institutions can aid in assessing an appropriate design for risk management, see annex VII.

Prudent risk management practices should also consider intangible risk factors such as environmental, political and regulatory changes, as well as the provider's potential market impact through its investment decisions. The risk management strategy should seek to proactively identify and explicitly balance short- and long-term considerations.

An effective risk management system comprises strategies, processes and reporting procedures necessary to identify, measure, monitor, assess, control and report, on a continuous and an ad hoc basis, all material risks and their interdependencies, at an individual and an aggregated level, to which the provider is or could be exposed. The risk management system needs to be well integrated into the organisational structure and in the decision making process of the entity.

The internal auditing function should cover the effectiveness of operations, the reliability of financial reporting, deterring and investigating fraud, safeguarding assets, and compliance with laws and regulations.

Consistently with EIOPA's views in the CP on PEPP, EIOPA believes that providers should maintain a sound risk management function and actuarial function, if biometric risks are covered by the contracts issued. Furthermore, they should have an effective internal control system and regular assessment of compliance should form part of this effective internal control system. The framework for internal control should include at least administrative and accounting procedures and reporting and compliance arrangements, outsourcing arrangements and appropriate controls for outsourcing. Furthermore, the set-up should contain a whistle-blowing requirement for the compliance function to inform the supervisory authority in those cases where the administrative, management board of the provider does not take appropriate and timely remedial action. The whistle-blower should be legally protected.

Remuneration policy

EIOPA believes that a sound remuneration policy for PPP should be a key part of a good governance system. Discussions on remuneration during the co-decision process of a number of European Directives in the past have shown that salaries, bonuses and similar payments are a means of motivating staff. While they are used to attract the most suitable applicants for the required tasks, they can, at the same time, provide inappropriate incentives at different points of the production chain, generating conflicts of interest that are difficult to manage appropriately. This may be, for instance, by encouraging risk taking that is not in the interests of the consumer, or encouraging the sale of a particular product irrespective of its suitability for a specific consumer.

As a broad range of financial institutions could be eligible PPP providers in the future, it may be difficult to cover all possible configurations of the production chain that might exist now or later in the financial sectors by giving detailed rules on the proportionality and appropriateness of all types of rewards, fees or compensation. CRD IV/CRR, UCITS and AIFMD, already contain far ranging rules on remuneration, which are specific to the scope of the relevant Directives and the associated business models. Provisions on detailed calculation principles, caps and ceilings for different elements can be found. Solvency II however is largely silent on remuneration as such.

Thus, it seems a more robust approach to avoid a huge body of detailed and sector-specific remuneration rules by instead requiring PPP providers to develop a remuneration policy appropriate to their activities. Such a concept is also mentioned in CRD IV and CRR, UCITS and AIFMD, but the concept is tailored in each of the legal acts to the prevailing business model of the particular sector and its idiosyncrasies. At the same time it caters for a level playing field for these PPP providers, as they all would be subject to the same principle-based rules.

EIOPA believes that the principles governing remuneration policy should be designed such that a remuneration policy must be consistent with, and promote, sound and effective risk management (concurrent wording in CRD IV, UCITS and AIFMD). In order to avoid conflicts of interest, a guiding principle should be that the remuneration according to an eligible policy ensures that the remunerated person always acts in the best interest of the consumer. Additionally, there could be an obligation introduced to publicly disclose either the remuneration policy, or – probably more effective in terms of transparency and consumer protection – the actual remuneration structure.

Later in the paper there is an analysis of distribution, and the appropriateness of measures in both MiFID and IDD for tackling conflicts of interest arising from remuneration arrangements and inducements/commissions in the context of sales and distribution - crucially important issues in ensuring good outcomes for consumers.

Risk self-assessment and documentation

The comparison of the relevant European Directives has shown that the concept of a risk self-assessment is more advanced in institution-based financial sectors (banks and insurers with CRD IV/CRR and Solvency II, respectively). An explanation for this finding may be that the business models in these sectors are usually interlinked with a wide variety of financial or real economic activities of various natures. Compared to that, fund managers are mostly not permitted to undertake a wide range of other activities, and indeed are limited in their investment opportunities by fund rules, regulatory limits, and similar statutory rules. Their business may also be partitioned (e.g. by outsourcing significant parts of their production chain to depositories and external auditors) or structured in a less complex way in order to be exposed only to limited risks.

All financial institutions should be able to understand their own financial position. In order for insurance companies to achieve this objective, the Solvency II Directive *inter alia* imposes an obligation on them to regularly perform their own-risk and solvency assessment (ORSA). The ORSA is an undertaking's economic view of the means required to run its business, irrespective of the requirements set out by the regulator. It is risk-based and founded on the undertaking's business plans and projections. In the Solvency II regime, the ORSA forms an integral part of the management process and decision making framework of the insurance undertaking. The purpose of the ORSA is to consider all material risks that may have an impact on the undertaking's ability to meet its obligations and to assess the capital adequacy relative to the risk profile of the undertaking.

Providing PPP products to the same markets, one could argue that all of the providers are exposed to similar risks – at least if they sell products with the same features. This suggests that it could be advantageous from a “good governance” point of view, to require them to regularly challenge their own business model from a risk management perspective and carry out a risk self-assessment.

EIOPA believes that the risk self-assessment carried out by a provider should not only comprise the review of the risks specific to the business of offering PPP product(s), such as liquidity, market, credit, possibly insurance, biometric and longevity risks and – connected to that – the solvency position of the PPP provider. All types of risks that could affect the provider should be challenged: operational risks, risks arising from likely changes in the legal, economic and social framework of the relevant markets and many more.

The risk self-assessment should be conducted regularly, presumably on an annual basis, and brought to the attention of the supervisor. The assumptions made should be clear and the range and granularity of risks considered should be proportionate to the nature, volume and complexity of the PPP products offered.

Depositories

Depositories are a specific organisational or governance measure for funds that reflects their legal form (as collective investments, where assets remain the property of investors). The use of a depository reduces the operational risks funds bear towards their investors by their management structure. Funds – especially AIF – often

have just one manager, who is responsible for the whole production chain from finding and assessing the investment opportunities, marketing the units or shares, investment and cash management and operating the redemption phase. The manager never owns the assets of the fund, but is authorised to purchase and sell the assets on behalf of the investors. Once the manager or the managing company has collected the capital, it is transferred to the depository for the purpose of investment according to the fund rules.

Capital requirements are usually not imposed on fund managers, as the insolvency of the manager should not impact the position of the investors. Depositories are also used in the fund sector to reduce the risk of misappropriation by the manager or the managing company, and as an independent check on the actions of the manager. Thus, depositories are an important risk mitigation tool for funds that also reflects the respective regulation, legal form of collective investments (that the assets are collectively owned by the investors).

CRR mentions several eligibility criteria for depositories that a regulated entity (a bank) can use to outsource certain tasks in relation to its UCITS exposures, which are specific to such types of assets. CRR and CRD IV do not require the appointment of a depository for a bank regulated under the banking regulatory framework. Solvency II regulated entities (insurance and reinsurance undertakings) are also not required to appoint a depository for their assets. In turn, asset managers' mandates may be subject to a depository requirement and this obligation arises from the respective regulation in the area of asset managers. For DC scheme IORPs the appointment of a depository would be compulsory according to European Commission's proposal on IORP II.

EIOPA suggests to follow the sector-specific requirements on the use of depositories to best reflect the provider's characteristics and business model, as those requirements are not necessarily specific to PPPs.

Outsourcing

For providers with lean management structures, with better staff endowment or sophisticated system of management, the (sub-) outsourcing of tasks and even key functions might be a desirable option to cover the compulsory range of tasks and functions. For key functions and other important management responsibilities in general, it is explicitly stated in Solvency II, UCITS and AIFMD, that the responsibility attached to the key function itself cannot be outsourced or delegated by outsourcing. This principle should be maintained for PPP providers to ensure a sufficient level of awareness, accountability and commitment.

The range of provisions on outsourcing and the detailed governance requirements varies across the compared legal acts. This is due to the different regulatory meaning outsourcing has in the different sectors, for the different types of regulated entities and for the different functions of the elements of the overall management that can be outsourced.

As the emphasis outsourcing receives in the legal acts obviously heavily depends on the type of PPP provider, EIOPA recommends that relying on the applicable European regulation governing outsourcing applicable to the specific PPP provider would be a simple and effective solution.

With regard to outsourcing the applicable international standard (OECD/IOPS good practices for pension funds' risk management systems) requires pension institutions

to develop a written policy on outsourcing, at least referring to the following elements:

- the ultimate responsibility for the outsourced activity must remain with the pension institution,
- the service provider must commit itself to enable monitoring of its activities by the pension fund governing bodies themselves or via audit as well as supervisory authority on an ongoing basis. This should include access to the information and the premises of the service provider (where appropriate), including right of the supervisory authority to perform or require an audit of the service provider. The service providers may not charge a fee for providing information or access.

Other aspects of the overall governance system

Because conflicts of interest have potential for significantly damaging the trust and confidence of consumers, an essential part of the governance system of PPPs should therefore consist of providing a framework that effectively detects and addresses conflicts of interest, including on ways conflicts of interest should be managed and mitigated. The latter should also be supported by appropriate regulation that sets out duty of care requirements on service providers within the PPP value chain and prevents the occurrence of self-interested transactions incompatible with the interest of consumers.

The scope of governance tools that has been analysed is already comprehensive. Further supportive areas, which could contribute indirectly to “good governance”, are possibly a sanctions regime, certain reporting requirements and obligations with regard to product information before, during and after the contractual relationship between consumer and PPP provider. As these issues have – as stated – just indirect effects on the overall governance regime, their appropriateness, efficiency and effectiveness would need to be analysed at a later stage in terms of cost benefit, proportionality and legal basis.

Draft advice on governance for PPP

Existing rules apply governance tools across a spectrum of providers. EIOPA believes that there are benefits to use them as the starting point for developing possible rules to be applied to PPPs (and PEPPs) instead of developing completely new requirements that may disproportionately disadvantage particular types of providers. In existing rules, governance tools strongly vary according to the type of PPP provider (roughly: banks vs. insurers/IORPs vs. funds/asset managers).

In relation to fit and proper requirements, EIOPA believes that the persons running the entity providing PPP or carrying out other key functions should be required to be:

- fit to do so, i.e. their professional qualifications, knowledge and experience have to be adequate to enable sound and prudent management or to properly perform their key function,
- proper, in other words to be of a good repute and integrity.

This is because fit and proper requirements on the entities providing PPP and other associated key functions are necessary to increase consumer confidence as outlined previously. Any regulation should ensure that there are effective procedures and ongoing controls in place to enable NCAs to assess the fitness and propriety of persons who effectively run the entities providing PPPs or who have other key functions.

In EIOPA's view, PPP providers must have in place an effective risk-management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis the risks and their interdependencies, at an individual and at an aggregated level, to which they are or could be exposed. That risk-management system must be effective and well integrated into the organisational structure and in the decision-making processes of the PPP provider with proper consideration of the persons who effectively run the entity or have other key functions.

The risk-management system for PPP providers must cover all the risks. This also includes risks which can occur in outsourced functions and activities as well as the impact on overall risk that is generated through the outsourcing. The risk-management system must cover where applicable the following areas (the list is not exhaustive):

- underwriting and reserving;
- investment, including the use of derivatives and similar instruments, and the use of so-called 'efficient portfolio management' techniques;
- liquidity and concentration risk management;
- operational risk management;
- risk-mitigation techniques, including reinsurance.

Since PPP consumers are risk-bearers, all these risks should be considered from the perspective of the consumers, in particular with respect to key elements defined in the default investment option. As regards investment risk, PPP providers must demonstrate that they comply with the investment rules set for PPP, which can be regulated as in the chapter on investments. PPP providers must provide for a risk-management function that shall be structured in such a way as to facilitate the implementation of the risk-management system.

Consistently with EIOPA's views in the CP on PEPP, EIOPA believes that providers should have an effective internal control system and regular assessment of compliance should form part of this effective internal control system. The internal audit function would need to include an evaluation of the adequacy and effectiveness of the internal control system and other elements of the system of governance of providers, including the outsourced critical or important functions or activities.

Whistle-blowing requirements should be ensured, including for the internal audit function to inform the relevant NCA in those cases where the administrative, management or supervisory body of the PPP provider does not take appropriate and timely remedial action.

In the context of PPP, the scope for risk self-assessment should include the risks of any guarantees that may be provided. The risk self-assessment would also be useful to ensure that providers make a comprehensive assessment of risk profile and risk management. A risk self-assessment for PPP should primarily seek to consider whether the defined investment and risk objectives (if any) are met taking the perspective of risk bearers i.e. PPP consumers.

The use of depositories relates to certain PPPs in particular (notably where these take the form of collective investment schemes). EIOPA does not take the view that all PPPs should be required to take such a form and use a depository for the holding of the PPP assets and for the segregation of these assets. However, where there is no depository, risk management measures and other conduct of business and organisational measures must necessarily be stronger, to mitigate possible contagion between the own business or other business of the PPP provider and the business of the PPP provider in respect of the PPP. In this regard, PPP holders that are not protected by a depository should be able to be reliant on the PPP provider being

subject to the relevant rules under Solvency II or CRD IV/CRR. Where a PPP takes the form of a collective investment scheme, the requirements related to depositaries under AIFMD or UCITS provide the relevant regulatory framework regarding depositaries, amongst other supporting matters.

These measures set out above are relevant for any possible PEPP - and could be considered as a starting point for any discussion on the rules to be applied to all PPPs. EIOPA takes the view that PPPs would not need to be restricted to any particular sector or governing framework, but in all cases it should be ensured that a balanced set of requirements applies without loopholes. In view of further developing trust across the EU in PPPs, however, greater consistency in measures might be sought, also so as to move towards a more level playing field.

In the context of a PEPP in particular, a more standardised model for governance could be advantageous, so that a consumer can be sure as to what a PEPP is and what their rights will be irrespective of its legal form. However, narrowing the sectoral form that a PEPP might take could have the detrimental impact of reducing uptake and availability.

EIOPA considers it essential that sufficient supervisory powers exist for every PPP to ensure the interests of PPP beneficiaries are effectively protected, irrespective of the legal form of the PPP provider. In general, EIOPA considers the responsibilities and powers of supervisors as set out in sectoral regulation as a strong basis for this, but care may be needed to ensure clear allocations of responsibilities in cross-border situations.

In addition, establishing effective redress mechanisms is a cornerstone of any consumer protection arsenal. It is vital to ensure that providers have adequate and appropriate complaints handling arrangements in place. EIOPA believes that all PPP providers - consistent with ESA guidelines on complaints handling - should have proper internal procedures to handle complaints, including appropriate remedial action where required. Separately, there will be a need for firms to be pro-active in their efforts to minimise complaints and in this context the product oversight and governance requirements to review the product at intervals will be a valuable tool. In this regard, all PPPs (including a possible PEPP) should also be covered by national ADR schemes such as an ombudsman service.

For asset managers that provide personal pensions there is an adequate level of protection in the measures under both UCITS and AIFMD, central to the operation of funds in the EU, whereby all assets are held in the name of the individual investors, in segregated accounts that separate them from those of the asset manager and other clients. For insurance undertakings that provide pensions it may be argued that an insurance guarantee scheme should be required to allay the fears of consumers in the event of the failure of an insurer. In addition, it may help drive trust if all personal pension provider, irrespective of their sectoral nature, were subject to some form of guarantee scheme in cases of bankruptcy or fraud, as such schemes may aid consumers in the timely recovery of assets.

2.2. Information to PPP holders

2.2.1 Starting point: overcoming cognitive biases

EIOPA's Report on Good practices on information provision for DC schemes (the 'Max Report')³⁸ provided valuable guidance to the market as regards "How" relevant information could be communicated to consumers. More concretely, in the 'Max Report', examples of good practices have been used to illustrate the recommendations put forward (e.g. to use plain language, visually highlight information etc.). About the question "How" do people process information to make choices/ take retirement planning decisions, the 'Max Report' establishes that people are short term oriented (also known as present bias) and lack self-control and willpower. Therefore, engaging consumers in long-term retirement planning is challenging as people tend to reverse their long-term preferences/rewards for shorter payoffs, hereby making inconsistent choices over time, also known as hyperbolic discounting.

More cognitive approaches should therefore be considered and adopted to attract people's attention as consumers are more likely to respond to stimuli that are novel, simple and accessible. In other words, consumers are more likely to take some action if their attention is drawn, for instance by focusing on easily recognisable features of a person, concept or product and resonating to their tendency for present bias (e.g. presenting projections in today's money). UK Behavioural Insight Team emphasised on the need for personalisation and presenting the effects of one's behaviour more salient in terms of the associated costs and benefits. A good illustration is people's reaction to using their own names in communications as quick and effortless ways to draw their attention - sending tailored, personalised messages make it easier for recipients to imagine the costs or benefits of a particular action - "what this means for me". Furthermore, this echoes the previous point on building trust and confidence given people's loss aversion - targeting, tailoring and personalising communications conveying negative messages would need to explain "what are you going to do to recoup my losses?"

Additionally, it is worth considering information provisions in relation to consumers' reference points. Research³⁹ found that consumers perceive past performance information as helpful in making investment decisions, particularly in informing their perceptions of the uncertainty of return and the downside risk of losing all the money invested. The study also suggests that individuals may therefore be resentful or suspicious if that information is either withheld or is only available at higher cost.

Transparency per se however may not be a simple solution (information is not a panacea). Information needs to be framed in such a way as to engage consumers, which prefer to do nothing or who fear to act related to their pension), and guide them to take knowledgeable choices for the better of their future. The interaction between providers and consumers should help individuals better understand pensions and their needs, desires and expectations alike. Moreover a certain level of standardisation in the context and form/channel of information would make it easier for consumers to compare and assess their current choices.

³⁸ Max was used as an average consumer in EIOPA's report on information provision to DC members, see EIOPA: Good practices on information provision for DC schemes, Enabling occupational DC scheme members to plan for retirement, 2013: https://eiopa.europa.eu/Publications/Reports/Report_Good_Practices_Info_for_DC_schemes.pdf

³⁹ See for example Druckman, J.N.: Communicating Policy-Relevant Science, American Political Science Association Task Force on Public Engagement. PS: Political Science and Politics, 48 (Supplement S1):58-69, 2015; Druckman, J.N.: How Frames Can Undermine Support for Scientific Adaptations: Politicization and the Status-Quo Bias, Public Opinion Quarterly, 78: 1-26, 2014,

EIOPA recommends that, based on EIOPA's previous findings, effective information provision has to be framed in terms of clear behavioural purposes, seek to answer key questions, it should as far as possible be personally engaging, and should restrict the number of topics covered (short and simple), while using reference points and style/ language that can work for the intended audience. As such, whilst information provision will not directly mitigate bounded rationality problems, it may prove helpful with ongoing consumer engagement. Additionally, there is evidence suggesting that interactive automated tools can have a positive impact on consumers' actual decision-making. In this respect, lessons learned from behavioural economics should be considered when designing such tools.

Disclosure of information is a vital part of the relationship between the financial services industry and consumers. It is an attempt to at least partially bridge the information asymmetry gap that exists between the parties. Arguably disclosure is more important with the greater level of complexity associated with investments. In the pensions environment additional complexity arises due to the longevity of the relationship between provider and consumer.

Consumers should not become detached from the retirement savings process. Therefore, EIOPA recommends that prospective and current pension savers should receive effective information from providers. For this reason, a "layering approach" seems important: in a first layer of information consumers should be able to find answers to their 'key' questions. In subsequent layers of information consumers should be able to retrieve answers to further questions. The content can be more complex for engaged consumers. Additionally, legal information should be retrievable and be written in comprehensible language.

Moreover, EIOPA's report on issues leading to detriment of occupational pension scheme members and beneficiaries outlines a significant potential for improvement in terms of transparency and appropriate communication towards the pension scheme members.⁴⁰ The conclusions of the report suggested that for occupational pensions measures need to go far beyond the design of pre-contractual and post-contractual disclosures, to look at all communication channels and the integration of these, to leverage new possibilities using new technology, while avoiding the trap of failing to serve customers with different needs equally effectively. Potentially those learnings can be important to develop communication in relation to PPPs.

The provision of appropriate information at regular intervals will be a strong factor in building trust in both the product and provider over time. In order to be able to assess if the PPP provider has made good on the objective to optimise returns, the consumer should periodically receive relevant information.

2.2.2 Bridging the information asymmetry

Financial products and services are complex and difficult for ordinary consumers to understand and compare. These problems are well researched, and are embodied within two systemic market failings.

The first is the so-called 'information asymmetry', whereby those bringing products and services to market and/or distributing them, on the one hand, and those seeking

⁴⁰ See EIOPA: Report on issues leading to detriment of occupational pension scheme members and beneficiaries and potential scope of action for EIOPA, 2014, p. 14-17, https://eiopa.europa.eu/Publications/Reports/8_1__EIOPA-BoS_-14-071_Report_on_Issues_leading_to_detriment_of_pension_scheme_members.pdf.

to buy such products or services, on the other, are not on an equal footing in regards their comprehension of the products and services.

The second is the so-called 'principal-agent conflicts', whereby there can be divergences in interests between the person selling or producing financial products or services and the consumer (the person selling or producing financial products or services in effect has interests both as a principal and as an agent of the consumer, and these interests do not coincide).

These general market failings can be particularly striking for those financial products and services that are particularly unfamiliar for consumers. Consumers will learn over time how to navigate certain markets due to undertaking repeated transactions in relation to these markets – e.g. the markets for motor, travel or house insurance – but others – for instance, for longer term savings and investments, or life insurance – are less frequently engaged with. This means reduced opportunities to learn from experience.

In addition, financial issues are viewed by consumers as 'difficult' and complex, such that the consumer has reduced motivation to engage in information search and to tackle decision making on a 'standalone' basis. This is compounded by the fact that some financial concepts are intrinsically complex for consumers – such as the nature of financial risk and expectations over future returns and the compounding of these, and how returns react with inflation and the impacts of costs and charges.

Regulatory disclosure measures can be used to address – though not fully mitigate – both information asymmetry and principal agent market failures.

By improving the comprehensibility and comparability of products and services, consumers can more readily make informed decisions, and information asymmetries can be reduced. The other measures examined in the remainder of this advice are also crucially important in mitigating these two market failings, as disclosures are not able to fully address either of these market failings on their own.

Apart from the general market failings outlined above, ensuring effective transparency for PPPs raises a number of specific challenges. Notably, PPPs are typically long term in nature. The very length of time involved aggravates comprehension challenges. For instance, the impact of inflation can be difficult to assess, while research shows that consumers can struggle with basic compounding, finding it difficult to make decisions in relation to longer term savings levels and expected returns in the future.

In addition, PPPs need to be considered in the context of other financial resources and retirement planning aspects: the other retirement plans the consumer may have in place, or rights they may have, including through their spouse, and the other financial assets they have or may in the future have access to.

2.2.3 Providing relevant information taking into account the presence of biases

As mentioned, there is considerable research on the challenges raised by disclosure in relation to financial products, including increasingly from a behavioural standpoint. Indeed, EIOPA itself has already worked extensively on information provision for members of occupational pension schemes and IORPs, and EIOPA considers the conclusions from this prior work as useful for PPPs as well. This has included a report and good practices related to individual transfers of occupational pensions, a report on costs and charges of IORPS, and a report on investment options for defined

contribution occupational pensions, and a general report on information provision related to defined contribution schemes.⁴¹

These reports highlighted the need for improvements in transparency, and the importance of using various techniques to increase the impact of transparency – for instance, the use of layering of information (separating key messages from detail about these messages), focus on key messages, including through graphical techniques, and the use of ‘plain language’ and avoidance of jargon, and the use of standardisation to aid comparisons and comprehension.

EIOPA's work has highlighted these techniques, because it has become clear that the disclosure of information without taking care over how the information is provided and presented, can significantly undermine its effectiveness. Information provision needs, that is, to start from the consumers’ perspective, and take into account research on consumer behaviour. As humans we all have cognitive and time-based limits to our information processing appetite and capacity, and so for information provision to be effective, it is crucial to take into account these limits, biases and ‘shortcuts’ (heuristics).

For these reasons, in addition to taking into account the techniques outlined above and prior findings, consumer testing of concrete proposals should also be undertaken, as far as possible, so as to assess how well proposals work in practice. In addition, EIOPA would stress that it can be considered good practice for PPP providers themselves to undertake such testing, as appropriate, to seek to achieve an effective communication strategy and to monitor and assess its effectiveness in practice.

In respect of pre-contractual disclosures, the work of the ESAs on developing Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs) and the associated consumer testing – organised by the European Commission – are of particular relevance.⁴² This is in large part due to the similarities between PRIIPs and PPPs, but also because of the general relevance of the findings from the PRIIPs testing work.

The research has underlined the importance of keeping information ‘short and simple’ and visually attractive, using a mixture of graphical presentation techniques. It has confirmed that disclosures should be focused on key messages. The number of key messages that can be effectively communicated may be relatively low – certainly, the second or third page of a disclosure will receive less scrutiny than the first. The messages should be designed so as to clearly show the consumer the choices they need to make, and where each product stands in relation to these choices. The research has also supported the use of a ‘Q&A’ format in aiding consumers in identifying the relevance of the different information provided to them.

In addition, the research has underlined that internal consistency in documents – coherence between the messages being provided – is very important to aid the consumer in engaging with documents. Perceived inconsistencies can quickly lead a consumer to stop trying to better understand the information in a document.

⁴¹ See EIOPA: Final Report on Good Practices on individual transfers of occupational pension rights, 2015; EIOPA: Report on Costs and charges of IORPs, 2015; EIOPA: Report on Investment options for occupational DC scheme members, 2015; EIOPA: Report on Good practices on information provision for DC schemes, 2013.

⁴² See Joint Committee: Joint Consultation Paper, PRIIPs Key Information Documents, Draft regulatory technical standards with regard to presentation, content, review and provision of the key information document, including the methodologies underpinning the risk, reward and costs information in accordance with Regulation (EU) No 1286/2014 of the European Parliament and of the Council, 2015, <https://eiopa.europa.eu/Publications/Consultations/JC%202015%20073%20CP%20PRIIPs%20Key%20Information%20Documentsb.pdf>. For the research see http://ec.europa.eu/finance/finservices-retail/investment_products/index_en.htm#maincontentSec1.

Finally, the research has supported the view that key 'metrics' or measures should be highlighted for comparison purposes, and standardised where that is feasible and presented as simply and as directly as possible. For instance, the research has endorsed the ESAs proposal for the risk rating in the PRIIPs KID to be presented as a single simple scale from 1 to 7.⁴³ The consumer testing showed that, while consumers often preferred the idea of receiving more information, for instance increasing the complexity of the information to include multiple risk dimensions, for instance, in practice the addition of complexity in fact led to lower scores on comprehension and ability to use the information to compare between products. A simple, standardised scale worked best.

A further challenge is worth underlining related to 'framing' or 'benchmarking'. Consumers can struggle to utilise information without a frame: for instance, should a disclosed figure (e.g. the cost of product) be seen as 'low' or 'high'? (Related to this is the question: is a high cost bad or good?) Setting benchmarks can be very challenging, as the benchmark becomes a 'target' for the consumer, which could lead to unintended consequences. Benchmarks can be seen as a form of advice. However, it should be borne in mind that in the absence of benchmarks, consumers are likely to search for other ways – which may be misleading – for assessing whether some information is 'high' or 'low' or 'good' or 'bad'.

It is important to acknowledge that layering of information should be permitted, including the addition of links in the PPP disclosure to where more detailed information can be found. A provider should make certain that the member disposes of the necessary and immediate comparable information in order to be able to choose based on his own profile from the available choices regarding the characteristics of the available PPPs (risk and reward characteristics, structure of the product, implied costs). However, the basic PPP disclosure and its focus on key 'Q&As' should not be undermined by layering, for instance by removing or downplaying important information. The PPP disclosure should in all cases offer a fair, clear and not misleading representation of the PPP, which is balanced and objective.

Requirements on the PPP disclosures should – as far as possible – be open as to the medium of delivery, and should not necessarily require that the information is always to be provided in the form of paper. Opportunities for easy and dynamic layering of information and cross-linking for provision of more detail, as are made possible through online delivery, might be facilitated. This could include linking to calculator functions, allowing the consumer to explore the PPP under different retirement scenarios.

Effective, meaningful disclosure during the pre-contractual stage

As outlined in its CP on PEPP, EIOPA is of the view that the PRIIPs KID⁴⁴ and the detailed measures on this, as proposed by the ESAs in their 2015 Consultation

⁴³ For the graphics see Joint Committee: Joint Consultation Paper, PRIIPs Key Information Documents, Draft regulatory technical standards with regard to presentation, content, review and provision of the key information document, including the methodologies underpinning the risk, reward and costs information in accordance with Regulation (EU) No 1286/2014 of the European Parliament and of the Council, 2015, p. 49.

⁴⁴ See Regulation (EU) No 1286/2014 on Key Information Documents for Packaged Retail and Insurance-based Investment Products. While the final draft RTS for the PRIIPs KID will only be delivered to the European Commission on the 31 March 2016, the draft of these RTS contained within the JC/CP/2015/073 is in the view of EIOPA sufficiently developed for assessing the viability of the PRIIPs KID - including level two measures - as a basis for PEPP and potentially PPPs.

Paper⁴⁵, offer a solid starting point for PEPP disclosures, with lessons also perhaps for PPPs more broadly.

PPPs are currently exempt from the scope of PRIIPS, though this exemption is subject to a review by the end of December 2018, in view of 'work by EIOPA on disclosure of product information requirements' related to pension products. Such a review will address at that time the extent to which the PRIIPS requirements might be extended or not to PPPs across the EU, and must, according to the PRIIPS Regulation, take into account in any such conclusions pre-existing disclosure requirements for pensions in Member States. Given this, while EIOPA endorses the PRIIPS KID as a starting point for PPP disclosures, it recognises further work will be needed to assess the application of the KID to PPPs and the adjustments that might be needed, including in regards the level of standardisation that is appropriate, together with the links between accumulation and decumulation needs for a given investment strategy.

As a response to EIOPA's consultation paper on PEPP, many stakeholders supported the proposition that the starting point for disclosure during the pre-contractual phase would be the PRIIPS KID, although indicated that the final detailed features of the PRIIPS KID have yet to be established. Consumers mentioned that a PEPP KID, which has the same format and follows the same principles as the KID for other investment products would be desirable in terms of better understandability and comparability. In addition to that, stakeholders requested that any specificities of a PEPP, compared to other investment products, should be clearly communicated.

EIOPA's conclusion in favour of starting with the PRIIPS KID is ultimately in view of the similarities between PRIIPS and PPPs: both are accumulation vehicles, where the comprehension of messages about risk, rewards, and costs, are of equivalent importance and broadly similar in nature. In addition, some PRIIPS can be equally long term in nature as PPPs, and in practice might be used by some consumers in effect as retirement savings accumulation vehicles. In EIOPA's view the similarities most likely outweigh the differences. However, it needs to be ensured that the specificities of pensions are fully taken into account, in view of the fact that pensions are savings products aimed at an eventual income in retirement, and not simple investment products.

This view also reflects the fact that the KID – which will be required across the EU from 2017 – will be a disclosure consumers see at the level of investment funds and other investment vehicles, such that it will become very familiar to consumers, and an obvious reference point regarding information on risks, rewards and costs. Any disclosures for PPPs should thereby be designed to take into account the possibility of comparisons with a PRIIP's KID. Further consumer testing may be necessary to calibrate and develop appropriate disclosures in this regard.

EIOPA notes that there are aspects of the basic approach adopted for the PRIIPS KID that could readily be applied to PPPs, including, as far as this is possible in view of the range of PPPs, a harmonisation of the information sections to be included, their sequence, and the broad substance of these sections. EIOPA also underlines that certain 'metrics' that can be used for comparisons purposes (such as summary indicators of costs or risks) will need particular attention in improving PPP disclosures, as the experience with the PRIIPS KID is that detailed rules on such measures are necessary to ensure fair comparisons can be made. In light of the currently

⁴⁵ Joint Committee: Joint Consultation Paper, PRIIPS Key Information Documents, Draft regulatory technical standards with regard to presentation, content, review and provision of the key information document, including the methodologies underpinning the risk, reward and costs information in accordance with Regulation (EU) No 1286/2014 of the European Parliament and of the Council, 2015, <https://eiopa.europa.eu/Publications/Consultations/JC%202015%20073%20CP%20PRIIPS%20Key%20Information%20Documentsb.pdf>

substantive differences between PPPs, it may well be particularly challenging to identify the relevant metrics. Therefore, comparisons of the costs, risks and possible performance of PPPs and PRIIPs will need to be given very careful consideration and consumer testing results taken into account. This is also necessary in view of avoiding, as far as possible, that PPP and PRIIP disclosures significantly diverge and ensuring any such differences do not lead to misleading comparisons between similar PPPs and PRIIPs.

EIOPA would underline, in this regard, that a PPP disclosure regime cannot be a simple 'cut and paste' of the PRIIPs KID; EIOPA is of the view that the PRIIPs KID should be adjusted in some respects in order to work optimally for PPPs.

This is in part because, for a PPP, additional information is needed compared to a PRIIP. For instance, a PPP disclosure should include information related to choices to be made or options provided by national law and the provider on retirement, and specific projections related to these options, in addition to the information foreseen in the PRIIPs KID.

In addition, for a PPP, the personalisation of information will often be desirable, whilst the PRIIPs KID approach does not foresee personalisation. Such personalisation aids in ensuring projection calculations are based on individual circumstances and so are more useful for the consumer. Such projections might be done on demand, or by preparing PPP disclosures for a range of sample circumstances (e.g. 10, 20, 30 years to retirement, various savings levels, and so forth). The approach adopted might need to vary according to the how complex the PPP is: a generic approach using a few sample scenarios might be sensible for simple PPPs, while personalised illustrations of how the PPP might develop more useful for complex PPPs or complex PPP options.

A common basic structure for PPP pre-contractual disclosures - as a starting point, EIOPA would propose the following basic structure for developing PPP disclosures, building on the PRIIPs KID, though this might need adapting as necessary for different PPPs and their features:

- **Details** of the regulator/supervisor, the identity of the PPP provider, and how to contact these;
- **What is this PPP?** This could also include information on how the PPP works – investment objectives and the strategy for achieving them, including on how the de-risking, if applicable, works and any limitations e.g. on assets that are invested in. The information should address whether the consumer needs to choose between investments. (In the latter case, the information could be split between a general document about the PPP in general, and more specific information about each investment option, including details of its risks, rewards and costs.) Where the PPP offers biometric risk cover it should be explained in this section.
- **What are the risks and what could I get in return?** Depending on whether there is a choice offered this would show the risks and returns, in a balanced way to show the risks plainly and clearly, but also communicate how accepting short term volatility might be appropriate for getting better long term outcomes. For PPPs the concept of risk has to be considered with respect to different time horizons, consistently with the distance to retirement of individuals and to the life-cycle approach to investment. Avoiding short term risk can mean facing other risks (e.g. linked to inflation) over the longer term; risks anyway need to be taken to get returns. The section should include projections to retirement under different scenarios, and information on the

possible income in retirement. It should also address whether the PPP includes a guarantee, and, if any, the limitations or features of this guarantee. In this context, a risk indicator similar to that with the PRIIPs KID could be designed to indicate risk in the short term, while performance scenarios could be more useful for communicating risk in the long term. However, consumer testing might be used to consider how these instruments need to be adjusted to ensure the clear communication of a balanced message on risks and rewards overall, in view of the long holding periods that have to be considered for PPPs.

- **What if the PPP provider is not able to pay out?** Information on whether the PPP provider is a participant in a guarantee scheme in case of default should be included. This can be very important where different PPP providers are differently covered.
- **What are the costs?** This should include all costs – in a manner that is consistent with the approach used for the PRIIPs KID – covering both PPP costs and those at the level of the underlying investments ('look through'). It should include both monetary and % figures, and include 'cumulative' figures to the retirement date used for the projection information.
- **Can I access my funds early and what would it cost?** Can I switch my investments to another PPP provider and what would it cost? This information should be included as relevant. The costs associated with ordinary switching (between different investment options but staying with the same provider) should be included in the cost section. Any limitations on early redemption, for instance in view of investment in less liquid assets, should be clearly disclosed here.
- **What happens if I die?** This section should address this particular situation.
- **What happens if I stop paying?** This could include information on whether you can get your money / transfer your money to another PPP provider during the life of the contract. It should not simply duplicate information related to switching.
- **What choices will I need to make in the future?** Different PPPs can offer different possibilities, depending on national laws, as to the future steps the consumer might need to take – this could include, for instance, a choice over whether to take a lump sum on retirement, or on the type of annuity to be taken. It could also, during the life of the PPP, be necessary to assess the performance of the PPP and its continued appropriateness. These should be stressed in the PPP disclosure.
- **How can I complain?** This should include information on complaints handling.
- **Other information.**

Detailed additional measures may be necessary to ensure comparability between PPPs, for instance on risk information, on projections to retirement, and on cost disclosures. The experience with developed detailed level two RTS related to the PRIIPs KID may be an inspiration in this regard; however the wide range of possible PPPs may impede the extent of such harmonisation that is possible.

In EIOPA's view, however, this would be less the case in the context of a PEPP. For the pre-contractual disclosures for a PEPP a fuller standardisation of disclosures can be recommended. Such standardisation would also, in EIOPA's view, be important in ensuring the success of the PEPP in cross-border situations, to ensure disclosure expectations in regards the PEPP are consistent across different Member States.

In respect of the most important information sections in the PPP disclosures, EIOPA would like to stress some additional considerations relevant for such detailed measures:

Risk information: "what are the risks?"

Risk information is essential when comparing between PPPs or PEPPs or the investment options they offer, as different consumers will have different expectations and needs in relation to the amount and kind of risk they are willing to take on.

As mentioned, the messages that need to be communicated on risk in relation to investments in PPPs or PEPPs include both the communication of the likely behaviour of the PPP or PEPP over time, including over the short term (notably, the risk of large fluctuations in values that typically will come with investing in 'riskier' assets) and the longer term (where the accumulated 'upside' of being exposed to riskier assets gradually becomes more relevant, though assets that can significantly fluctuate in value continue to carry some risks even if held for decades). In this regard a balance between information on 'risks' and on 'rewards' is essential, and a clear communication needs to be made of the extent that rewards require risks: a focus on avoiding short term risk could lead the consumer to overly allocate to low risk assets which fail to deliver the outcomes expected in retirement, including indeed a possible loss in real terms once inflation is considered.

The PRIIPs KID includes a summary risk indicator (1 to 7 classifications) that shows how far an investment may fluctuate in value (amongst other things), accompanying narrative text, and projections of how the risk translates into possible rewards through so-called performance scenarios ('... and what might I get back?'). EIOPA notes that information on risks and on likely returns across different relevant time horizons are important for personal pensions. However, specific consumer testing may be appropriate in the context of such an approach to see how well it offers balanced messages on risk for PPPs or PEPPs, and whether additional information or a different approach would be needed.

For products with a life-cycling approach it will be important to ensure the risk rating shown reflects the lower overall risk of this approach at maturity but the better rewards compared to a portfolio that avoids higher risk assets throughout.

Performance: "what might I get back?"

As noted in the context of risk, information on what the level of risk shown means in terms of performance is vital. As stated, the benefit for taking higher risk is higher performance - and in many cases a better chance of hitting retirement goals. There is no 'free lunch'.

For PPPs or PEPPs it is also important to project and estimate how investments (typically based on periodic contributions) and the related returns accumulate over a potentially very long time period, and what that could mean in terms of a retirement income according to the features of PPP or PEPP. The impact of inflation can also be significant over the longer term. Evidence shows consumers find compounding or discounting difficult, and will thereby not take account of inflation in an accurate way.

Ultimately, when considering a PPP, the consumer needs to take a view on the appropriate level of market risk they should be taking in the context of the performance they need, taking into account such factors as their time horizon, the risk of inflation, their desired retirement income and the different de-risking approaches offered by PPP providers. They also need to consider how much to save.

The PRIIPs KID is required to include performance scenarios (indications of the range of possible future returns). The ESAs have proposed the use of tables to show at least

three outcomes (an unfavourable one, a neutral one and a favourable one). The aim of these is to show how the risk of the PRIIP relates to the range of possible outcomes. This is similar to information requirements for certain life insurance contracts according to Art. 185 (5), paragraph 2 of Directive 2009/138/EC that requires projections, where provided, to be based on three different rates of return.

EIOPA believes that these approaches are a good starting point for PPP or PEPP projections or performance scenarios. However, some refinements might be needed. These relate to the need to clarify the relationship between risk and reward over the long term as set out already above in relation to information on risks, the impact that inflation might have, and what the accumulated amount in the PPP or PEPP could mean in terms of an income in retirement, or a lump sum, or a combination of these. EIOPA would propose that consumer testing be used to clarify how best to provide these additional elements of information, for instance whether to show inflation-adjusted (real) figures only, or whether including both nominal and real figures would be best, or whether to show nominal figures with a separate illustration in real terms.

Further to this, given the long term nature of a PPP or PEPP, it may be necessary to standardise a range of assumptions, such as on income inflation or contribution rates, or savings amounts. Careful consideration of the degree of standardization needed for the purposes of comparability will be necessary in relation to detailed measures. The downside of increased standardisation is that PPP disclosures may be less specific to the situation of the individual consumer, requiring work by the consumer to relate the disclosures to their own circumstances. Conversely, however, the lower the standardization, the harder it will be for the consumer to compare information from different PPP providers. Nonetheless, for PPPs or PEPPs, such factors as time to retirement, savings rates, and options selected, amongst other features, can vary so significantly that a degree of comparability may need to be sacrificed in favour of ensuring the accuracy and relevance of the information for the individual consumer.

In this regard, supplementary tools may be very useful in improving consumer decision making – such as online calculators for each PPP, capable of showing how incomes in retirement vary for different assumed returns, inflation amounts and savings rates.

However, one factor that is extremely important to building performance scenarios is that members fully understand that such scenarios represent a mere estimation of future performance and do not involve any form of certainty.

Also, EIOPA notes that special attention should be given to disclosure with regard to the collective investment options. Here, the allocation of and moments when realised returns will be allocated to individual pension savers is not as straightforward as for PPPs with individual investment options. Therefore, if a PPP contains such an investment option EIOPA strongly believes pre-contractual information should provide absolute clarity with regard to how and when returns will be allocated to individual policy holders.

Costs

Costs are important for comparing between different PPPs and providers. The level of costs will have an important impact on returns, and it is important that there is transparency on costs and the likely performance that can be expected. Consumers can face significant challenges understanding how costs apply to them and what the scale of the impact of costs will be. This can be particularly the case when trying to aggregate different costs that are taken in different ways, to try to see the true overall picture.

Rather than clearly defining objective cost categories and trying to harmonise the actual application, the PRIIPs KID requires a summary indicator of the costs of the PRIIP, to include implicit and explicit costs. These must be expressed in monetary and percentage terms, along with their impact in an aggregate manner on what the investor can expect to receive. The monetary disclosures and the presentation of aggregate costs through 'overall' figures in the KID are designed to address the challenges consumers face when trying to understand the impact of costs and to provide a simple overview of the costs once they have been combined, using a 'reduction in yield' metric that enables comparisons on a fair basis between different products.

The ESAs proposed rules for the KID cover, in addition to the presentation of the costs, methods for the calculation of cost figures, and includes certain costs that have hitherto been excluded, such as costs for portfolio transactions.

In EIOPA's view, the cost disclosures in the PRIIPs KID should be considered for use as a basis for PPP disclosures, following a similar calculation methodology and presentational approach. There may need to be some supplementation of detailed measures to show how specific costs related to PPPs are to be calculated or estimated. For PPPs, however, a large part of the costs will typically be the costs relating to the management of the underlying investments, where these underlying investments may be in practice PRIIPs whose investment management costs will be disclosed in their respective KID.

In EIOPA's report on Costs and charges of IORPs, it was assumed that standardised breakdown and calculations would increase transparency of investment returns and could also help make comparisons between schemes and providers (IORPs) easier.

EIOPA considered that it would be beneficial for all parties that bear costs and charges if:

(1) All costs and charges within the value chain are disclosed transparently and comprehensively to the parties bearing them, so that:

- The parties bearing costs and charges are able to assess if the costs and charges they are paying represent good value for money, and;
- Disclosure of 'costs and charges' information better enables all parties to exert market pressure on costs.

(2) NCAs have effective means to assess costs and charges so as to be able to – in a wider perspective – assess how these affect value for money or the affordability of the pension schemes provided.

Costs and charges heavily affect long-term products. The disclosure of the actual amount of the costs and charges is important. However, it is similarly important how information on costs is presented, structured and broken down to ensure that the involved parties have all the necessary information for decision making and for assessing the costs they have to bear.

Reconciling pre-contractual information to regular information

Due to its long-term nature and defined purpose to achieve future retirement income, EIOPA is of the view that the consumer should be enabled and encouraged to follow-up on the development - in view of its desired outcome - of the PPP. Consumers should be regularly informed about the performance of the PPP and the impact of the

choices made, which is in line with EIOPA's advice on IORP II and more specifically on a Pensions Benefit Statement (PBS).⁴⁶

In relation to PPPs and PEPP it seems natural to reconcile pre-contractual information given to the current situation during the accumulation phase.

Following EIOPA's advice, the European Commission's proposal on IORP II⁴⁷ sets out key requirements on annual information to active occupational pension scheme members (in the form of a Pension Benefit Statement (PBS)), which are fully consistent with the advice so far. A European-wide standardised PBS can be seen as an essential instrument to ensure that all EU citizens have a consistent level of basic information on their occupational pensions, in light of IORPs' members having saved into different occupational pensions schemes (potentially within different Member States) throughout their career. Currently, the information provided to members – be it within a Member State or amongst Member States - varies significantly and makes it difficult for members to understand and to compare. The details of presentation and content and how standardisation is suggested to be coordinated through level two measures⁴⁸. The Directive proposal sets out key principles and the main contents of the PBS.

The PBS in the European Commission's proposal needs to be seen as one key element of the better governance of IORPs, of increasing importance as the previous quantitative limits on investments are proposed to be alleviated or removed.

The elements of the PBS⁴⁹ include information on the following, which is specified in relation to DC or DB schemes:

- Liability warning, PBS title, personal details of a member, identification of an institution and supplementary information (Articles 44-47 and Article 53)
- Guarantees (Article 48)
- Balance, contributions and costs (Article 49): aggregate and break down of costs, contributions over the last 12 months, capital accumulated or accrued entitlements
- Pension Projections (Article 50): estimated amount of capital accumulated at retirement or target level of retirement income
- Investment profile (Article 51): risk and reward profile, in line with the corresponding, envisaged information in PRIIPs KID
- Past performance (Article 52): performance reporting in line with the corresponding, envisaged information in PRIIPs KID

EIOPA believes that its views on important information requirements for PPPs and PEPPs are mirrored in the European Commission's proposal on PBS. For example, it is suggested that specific information is to be provided to members that bear investment risk and highlight the the risk and return profile and a specific risk indicator, which shall be accompanied by explanation of that indicator and its limitations to capture all relevant risks. The language used for PBS in this context is very similar to that used in the PRIIPs KID level one regulation, indicating a prima facie case for similar approaches. Having said this, occupational pensions exhibit different characteristics compared to personal pensions, as members' choices, if available at all, are often

⁴⁶ Notwithstanding that EIOPA acknowledges significant differences between PPPs and occupational pensions, as well as significant differences between occupational pensions systems amongst Member States.

⁴⁷ Please note that the European Commission's proposals are in a legislative procedure, in which the Council and the European Parliament have developed different stances compared to what was initially proposed by the European Commission.

⁴⁸ Again, please note that the Council and European Parliament have developed different stances compared to what was initially proposed by the European Commission.

⁴⁹ Again, please note that the Council and European Parliament have developed different stances compared to what was initially proposed by the European Commission.

limited in comparison to consumers considering to save into personal pension products – or to invest in other financial products -, which makes a strong case for comparable information across different investments in the pre-contractual phase.

EIOPA is of the view that the type of information that is relevant for the pre-contractual phase need to be followed-through in the annual statement which consumers shall receive. Hereby, particular attention should be given to information concerning:

- Risks and return
- Costs
- Choices: Access to funds and switching, cancellation of contributions
- Decumulation

Critical decision making points and decumulation

Ensuring the comparability of information is particularly important in the context of personal pensions. This is in line with EIOPA's research in relation to occupational pensions, where the occupational pension scheme is typically selected by the employer and the pension scheme members themselves have often only little or no influence on this decision.

Even against this background, it may be beneficial to ensure comparability of information available to consumers allowing them more insights as to their economic situation. It is said the initiative "Comparing Pensions" by the Danish Insurance Association (DIA) could be used as a source of inspiration to enable consumers to compare different pension schemes from different pension funds and life insurance companies. In this way, should the consumer not be satisfied with the (long-term) performance of their pension scheme in comparison to other pension schemes, they are in a position to change the pension scheme provider, encountering proportionate exit charges.

Fostering competition, however, is not possible without clear and concise communication in the pre-contractual and ongoing phase to consumers on the switching costs and possible delays in transferring assets. Furthermore, consumers should be clearly informed about the consequences of switching e.g. benefits staying with the provider or consequences in case biometrical risk coverage was taken. Next to switching or surrender options and their respective costs should be clearly communicated as well.

The Final Report on Good Practices on individual transfers of occupational pension rights established the information disclosure and advice as the main impediments to (cross-border) transfers of supplementary pension rights. Where consumers are required to make an active decision over transferring vested pension rights, it is important that they are able to make an informed decision – therefore, it is essential that sufficient information is given to consumers concerning the implications of transferring as they may not be aware of the transfer options. For those purposes, Good Practices related to the information disclosure in transfers were established by EIOPA.

Here, EIOPA considered it Good Practice for the member's current scheme to inform the scheme member about all aspects concerning the transfer needed to reach a decision whether to transfer, e.g.: transfer value, transfer options, procedure, timeframes (if applicable), impact of the transfer on benefits and other specific risk coverage (if applicable) - incl. whether any specific risk coverage may be lost as a

result of the transfer as well as the tax implications of a transfer. Since the economic consequences of a transfer are arguably most important for the member, all reductions and costs associated with a transfer should be clearly stated.

EIOPA also considered it Good Practice for members to be automatically (i.e. without request) provided with the relevant information at the moment of the communication for transferring their accrued pension rights. Another Good Practice was established to provide the scheme member with access to an online tool/portal with (additional) relevant information concerning his/her transfer. Finally, EIOPA considered it as Good Practice for the scheme to inform the scheme member about the possibility and/or need to get specific advice.

In addition to that, EIOPA carried out some research in the decumulation phase of IORPs. The report considers as general remark that the main aim of information disclosure to members approaching or in retirement should be to help members better understand the decumulation phase. Good disclosure should also engage members and encourage a positive attitude towards their retirement. Ideally, all information will take members through a journey of understanding retirement, understanding different ways of taking their retirement income and understanding how to buy annuities where applicable.

EIOPA believes that critical decision making points and reaching the decumulation phase need to be prepared properly by providing tailored information at national level (due to regulation on decumulation being specific to Member States) in advance of these events.

Advice on information

Due to the standardisation of PEPP and the wide variety of possible PPP characteristics with the consequential need to keep most effective disclosure provision flexible, disclosures for PEPPs can be more easily standardised than for PPPs. This chapter has set out how the PRIIPs KID can be used as a starting point for such disclosures and EIOPA is developing views on the applicability to PPPs. EIOPA also notes that there are limits on the degree of standardisation possible for PPP disclosures, compared to disclosures for a standardised product like a PEPP. EIOPA has noted that standardisation of pre-contractual and post-contractual disclosures can aid consumers in comparing between different PPPs, or monitoring their PPP alongside other holdings or entitlements. It could also contribute to a Single Market in PPPs more widely, by reducing barriers to cross-border business. For both reasons, it would be desirable in the context of PPPs.

EIOPA has also noted that more broadly (for communications other than specific pre-contractual documents designed for comparing PPPs, or recurrent annual disclosures also of use for comparisons) communication strategies should be developed that seek to address cognitive biases and other challenges - by identifying clear target audiences, and using personalisation tools and 'framing' devices as needed to encourage effective engagement. EIOPA recognises that there is a tension between these two, but believes both approaches are necessary to tackle information asymmetries in the PPP market more widely.

This reflects the expectation of a continued diversity to the PPPs on offer, even in the context of harmonisation, and thereby the need for some tailoring of PPP disclosures for these differences, and also to take into account national markets and their peculiarities.

Notably, differences in the options offered or features of PPPs across different Member States, including differences related to their position in relation to tax or social welfare

policy or in relation to pillar I or II provisioning at the national level, mean that the conclusions set out above may be difficult to apply in a fully standardised way across all PPPs without modification for individual specificities.

This would not however be the case for a PEPP to the same degree. In the case of the PEPP, given the standardisation of the product itself at the EU level, the highest degree of standardisation would be possible and in EIOPA's view should be sought.

In EIOPA's view such standardisation of the information provided to consumers would be essential (though not sufficient in itself) to the success of a PEPP. This is because consistency in information would be crucial in the cross-border situation, aiding both consumers in using and comparing PEPPs across different providers, including those working cross-border, while it would be also crucial in allowing for smooth cooperation between host and home supervisors. Experience in other markets – including that for UCITS – has shown that divergent disclosure and marketing requirements need to be tackled through standardisation if the full benefits of the Single Market are to be realised.

More generally, standardisation of PEPP pre-contractual disclosures would aid significantly in defining the 'brand' of the PEPP through the first contact – pre-contractual information – many consumers would have with a PEPP.

2.3. Distribution of PPP

2.3.1 Conduct of business

EIOPA can imagine that distributors could be a key interface, both in 'pre contractual' and in 'post contractual' phases for those buying PPPs.

As noted above in relation to the effects of an imperfect market for personal pensions, consumers face significant challenges in relation to financial products and services, and given this the role of distributors, and in particular the advice they provide, can have a very significant impact on the development of sound PPP markets that serve the interests of consumers well. Distributors are a source of information on the market, and can aid consumers in accessing products and assessing them. Distributors can also play a crucial ongoing role, aiding consumers in assessing their retirement provisions over time, and helping trigger changes in the consumers' allocation of resources to a PPP or investment option within a PPP over time, including in the run up to retirement.

Distributors can take many different forms - they can directly be part of the PPP provider or agents of that PPP provider, or third parties, offering services of a more or less limited nature (e.g. in terms of market coverage). They may or may not provide advice.

In this context, as this chapter will set out, there are already EU regulatory frameworks focused on the conduct of business of distributors, mostly organised on a sectoral basis, but with strong moves over recent revisions towards consistency for the more complex investment-focused products (PRIIPs) that are in practice very similar to PPPs. In general, this chapter endorses these frameworks as a basis for measures for PPPs. For PEPPs, this chapter sets out EIOPA's view that - at least for the default option - sales without advice via the internet should always be permitted, in view of the regulation of that default option and in view of the cost effectiveness amongst other factors of such a distribution channel.

Similarly to conclusions in previous chapters, EIOPA believes that drawing on existing sectoral policy approaches from closely related areas would be a more efficient approach helping to bring providers on a level playing field - compared to developing stand-alone policies (which for PPPs already subject to existing sectoral rules, would entail amending recently agreed approaches).

Two specific aspects are worth highlighting:

- The first is the long term nature of PPPs and the necessity, therefore, in EIOPA's view, for a long term focus in the provision of distribution services, including advice. This relates, amongst other things, to the support consumers will need at future trigger points - for the correct ongoing monitoring of their PPP arrangements, and the need to plan ahead when approaching retirement.
- The second is the role of non-advised distribution. While EIOPA recognises this will not be a channel that is suited to all consumers and their needs, and that advice has a crucial role to play for some consumers with more complex needs, EIOPA considers that non-advised distribution has a key role to play, particularly in the context of a highly-standardised PEPP and its proposed 'default' option, which will have an inherent high level of built-in consumer protection. EIOPA supports the consumer protection approach which varies consumer protections in view of the complexity of the product and the extent of detriment possible for the consumer. As noted, EIOPA believes it will be crucial for the PEPP that non-advised online sales of the default option are possible in a cost-effective manner.

As set out in EIOPA's Preliminary Report to the European Commission and in light of EIOPA's recent survey, see annex III, it is clear that currently most consumers access a PPP through the services of an intermediary, with protections provided for the most part via the IMD or MiFID (depending on the nature of the PPP). Indeed, the IMD is currently at an advanced stage of revision and will be replaced by the Insurance Distribution Directive, which will for the first time also introduce key consumer protection requirements for Insurance Undertakings. The requirements in the IDD will mean that there will be a close alignment of consumer protection in the insurance and securities markets. A key part of this consumer protection is what is required when providing advice to consumers.

Under the IMD, distributors are obliged as a minimum to ascertain the demands and needs of the individual that is considering buying a pension product. This requirement is retained in the latest text of the IDD.

Additional requirements are set out in MiFID II related to suitability and appropriateness - requiring advisors to collect information about the client's knowledge and ability relevant to the product or service in question, as well as that person's financial situation including their ability to bear losses, and their investment objectives including their risk tolerance.

Neither IDD nor MiFID II require advice in a given circumstance. Rather it is left as a matter of choice for the individual. Instead, the directives define what must happen in circumstances where advice is given to the individual (where a personal recommendation is made, of which a suitability test is a key part), and provide for heightened protections where non-advised sales are undertaken for complex products, where an appropriateness test is undertaken, for complex instruments, to assess the knowledge and experience of the consumer.

Conflicts of interest, again connected to the market failures described above, and principal-agent conflicts exist between the consumer and the distributor: A key

element of both the IDD and MiFID II relates to potential conflicts of interest arising in the context of the provision of advice.

Because of the prevalence of the commission basis of remuneration there is a potential conflict of interest for the intermediary who gives advice to a client where they receive commission from a third party, usually the provider. While commission-based remuneration exists in many markets it is banned in some.

Safeguards are foreseen, where commission payments are permitted, to offset the possible conflict of interests that can arise; these include rules on procedures and arrangements to follow to avoid the conflicts of interest harming the consumer, and disclosure and transparency measures.

To address the challenges posed by the very nature of these principal-agent relationships, MiFID II has also introduced a concept of independent advice, so as to draw a distinction between those intermediaries who are remunerated by the consumer on a fee basis, and those intermediaries who are remunerated by the provider on a commission basis.

Appendix VI summarises the legal requirements and ESA work on advised and non-advised distribution for reference. It also sets out conduct of business requirements and other applicable obligations.

Other conduct of business requirements have been developed: In general, MiFID and IDD also contain wider measures to regulate conduct of business so that it is undertaken in ways that are in the best interests of the consumer. These include organisational measures on ensuring compliance, record keeping, product governance, risk management, and so forth.

EIOPA believes that the standardisation of a PEPP allows for additional possibilities, particularly in the context of online distribution and non-advised sales.

Online distribution could indeed help to alleviate the information asymmetry between PEPP providers and PEPP holders. Consumers may derive benefits from online distribution, particularly in the area of cost savings. Further benefits may be realised especially when disclosure requirements and product comparability are - due to standardisation - able to facilitate effective comparisons between different PEPP offerings. In view of these factors, EIOPA believes it would be beneficial, also in view of aiding the development of the single market, to facilitate non-advised online distribution of the PEPP, by ensuring that the default investment option of the PEPP is always designated - by virtue of its strong regulation - as 'non-complex' so as to avoid the application of appropriateness requirements, as required for complex instruments under MiFID and complex IBIPs under IDD. 'Demands and needs' requirements foreseen in the IDD for all insurance distribution shall need to be calibrated carefully in the context of online sales of insurance-based PEPPs.

That said, one should be mindful that the digital PEPP market of the future may introduce some new specific consumer detriment or increase, due to the nature of the internet, the scale of difficulties that exist already in offline distribution. It will be important for policymakers and distributors alike to be alert to the potential for such developments and work proactively to manage them in the best interests of consumers.

It should be noted that online distribution can generate benefits with regard to information to be provided at the different pension stages. PEPP and PPP providers could use digital channels for pre-contractual information as well as for ongoing

reporting obligations. Furthermore, PEPP and PPP holders could engage via various digital channels, if these channels are supported by providers.

For providers, there are many advantages of automation including that it can reduce costs. Automation can also improve consistency and accuracy in completing tasks because the element of human error is removed and thus reduce costs incurred from errors. Automating the process could therefore ultimately decrease the costs for the consumer. The decrease in costs could also increase the accessibility to the service. Finally, automated financial tools aimed at advising consumers could remove behavioural biases and limit poor judgement.

In the context of a PEPP, consumer risks can be managed to a degree through careful regulation of the product (to ensure its features are broadly appropriate and as simple to understand as feasible for a product of this type) and the provision of clear disclosures about the product.

However, for investment options outside the default option, as explained in the chapter on standardisation of investments, the scope for internet sales without stronger consumer protection measures will need to be carefully considered. Apart from the application of an Appropriateness Test to investment options that fall to be classified as complex products, limitations on access in an online context, or clear statements used to encourage the investor to seek advice may be warranted.

In the consultation paper on PEPP a question was asked about whether or not there should be a requirement for an Appropriateness Test in the case of non-advised sales of PEPPs. Many respondents believed that such a test should not be required in the case of consumers choosing a default investment option, with some arguing that these would be considered anyway to be non-complex investments as set out in MiFID. Consistent with this those that said that there is no need for an Appropriateness Test argued that the PEPP is a simple product. Other respondents however stated that pension products should always be sold on an advised basis.

Advice for PPP related to distribution ('point of sale')

EIOPA recognises that advice is very important for many individuals in aiding them to make the best decisions when purchasing financial products or services. For this reason, the provision of fit-for-purpose advice in the PPP market is crucial and essential for those who are in need of such advice, and it should be ensured that the sectoral measures in the IDD for IBIPs and MiFID apply for PPP business as well, as appropriate to the legal form of the PPP. However, EIOPA believes that, consistent with these requirements, the objective in the case of PEPP should be to develop default investment options in a way that would see them capable of being automatically designated as non-complex investments. This approach would support the introduction of a simple, low-cost product (where distribution costs are a significant factor in terms of overall costs) which still offers a high level of consumer protection by virtue of the high levels of regulation of the product itself.

The range of the service of advice needed by consumers can vary, including for non-independent advice, so EIOPA would not propose any limitations on who may or may not provide advice in relation to PPPs, for instance limiting advice to only independent, whole of market advisors, as long as they comply with appropriate requirements consistent with those applying for other distributors of retail financial products, including sufficient knowledge and ability requirements.

However, EIOPA would note that the basis on which advice is provided should be clearly explained to the individual, particularly in view of the possibility of consumers being confused.

EIOPA also notes that potential consumer protection issues vary depending on the scope of the advice offered and the conflicts of interest that might arise in relation to the arrangements made for the provision of that advice, including on the remuneration of the advisor, and therefore the consumer protection measures should also vary according to the nature of the advice being offered, while still taking into account the scope for a proportionate approach related to the complexity of the underlying investments.

EIOPA notes that this concept is already to be found in both the IDD and MiFID II, and would not propose any additional steps for PPPs compared to the requirements set down in these sectoral instruments.

Further to this, so as to increase the level of trust that EU citizens have in PPPs it is important, in the view of EIOPA, to have consistent conduct of business requirements across all providers and distributors. The level of consumer protection will need to be calibrated to the risks that are associated with the PPP. All in all, the aggregate protection afforded by the combination of product and conduct of business requirements needs to be at a high level to provide the necessary confidence among potential PPP savers, and has to be proportionate to the risks of consumer detriment arising related to both different products and different distribution channels.

As mentioned above, EIOPA supports the existing structure of sectoral rules under MiFID and IDD, and believes the application of these to all PPPs should be considered. In this context, EIOPA has considered that the appropriateness test should be applied to the distribution of PEPPs in specific circumstances, and PPPs, including where this takes place online. The circumstances in which the MiFID appropriateness test would be applied to PEPPs would be where complex underlying instruments could be sold to consumers who lack the knowledge or experience to understand the risks to which they would be exposed. EIOPA, however, strongly supports the development of standardised default investment options such that they can be classified as investments in non-complex products and accordingly not require an Appropriateness Test to be carried out in the event of a non-advised sale. This approach in turn would support online distribution of PEPP default investment options without the need for advice, although it would not preclude advice where the consumer so wished.

EIOPA would like to highlight the following specific points that in its view are of particular relevance, in the context of the requirements set out in the IDD, MiFID and DMD⁵⁰ for insurance based investment products and financial instruments that are similar to PPPs:

- The nature and scope of any advice should be made very clear, including any limitations on the range of the advice. In non-advised sales, the consumer should be very carefully informed of this fact, and any impression of advice avoided. The risk taken on by the consumer in such a case should be made clear.
- Access to advice is likely to be important for many consumers, even though EIOPA does not consider a mandatory advice regime to be appropriate.
- Cooling off periods should be available.

⁵⁰ Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, OJ L 271, 9.10.2002, p. 16.

- When assessing the suitability of a PPP, advisors should take into account the long term nature of a PPP commitment, and the consumers' expectations in the context of retirement, including the options that may be available at retirement. Other pension arrangements that the consumer has should also be considered.

EIOPA would underline that strong standards of professionalism and knowledge on the part of the advisor - proportionate to PPPs being advised on - are essential, given the potential complexity of some PPPs and the breadth of investment options offered in their context.

EIOPA would also like to stress the importance of conflicts of interest measures, as are already set out in IDD and MiFID. PPP distributors should have in place effective organisational and administrative policies and arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest from adversely affecting the interests of potential and existing customers. These policies and arrangements should not be restricted to remuneration and incentives but should consider all possible sources of conflicts of interest. Examples of these other areas could be shareholdings or other relationships with other distributors, relationships between other units or entities within the same group of companies. Where a distributor cannot mitigate a conflict of interest it should disclose the nature of the conflict of interest to the potential or existing customers.

EIOPA believes, in the context of remuneration, that it is essential that providers do not create incentives for sales staff and intermediaries to sell one PPP offering over another in conflict with the proposed requirement to act in the PPP holder's best interest.

Distributors of PPPs should ensure that their remuneration policies, including incentive schemes, and sales targets are aligned with the best interests of their potential and existing customers. Potential PPP holders should be informed in advance in a clear way about the types of remuneration and incentives that the seller will receive for the sale. For direct sales by providers the potential PPP holders should receive information about the nature of remuneration and incentives that applies to provider staff involved in the sales process. Any remuneration or benefits received from third parties related to the sale should also be disclosed.

Ensuring strong information flows between distributors and providers - in general, EIOPA would highlight - for both PPPs and PEPPs - the crucial importance of strong information flows between distributors and providers. While the obligations in the IDD and MiFID clearly apply to distributors or intermediaries (direct sales notwithstanding), the proper fulfilment of these obligations by these distributors or intermediaries depends on an effective information flow between both. It is essential that distributors understand the PPP or PEPP they are selling, and all of the options they contain, and that the provider is able to support the distributor through the provision of effective information.

As mentioned, EIOPA considers that the regulations appropriate for PPPs are also relevant for a PEPP, but there would be greater scope for a PEPP to be distributed using online tools in the absence of advice - notably, for default options designed to ensure simplicity and minimise risks to consumers. EIOPA believes therefore that the PEPP should be specifically designed to ensure that the default options are non-complex and suited to sales in such a manner.

Additional transparency measures may be necessary to ensure consumers understand the nature of the PEPP and the choices they are to make when comparing different

PEPPs, in addition to pre-contractual disclosures about the PEPP itself (as covered in early section). Where the PEPP allows for choices that are more complex than the default option, a very clear demarcation between these choices should be made, including in regards warnings on the possible need for advice in the context of more complex options.

2.3.2 Distributor's ongoing role

An overriding duty of care - a requirement to act in the best interests of the consumer - is common across several EU Directives, although it takes somewhat different forms. For instance, MiFID II has amended the IMD to require intermediaries and insurance undertakings to act honestly, fairly and professionally in the best interests of the consumer when selling insurance-based investment products. Similar measures also apply to those subject to MiFID II; the IDD also has similar wording. Given the different emphases across different existing directives it would be important in the view of EIOPA to have a consistent requirement of this nature applying to providers of PPPs (including PEPPs) irrespective of the sectoral legislation that applies to them. In addition, a general requirement to ensure that all information, including marketing communications, is fair, clear, and not misleading would be an important reinforcement of this concept.

Consistent with this duty of care there is a need for distributors to take a long-term view in their dealings with clients. This requires that distributors are proactive in their dealings with the consumer so that they can engage with trigger events that can and will occur during the time that they hold the product. Examples of such events are where a consumer is considering switching investment options (e.g. rebalancing the portfolio) or providers, or when approaching retirement.

Where advice has been given at the point of sale, it would be important to examine ways of encouraging distributors to clearly continue to offer advice services to clients after a sales process has been completed, i.e. where ad-hoc or continuing advice on existing products is given to consumers, including as possible the provision of ongoing advice services. Given the long-term nature of the product and therefore the potential long-term relationship between provider and consumer, situations where ad-hoc or continuing advice are requested and given are more likely to arise. In such situations the distributor should update the existing information about the consumer in relation to their financial situation, their knowledge and experience, and their retirement objectives so that the advice is based on current information - consistent with obligations in IDD and MiFID II for other investments.

To properly provide ongoing advice services and be proactive in doing so, EIOPA believes that the distributor will need to monitor and review the product in the context of the saver's needs and future plans. For known trigger events such as when the saver is nearing retirement the provider or distributor as appropriate will need to prompt the saver about the upcoming event and ensure that the consumer has all the required relevant information to deal with these trigger events and that such information has been provided in a clear and understandable form. Contact details should be provided to allow the saver to seek further information, ask questions or seek advice if appropriate.

It may be that in some cases the provider takes on more of a responsibility on an ongoing basis; in some cases it may be more effective if this role is taken by the

distributor. EIOPA does not consider that any single model of a split between provider and distributor responsibilities is best, but as with advice or information provision at the point of sale, the provision of advice and information on an ongoing basis will require strong coordination between providers and distributors, including clear agreements as to the responsibilities of each. From the perspective of the consumer it is essential to avoid the situation where neither the provider nor the distributor takes responsibility for the ongoing duty of care towards the consumer.

3. Single Market for personal pensions - opportunity for greater efficiency gains

3.1. Product regulation

A cost-efficient PPP must be capable of enabling the provider to reap economies of scale, which EIOPA believes can be achieved by, amongst other means, standardisation of products and efficient processes for product design and maintenance - and at the same time bridging those objectives with the demand for optimised products for consumers.

3.1.1 Product governance

Most consumers regard financial products including PPPs as too complex, which explains why they are prone to making errors. Whilst improving information disclosure is a step forward in encouraging greater transparency, such a measure would not be sufficient, on its own, to enable consumers to make better informed decisions due to their cognitive and behavioural biases.

As mentioned already, EIOPA proposes that the development of an EU-wide PPP market will depend on a multi-pronged regulatory approach, including governance requirements directed specifically at the product. Such requirements are designed to resolve the mismatch between what PPPs are supposed to be used for and how consumers actually use them in practice, and to ensure that PPP providers fully understand the features of the PPPs they market and the consumers their PPPs should be targeted at.

Product governance requirements relate both to measures to be taken by PPP providers and distributors prior to a PPP appearing on the market, and measures over the lifecycle of the PPP - both in terms of measures to monitor its continued marketing and the appropriateness of the distribution of the PPP, and measures to monitor existing PPP business in relation to its continued suitability. Such measures would need of course, to be consistent with and linked to the steps by PPP providers and distributors related to disclosures, transparency and advice.

In view of their importance, the ESAs have published a Joint Position⁵¹ outlining important high-level principles on product oversight and governance arrangements applicable for all financial products across the three financial sectors. EIOPA is of the view that these principles should equally apply to all PPPs.

The purpose of these measures is in part to encourage providers to increasingly take a consumer-centric approach and place consumers' best interests at the centre of the product development due diligence process for every stage of the product design.

⁵¹ Joint Committee: Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight & Governance Processes, 2013, https://eiopa.europa.eu/Publications/Administrative/JC-2013-77_POG_-_Joint_Position_.pdf.

To achieve a consumer-centric approach, EIOPA proposes that providers must:

- Identify a target market
- Consider the needs of the target market
- Design products that offer solutions for these needs
- Carry out stress testing of the product, e.g. using realistic 'worst' (and 'best') case scenarios to ensure a clear understanding
- Select appropriate distribution channels, and ensure these channels understand the nature of the product on offer and the target market for which it may be suitable
- Manage potential risks for the target market on an ongoing basis
- Monitor that the product is being sold to the right consumers in the right target market
- Account for changing consumer behaviour over time

In EIOPA's view, building more consumer-centric cultures across PPP providers will entail instilling such a focus from the very beginning of the product design process, continuing this during the entire life-cycle of the product, including any reviews, making sure that the experience is to the mutual benefit of both parties to the contract. This is reflected in the importance of Product Oversight and Governance measures in both MiFID II and the new regulatory requirements under IDD. (The ESAs have indeed already issued guidance on product oversight and governance arrangements, and EIOPA will establish additional measures pursuant to IDD).

EIOPA considers it vital that the product development process related to PPPs should be consistent with the ESAs' joint position, leading to clear processes to be adopted within PPP providers to identify and assess target markets in terms of customer needs, to develop products that satisfy these needs, to stress test these products to assess how well they can meet these needs, and to identify a distribution strategy, including appropriate distribution channels, and the support needed for distributors within such a strategy. Staff involved in product development work should have the appropriate knowledge and ability to carry out the required tasks, and lines of responsibility and communication will need to be clearly established and monitored. EIOPA also considers that senior management responsibility will be of crucial importance in ensuring the effectiveness of such obligations and buy-in amongst PPP providers.

EIOPA recognises that product oversight and governance arrangements need to be proportionate to the level of complexity and the risks related to the PPP as well as the nature, scale and complexity of the relevant business of the regulated entity. In this regard, product oversight and governance requirements can be split into two areas, one area covering those that manufacture products being a traditional product provider or an intermediary, the other covering distributors that distribute products manufactured by other providers. While the role of the two areas differs, there is a high level of commonality in the principles that should apply.

Product oversight and governance requirements, to be effective, need to operate throughout the product life cycle so products are not only developed in a way that aligns them with the needs of the consumer but so that monitoring and review mechanisms can ensure that any misalignment that emerges over time can be rectified in a timely manner. With this in mind EIOPA is recommending that POG

requirements, as set out in annex VIII, be applied to PPPs at provider and distributor levels respectively.

3.1.2 Product standardisation

As set out in the previous section, it is clear that product governance on its own cannot fully address issues of asymmetrical information - even though those requirements are equally meant to provide for efficient processes to eventually save costs simply by applying good product governance.

In EIOPA's view, product standardisation combined with robust governance rules are two essential factors to effectively address information asymmetries streamline processes and ultimately encourage the provision of good PPPs for EU consumers - and is also a vital measure for developing a stronger EU single market for PPPs.

Product standardisation is not just about generating efficiency gains, it also helps overcome information asymmetry. The economic rationale for product standardisation typically stems from the need to reduce both transaction costs and information asymmetries. Whilst lower transaction costs result in decreasing production and distribution costs, they also reduce search costs (e.g. time and effort) for consumers by sending transparent signals on the product quality. In addition, product standardisation can facilitate economies of scale and cost efficiencies, two elements necessary to foster competition and innovation. In the context of personal pensions, product standardisation presents five benefits:

(1) By simplifying the characteristics of PPPs, product standardisation seeks to overcome information asymmetries as well as help consumers overcome cognitive and behavioural biases which often lead them to sub-optimal (retirement saving) outcomes;

(2) By reducing the diversity and number of product characteristics e.g. choice of investment options, product standardisation can lead to economies of scale and hence lower costs. Furthermore, simplifying and reducing the number of product characteristics through standardisation can help PPP market players better focus on their target market through a better alignment of consumers' needs. This, in turn, helps facilitate market take-up for PPPs;

(3) Product standardisation facilitates information standardisation which in turn assists consumers with valuable and transparent information to evaluate and compare product characteristics of PPPs.

(4) Product standardisation represents an important instrument to facilitate the diffusion of product innovation. Whilst the development of new PPPs is a necessary condition for promoting innovation, it is not sufficient, on its own, the diffusion of innovation, such as newly created PPPs, is a pre-requisite to any future positive impact on the economy. By reducing information asymmetries and enabling greater product comparability, product standardisation can increase the probability for consumers to purchase PPPs, especially if standardisation led to lower costs for consumers through economies of scale. Achieving critical mass consecutively increases the likelihood for new innovations.

(5) In the context of the EU Single Market, setting common PPP characteristics and minimum quality standards that consider both the needs and behavioural biases of EU consumers would ease market access barriers. This is because product standardisation at EU level would facilitate more stable and predictable behaviour between market players seeking to offer PEPP by lowering information costs. Furthermore, reducing the variety of PPP characteristics through a simplified

PEPP would contribute to increasing cross-border and intra-sectoral transactions within the Single Market.

Bearing the above five elements in mind, EIOPA carried out an impact assessment (see annex I for more detail) to assess if the benefits from full standardisation of PPPs would outweigh any negative effects and associated costs. The analysis concluded that full standardisation of PPPs would necessitate a detailed prescription of PPP characteristics, which are likely to be difficult to determine given the great diversity of the European PPP market. In addition, full standardisation of PPPs would require significant amendments to existing national regimes, giving rise to potentially hindering both competition and innovation by making PPPs more rigid and therefore unattractive to providers.

In EIOPA's view, a voluntary 2nd regime sitting beside national PPP regulations, as proposed in its recent consultation paper, could easily implement essential elements that need standardising whilst retaining providers' ability to adapt to a highly divergent EU market for personal pensions. EIOPA initially set out essential characteristics to be standardised and mandatory in the PEPP:

- High level investment principles to which PEPP providers must adhere;
- A default investment option;
- A default investment option featuring either a guarantee or lifecycle strategy with de-risking;
- A limited number of alternative investment options (if provided);
- Facilitating free-of-charge provider switch.

In addition, EIOPA initially proposed for the PEPP to include the following optional, flexible elements:

- Developing investment options where costs and charges are capped, thereby allowing PEPP providers to create suitable PEPPs for sales in jurisdictions where there is a legal cap on costs and charges of PPPs.
- Adding a biometric risk cover to the PEPP allowing providers to meet consumer needs where relevant. As with the minimum return guarantees, EIOPA believes these risk covers should be supported by robust solvency requirements.
- Choosing a retirement date and including forms of decumulation, mainly to allow PEPP holders comply with national decumulation requirements since PEPP solely focus on the accumulation phase.

Investment

In its consultation paper on the creation of a standardised PEPP, EIOPA outlined that a 2nd regime should consist of:

- A simple, accessible product offering value for money
- Maximising the take-up by consumers and industry alike
- Ensuring strong consumer protection.

Fulfilling the above objectives in the context of investment is challenging due to many cognitive and behavioural biases⁵² that need addressing. This is because:

- **Consumers are likely to struggle with building their own investment portfolio** as they tend to exhibit "naïve" notions about diversification⁵³.

⁵² More detail can be found in annex 2 of EIOPA: Consultation paper on the creation of a standardised Pan-European Personal Pension Product, 2015.

- **Consumers tend to wrongly assume that their preferences remain stable over time** which explains why they may not monitor, review and rebalance the asset allocation of their investment portfolio over time i.e. projection bias⁵⁴
- **Consumers say they want choice but in reality they become overwhelmed** by too much choice and hence procrastinate as a result of choice overload.
- **Consumers can be strongly influenced by the way choice is presented and framed to them.** For instance, the number of options to choose from, in the context of a complex decision, can influence consumers who will seek to simplify choice and, for instance, use a simple rule of thumb of avoiding extremes and choosing the middle option.
- **Consumers prefer choosing a "standard" default investment option** relative to building their own investment portfolio. This is because a "standard" investment option would represent a reference point that consumers can easily understand, especially if it is constructed and framed to consumers as being the social norm.
- **Consumers prefer the status-quo** when faced with complex investment decisions. Some may perceive the status quo as being "good". For others, this may simply reflect the position where they are at. Many mandatory and semi-mandatory second pillar DC pensions, where scheme members can but do not actively exercise investment choice when joining and on-going, resort to investment defaults to address the status quo issue⁵⁵. EIOPA's recent report⁵⁶ also showed that the investment strategy of DC defaults needs careful considerations to ensure its suitability vis-a-vis the membership's characteristics and risk-return profile over time.
- **Consumers may adversely react to market volatility.** Instead of taking a long-term view, they may pursue loss avoidance strategies and place a high value on certainty. In the context of PPPs, the latter may translate into a preference for guarantees although recent research⁵⁷ suggested people may not necessarily be prepared to pay more for it. Instead, they would prefer for the investment strategy to focus on reducing downside risk, thereby accepting to give up some potential upside. The research also suggested a lack of appetite for people to become semi-experts. Instead, communicating information and providing reassurance on how the downside of risk is being managed was considered as more effective.

To address, to the extent possible, the above challenges, EIOPA outlined in its consultation paper the necessity for PEPP to include high level investment principles which PEPP providers must adhere to⁵⁸ and a set of mandatory conditions on the investment options where each PEPP must include:

- A limited number of investment options to help address consumers' choice overload
- A default or "core" investment option if it offers more than one investment option to simplify decision-making for the majority via choice and information architecture
- A de-risking strategy for at least the default investment option⁵⁹ unless all investment options contain a guarantee. Furthermore, a PEPP with investment option(s) containing a de-risking strategy should aim to maximise returns at

⁵³ For example, they would follow the "1/n strategy" by dividing their contributions evenly across the funds offered in the pension plan, with no actual assessment of the impact that the strategy has on the risk and return characteristics of their overall portfolio.

⁵⁴ Inertia and present bias would inherently amplify the issue.

⁵⁵ EIOPA: Report on investment options for occupational DC scheme members, 2015.

⁵⁶ EIOPA: Report on investment options for occupational DC scheme members, 2015.

⁵⁷ NEST: Improving consumer confidence in saving for retirement, 2014.

⁵⁸ This is also in line with setting requirements on provider governance as outlined in the previous section.

⁵⁹ With provider flexibility to develop their own de-risking strategies.

defined risk levels for that investment option. These conditions seek to mitigate potential issues of loss and regret aversion.

Switching providers and transfer of funds

In its consultation paper EIOPA suggested that PEPP providers will compete for business by developing competing investment strategies that will consequently generate different costs and returns - and in turn enabling financial innovation and cost-efficient products. On the other hand, like for other types of savings, it is important for PPP consumers to be enabled to assess and amend their PPP to ensure that the purchased product still meets their needs in a way that will lead to a satisfactory outcome at retirement. Considering the challenges of overcoming inertia, consumers may have been satisfied with their chosen PPP when they first took it out, but due to changes in circumstances or finances, would at a later stage need to consider possibly switching to something more suitable, be it transferring their savings to another investment option or switching to another PPP provider.

Especially for very long-term products such as PPPs, it is necessary to offer consumers the flexibility to switch between PPPs as well as PPP providers. For a consumer to be locked into in a product or with a provider until reaching the retirement age, regardless of the performance, can be highly detrimental for one's interest. Pension savers - to varying degrees - are expected to bear the risk of providing for an adequate income in retirement, but would be less likely to acknowledge this responsibility if they are unable to manage and control their savings. Indeed, the possibility of switching is deemed a key driver for consumer trust and significantly lowers the psychological hurdle to buying a product for the very long term. It also keeps the market open to new players, increases the incentive to apply a duty of care, benefits competition from demand side pressure, and allows for future improvements.

In line with the idea of long-term saving and of creating a Capital Markets Union, the PPP should help generate funding for long-term illiquid investments (infrastructures, real estate, unlisted SME equities). This would not be possible should consumers shift providers constantly, leading to short term liabilities and forcing providers to invest in more liquid assets.

Additionally, an illiquidity premium can only be earned if and when long-term investments enable higher returns. Switching investments before maturity could considerably reduce consumers' investment return. Furthermore, the market value of illiquid investments is often only known when buying or selling the investment. During the holding period it will be difficult to find an objective valuation. In most cases, the book value of illiquid investments is based on appraisals which are typically lagging the underlying market value. Especially in times of financial stress, the sale price of illiquid assets may be significantly lower than the book value.

Therefore, consumers should be incentivised to save for the long run, ideally until retirement. However, such incentives should not have the effect of actual obstacles, in particular in terms of costs, and administrative burden, when switching PPPs and PPP providers. Clearly, different investment options call for different measures: The possibility of switching is highly desirable but, as noted, it could interact unfavourably with illiquid long-term investments. However, not all PPPs will invest long-term and surely not all long-term investments will be illiquid. Additionally, a clear distinction needs to be made between those products where the consumer fully bears the investment risk and those where the providers bear the risks to any extent. In other words, the nature of the investment option and liquidity profile of the portfolio should be taken into account.

Considering the views of respondents during the public consultation of PEPP, there was no unanimous view that switching should only be allowed in specified frequencies or schedules. In contrast, some argued that consumers could be allowed to switch between providers at all times. The transfer of actual assets of an allocated portfolio can be ruled out, which consequently means that switching can practically only be done in cash. This automatically means that cash will be transferred from one PPP provider to another as long as the new provider will accept this transfer.

This should not stop providers to invest in illiquid assets. If PPP providers invest in a sound and profitable fashion, they will attract savers and reduce the need for switching. Furthermore, the scale of the PPP plays an important role. The greater the scale of the PPP, the more likely it enables holding illiquid assets without experiencing liquidity issues caused by consumers switching products.

Also investments in pooled solutions offering exposure to long-term illiquid assets that are traded on the secondary markets may assist in balancing the switching between providers and investments in illiquid assets. Such products are easier to sell than their underlying assets.

Should for some reason the provider not be in a position to accommodate all switching requests due to a lack of liquidity which may well lead to fire sales of the corresponding asset portfolio, the PPP provider could be allowed to temporarily suspend transfers outside the normal timeframe (gate option). If PPP providers invest a certain percentage of their assets directly in illiquid assets - aimed at a predefined holding period - a delay could be required between the announcement of the switch and the actual transfer of the assets. This leaves the flexibility to the providers to decide on its product design and asset strategy without the obligation to hold a minimum amount of liquid assets. Additionally, there is a risk that with unlimited switching, consumers would chose a product where providers bear the investment risk in periods of economic downturn and switch to products where consumers bear the risk in periods of economic upturn. Therefore, EIOPA believes that switching between products in particular where the providers, fully or partially, bear the investment risk certainly could be limited in terms of minimum holding periods and should allow the transfer of assets at market value. This should prevent short-term reactions to market movements. Transfer values should generally be fair market values, yet EIOPA acknowledges that the determination of a fair transfer value of guarantees may not be straight forward.

PPP providers investing in illiquid assets will need a detailed liquidity management policy to cover the effects of transfers out of the scheme thereby increasing the concentration of investments in illiquid assets. This could also be mitigated by for example the use of side pockets. Of course, allowing for unlimited switching should be complemented by good governance, relevant information and access to advice.

Switching is not harmonised at European level. It should be emphasised that, for example, in UCITS the design of the framework has been to allow for redemptions on demand, so that in effect switching is allowed at any time, with some major consequences for the risk-reward profile of a UCITS (such as limitations on investments in non-liquid instruments, for instance). By comparison, closed-ended investment funds typically are only as liquid (open to switching) as the market in that fund permits, as no redemptions from the asset of the fund are made: liquidity can dry up, such that investors are not able to leave without accepting a fire-sale. Other instruments - such as for instance some fixed term investments - offer little or no options for early redemption. Naturally, any element relating to limiting switching must be fully explained in pre-contractual information provisions and disclosed in the contract with providers. Further, switching also bears a risk for consumers if the effects of the transfer or switching are not well explained.

EIOPA does not favour periodical cost-free switching periods per se. Introducing a minimum investment period in PPPs or the PEPP could make the PEPP less attractive to consumers compared with the products currently available at national markets. However, in order to avoid an uneven alignment of short-term liabilities and long-term investments that create costly liquidity risk and may eventually even impact financial stability, some limitations on switching, such as minimum holding periods, should be possible. Setting dates or timing of periodical free transfers could determine consumer behaviour, potentially against their own interests. It could delay their switch to the next cost-free period or give the impression consumers need to switch during a specific period, as they cannot do it with the same costs in the upcoming years.

Costs for switching need to be fair - the implementation of a right for consumers to switch between PPP providers goes hand in hand with a cost increase for the PPP providers. In order to mitigate the risk that costs are being hidden or mutualized between all PPP holders of one provider, eventually reducing investment returns for those who are not switching, EIOPA is of the view that transparent, clearly allocated costs of switching are preferable to mandated free-of-charge switching. The applicable charges should be fair and reflect the true costs borne. Punitive charges would be prevented by full transparency, as endorsed by market pressure. However, national supervisory authorities should be attentive to actual market practices and monitor if the actual switching costs are reasonable and reflect the administration and transaction costs actually borne.

EIOPA considers this consistent with ensuring that PPPs can invest effectively in longer term, less liquid assets, which may in general have a risk-reward profile that can be matched to the liabilities of a PPP provider.

Cap on costs

EIOPA proposed in its consultation paper on PEPP that a cap on costs and charges could be a key element for PEPP. However, the vast majority of respondents were of the opinion that neither costs and charges of PEPPs, nor individual components of costs and charges should be capped. Most of the respondents believe that opening the new PEPP market at the European level would enhance and foster competition between PEPP providers and would lead to lower costs and charges of PEPPs. This competition between PEPP providers would also ensure that the consumers are offered competitive products, whereas caps could have negative effects by reducing the number of PEPP providers and high quality products eventually available to consumers. Some respondents said that caps would distort the market and would actually limit innovations in the PEPP market and capacity of PEPP providers to create and pursue innovative products and investment options.

Based on the evidence gathered in EIOPA's recent survey, see annex III, in 12 out of 25 countries at least one of their PPPs is capped. However, the means to apply this cap vary significantly. In eight countries, a cap on the costs and charges on assets is applied. In four countries, the maximum costs and charges on the contribution is capped. Only in two countries, charges applied to the investment returns are capped. In three countries costs and charges are capped with a fixed amount. This applies for example on the entry costs. In most of the markets⁶⁰, PPP providers are also legally obliged to inform their NCAs about the costs and charges applied to PPPs.

⁶⁰ Excluding DE, FR, LI, LT, MT, NL, PL, SK or UK.

EIOPA agrees that a cap on costs and charges should be the measure of last resort in an imperfect market like personal pensions. Clearly, in terms of fostering healthy competition and using market pressure through disclosure, caps on costs and charges are not the first-best option. However, considering consumers' cognitive biases, as explained in the information section, and shortcomings in full standardisation of these complex products, it may require setting caps on cost and charges - at least for the default investment option - in the interest of the consumer. Setting the right level of the cap may need to be left to the Member States' discretion to tailor it to local cost structures. In addition, the need for additional supervisory powers tailored to PEPP may need further considerations in the future which could involve:

- Developing a common EU standard defined level of a Total Expense Ratio (TER), expenses in relation to services provided, applicable to PEPP
- Requiring providers to disclose the target charge/TER for each of PEPP's investment options and if exceeded, systematically inform and explain to both PEPP holders and national supervisory authorities the reasons and remedial actions.

Decumulation

In EIOPA's consultation paper on PEPP it argued not to standardise the decumulation phase of PEPP. Respondents agreed that decumulation aspects should be included in the product and forms (options) of decumulation, yet should be kept flexible. Others, in particular insurers, argued that the decumulation phase should be a mandatory feature of PEPP, as accumulation and decumulation must be linked in order to ensure optimal outcomes for the future retirement income.

EIOPA remains of the view that the benefits of standardisation, including optimising returns and cutting costs through economies of scale can largely be achieved in the accumulation phase. EIOPA would require further analysis on the advantages and disadvantages of various decumulation options (or a combination thereof), ie lump sums, programmed withdrawals, life-time (inflation-indexed) annuities, as well as, ongoing-life styled savings.

Another factor that cannot be standardised at European level, due to its connection to national social and labour law, is the permitted entry age into decumulation.

Advice on standardisation

As discussed at the beginning of the section, it is important that the features of PEPP meet conditions that will benefit consumers and providers through the realisation of economies of scale, lower costs and an environment fostering both open and fair competition and innovation.

Consequently, it is important to achieve the right balance such that the mandatory elements of the PEPP protects the interest of consumers, lower information costs for providers whilst at the same time mitigating any risk of developing an overly prescribed product making the proposition unattractive to providers due to lack of profitability, too expensive for consumers and/or as hindrance to creating a competitive and innovative Single Market.

Overall, stakeholders' broad support - be they providers, distributors or consumers' representatives - for PEPP's standardised features, give or take a few adjustments, is

a compelling testimony that the 2nd regime would make a difference in addressing many of the market failures whilst enabling positive externalities of a truly Single Market for personal pensions as outlined in section 1. Stakeholders made similar points as the European Commission in its action plan for the Capital Markets Union⁶¹ that standardisation in specific areas is necessary to overcome market failures by providing transparency, comparability and understandability of products, which in particular helps cross-border business to achieve economies of scale.

By offering a default investment option and reducing choice through a few alternative investment options, the PEPP would bring simplicity for most EU consumers whilst allowing choice for the significant minority who want to exercise investment choice.

The mandatory standardised features of PEPP with respect to investment would also improve product comparability between providers across the EU. The latter would be further enhanced through the provision of standardised information disclosures to future PEPP holders. EIOPA also believes that the PEPP should provide a guarantee or suitable de-risking strategy closer to retirement, in particular for the default investment option, as consumer protection measures to help address behavioural biases (e.g. inertia, regret and loss aversion) and foster future consumer confidence in the PEPP.

In contrast, harmonising national PPP regimes could improve prudential requirements and consumer protection for cross-border transactions. However, harmonising national PPP regimes would face significant challenges in introducing a high level of standardisation, given this approach would impact all existing PPP provisioning, and so it would not be able to provide sufficient alignment to effectively improve both the comparability and transparency of PPPs⁶², which in EIOPA's view can only be achieved through a high level of product standardisation.

Furthermore, it may be difficult to sufficiently address behavioural and cognitive biases across existing PPP business through harmonisation measures, compared to what might be achieved for a PEPP.

In addition to helping to address consumer behavioural biases, the default investment option foreseen in PEPPs would also enable providers to achieve scalability. The PEPP's standard default option could be designed to be simple and hence possibly be more attractive to a large EU consumer base that has no desire to become semi-experts in pensions. This latter argument was also put forward and emphasised by some stakeholders in the consultation.

Likewise, the scalability of the default investment option as well as other standardised features of PEPP should play an important role in lowering barriers to market entry including for non-EU providers whilst not affecting other market players within the EU through passporting.

Economies of scale are important because it may take some time before providers of PPPs break even and fully recoup upfront costs⁶³. As a result, new market entrants need to be confident that they will achieve sufficient economies of scale as a prerequisite to generating enough revenue from charges to recoup costs and make it profitable to enter the market. Furthermore, as a simple product with transparent charges, PEPP would foster fair and open competition, as market players are required

⁶¹ See European Commission: Action Plan on Building a Capital Markets Union, 2015, http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf.

⁶² It is worth noting that Member States presumably have some flexibility when transposing European Directives.

⁶³ Usually those include costs in relation to research and development, marketing, distribution and other scheme set up costs (i.e. fixed costs) as well as ongoing administration costs such as communication, record-keeping.

to comply with the same product regulation. Market familiarity with the new framework could, it can be argued, develop relatively quickly.

In contrast, harmonising national PPP regimes would not lead to standardised PPPs and would therefore significantly reduce the scope for cross-border scalability for providers. Furthermore, potential new market players may further be deterred from market entry, for example in another EU jurisdiction, because the lack of comparability between PPPs would foster consumer inertia even if a Directive would set a principle for free-of-charge provider and product switching.

EIOPA believes that the essential features of the PEPP should include a default investment option and, if provided, a limited number of alternative investment options that adhere to the following guiding principles:

- **Simplicity:** The default investment option consists of investment vehicles that seek to meet a range of needs suitable for a large proportion of consumers within the Single Market. PEPPs can also include a limited set of alternative investment options to the default investment option where decision-making is made as simple as possible for consumers. Alternative investment options available to consumers should be limited and set in such a way that it prevents consumer choice overload and confusion. The alternative investment options should offer a range of funds from several broad investment strategies that work and are suitable for most consumers within the Single Market. Self-investment whereby financial sophisticated consumers build their own portfolio is prohibited and cannot be offered in PEPPs as an investment option. Including a bespoke self-investment option in PEPPs would make product standardisation redundant whilst hindering PEPPs' goal to provide a simple and trustworthy product. Providers must offer PEPP following the principle of guided choice architecture and clear labelling of investment options where the default in PEPP represents one investment option located within a set of limited straightforward alternatives that does not overwhelm consumers.
- **Duty of Care:** Providers must adhere to the Prudent Person Principle and act solely in the best interest of consumers with respect to investment matters. Because one of PEPP's objectives is to help consumers secure a source of retirement income, all investment options available in PEPPs must protect consumers from inappropriate risk exposure through adequate and systematic re-balancing of asset allocation as they approach retirement or other appropriate means. The mechanisms used to secure a source of retirement income for PEPP holders should also account for relevant forms of decumulation, if available. Providers must assess the appropriateness of PEPPs for potential customers nearing retirement to ensure its suitability. Providers must regularly assess the ongoing suitability of the default investment option for PEPP holders in the default option against the objective of PEPPs (see below Value-for-Money). Similarly, providers must regularly review the ongoing suitability of the charge level for consumers. In the event that the default investment option becomes unsuitable (e.g. following a regulatory change), providers must act promptly in the sole and best interest of consumers in the default option to adjust the investment strategy of the default option. Any change in the default investment option must be supported by timely, transparent and easily understood communications to consumers in the default option.
- **Value for Money:** All investment options in PEPPs including the default option need to provide good quality and value for money to PEPP holders which includes the objective to maximise returns at defined risk levels for that

investment option so that it pays to save in a PEPP. Providers are required to disclose standardised charges information in a consistent way annually to consumers.

- **Fairness:** Costs for switching provider and transfer of funds are to be fair and transparent and should consist of a relatively minor fee to reflecting the true costs borne for administering the switching process. Therefore, there should be no implicit or explicit commercial barriers forcing consumers to stay with the same provider at any point in time.
- **Adaptability:** PEPPs should be capable of incorporating flexible features to enable providers adapt PEPPs to a diverse EU personal pension landscape so that: (1) PEPPs cater for satisfying potential demand to cover against certain risks such as biometric risk and the provision of a minimum return guarantee, both of which should be supported by robust solvency requirements and (2) consumers can choose a retirement age as well as appropriate forms of decumulation, if available in the relevant EU jurisdiction.

3.2 Cross-border activities and transfers

Apart from smart product regulation and standardisation, EIOPA strongly believes in the opportunities to achieve economies of scale through a proper use of a Single Market for personal pensions. The market forces, enabled through highly harmonised requirements, or even more effectively through standardisation via a 2nd regime, can reach significant economies of scales and cost-efficient management of PPPs.

EIOPA fully supports the European Commission's assessment that PPPs should be able to benefit from an efficient Single Market with its legal freedoms (services, capital and establishment) and support labour mobility. Indeed, developing and selling products to a larger client base can increase efficiency through scale economies, innovation, risk diversification and competition. As the European Commission indicated, the potential savings by streamlining costs and fees and spreading them over a larger pool of PPP holders and a typically long accumulation period could be significant.⁶⁴ Additionally, developing and selling products in a European market can increase innovation, risk diversification and competition.

EIOPA believes that improved transparency, standardisation and comparability of PPPs in different Member States, together with strong governance requirements to restore consumer trust, should enable cross-border sales and reduce impediments to cross-border labour mobility, thus furthering a Single Market. However, at the same time, cross-border offerings of PPPs can only be facilitated if existing barriers to cross-border business are removed.

Cross-border provision can be arranged in four different ways:

- By the freedom of establishment by entities with legal entity (subsidiary) in the domestic market
- By the freedom of establishment by entities without a separate legal entity (branch) in the domestic market
- By the freedom to provide services
- By financial institutions not benefiting from a "passport"

⁶⁴ See, for instance, DNB (2010), "The impact of scale, complexity, and service quality on the administrative costs of pension funds: A cross-country comparison", DNB Working Paper 258; Lane, Clark and Peacock (2012), "Pension costs survey 2012".

EIOPA has collected quantitative data from 13 Member States with regards to cross-border contracts, see annex V. Other Member States could not provide detailed information with respect to cross-border services. Those 13 countries represent around 25 percent of the total PPP market (excluding Germany) as at the end of 2014.⁶⁵ Almost 65 percent of these assets were reported by Belgium. France and Italy together reported a further 25 percent of the total cross-border assets.

These three markets dominating the results have well established local market players. Therefore, the total amount of cross-border business in all 13 countries is limited to less than 4% of the total PPP assets (approximately 9,700 million euro). Half of these assets are managed by foreign providers applying the freedom of establishment principle and establishing a legal entity in the domestic market. A quarter of the cross-border business is provided by financial institutions not benefiting from a "passport". The last quarter is split equally by providers applying the freedom of establishment principle without a branch in the local market and providers applying the freedom to provide services principle. More details on the study, as well as additional information on cross-border business can be found in annex V.

Additionally, EIOPA has conducted a qualitative study amongst its members identifying cross-border obstacles for third pillar pension products. From the 31 EIOPA members, 25 markets provided a response. Two markets (Cyprus and Greece) indicated that no PPPs are currently provided in their markets and therefore could not respond to the survey.

As the responses to EIOPA's survey show (see annex V), there are obstacles to cross-border management, investment in foreign pools or currencies and to transfers of funds in a significant number of Member States. However, it seems that the most important obstacle is posed by taxation on cross-border transfer and in the application of general good rules and contract law. Even Member States that claim not to cause any other obstacles to cross-border activities exhibit only negligible cross-border transfers - apparently due to direct and indirect effects of taxation, for example national tax regulations may consider cross-border transfers as withdrawals, subject to tax penalties

Tax impediments for cross-border provision

Taxation is a significant hurdle that prevents the emergence of a Single Market for PPPs. Currently there is no specific EU legislation on the taxation of pensions.⁶⁶ This area is covered by national laws and bilateral tax treaties. Pensions are taxed very differently across the EU and the tax treatment is often linked to specific characteristics of eligible products, such as holding period until tax-relevant retirement age or specific investment strategies. This already raises various challenges to the creation of a Single Market for PPPs, as products need to exhibit different features to receive beneficial tax treatment in different Member States. In addition to that, the definition of taxable income and when to tax retirement income or contribution to savings is different amongst Member States, which is a significant cross border tax issues. Regarding the taxation of contributions, some Member States may have restricted the tax deductibility of contributions paid to providers that are not established in their territory, while allowing such deductibility for contributions paid to domestic providers. This can lead to discriminatory treatment on the basis of

⁶⁵ Please note that the data in relation to FR refers to 31 January 2013.

⁶⁶ See European Commission: Pension taxation, http://ec.europa.eu/taxation_customs/taxation/personal_tax/pensions/index_en.htm; European Parliament: Pension systems in the EU – contingent liabilities and assets in the public and private sector, a survey requested by European Parliament's Directorate General for Internal Policies, 2011, p. 34, <http://www.europarl.europa.eu/activities/committees/studies.do?language=EN>.

the provider's origin. However, these tax obstacles could be tackled with corresponding mutual tax treaties, if not harmonised at European level.

Summarising, EIOPA was made aware of the following main types of tax impediments relevant for PPPs:

- Differences among Member States in taxation of investment income paid to foreign PPPs - PPPs may be tax exempted in the Member State of residence of the PPP holder or receive a credit for withholding taxes levied on their domestic investment income (dividends, interest). Nevertheless, PPPs may suffer source taxation on their foreign investment income which, due to the domestic exemption regime, becomes a final tax burden. However, in theory, this tax obstacle seems to be eliminated to the extent that Member States cannot discriminate against foreign providers.
- Impediments to the transfer of accumulated capital - when a member wants to switch between PPPs or decides to change the provider of the PPP, a transfer of accumulated capital from a PPP in one Member State to a PPP in another Member State may be subject to withholding tax in the exiting Member State or may even be prohibited.
- Again, in theory, this tax impediment seems to be eliminated to the extent that a Member State cannot discriminate against foreign providers. However, when domestic transfers are taxed, the Member State from which the transfer abroad is made is free to levy an exit tax on transferred capital. If the Member State to which the transfer is made levies an entry tax on transferred capital, the transferred capital would be taxed twice. This double taxation would dissuade both providers and individuals from making the transfer.
- Differences in Member State tax arrangements and conditions for granting tax relief for contributions - most Member States employ the so-called EET system (Exempt contributions, Exempt investment income and capital gains of the pension institution, Taxed benefits) or ETT principle (Exempt contributions, Taxed investment income and capital gains of the pension institution, Taxed benefits).⁶⁷ Other systems (such as TET, TEE, EEE) are less common, but can also be found across the EU. Even within the EET system, the requirements for tax deductibility of contributions vary widely from one Member State to another and may be often limited to a certain level of income replacement or a fixed amount.
- Moreover, the transfer of accumulated capital from a TEE/TTE Member State to an EET/ETT Member State can lead to double taxation. Since direct taxation is within the competence of individual Member States⁶⁸, the principle of non-discrimination under EU law is not applicable as such. Any change in this area would probably require harmonisation that would be conditional upon unanimous approval by the Member State. Alternatively, to prevent double taxation and non-taxation Member State could be encouraged to adopt unilateral domestic rules or adjust their existing tax treaties.

Based on its consultation, EIOPA was not able to collect extensive information on taxation. Often the supervisory authorities are not the competent authorities for tax treatment. However, based on the limited responses received (8 countries), it appeared that if a tax treatment is provided – be it on contributions, investments,

67

68 See ECJ: Case In Case C-96/08 CIBA Speciality Chemicals Central and Eastern Europe Szolgáltató, Tanácsadó és Kereskedelmi kft v Adó- és Pénzügyi Ellenőrzési Hivatal (APEH) Hatósági Főosztály delivered on 5 June 2010 CJEU noted that “[...] in the current state of the development of European Union law, the Member States enjoy a certain autonomy in this area provided they comply with European Union law, and are not obliged therefore to adapt their own tax systems to the different systems of taxation of the other Member States in order, inter alia, to eliminate the double taxation arising from the exercise in parallel by those States of their fiscal sovereignty. [...]”.

benefit payments or transfers - there is always a tax treatment for all types of PPPs in that country. However, this does not mean that the tax treatment is similar.

Other impediments for cross-border provision

Analysis of the responses shows that in 40% of the responding countries there are barriers to the management of cross-border schemes. Barriers often exist in the obligation by national law to establish a branch in the country where the PPP is provided. Additionally, responses showed an unlevel playing field between the insurance sector and other PPP providers when it comes to the cross-border management of PPPs.

Furthermore, analysis of the results indicated that the prohibition on foreign investments is generally very limited. Most of the countries indicated that their national law did not prohibit cross-border investments or investments in foreign currency. However, in a number of countries the amount that may be invested in foreign currency is limited to reduce exposure to currency risks at the pay-out phase. These and other investment restrictions are often not applied equally to all providers. It is also worthwhile to highlight that certain countries have implemented some rules restricting certain investment options, e.g. art, fine wines etc. While these do not present a cross-border barrier, a foreign provider should take these restrictions into account if considering entering the local market.

Likewise, more than half of the countries have barriers to cross-border transfers (excluding taxation issues). This could be due to a lack of transfer legislation in national law, problems relating to cross-border scheme management and interference with other regulations. It is worthwhile noting that some of the obstacles could apply to both domestic and cross-border products.

Additionally, as indicated in its preliminary report to the Commission, EIOPA believes that (insurance) contract law might be an impediment for cross-border pension provision. In its final report⁶⁹, the Commission's expert group on insurance contract law concluded that for pensions, tax law and social security regulations supersede insurance contract law as the principal source of regulation. However, this does not mean that there are no contract law obstacles that need further attention. Especially, with regards to pre-contractual disclosure, withdrawal rights, contract termination and pay-out options different measures apply across Europe.

For example, as highlighted in the final report of that expert group, in the Netherlands an individual can save for PPPs and under certain conditions the contribution is deductible and the annuities are taxed. The Dutch tax law penalises the pay-out of a lump sum by a high taxation rate. If individuals move residence to another Member State and retire there, according to Dutch law they would have to convert their accrued pension capital into an annuity. However, according to the Dutch Central Bank, the conversion into an annuity is a new legal agreement and not the continuation of the old contract. For the provider this means that they would be considered to be conducting cross-border activity and would for instance need a notification and ensure compliance with general good rules of the country where the individual is now resident. Thus, the company may not wish to offer the new contract in the form of an annuity. Consequently the individual would be confronted with a major fiscal claim. This example would be similar in the UK where the conversion of a pension into an annuity is also a new legal agreement.

⁶⁹ European Commission: Final Report of the Commission Expert Group on European Insurance Contract Law, 2014, http://ec.europa.eu/justice/contract/files/expert_groups/insurance/final_report_en.pdf.

Such differences in national laws mean that providers need to adjust their contracts to meet local requirements. This is an important issue as the contract itself is the product.

Another aspect identified by EIOPA in its preliminary report is social law. Firstly, it is national social legislation that recognises and defines a financial product as a PPP and distinguishes it from other similar long term investment products. Secondly, national social legislation also identifies the main characteristics of personal pension plans, with reference for example to the participation requirements and pay-out options. Thirdly, the benefit structure of a PPP is modelled on social law requirements regarding retirement age.

Finally, other legal and non-legal barriers might be identified, including amongst others: understanding the local market and risks; the costs of IT systems and of a reliable service network; cultural features as well as sensitivities and expectations; the regulatory environment and supervision; pre-contractual and 'know-your-customer' rules; variations in the prevalence and form of insurance frauds; knowledge of local languages.

Conclusion on cross-border opportunities for PPP

In order for PEPPs to fully benefit from the Single Market the existing barriers to cross-border business need to be removed. Only then can products be sold to a larger client base resulting in economies of scale, innovation, risk diversification and competition. The most significant barrier is taxation. But, restricting the management of cross-border schemes, restricting foreign investments or investments in foreign currency, limiting transfers and different social or contract law can also form barriers.

EIOPA has looked into the PEPP as a retirement savings product under a 2nd regime that covers both domestic business and cross-border business, thereby establishing an alternative set of rules to the regimes existing in Member States. This set of rules would be free from many of the legal obstacles arising from the disparity and the limited territorial application of existing national laws.

As a result, the PEPP should help to enhance legal certainty for financial service providers that will have previously experienced difficulties to bridge national laws governing PPPs. Such a PEPP should be sufficiently robust at the level of the product and provider, so as to allow widespread distribution but at the same time provide the flexibility to allow the product to adapt to the different social laws available in all countries. Furthermore, the PEPP should solve the lack of a level playing field that some of these barriers have posed to the different providers. As a simple product with full transparency, PEPP should foster fair and open competition, as market players are required to comply with the same product regulation.

However, for a standardised pension product to be genuinely operational across borders, a solution to remove the existing tax barriers needs to be found. Especially in developing markets without well-recognised PPPs by providers and consumers, the possibilities to enable cross-border business will be vital to create economies of scale. EIOPA believes further research is needed to solve taxation issues.

Tax incentives offered in each Member State also play a crucial role in generating consumer demand for PPPs. At the same time, more and more countries are considering to abolish tax incentives related to PPPs. Therefore, generating economies of scale for PEPP can only be achieved if the costs of the set-up, administration and distribution can be kept to minimum, if not benefiting from tax incentives. A 2nd regime Regulation instead of harmonising current Directive to define European standards can be regarded as the optimal solution to keep the costs low, by avoiding legal uncertainty and gold-plating by Member States.

Harmonising national PPP regimes would not lead to standardised PPPs and would therefore significantly reduce economies of scale. On the other hand, harmonisation (including taxation) would help to solve tax hurdles currently blocking providers to operate cross-border.

Finally, it seems important to designate the competent authorities responsible for authorisation and supervision and their respective responsibilities, especially in cross-border situations.

4. Requirements of a relevant prudential regime

PPPs currently feature an array of savings elements, investment options and of different types of guarantees. These elements of PPPs are all regulated within the sector-specific regulations, which often approach the sectors' different business models in a holistic manner. Both recently overhauled regimes CRD IV and Solvency II exhibit the same risk-based approach and consequently could be regarded as systemically consistent.

Most important for PPPs is the prudential treatment of guarantees, where these are offered, and regulations that may limit the freedom to invest - in relation to a level playing field between different types of providers and when deciding, which is the most relevant prudential regime, if any, for PPPs.

4.1. Technical provisions and capital requirements

In terms of valuation of technical provisions and the most relevant set of capital requirements, PPPs' only relevant features are explicit or implicit guarantees. Those guarantees can be financial ones, biometric ones, performance-related ones or such to protect against inflation - or a combination thereof. All those guarantees are not just expensive in light of the current low interest environment and a sluggish economy; they are real obligations, i.e. liabilities, of the provider, which brings them on the provider's balance sheet. Consequently, a provider will tailor its own asset portfolio management strategy on managing these obligations.

Different types of providers are authorised to issue (or are prevented from issuing any) different types of guarantees. Some financial guarantees can be offered by both banks and insurers and quite often providers separately 'buy-in' insurance guarantees from insurers to complement their own offerings of PPPs.

EIOPA asked stakeholders on their views on the most relevant prudential regime for PEPPs and stakeholders generally agreed that the entity providing a guarantee has to be subject to a robust solvency regime. Furthermore, the PEPP should enjoy an appropriate prudential treatment in general. This goes along with the request for a level playing field respectively "same risk, same rules". This has also to be taken into account when choosing between harmonising PPPs and PEPPs. Otherwise, there is a risk for regulatory arbitrage, not just between PEPPs but also between "regular" PPPs and PEPPs.

In addition, the predominant opinion seems to be that there is no need for additional regulation. Meaning the already existing regimes at EU level are sufficient for the purposes they were designed for. Some participants would favour some adjustments to the existing rules in connection with PEPPs (particularly in respect to reporting requirements for example). Especially Solvency II seems to be considered as the most sophisticated regime as far as minimum return guarantees and/or biometric risk coverage is concerned.

Nevertheless, some participants believe that there should be one identical solvency regime for all PEPP providers to really achieve a level playing field. In doing so, some consider Solvency II as the appropriate regime. It was also suggested that there should be equivalent conduct of business and investor protection rules.

EIOPA is of the view that, when imposing capital requirements, the focus should lay on the product and not on the provider. Especially since the consumer will expect an equal level of protection against adverse developments irrespective of the provider. More research has to be undertaken to understand if and where existing solvency requirements have to be touched to achieve the goals of improving PPPs and to develop a relevant framework for PEPP. It does not seem feasible or proportionate to design one solvency regime that fits all possible PEPP providers and characteristics of possible PEPPs.

4.2. Investment rules

EIOPA has analysed several relevant sources of investment rules, such as international standard setter references⁷⁰ as well as the relevant European frameworks, such as Solvency II, IORP Directive⁷¹ and CRR, but also EIOPA's Report on the IORP Quantitative Impact Study⁷² (including the QIS technical specifications). EIOPA acknowledges the efficiency gains of taking into account existing policies to accommodate the specific characteristics and nature of a range of relevant providers - in comparison to developing a completely new set of policies. Nevertheless, EIOPA appreciates that existing frameworks may need to be amended and further developed to address the specificities of PPPs.

The idea of a prudent person investing

The prudent person principle states that the governing body of a PPP provider, or another responsible party (to be determined by prudential regulation), is authorised to invest the consumers' contributions in an asset allocation that is consistent with its business model and, if applicable, its liabilities. All decisions of the governing body or responsible party are to be taken with the requisite level of skill to effectively carrying out the investment management function. If the governing body or responsible party should lack the required skills, knowledge or experience, it should instead make use of the external assistance of an expert in the particular matter. All investment decisions have to be made in the best interest of the beneficiary of the contract. For all assets that the PPP provider may want to invest in, it is required that the prudent person (governing body or other responsible party) can prove that he or she can properly identify, measure, monitor, manage, control and report the risks contained in it.

The asset allocation has to closely interplay with the business model and, if applicable, the liability profile of the provider's contract portfolio at any time. This correspondence has to be achieved by a sufficiently granular asset liability management that takes into account riskiness, quality, liquidity (availability) and profitability. Asset Liability

⁷⁰ OECD: OECD Recommendation on the Core Principles of Occupational Pension Regulation, 2009; OECD: OECD Recommendation on Guidelines on Funding and Benefit Security in Occupational Pension Plans, 2007; OECD: OECD / IOPS Good Practices for Pension Funds' Risk Management Systems, 2011; OECD: OECD Guidelines on Pension Fund Asset Management – Recommendation of the Council, 2006; OECD: Good Practices on Pension Funds' Use of Alternative Investments and Derivatives, 2011.

⁷¹ Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision, OJ L 235 , 23.09.2003 P. 10.

⁷² EIOPA: Report on QIS on IORP, 2013, https://eiopa.europa.eu/Publications/Quantitative%20impact%20studies/EIOPA-BoS-13-124_-_Report_on_QIS_on_IORPs-20130704.pdf.

Management (ALM) rules should refer to maturity, duration and currency. An ideal ALM would possibly refer to modelled liability cash flows from individual contracts, or at least to classes/model points of cash flow profiles which are expected for certain groups of contracts. These have to be aligned with the modelled asset cash flows.

A prudent person has to cater for sufficient diversification of the asset portfolio in order to properly mitigate market and credit risks. A prohibition or limitation of self-investment (investment in units or shares of the PPP provider itself or in units or shares of the group of associated undertakings to which the PPP provider may belong), should be part of the rules on diversification.

Additionally, the prudent person rules can contain limitations on certain asset classes. These limitations may range from investment prohibitions in certain types of asset, e.g. highly complex assets that are not listed and/or traded in small, illiquid markets, to ceilings for asset classes. These ceilings are viewed only as a supplement of the prudent rules for PPP providers, as a regulation based solely on such inflexible type of rules would prevent the prudent person from achieving an optimal portfolio composition. Floors for investments in certain classes are generally regarded as impediments for a sound investment management, as they can usually not be justified from a risk, ALM or diversification perspective and tend to artificially prefer certain asset types. Such a policy would be regarded non-compliant with prudential regulation. A policy of pre-approval for investment decision by a prudential authority is generally viewed in a similar vein. As such a policy has no merit in terms of risk management, ALM or diversification and is usually linked only to policy benefits, it should be strictly avoided.

In order to comply with the retirement income objective, providers need to take into account the availability and liquidity of assets. If an asset is pledged, it is subject to obligations with relation to third parties. These other obligations may negatively interfere with those imposed by contracts. As it is the legal obligation to the provider to meet the obligations from contracts with consumers, pledging of assets should be prohibited.

Derivatives are complex financial instruments that are used for hedging, or market and credit risk management purposes in general. If done in a prudent fashion, it may be a useful tool to reduce the investment risk or to facilitate efficient portfolio management. But derivatives can at the same time increase the risk of an asset portfolio, especially when they involve clauses with unlimited commitments. The investment in such derivatives, or the use of derivatives for speculative purposes should be prohibited.

Valuation is the basis for effective and efficient asset management. Within Solvency II the use of marked-to-market valuation has been chosen. As this corresponds to the liquidity criterion of ALM (see above), it is a natural choice. Where it is not available, the fair value concept could be used. If a PPP provider opts to use a different valuation method, this should be subject to disclosure.

Draft advice on investment rules for PPP

A prudent person principle, and in particular, the need for proper diversification and effective risk management can be seen as a critical feature to secure optimal outcomes for consumers based on sound management of their investments and proper monitoring of the sustainability of guarantees offered to consumers. Those principles are for example all well reflected in Articles 132 to 135 of Directive 2009/135/EC.

In addition to that, EIOPA believes that any provider should be required to establish an investment policy for its PPPs and to describe it in a written statement. The income

policy should contain the financial objectives of the provider in relation to the offered PPPs. These objectives need to be consistent with the overall retirement income objective of the consumers. The retirement income objective, according to which a provider's asset/investment management should act, is eventually for the PPP to serve as a secure source of retirement income and basis for appropriate accumulation for consumers to their target retirement dates. Furthermore, an eligible investment policy should address, how all short and long term obligations, imposed by the pension contracts issued, can be met by the corresponding asset management and investment strategy. The investment policy should identify the strategic asset allocation (i.e. the long-term asset mix over the main investment categories), the overall performance objectives of the provider, means of monitoring and a concept for the modification of broad asset allocation and performance objectives, which may become necessary, if the obligations and/or market conditions change. An eligible investment policy should also state, if the management of the provider will employ internal or external investment management. For these investment managers, the range of activities and responsibilities, as well as the respective selection and monitoring processes should be outlined in the investment policy, together with an assessment of the associated costs. If the investment management is intended to be outsourced, an appropriate agreement with the external provider should be part of the investment policy. Clearly, the investment management, its monitoring and steering should be an essential part of a provider's risk management system.

An investment policy has cater for contracts that allow for direct influence on investment decisions by the consumer, as well as options and guarantees granted by those or other contracts.

4.3. Supervision

In analysing an appropriate prudential regime for PPPs, it is essential to look into the determinants of a balance between the characteristics of a relevant product and the possibilities of providers to offer those products in light of their licensing based on their authorisation.

Those questions are particularly relevant when considering the opportunities of a standardised 2nd regime product and the options available: a stand-alone authorisation regime or mere product regulation with passporting of PEPPs.

Furthermore, some of the ideas introduced in EIOPA's Consultation Paper on PEPP, as well as the relevant features supported in this analysis may benefit from further, yet tailored, supervisory powers to endorse the benefits for the consumers of those product features.

Appropriate authorisation regime for PEPP

In the Consultation Paper on PEPP EIOPA proposed that providers should be specifically authorised to sell PEPPs only if the national competent authorities are satisfied that they meet all necessary requirements, including e.g. the investment principles, conduct rules, that the senior management of the provider are of sufficiently good repute and do not lack the experience required for the performance of their duties, and good administration and record keeping rules. The vast majority of stakeholders agreed with that stance that every entity providing or distributing PEPPs should be authorised, registered or licensed in some way.

While there is a common agreement on the need for a level playing field and for the avoidance of regulatory arbitrage, views differ regarding the nature of the authorisation regime and on how a level-playing-field should be achieved in practice. EIOPA had suggested that the benefits of a PEPP were more likely to occur if it would be designed in a provider-neutral fashion. Initially, EIOPA had envisaged that not only

providers that are authorised under existing EU legislation should be able to offer PEPPs, but also suitable providers that are not authorised under existing EU regimes, but instead under national law. However, that approach would have required a stand-alone regime for the authorisation of PEPP providers.

The majority of stakeholders disagreed with the proposal of a stand-alone regime on the grounds that the current authorisation regimes at European level are appropriate and sufficient. They argued that a stand-alone authorisation regime is not needed, as it would create an additional regulatory burden for providers that are already authorised under sectoral legislation. Many see existing legislation as sufficiently broad in approach, and believe that the rules of Solvency II, MiFID, UCITS, CRD IV and the IORP Directives would in effect cover all relevant providers offering pension-like products in an appropriate manner. Referring to existing regulatory regimes also has the advantage that competent authorities already exist on the national and European level and no additional authority would have to be established.

In order to keep regulatory burden to the minimum, EIOPA can see the merits of not requiring an additional authorisation regime for PEPP providers, with the consequence that providers, within their current authorisation, may not be authorised to provide the entire range of possible PEPPs, considering the envisaged flexible elements of PEPP.

At European level, it is reasonable to only address those providers that are authorised according to European legislation, also in view of the sufficiency of these for cross-border activities.

EIOPA's objective to foster a level playing field and healthy competition in the field of PPP providers should not lead to lower prudential requirements or opportunities for regulatory arbitrage. Furthermore, taking into account EIOPA's research as in annex III, most potential PEPP providers would already be authorised through one of the existing authorisation regimes - particularly as either insurers or asset managers. Nevertheless, a standalone authorisation requirement for new entrants to the sector could be desirable to increase the diversity of providers.

A standalone regime is probably costly and causes a significant regulatory burden. Any additional authorisation procedure would entail additional costs with a negative impact on the benefits level for the consumers. Further, developing a stand-alone regime would be difficult and would require extensive analyses. Similarly, the determination of equivalent regimes would be an immensely challenging task, which could lead to significant efforts, costs and complexities, which could challenge the launch of PEPPs.

EIOPA is of the view that current authorisation regimes should be used and that the provision of PEPP should be limited to those providers authorised under a relevant European Directive. Consequently, the authorisation received may limit the range of PEPPs that can be offered according to the authorisation.

Product passport

As far as the objective of CfA is to remove existing barriers to free cross-border offer and to overcome barriers for creating a Single Market for PPPs, EIOPA recommended in its Consultation Paper on PEPP the introduction of a "product passport" for PEPP. Upon an authorisation the free offer of PEPP in EEA Member State should be possible. The notification procedure should be fast, not too costly and free of unnecessary administrative burden; a centralised EU register could support the procedure.

A notification procedure is a standard tool to ensure a high level of standards for providing harmonized financial services on a cross-border basis and to ensure protection of consumers and other clients. It is based on the mutual trust of Member States that harmonized rules leads to level playing field and therefore avoid any unfair or inadequate levels of consumer protection. Within a notification procedure, the competent authority of a home Member State assures the consumers and other providers of another (host) Member State that, via the competent authority of that host Member State, the notified financial services and products fulfil the standards set by harmonized EU legislation. The notification also means that the operations of a financial services provider within the territory of a host Member State are recognized and should be adequately supervised. Finally the notification brings a transparency to the financial market in the host Member State.

The financial regulation basically recognizes a notification of the intention to provide its services in the host member state (e.g. Solvency II, CRD IV, MiFID; the notification is often structured) and notification of a particular product that is intended to be marketed in the host member state (UCITS). There is also a combined approach where e.g. UCITS management company separately notifies the intention to operate in the home member and provide its services in these host member state (e.g. to manage an UCITS) and separately notifies its intends to market a UCITS. As the management of UCITS is harmonized, the marketing of UCITS shall not be conditioned by notification to provide services in the host member state.

A product passport is based on the fact that a PEPP provider would be a financial institutions authorised and supervised - in relation to the PPP business - by its home Member State and such authorisation and supervision ensures a high level of consumer protection and the necessary prudential requirements as well as requirements on conduct of business.

As PEPP is intended as a standardised product, for the notification procedure it should be satisfactory to enable cross-border marketing upon a product notification. Such a notification should be (in the line with UCITS and AIFMD) feasible upon a certification that the provider simultaneously complies with the EU harmonised regime applicable to its activity (e.g. UCITS management company) and a certification that PEPP complies with the EU rules.

Cross-border marketing should be available only for those providers who provide their services under EU harmonized rules (Solvency II, MiFID, UCITS, AIFMD, CRD IV and IORP directives).

A notification procedure is a technical and highly recognised procedure. The practical experience from UCITS shows that for an effective notification clear rules for exchange of documents and use of standardized documents are important. The lesson is COM regulation 584/2010 (notification of UCITS). For PEPP passport regulation therefore seems to be the preferable option.

A 2nd regime product instead of a Directive harmonising European standards is the best solution to keep the costs low, by avoiding legal uncertainty and gold-plating by Member States.

Further supervisory powers tailored to PEPP

As mentioned in section 1, the rationale for PEPP in the context of the Single Market stems from the need to address market failures such as information asymmetries and principal-agent problems, both of which are exacerbated by consumers' cognitive barriers and behavioural biases. To overcome these different market failures and address behavioural biases for most consumers, section 2 stressed that having robust

product governance, provider governance and business conduct requirements are key pre-requisites alongside the need to simplify and standardise key features of PPPs through the 2nd regime.

With this in mind, it is also important to ensure that the product regulation that will govern PEPP adequately empowers national supervisory authorities, enabling them to quality assure and sense check on the appropriateness of the PEPP and conduct of business carried from all market players involved in the PEPP value chain, i.e. manufacturing and distribution through to asset management and administration.

As discussed in section 1, consumers cannot effectively monitor providers because:

- they are widely dispersed;
- they are prone to making mistakes due to cognitive barriers and behavioural biases which may ultimately result in sub-optimal outcomes;
- PPPs have an inverted production cycle.

These issues therefore emphasise on the necessity to develop an effective prudential supervisory regime whereby national supervisory authorities must act as a guardian claimholders to protect widely dispersed PPP holders as outcomes may not be apparent until years/decades later but also avoid regulatory arbitrage on cross-border matters by clearly defining supervisory responsibilities.

Since a PEPP would feature a default or core investment option used for a large proportion of consumers, a guardian claimholder must therefore check on the compliance against investment rules, Prudent Person Principle but also ensure the ongoing suitability of PEPP's investment approach, its execution, implementation of risk management procedures.

As PEPP holders bear investment risk, EIOPA believes that it is therefore essential to put in place a suitable supervisory framework which empowers national authorities to check on the mandatory elements of the PEPP including:

- The PEPP's investment options, for instance, their performance, compliance with Prudent Person Principle, the execution of the investment policy;
- The default investment option including monitoring its ongoing suitability to generate good outcomes and Value for Money for PEPP holders.

To build a robust supervision for PEPP, more detailed analysis will be required on the most appropriate supervisory and disclosure tools to enable national supervisors collect evidence and check on compliance with business conduct, governance such as the application of guiding principles underpinning PEPP's key mandatory characteristics, especially relating to duty of care, fairness and Value for Money.

These instruments may include requirements on:

- A set of standardised disclosure documents also used for supervision including a Statement of Investment Policy Principles to check on PEPP's investment governance, the investment policy and its execution, implementation of risk management processes
- Developing adequate benchmarks to compare, over time, the performance of PEPP's investment strategy between providers, especially for the default investment option
- Setting up independent watchdog committees acting in the sole and best interest of PEPP holders to monitor PEPP's investment approach and assess Value for Money

Because most consumers find it difficult to monitor providers, national supervisory authorities, acting as guardian claimholders could take on the role of monitoring the appropriateness of the PEPP notably in the context of its investment strategy on behalf of PEPP holders. Amongst the instruments that can be made available to supervisors, the Statement of Investment Policy Principles (SIPP) could represent a useful source of information not only to authorise the PEPP before its distribution but also to help national supervisors identify any risks e.g. unsuitability of the default option.

Another instrument worth exploring in the future would consist of enhancing the investment governance for PEPP by developing adequate EU benchmark measures, especially for the default investment option. A benchmark measure for PEPP would seek to enable the comparison of the performance of a PEPP provider's own strategy with those of other PEPP providers. Benchmarks should be treated as a supplementary instrument to incentivising PEPP providers to set up good investment principles and objectives for PEPP.

Notwithstanding that technical work would be required on constructing effective benchmarks, detailed analysis of the pros and cons for using benchmarks would also need to be carried out. Some of the considerations would, for instance, include: (1) An assessment of risks of replicating/converging toward the benchmark, as opposed to maintaining PEPP's own investment strategy and any unintended consequences e.g. reducing consumer choice, hindering innovation. (2) Maintaining some consistency with other investment governance tools used e.g. SIPP in order to avoid any misalignment which could bring confusion.

As a supplementary layer of consumer protection and way to further strengthen PEPP's governance, providers could be required to set up an independent watchdog committee. This is because PEPP holders, in particular those in the PEPP's default investment option, have difficulties in assessing if they are receiving value for money. An external and independent body with relevant pension knowledge and expertise acting in the sole and best interest of the PEPP holders could ensure that consumers are being treated fairly and access investment strategies that best suit their needs and objectives. Such committees would be responsible and accountable for assessing the ongoing Value for Money, especially with respect to the default investment option, and act as a challenging function to the PEPP provider to make appropriate changes as and when needed e.g. risk of unsuitable investment strategy.

Further work would need to evaluate if benefits for additional consumer protection would outweigh the costs of setting up and running such committees which PEPP holders would ultimately bear. In addition, considerations on both the diversity and composition of the boards would be worth investigating to ensure that a robust governance structure is in place. The following non-exhaustive list illustrates the nature of activities independent watchdog committees could be responsible for evaluating:

- if the PEPP's default investment strategy is designed and executed in the sole and best interest of PEPP holders with a clear statement of objectives and structure appropriate for defaulted PEPP holders;
- If PEPP's net performance is regularly reviewed to ensure alignment with PEPP holders' interests and ensure that remedial action to make necessary changes has been taken forward;
- The levels of charges, direct and indirect costs incurred as a result of managing and investing assets including transaction costs;
- Raising and disclosing issues or concerns on the value for money delivered to PEPP holders with national supervisory authorities.

'Caveat venditor' principle

Given consumers' behavioural biases outlined in earlier sections, putting greater onus on PEPP providers and appropriately empowering national supervisory authorities should clearly be further investigated. As a next step, EIOPA would recommend exploring the application of the 'caveat venditor' principle⁷³ to ensure PEPP holders secure a source of retirement income. Further work would also imply identifying regulatory and supervisory requirements to enable appropriate empowerment of national supervisory authorities. The idea would be that PEPP providers would need to assert PEPP's implied warranties of merchantability and fitness for purpose. Merchantability makes PEPP providers recognise that they are better suited than PEPP holders to determine whether a product will perform properly. Fitness for purpose requires PEPP providers to recognise they possess adequate knowledge and expertise, relative to PEPP holders, on which the latter may reasonably rely.

In practice, caveat venditor could, for instance, require the drafting of a 'commitment memorandum'⁷⁴ in which PEPP providers would make some 'pre-commitment' to PEPP holders by setting target charges and expected performance whilst explaining what remedial actions would be taken in the event of market up- and down-sides and/or exceeded target charge. This pre-commitment document disclosed to consumers initially at the point of purchase would cover all investment options and could be made available to national authorities as a supplementary supervisory instrument which could also be coordinated with the Statement of Investment Policy Principles.

Such document could, for instance, form part of the authorisation process for a PEPP provider. PEPP providers could be required to report to PEPP holders on an annual basis on the extent to which they met 'pre-commitments' set in the memorandum, explaining the reasons and actions for those that they did not meet. PEPP providers' compliance function could also be required to systematically notify national supervisory authorities of any significant departure from the target levels set in the document.

5. Conclusions

5.1. Appropriate legal framework

EIOPA's research and analysis clearly shows that there are several measures that can be recommended to enrich the personal pensions market in the EEA for the benefit of consumers and providers alike.

Concluding on the potential of the presented policies to deliver on the objectives to make personal pensions savings safe, cost-effective, transparent as well as sufficiently flexible to cater for an European labour market that is characterised by more and more unconventional careers and heightened mobility of workers and the thereby required characteristics of personal pension products to be:

- **Safe products:** requiring smart regulation to address agency conflicts and information asymmetry as shortcomings of an inefficient market. Smart regulation

⁷³ This idea was explored in the context of UK auto-enrolment reforms in Harrison, Blake & Dowd: Caveat venditor: The brave new world of auto-enrolment should be governed by the principle of seller not buyer beware, Pensions Institute, 2012, www.pensions-institute.org/reports/CaveatVenditor.pdf.

⁷⁴ This idea, also known as 'Ulysses contract' was first discussed in the context of managing consumers' expectations as a result of their behavioural biases in Benartzi: Reining in Lack of Investor Discipline: The Ulysses Strategy, Centre for Behavioural Finance, Behavioural finance in Action part 3, Allianz Global Investors, 2013, www.allianzqi.com/en/Market-Insights/Documents/BeFi-Ulysses-Mar2013.pdf.

acknowledges conflicts of interests and sets out positive incentives enabling optimised results for consumers.

- **Transparent products:** in a market of highly complex products for long-term savings, it is necessary to enable a consumer to make well-informed decisions about taking up and maintaining long-term savings. Recognising cognitive biases on the need for savings and addressing the difficulties of projections, regulation must cater for relevant means on information provision.
- **Cost-effective products:** smart regulation needs to find a balance between setting relevant and high consumer protection measures and enabling viable PPPs via exhausting the benefits of a Single Market on economies of scale and diversification.

as well as on EIOPA's commitment and strategic objectives to:

(1) Develop and strengthen the regulatory framework for the benefit of protection of consumers - addressing consumer needs and incentivising good pension outcomes:

- balancing simplicity for the majority of EU consumers but allowing choice for the significant minority who want the latter;
- improving product comparability, information transparency and confidence in PPPs;
- in doing so, the approach should be consumer driven rather than product focused by seeking to protect PPP holders against risks of fraud, conflict of interest, market abuse and help them overcome key cognitive and behavioural biases.

(2) Improve the functioning of the EU internal market in the field of pensions and insurance through appropriate regulatory market intervention:

- encouraging fair and open competition between all market players;
- facilitating financial innovation;
- harnessing existing and creating new cross-border opportunities throughout the EU PPP value chain;
- reducing barriers to market entry;
- enabling efficiency gains through economies of scale and lower costs;
- in doing so, the approach should mitigate any potential risk for regulatory arbitrage and ultimately benefit EU consumers so that it pays to save in PPPs,

EIOPA came to several conclusions on requirements for providers and product features that would improve the efficiency of the current PPP market in light of the current circumstances and nature of the PPP market. EIOPA believes the legal framework that needs to be developed should be capable of most effectively and efficiently implementing those policies.

EIOPA considered several policy options, acknowledging their individual and aggregate merits, weighted them and assessed them in terms of application in the current market situation:

- **Product features - investment options:** EIOPA assessed whether to regulate the number and the nature of investment options. The analysis showed that unlimited and/or unregulated investment options without a default "core" investment options increasing the complexity of the products would lead to suboptimal results for consumers and efficiency losses for providers.
- **Product features - biometric and financial guarantees:** EIOPA considered whether guarantees are an indispensable or disadvantageous feature of PPPs, and consequently whether to require or to ban them for PPPs. Considering the current PPP landscape and the market situation, EIOPA concluded that the

provision of guarantees should be allowed, yet not be required, to cater for satisfying potential demand to cover against certain risks.

- Product features - switching of providers and investment options: EIOPA assessed the regulation of transfers of funds and the possibility of switching providers of PPPs. Initially EIOPA contemplated free-of-charge switching provisions at specified points in time (for example every five to ten years into the contract). Other options would have been to prevent switching to emphasise the long-term nature of those contracts. Eventually EIOPA came to the conclusion to regulate switching and transfer of funds, which should naturally be possible during the life of the contract, in a principle-based manner.
- Product features - cap on cost and charges: Charges have a major influence on the outcomes of PPPs, therefore EIOPA considered whether there is the need to regulate costs and charges or to leave them up to the determination by market forces. The current circumstances for PPPs in Europe, and specifically in some Member States, would call for setting an appropriate cap on costs and charges for PPPs. However, the difficulties of appropriately regulating such a cap at European level, led EIOPA to conclude not to require a cap at European level, but to regulate it in principle.
- Product features - decumulation: Requirements relating to retirement age and decumulation options are highly diverse in the EU. EIOPA assessed possible benefits of regulating both areas at European level. Given the current diversity and the individual conditions in the Member States, EIOPA reckoned that the benefits of standardising those features would not outweigh the difficulties of properly regulating them and to achieve optimal outcomes for every Member State.
- Information provision: EIOPA assessed the need to regulate information provision relating to PPPs to consumers. The options were not to regulate them specifically, to regulate them in high-level, principle-based terms or to regulate them through standardisation and rules. EIOPA weighted the importance of relevant information provision in terms of consumer protection and leading to efficiency gains for providers and eventually viewed standardisation as the most favourable option - however, acknowledging the specificities of PPPs in comparison to PEPP.
- Conduct of business: PPPs are not necessarily simple products and can affect individuals' lives greatly, which in turn may have consequences on regulating distributor's conduct of business. EIOPA contemplated the need to regulate the provision of advice and conflict of interest mitigating measures specifically for PPPs or to leave it up to sectoral rules. EIOPA appreciated the value of level playing field considerations and consistent features to safeguard consumers' interests - and concluded that it may be most efficient and effective to use the relevant sectoral rules of MiFID and IDD as a starting point for all PPPs.

Considering the chosen policies and the assessment of the individually or aggregate suboptimal results of the dismissed policy options, EIOPA studied the merits of standardising one PPP, which has been labelled PEPP. Through its deliberations, EIOPA settled for a standardised PEPP with flexible elements that - for the reasons described in the relevant chapters and outlined above - would be capable of meeting EIOPA's objectives of improving the European market for PPPs - in the most efficient manner compared to the other possible approaches.

It should be noted that EIOPA felt that the proposed measures could potentially be implemented by either harmonising existing Directives to cater for a level playing field for PPPs offered by the corresponding providers or by setting up a second regime for a standardised PEPP or a combination of both approaches.

EIOPA concluded that, whilst both approaches are possible, the analysis showed that particularly in terms of reaping efficiency gains for consumers, providers and competent authorities alike, a standardised PEPP regulated by a second regime would promise superior outcomes than harmonised regimes. Considering the current PPP market, the introduction of a PEPP via a second regime is expected to lead to minimum implementation efforts and maximum effectiveness, compared to probably considerable lead times to amend all relevant Directives and develop implementing measures to arrive at a similarly standardised PEPP. In addition, the risk of creating regulatory arbitrage would be sizeable in light of holistically different prudential approaches that potentially cannot be fully harmonised in terms of one contract class.

The difficulties of harmonising current Directives can be underlined by the need to first assess potential gaps or potential additional burden for specific groups of providers, before additional requirements shall be included. The European Commission is currently undertaking further research on the individual and aggregate effects of the reforms of Directives, such as CRD IV or Solvency II,⁷⁵ which may further educate research in the potential of harmonising Directives.

Similarly, a hybrid approach that would require harmonising the relevant Directives just for some aspects, for example for conduct of business requirements, and developing a second regime for the other aspects, would not achieve the same level of efficiency gains compared to one second regime for one PEPP, due to the persisting difficulties amending the relevant Directives and to ensure a standardised application.

Harmonising current regimes to the extent needed to fully deliver single market benefits is likely to be costly and pose challenges to overcome current national legal hurdles, such as with regard to taxation and social and labour law. A complementary second regime can be chosen by those Member States that perceive the need for a PEPP on their national markets, as the EIOPA analysis also showed that the demand for PEPP may be highly divergent amongst Member States. It would provide clear rights to PEPP providers to market across the EU - reducing national barriers - yet would not cause the significant disruption that might be anticipated from an attempt to fully harmonise PPPs. Convergence and comparability can be fostered by the ESA's powers to develop and facilitate convergent supervisory practices, in particular concerning cross-border challenges between home and host supervisors, which would in turn require adequate empowerment provisions for the ESAs to achieve that.

In order to achieve a true Single Market for pensions and to overcome barriers to use the efficiency gains of the Single Market and ensuring a high level of consumer protection, it is therefore EIOPA's view that only a second regime PEPP will be capable of realistically tackling the currently under-developed EU market for cross-border pensions.

⁷⁵ See European Commission, Call for Evidence, EU regulatory Framework for Financial Services, 2015: http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/consultation-document_en.pdf.

However, EIOPA would add that taxation hurdles should be tackled, to give providers significant incentives to provide products cross-border. Especially in mature markets with well-recognised PPPs by providers and consumers, opening up possibilities for wider participation amongst potential PEPP providers will be important. EIOPA does not believe progress in harmonising taxation is needed for a PEPP to succeed, but EIOPA does believe that progress on harmonising taxation would be hugely beneficial in developing a Single Market for pensions - and indeed building deeper, wider and more liquid capital markets in the EU.

5.2. Attractiveness of the PEPP in the form of a 2nd regime

EIOPA conducted an online survey and also held some roundtable discussions with industry representatives to gauge industry thoughts on the attractiveness of the PEPP proposal. The investment options, including lifecycling/derisking and guarantees, were considered attractive although some believe that the offer of annuities should be linked to the investment aspect. The need for strong stable legislative backing for the PEPP, for instance so as to allow for cross-border marketing without 'road-blocks' was highlighted as of key importance by those with experience with existing cross-border models, such as for UCITS. The scope for a PEPP to deliver economies of scale and reduced costs would depend, to a degree, on building cross-border business, though the PEPP could also need some local adjustments for marketing purposes. The right to offer biometric risk cover is considered an important element by the insurance industry.

Decisive elements identified in the survey and discussions that are not included in the PEPP proposal tended to be in areas beyond EIOPA's fields of competence. Addressing the impact of tax incentives on competition between different long term savings vehicles, including national PPPs, was considered critical to the attractiveness of PEPP over the long term. The lack of greater harmonisation of social and labour laws was also cited as a potential barrier. Several responses indicated that inclusion of the decumulation phase would aid attractiveness.

Most respondents believe that there will be demand for PEPP although they tend to believe it will grow slowly at first – as in the experience of UCITS from the late 1980s until the last decade. Strong demand can be expected from countries that have less developed markets, particularly but not limited to third pillar markets. A successful PEPP model might therefore benefit from paying particular attention to driving uptake in these markets in the first instance. Respondents supported the view that the uptake of a PEPP would be greatly enhanced by ensuring it would be available via all distribution channels, including both intermediary and online (non-advised) sales. A clear majority of respondents indicated that if they would offer the PEPP across national borders they would do so on a freedom of services basis in the main.

Based on its own internal analysis and the extensive input received from various sources, EIOPA believes that a PEPP can be designed to be attractive to distributors and consumers alike. The availability of a simple, transparent, trustworthy product as proposed in the PEPP consultation paper received broad support in exchanges with stakeholders, as central to building a basis for consumer trust. There is broad support for a strong European legislative structure at the level of product and distributor, with a limited number of investment options including a default option, to simplify the PEPP whilst also ensuring effective consumer protection measures are in place. There is broad agreement on the elements the default investment option should include to limit the risk to consumers, so as to allow the widest distribution and thereby uptake. There is also broad support for making the PEPP available via all channels and capable of cross-border distribution, so as to maximise economies of scale and thereby reduce costs. The PEPP could also, in some markets, usefully broaden the options available to

consumers in those markets whilst reducing costs, so that the PEPP could in practice better compete with other offers.

In considering the elements of taxation when developing the PEPP proposal and having concluded that, given the diversity of requirements and the fact that this area is beyond its fields of competence, EIOPA is advocating that a non-discriminatory approach would be applied to PEPP vis-à-vis PPPs sold in the individual national markets. In EIOPA's view, this could reduce the impact of tax in the uptake and evolution of the PEPP. EIOPA would also recall that the development of a sound PEPP model that is widely accepted as a strong and well-regulated product, could well, in time, lead to an evolution of national taxation approaches, (and social and labour law), to take into account the PEPP model in an appropriate way.

Taking all things together including its own analysis and the largely positive input from stakeholders EIOPA remains convinced that a PEPP based on a 2nd regime legislative approach can be a successful prospect for PEPP manufacturers, distributors and consumers alike.

Annex I: Impact Assessment

Section 1. Procedural issues and consultation of interested parties

In accordance with Recital 12 and in line with Article 16 of the EIOPA Regulation⁷⁶, EIOPA conducts analyses of costs and benefits in the policy development process. The analysis of costs and benefits is undertaken according to an Impact Assessment methodology.

Evidence

EIOPA used the data within its pension database and the data gathered during ad hoc surveys amongst EIOPA's members for the development of this policy proposal.

Consultation with stakeholders

During the drafting process stakeholders' views were invited through public consultation relating to the Consultation Paper on PEPP, several meetings with EIOPA's official stakeholder groups (IRSG and OPSG), as well as during a stakeholder event on 7 September 2015 and through several appearances in conferences and more informal outreach to stakeholders. The purpose of the consultation was to obtain specific feedback on the following issues:

- Need for standardisation of PPPs, in particular on information to consumers, investment, switching and cap of costs
- Opportunities and current barriers of cross-border activities

The public consultation was carried out from 7 July to 5 October 2015 and was addressed to all interested parties. Most responses came from the insurance and asset management industry, whereas consumer representatives' input was fairly limited.

The main results from the consultation were that most stakeholders were positive towards the introduction of a voluntary standardised Pan-European Pension Product via a 2nd regime. Stakeholders were optimistic that at least in some Member States there would be demand for diversifying the sources of future retirement income, and in particular where there is pressure on state pensions and underdeveloped occupational pensions. Stakeholders agreed that standardisation will make personal pension products more attractive to both consumers and providers and enable cross-border activities. Many stakeholders stressed that the main barrier to cross-border activities- taxation - cannot be resolved at European level.

This impact assessment is based on the input received also from the previous consultation. EIOPA seeks stakeholders' views on the current analysis of the expected impact.

Section 2. Problem definition

When analysing the impact from proposed policies, the impact assessment methodology is anchored to a baseline scenario as the basis for comparing policy options. This helps to identify the incremental impact of each policy option that was considered during the development of the policies. The aim of the baseline scenario is to explain how the current situation would evolve without additional regulatory intervention.

⁷⁶ Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, OJ L 331, 15.12.2010, p. 48..

For the analysis of the potential impacts on regulating personal pensions at European level, EIOPA has applied as a baseline scenario the current situation in relation to personal pensions in Europe. This baseline scenario is characterised by PPPs that are governed by a wide range of European Directives (e.g. Solvency II, CRD IV and CRR, IORP Directive and UCITS) and by national legal frameworks. EIOPA's powers to aim for supervisory convergence are within the scope of two of these Directives, which could further enhance efficient supervision of those providers. However, the design of pension systems in Member States and the role of PPPs within those diverge greatly in the EU and the EEA.

In line with the objective of the Call for Advice, the aim of this initiative is to develop an EU-wide framework for personal pension products (PPP) that can contribute to meeting the challenges of an aging economy, the sustainability of public finances, an adequate retirement income and long-term investment. EIOPA is of the view that strengthening the development of PPPs at European level has the following advantages and challenges:

- addressing principal agent conflicts and information asymmetry, as shortcomings of an inefficient market, by introducing disclosure requirements, improving product comparability and good governance;
- efficiency gains through economies of scale and opportunities for risk diversification as well as for competition and innovation;
- facilitating cross-border activities and reducing obstacles to further the Single Market;
- opportunity for multi-pillar diversification.

EIOPA worked on providing further clarity about these findings and focused primarily on consumer protection and prudential regulation provisions and to further research cross-border activities.

Section 3. Objective pursued

Contributing to the overarching general objective to facilitate an efficient functioning Single Market for personal pensions, EIOPA's work is meant to add technically sound ideas to the current debate on sustainable and adequate pensions and shaping the role of PPPs in light of an efficient and functioning Capital Markets Union.

Objective: To establish concepts that can endorse personal pension products that are:

- **Safe products:** regulation needs to address agency conflicts and information asymmetry as shortcomings of an inefficient market. Conflicts of interests need to be acknowledged and the right incentives need to be set to facilitate optimised results for consumers. The main tools are setting the right authorisation regimes, governance, distribution and rules, as well as capital requirements, where appropriate, and supervisory powers - whilst provision of relevant information is critical for the endorsement of that regulation.
- **Transparent products:** high complexity is inherent in the nature of long-term savings. In order to enable a consumer to make well-informed decisions about taking up and maintaining long-term savings relevant information on those products need to be provided. Experience shows that individual cannot necessarily rationalise an estimate of the need to save for pensions and the extent to which additional savings are required. The nature, the frequency and the presentation of information is crucial here.
- **Cost-effective products:** determinants of administration costs are the level of distribution, information and manufacturing costs, which are intrinsically linked to the complexity of products - or to say the lack of standardisation. Asset management costs are linked to the size of the asset portfolio under management. Efficiency gains can be sought through economies of scale and risk diversification.

A well-functioning Single Market without obstacles for cross-border activities, facilitating healthy competition and financial innovation, should be the remedy here.

Section 4. Policy options

With the aim to meet the objective set out in the previous section, EIOPA has analysed different policy options throughout the policy development process. Considering the - in some Member States - insufficient, inefficient and throughout Europe divergent market for personal pensions as the baseline, none of the proposals and concepts proposed are expected to have any negative impact aggravating the challenges of the current baseline. Nevertheless they are assessed in light of the different degrees of improvements to the baseline situation.

The section below reflects the most relevant policy options that have been considered in relation to the concepts presented here. We also list relevant options which have been discarded in the policy development process.

4.1 Policy issue 1: Standardisation

4.1.1 Policy option 1: Fully standardised PPP. The elements and characteristics of a personal pension product are fully standardised and there is no scope for adjustments in relation to individual consumers' needs or acknowledging national specific circumstances.

4.1.2. Policy option 2: Standardised PPP with defined set of flexible elements. Here, key elements of a PPP are standardised, but a couple of elements are left flexible (within limits) to accommodate individual consumers' needs or to accommodate national specificities.

4.1.3 Policy option 3: PPPs governed by a set of principles, leaving complete discretion on the design of PPP to providers and Member States.

4.2 Policy issue 2: Harmonisation or 2nd regime

4.2.1 Policy option 1: Harmonising the rules for current providers of PPP to set them on a regulatory level basis for providing PPP within their license.

4.2.2. Policy option 2: Establishing a voluntary 2nd regime that sits beside national PPP regulation. A 2nd regime overrules national regulation within the scope of the 2nd regime regulation.

Section 5. Analysis of impacts

5.1 Policy issue 1 Standardisation

5.1.1 Policy option 1: Fully standardised PPP

Considering that currently there is significant divergence in the European market for personal pensions, full standardisation would be an immense change. Notwithstanding the benefits of standardisation in terms of simplicity for the consumer and cost efficiency gains for the providers, full standardisation would be hard to achieve. What would be the challenge? Firstly, the product would need to be highly regulated to the very detail of its characteristics, which may be hard to determine in a currently divergent market, ie what are the current best elements to optimise the results for any consumer in Europe. Further, currently existing regimes would need to be significantly amended, which may make products unattractive to providers.

Analysis according to the expected impact on stakeholders:

EIOPA's analysis covered the effects on both consumers and providers. Whilst a fully standardised approach allows fully reaping the benefits of economies of scale for the provider and simplicity for the consumer, it has a maximum impact on national regimes and would need to be applicable in every Member State. At the same time it prevents financial innovation and competition driving better outcomes for consumers.

This analysis came to the conclusion that the positive impact of the advantages of full standardisation does not outweigh the negative impacts of lacking adaptability and prevention of competitive innovation, which would lead to sub-optimal outcomes for consumers.

Proportionality:

Clearly, regulating a fully standardised product is prone to be challenged as being disproportionate, as it needs to justify that each and every standardised element is best designed by regulation, preventing flexibility to accommodate the specific situation of the individual consumer or within a specific Member State.

5.1.2 Policy option 2: Standardised PPP with defined set of flexible elements

The standardisation of key elements, such as information to consumers and default investment options, linked with flexible elements such as guarantees, caps on cost, switching and decumulation options can link in an advantageous manner the positive effects of standardisation, ie economies of scale and simplicity, with the need for pension products to be adaptable and flexible to address consumers' needs and to accommodate specificities of Member States. In developing EIOPA's stances on personal pensions, EIOPA came to the conclusion (and receiving stakeholder feedback supporting that approach) that it is optimal to standardise:

- Information provision based on the proposals of a KID within the PRIIPs framework
- Limiting investment choices and defining one default "core" investment option

EIOPA is convinced, in particular after taking into account stakeholder comments that the following elements shall be regulated, yet shall not be fully standardised:

- Biometric and financial guarantees
- Caps on cost and charges
- Switching and transfer of funds
- Decumulation options (here further research would be necessary to assess how to best regulate)

Analysis according to the expected impact on stakeholders:

EIOPA's analysis covered the effects on both consumers and providers. A semi-standardised product with optional flexibility and adaptability can best serve consumers' needs whilst enabling providers to benefit from economies of scale and cost-efficiencies of a standardised product.

This analysis came to the conclusion that there are explicit positive impacts for consumers and providers, minimising the negative impacts of policy option 1.

Proportionality:

A well-regulated, standardised PPP with a defined set of regulated, yet flexible elements allows for a proportionate approach by its very nature. The choice of the standardised elements and the nature of the regulation of the flexible elements must ensure that a proportionate approach can be fully enforced.

5.1.2 Policy option 3: PPPs governed by a set of principles, leaving complete discretion on the design of PPP to providers and Member States.

Leaving the design of PPPs up to the provider based on some high-level principles may only slightly address the policy objectives to make PPP safer, more transparent and cost efficient and would not necessarily change the baseline scenario and missing the opportunity of generating significant efficiency gains.

Analysis according to the expected impact on stakeholders:

EIOPA's analysis covered the effects on both consumers and providers.

A high-level principle based approach will improve some inefficiencies of the personal pension markets, but would not lead to significant efficiency gains for providers or gains in terms of simplicity for consumers. This would not facilitate a large take-up of personal pension products.

This analysis came to the conclusion that there are explicit minor positive impacts for consumers and providers, minimising the negative impacts of policy option 1 and missing out on the positive impacts of policy options 1 and 2.

Proportionality:

A principle-based approach allows for the application of the proportionality principle, yet it does not, just like a rules-based approach, by its very nature determine a proportionate approach.

5.2 Policy issue 2 Harmonisation or 2nd regime

5.2.1 Policy option 1: harmonisation of the rules governing PPPs

Considering the conclusions of the previous policy issue, it appears impossible or at least sub-optimal to achieve full (or part) standardisation of PPPs via harmonisation. The reason for that being that all current national regulations relating to PPPs, which are currently highly divergent, would need to be amended and brought to one level. Harmonisation of current regulation would not prevent at least one of the current obstacles to cross-border activities, which is the application of general good rules. Harmonisation cannot facilitate more efficient cross-border activities and cannot achieve a true Single Market for personal pensions. However, harmonisation of current rules can improve and achieve most of the elements of the policy objective, yet it is more difficult to endorse them, in particular concerning cross-border activities.

Analysis according to the expected impact on stakeholders:

EIOPA's analysis covered the effects on both consumers and providers.

Positive impacts of improving the regulation of personal pensions would be positive for consumers. However, the actual application and implementation of harmonised regulation will be costly for providers. Also, harmonisation will not benefit providers in terms of cross-border activities and will challenge the endorsement of (partly) standardised elements. The outcomes are expected to be sub-optimal

Proportionality:

The option does not per se impact proportionality, as it may or may not be proportionate. However, through harmonisation it cannot be guaranteed that consumers and providers are treated in the same manner throughout Europe. That has an impact on consistent application in terms of "similar characteristics, similar treatment; dissimilar characteristics, dissimilar treatment".

5.2.2 Policy option 2: establishing a voluntary 2nd regime (PEPP)

In light of the conclusions of the previous policy issue and the benefits of standardisation of defined elements, a 2nd regime can easily implement those standardised elements without the need to harmonise the entire, currently highly divergent, market for personal pensions. In addition to that, a 2nd regime can overcome issues currently preventing effective cross-border activities (except for issues around taxation).

Analysis according to the expected impact on stakeholders:

EIOPA's analysis covered the effects on both consumers and providers. A 2nd regime would not impose any costs for consumers or disadvantages in terms of consumer protection. It also appears to be the most cost efficient solution for providers who seek opportunities for economies of scales and efficiencies based on cross-border activities. EIOPA notes that there may be a possibility of costs and risks to the approach, in cases where similar regimes are already prevalent in a Member State, which could risk confusion for consumers and costs to supervisors of supervising two regimes. In cases where Member States set higher requirements on their local PPPs than envisaged in the 2nd regime, there may be a risk of regulatory arbitrage.

Proportionality:

The option does not per se impact proportionality, as the 2nd regime may or may not be proportionate. In any case, as a 2nd regime is an addition to the current market for PPP it does leave it up to Member States and providers to use the 2nd regime or not, which can be seen as a proportionate approach in relation to the needs of the specific Member State and its citizens.

Section 6: Comparison of options

Policy issue 1 Standardisation

The preferred policy option for this policy issue is a standardised PPP with a defined set of flexible elements, because it combines the desired advantages of standardisation in a currently inefficient market with the flexibility and adaptability that is needed on a currently highly divergent market in Europe.

The selection of the preferred option has required a trade-off between the potential of full standardisation and the freedom to choose the most appropriate solution for the national circumstances. More weight has been given to the positive and needed opportunities for efficiency gains and simplicity for consumer.

Policy issue 2 Harmonisation or 2nd regime

The preferred policy option for this policy issue is to establish a voluntary 2nd regime (PEPP). The reasons for this are that the advantages of the policy stances on policy issue 1 can only be fully reaped by a 2nd regime. Also, a 2nd regime can overcome more obstacles to cross-border activities than a harmonisation option can.

The selection of the preferred option has required a trade-off between the potential of improving all PPPs in the EEA against the optimised implementation of standardisation and an efficient Single Market for personal pensions. Considering the currently highly divergent market for personal pensions, the only feasible option was regarded a 2nd regime at this point in time. More weight has been given to the efficiency of implementation of the positive outcomes of policy issue 1 and of the overarching policy objective.

Annex II: Summary of research questions

Q1: Would PPPs benefit from harmonisation of provider governance standards? What should be the basis for provider governance standards for PPPs? Do you agree with EIOPA's proposals?

Q2: Would PPPs benefit from harmonisation of product governance rules? What should be the basis for product governance rules for PPPs? Do you agree with EIOPA's proposals?

Q3: Would PPPs benefit from harmonisation of distribution rules? What should be the basis for distribution rules for PPPs? Do you agree with EIOPA's proposals?

Q4: Would PPP benefit from harmonisation in disclosure rules? What should be the basis of these rules? Do you agree with EIOPA's proposals?

Q5: Are you aware of any differences in prudential regimes that would lead to an unlevel playing field amongst PPP providers? Do you agree with EIOPA's view not to add specific capital requirements for PPPs?

Q6: Are further supervisory powers - tailored to PEPP - necessary? Do you agree with EIOPA's proposals?

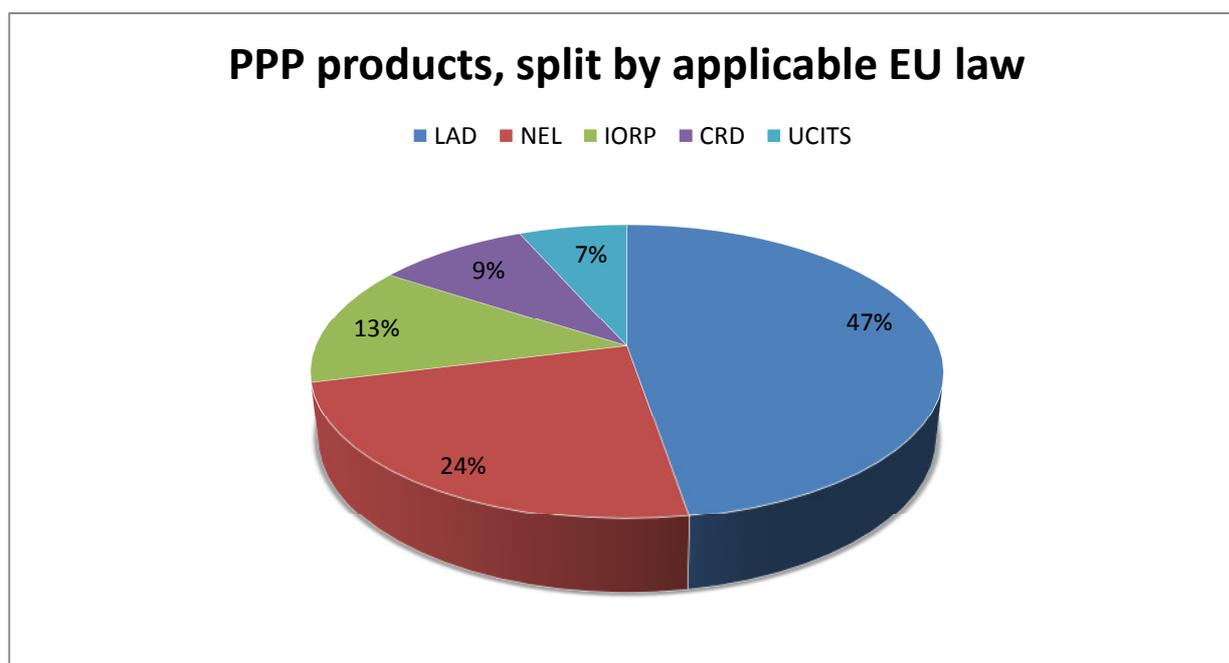
Q7: Do you agree with EIOPA's assessment of the policy options' impacts?

Annex III: Personal Pension Products in the EEA

Using its database⁷⁷ as a basis, EIOPA collected updated data from 25 respondents. Three countries (Cyprus, Greece and Liechtenstein) have indicated that there are currently no personal pension products (PPPs) available in their markets. Three EIOPA members (Finland, Slovenia and Sweden) have not participated in this survey.⁷⁸

EIOPA would also like to stress that despite the input received, more analysis may be needed to exhaustively assess the market. This could include, for example the current access to PPPs.

Based on the feedback received, the European market counts 72 different types of PPPs. Almost half of these products are regulated by the Life Assurance Directive⁷⁹. A quarter is regulated at local level by national law (NEL), while the remaining products are regulated either by the IORP Directive, CRD IV or UCITSDirective.



Those PPPs represent 1,089 billion euro of assets⁸⁰ and attracted 67 million consumers⁸¹ based on the most current⁸² data. Except for the German market⁸³, the asset value of PPPs not included in the data should be relatively small. The graph below shows that there are large differences between countries. The market is dominated by the Netherlands, which hold 40% of the total reported asset amount.

⁷⁷ EIOPA database of pension plans and products in the EEA, see: [https://eiopa.europa.eu/publications/database-of-pension-plans-and-products-in-the-european-economic-area-\(eea\)](https://eiopa.europa.eu/publications/database-of-pension-plans-and-products-in-the-european-economic-area-(eea)).

⁷⁸ The data shown for these countries was extracted from EIOPA's pension database, where available.

⁷⁹ Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance, OJ L 345 , 19.12.2002, p. 1.

⁸⁰ DE did not provide asset data for PPPs.

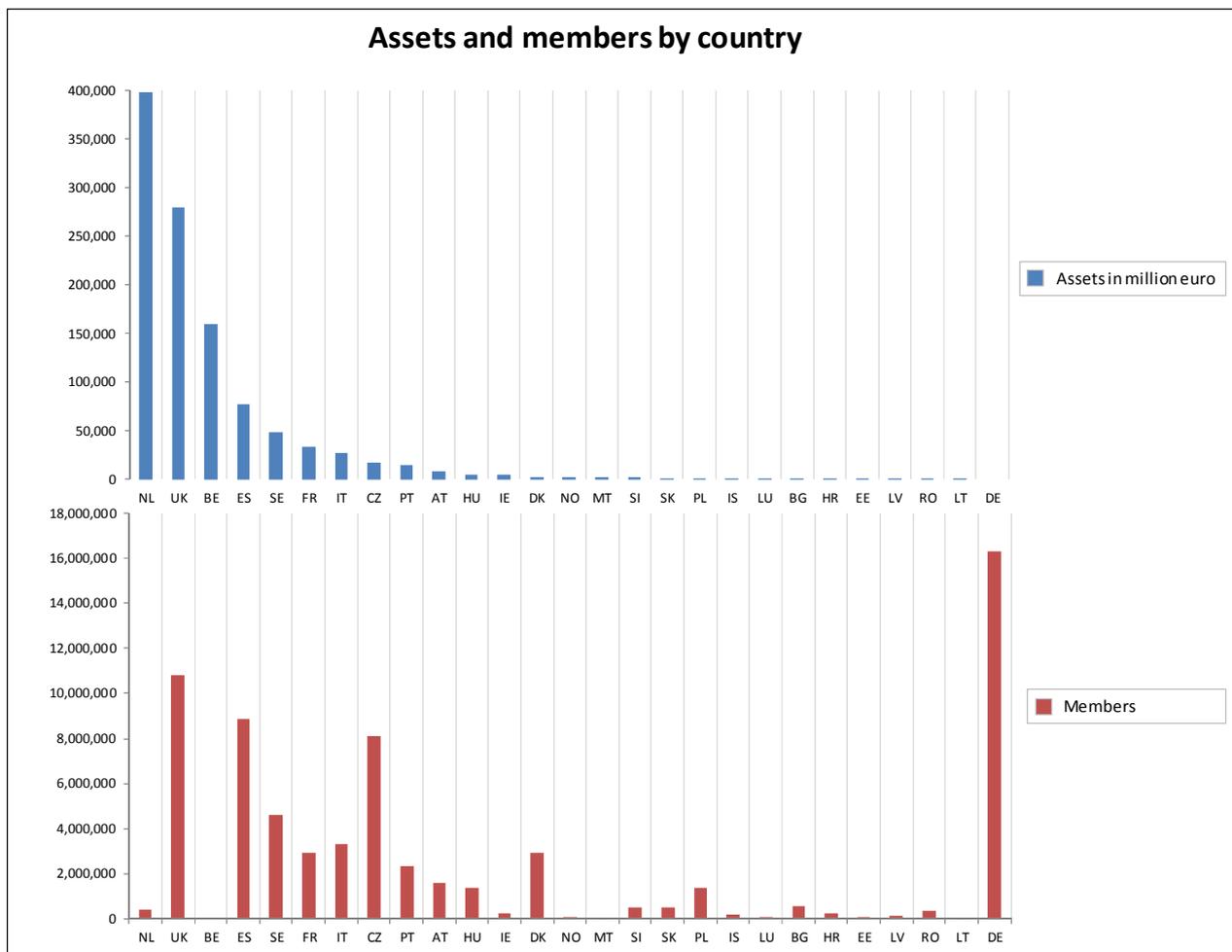
⁸¹ The available data does not cover all products (e.g. the majority of Dutch products are not included, BE did not provide figures of members nor contracts). Additionally, the quantitative assessment takes into account that some countries collect information on the number of contracts and not in relation to the number of active members, other countries collect information on both contracts and active members. EIOPA used the available information for the number of active members, where available, and on the number of contracts, if information on the number of members was not available.

⁸² End of 2014 data for all participants, except FR, NO, SE, SI and UK.

⁸³ DE could be seen as potentially the biggest PPP market in Europe due to the highest amount of PPP holders and considering the aggregate and combined annuity and individual pension mathematical reserves of insurance companies that accounted for 417 billion euro at the end of 2014, see GDV: Die deutsche Lebensversicherung in Zahlen, 2015.

Together, the Netherlands, the UK and Belgium account for almost 77% of all reported PPP assets.

Compared with 2013 data⁸⁴, the value of assets has increased by 8%. This is mainly the result of a 20% asset increase in the Netherlands during 2014.



The graph also shows that there is no direct correlation between the assets and the amount of members. This is due to the differences in pension's savings culture and the maturity of the third pillar in the country. Countries with the most members/contracts are Germany, the UK and Spain.⁸⁵

Central and Eastern European countries tend to have newer PPP markets, meaning that assets have had less time to accumulate reducing their market size. Based on the number of active members, Eastern European countries did not attract fewer consumers than some of their Western European counterparts.

Most of the individual contracts are within the scope of LAD (Life Assurance Directive). A quarter is covered by national law and another quarter is covered by the UCITS, CRD IV or IORP Directive. In Poland the amount of members cannot be split according to the applicable law.

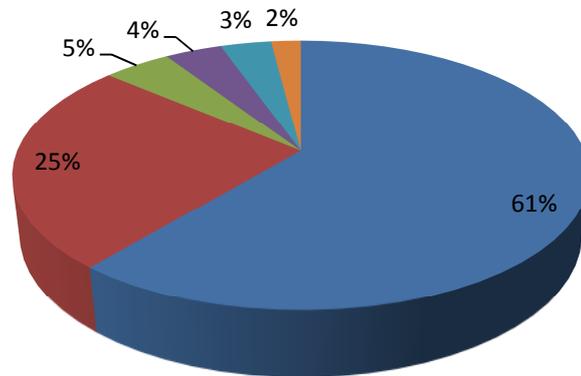
The division in this graph indicates that the number of members affected by LAD is proportional higher than the number of existing products governed by LAD, with those being covered by national law being equal.

⁸⁴ Using date of EIOPA's database of pension plans and products in the EEA (see footnote 1).

⁸⁵ Please note that for some markets, the data is not collected for all product types e.g. BE and NL.

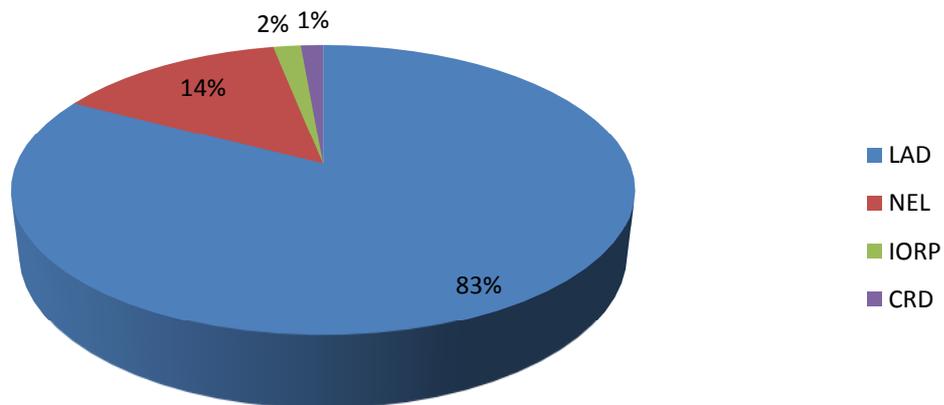
Members split by applicable EU law

■ LAD ■ NEL ■ UCITS ■ CRD ■ IORP ■ UCITS, LAD, CRD



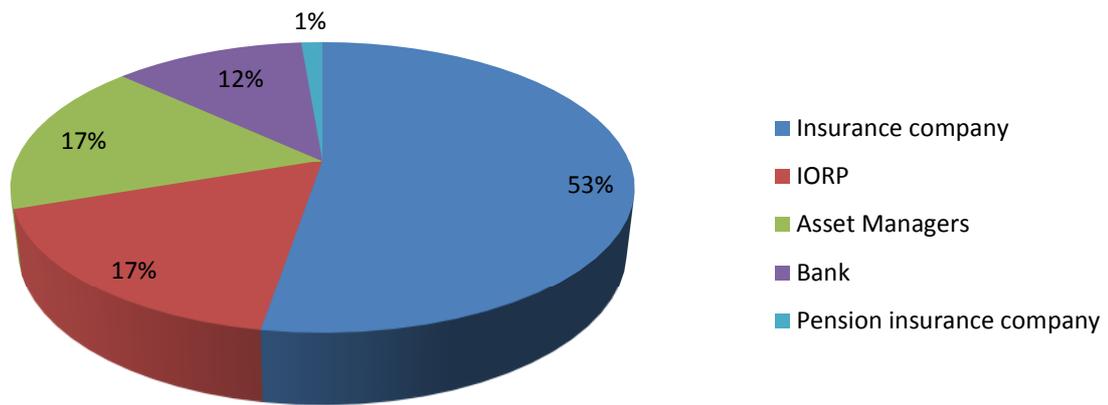
A split by assets even shows a bigger coverage by the LAD. Without the German PPP market, 82 percent of the product assets are covered by the LAD, 14 percent by national law and 3 percent by the IORP Directive and CRD IV. Products covered by the UCIT Directive are marginal in terms of assets.

Assets split by applicable EU law



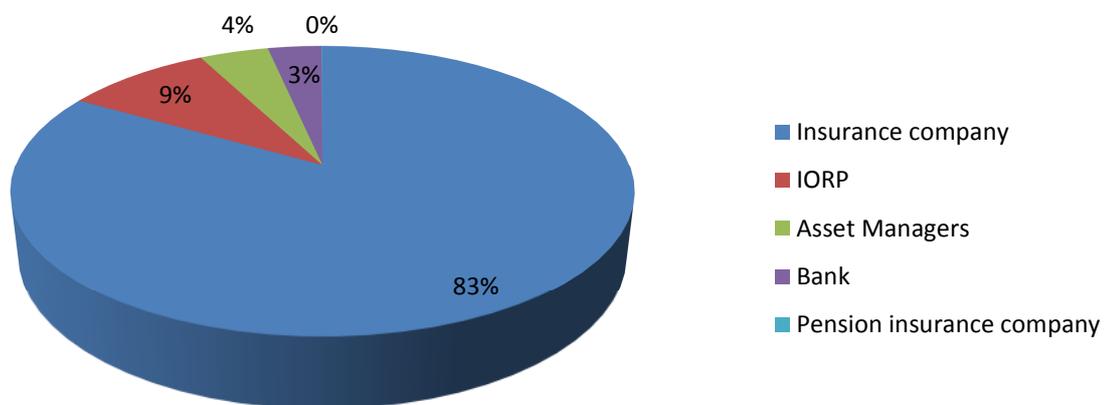
Unsurprisingly, more than half of the products are provided by insurers. The second largest providers of PPPs are IORPs and the asset management industry. Asset managers, but also IORPs and banks, often provide products under national legal requirements.

Products split by provider



As shown below, the role of the insurance sector in the provision of PPP products is significantly higher when considering the assets under management rather than the product categories.⁸⁶ Comparing this graph with the graph "assets split by applicable EU law" one can see that IORPs, asset managers and banks often provide their product under the national framework. As a result these providers face difficulties selling their products on a cross-border basis.

Assets split by provider



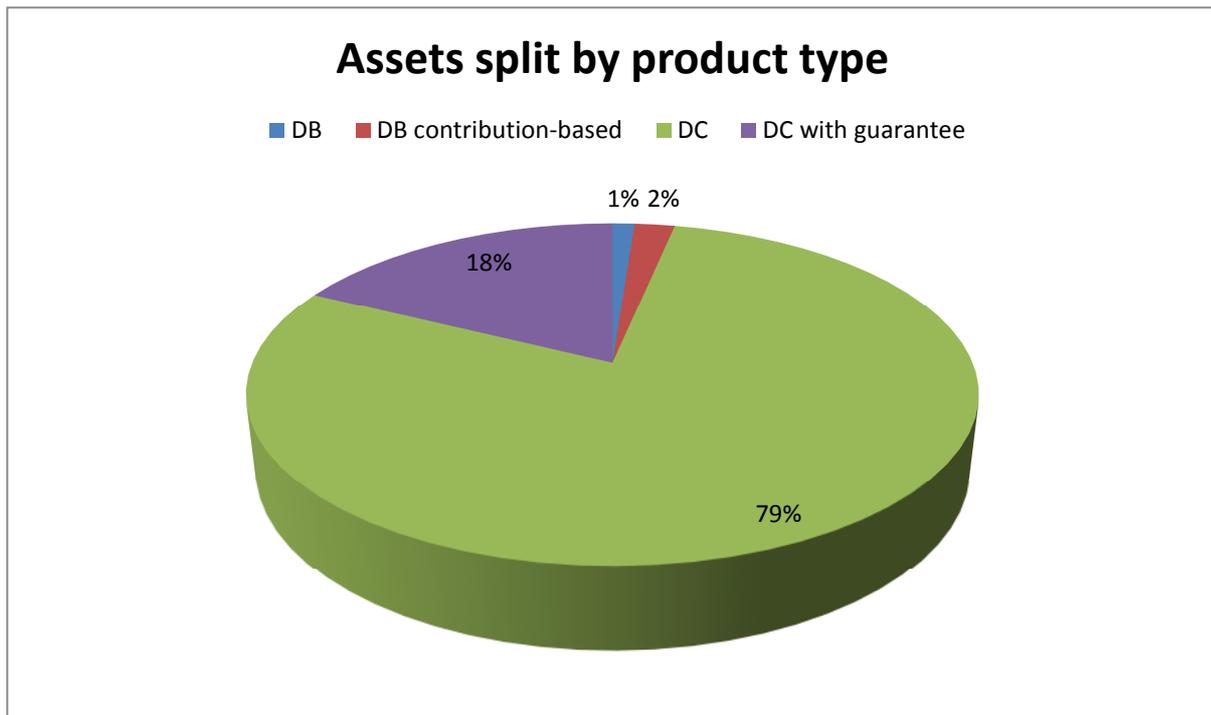
Assessing assets split by product type, one notices that pure defined contribution (DC) products, dominate - with almost 80 percent - the PPPs market.⁸⁷ Additionally, in a PPP context it is hard to differentiate between DC products with a guarantee and defined benefit (DB) products that are contribution based.⁸⁸ Therefore, one may assume that at least 20 percent of the market, in terms of asset values, is providing

⁸⁶ Please note that the role of the asset management sector is underrepresented in comparison to IORPs and banks. In Germany, which is not included in this chart, asset managers are the second biggest provider of PPPs with over 3 million contracts.

⁸⁷ These results need to be seen in the context of the asset data excluding DE data. For Germany all products are regarded as contribution-based DB. Consequently, if DE data would have been included, presumably the share of contribution based DB schemes would increase considerably.

⁸⁸ In EIOPA's pensions database EIOPA distinguishes DB from DC based on a number of occupational pensions characteristics and is further explained in the corresponding guide for compilation. See the reference to column 2.2. https://eiopa.europa.eu/Publications/Reports/EIOPA-OPC-14-058_Database_of_pension_plans_product_in_EEA-guide_for_compilation.pdf.

DC products with some sort of minimum guarantee. Only a small proportion of the assets are linked to pure defined benefit (DB) liabilities. No Member State has reported hybrid products in its market.

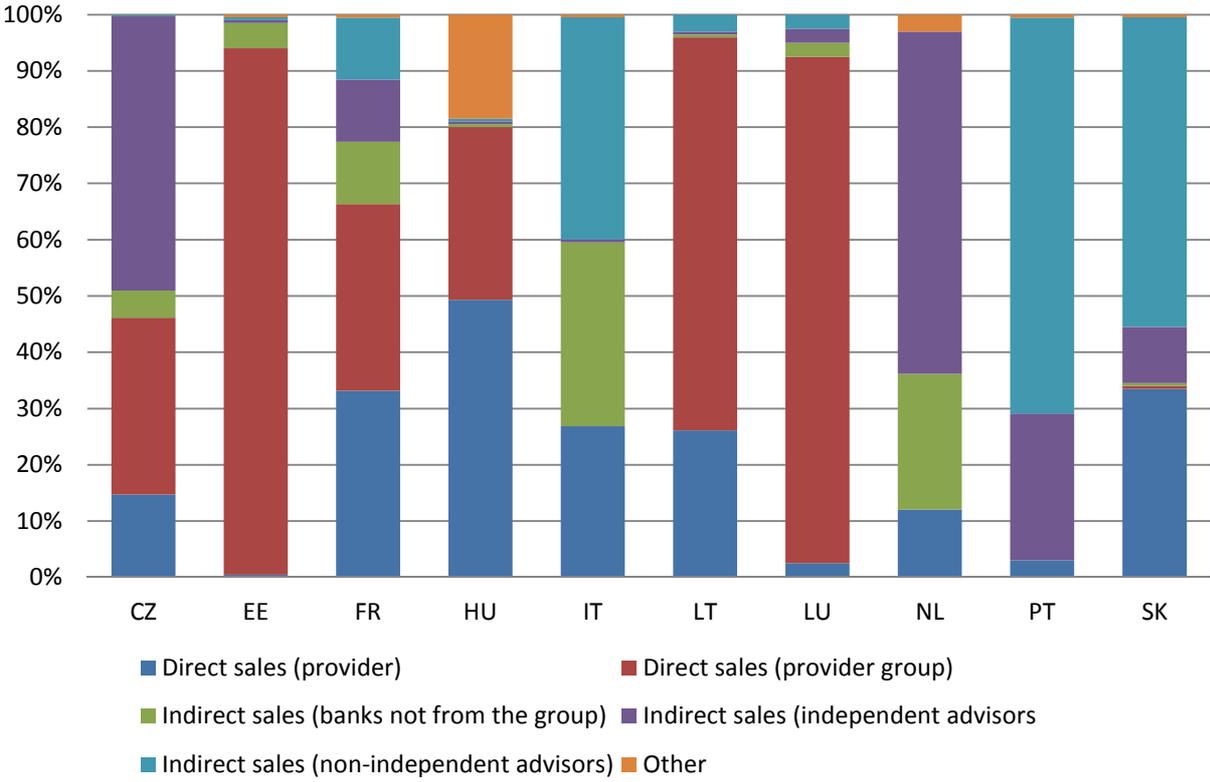


In relation to the question in the call for advice on the distribution of PPPs in Europe, EIOPA received responses from 10 countries accounting for almost 50 percent of the total assets under management. However, 80 percent of these are from products sold in the Netherlands. As a result, the accumulated distribution of the countries providing input reflects the distribution in the Netherlands: more than half of the distribution is provided through independent advisors, followed by sales by banks which are independent of the provider's group.

However, in most countries providers distribute the majority of their products through direct sales, either through the provider or by the group of the provider (see the graph below).

The category "other" in the graph reflects mainly internet sales. In general, the amount of sales through the internet is very low. Only in Hungary the category "other" is relatively substantial. However, also PPPs sold through the employer are included in this category in Hungary.

Distribution by country



Annex IV: Pillar 1bis schemes

In the period between 1998 and 2006 many Central and Eastern European (CEE) countries introduced a pension reforms aimed at reinforcing the sustainability of their pension systems.⁸⁹ As part of these reforms, they established so called pillar 1bis schemes.

Pillar 1bis schemes were carved out of the public pension's pay-as-you-go (PAYG) systems by diverting parts of the contributions to the traditional 1st pillar PAYG system into pillar 1bis schemes managed by dedicated private management companies.⁹⁰ Pillar 1bis contribution rates are often expressed as a percentage of the wage. Generally, the higher the contribution rate to pillar 1bis, the lower the contribution rate to the public PAYG system.

As set out in EIOPA's preliminary report on personal pensions, pillar 1bis products often have similar characteristics to PPPs. The main difference between PPP and pillar 1bis products is the public interest and implicit state support in their set-up.

One could argue for example, as both systems are based mainly upon the DC principle, that pillar 1bis scheme members may encounter the same risks as holders of 'regular' PPPs. Especially in case scheme members must decide on the investment strategy, the responsibility for the ultimate investment result is redirected to the scheme member.

Taking into account that the majority of people are not 'homo economicus', the desirability of an EU wide introduction of default investment options / life styling (thus offering the investment expertise of the provider to the scheme member) might be wanted both for 'regular' and pillar 1bis PPPs.

Additionally, the costs and charges of pillar 1bis products - which are mainly DC - are an important factor, influencing the level of a pensioner's future income. Therefore, pillar 1bis would equally benefit from EU wide disclosure rules, in the same way holders of 'regular' PPPs do.

However, pillar 1bis schemes are generally considered to be part of the social security system of the Member State concerned. The organisation of these statutory schemes falls within the exclusive competence of the Member State concerned. Additionally, assets are often owned by the government and participation is not always voluntary. Therefore, while a political decision, EIOPA believes pillar 1bis schemes do not include the main characteristics of a PEPP: voluntary and personal.

Finally, in all countries providing pillar 1bis schemes, obstacles arise with regards to cross-border arrangements. Firstly, there is no legal basis for pillar 1bis schemes at EU level. Moreover, even with a legal basis, a series of technical issues would arise in practice, e.g. access to cross-border providers, compliance local social and labour law, application of the provisions regulating opt-outs, ring-fencing the assets, etc.

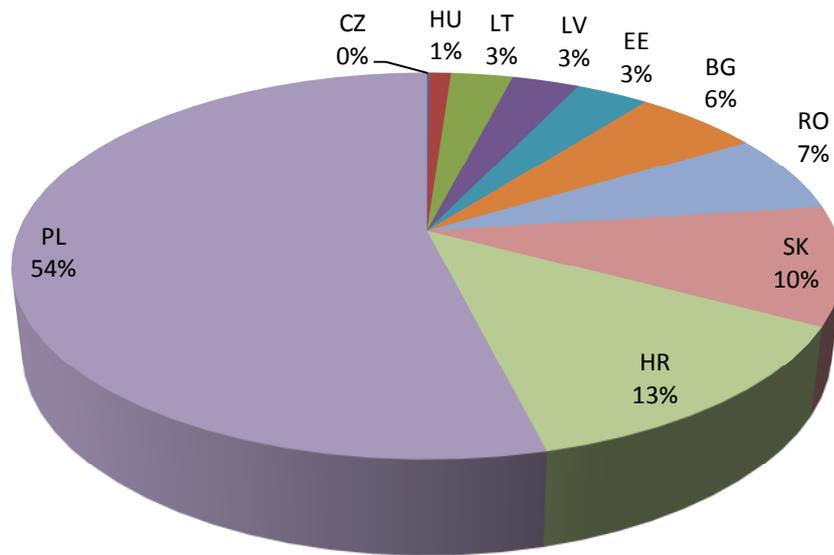
According to EIOPA's pension database, pillar 1bis schemes exist in ten countries, namely: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Romania and Slovakia.

At the end of 2014, these pillar 1bis schemes held 65 billion euro in assets. As the graph below indicates, there are significant differences between countries with Poland accounting for over 50% of the total assets invested in pillar 1bis schemes.

⁸⁹ CZ established its pillar 1bis in 2012.

⁹⁰ CZ and BG pillar 1bis funds are managed by PPP providers. LV pillar 1bis is managed by UCITS management companies

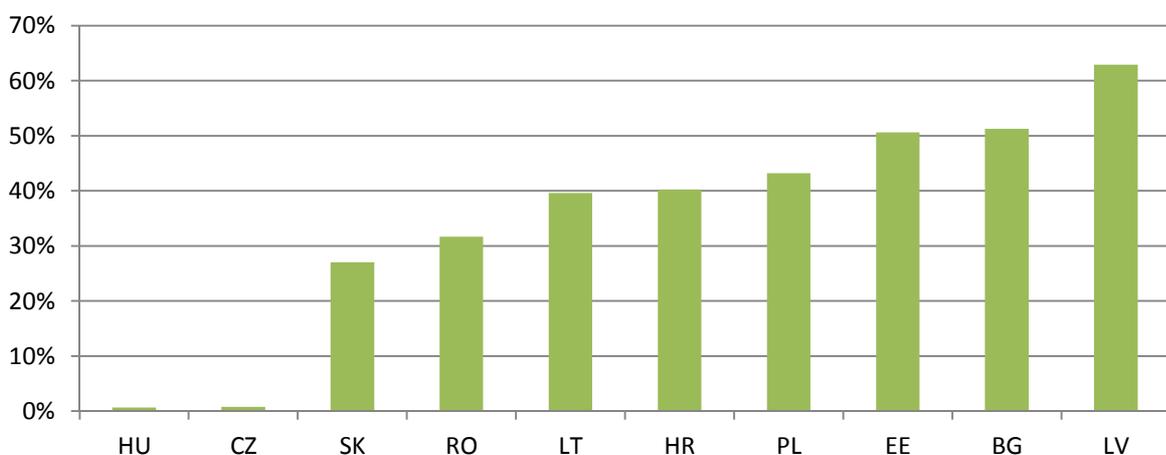
Assets (EUR mio.) 31/12/2014



The value of assets has declined by one third in 2014. This is solely due to the Polish pension reform diverting contribution flows and accumulated assets from the pillar 1bis system towards the public PAYG system. All other countries have recorded increases in terms of pillar 1bis assets over 2014.

However, assets are not the only factor to consider. Both the total population and the maturity of the pillar 1bis system have a significant impact on the total asset value. In terms of population, 33 million European citizens were covered by a pillar 1bis system at the end of 2014. Around 50% of these 33 million are Polish citizens. Comparing the 33 million with the total population of these countries (102 million) shows that around 32% of the citizens are included in pillar 1bis schemes. Again, there exist large differences between countries, as the figure below shows.

Percentage of the population covered by the 1st pillar bis system

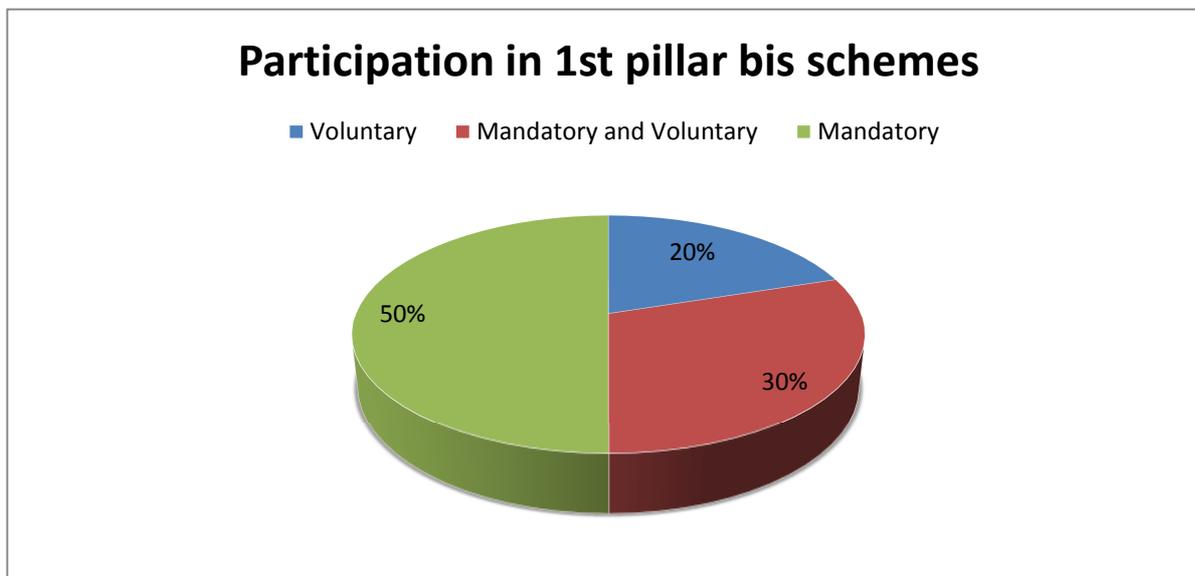


The low amount in the Czech Republic is explained by the very recent set-up of the system while the low amount in Hungary is due to its 2013 reform in which pillar 1bis participants were redirected to the PAYG system.

Participation in pillar 1bis schemes

In six countries, participation in the pillar 1bis schemes is mandatory. Only in Hungary and Lithuania, participation is voluntary. In Poland, Slovakia and Latvia participation can be both mandatory and voluntary. In Latvia, participation is mandatory for individuals born after 1 July 1971. Those born between 2 July 1951 and 1 July 1971 can participate voluntarily in the pillar 1bis system.

In addition, in certain Member States, e.g. Bulgaria, participation is mandatory, but participants have the possibility to opt-out into the PAYG system.



In all of the ten countries, the initiative of the scheme choice lays with the participants allowing free choice between the different providers permitted to provide pillar 1bis schemes in the respective markets.

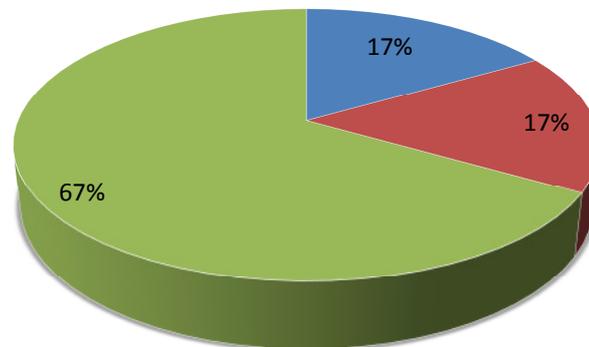
However, in certain countries, if a person mandated to join a pillar 1bis system, does not choose a provider before a certain date, it is automatically enrolled with a certain, often conservative provider.

When considering the parties paying contributions into the pillar 1bis schemes, it should be noted that both in Bulgaria and in Lithuania, two pillar 1bis systems co-exist. As a result there are twelve different pillar 1bis systems in the EEA.

In eight of these twelve countries, the contributions are paid by employees. In Croatia and in one of the Bulgarian systems, contributions are paid by employers. In the other Bulgarian system and in Poland, contributions can be paid by both employers and employees.

Contributions into 1st pillar bis schemes

■ Employer ■ Employee and employer ■ Employee



91

Participant's role in the decision making process

In most countries, participants have no role in the decision making process of pillar 1bis systems. They do, however, often have a possibility to choose an investment strategy by choosing the provider and plan that best matches their personal needs. They can also often switch providers or plans against no or small fees. Sometimes this is only possible after a certain holding period or between certain dates. In the Czech Republic, participants may decide on an individual investment strategy.

Only in Bulgaria and in Hungary, participants have influence on the decision making process of their pillar 1bis provider. In Bulgaria, the interests of the participants are represented by a Board of Trustees which includes representatives of the labour unions and the employer unions, as well as a representative of the provider. The decisions of the Board of Trustees have advisory nature (i.e. are not legally binding).

In Hungary participants hold general meetings (or delegates' meeting) at least once a year. During these meetings, participants are allowed to decide on a number of issues, amongst others: approval and amendment of the bylaws; election and removal of the participants and the chairman of supervisory board and the board of directors as well as determination of their remuneration; approval of the annual report, the balance-sheet, decision on the utilization of profits or the settlement of any deficit in the individual sub-funds; or approval of the fund's annual and long-term financial plan.

Asset ownership

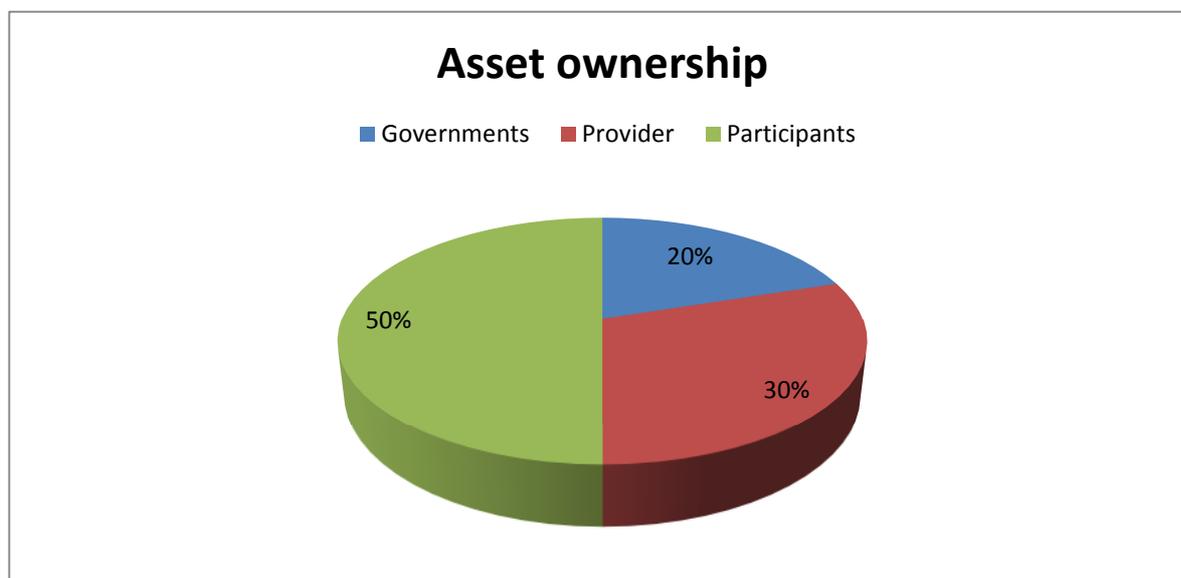
In half of the countries, the assets are owned by the participants. However, owning the assets does not mean that they have direct access to these assets. For example, participants are often not allowed to withdraw any amounts before the legally allowed age. Furthermore, in most countries these assets cannot be used for pledging loans or as loan collateral.

In three countries, the assets are owned by the provider. However, the difference with assets owned by participants is relatively small. While the contributions of the participants are accumulated in individual accounts, from a legal perspective the assets acquired in the course of investment of the contributions are the property of

⁹¹ Due to rounding differences, the numbers do not sum up to 100%.

the provider as a legal entity. Participants are then entitled to a proportional share based on the actual contributions. These could be paid out in the form of their respective benefits, or transferred to other providers.

In Latvia and Poland, the assets are considered to be public assets under management of the provider. As such, these are not considered as personal savings.



Solidarity in pillar 1bis

In most markets no solidarity exists between the participants of pillar 1bis schemes. Only in Estonia and Lithuania there is a form of solidarity included.

In Estonia, the state contribution of 4% is paid from the social security income collected. However, as Estonia has a single flat tax rate on the taxable income, the redistribution power of the taxable income is very limited. In Lithuania, a part of the social security income is redistributed to top-up the pensions of future retirees. Currently this part is still attributed to the PAYG system.

In all other countries, the pension benefit is calculated on the basis of the contributions and investment returns on the individual account. Some intergenerational solidarity can be found by for example the fact that the savings are inheritable (CZ) or the possibility to opt for a joint annuity (LV).

In the Czech Republic, a person that saved in a pillar 1bis scheme and becomes disabled can request for a disability pension when transferring its assets to the PAYG system.

Pillar 1bis providers

In all but one country, the provision of pillar 1bis pension schemes is a for profit business. Only in Hungary, providers work on a non-for profit basis.

In a number of markets the providers are organised as a joint stock company, which operates for the profit of its shareholders. The provider distributes the profits from its investments to the individual account of the participants.

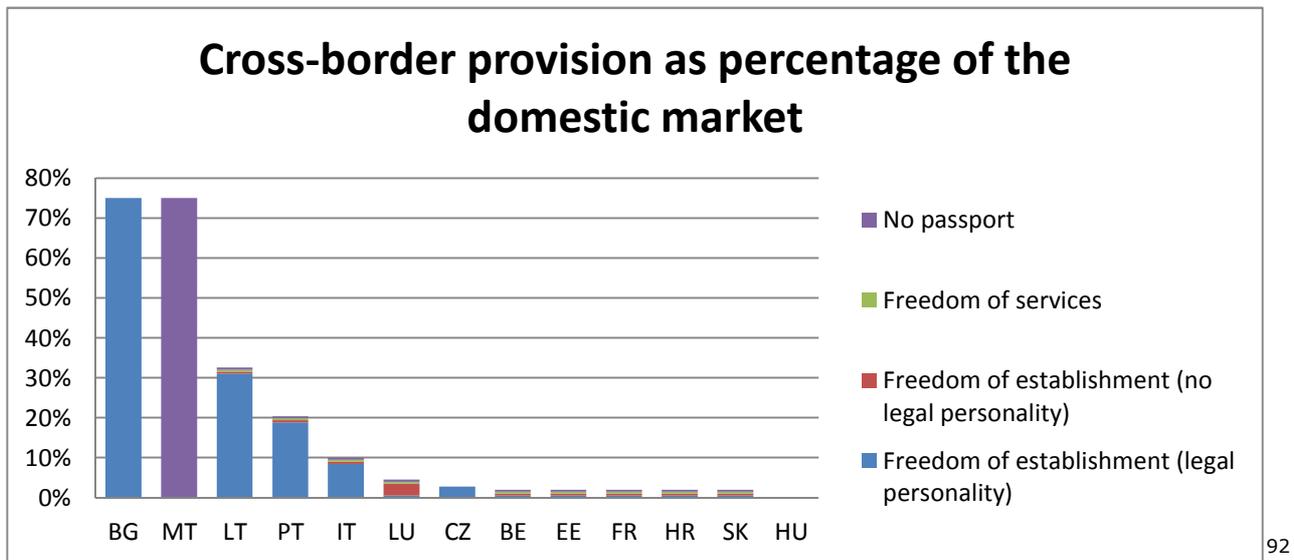
Additionally, in all countries providers are allowed to advertise their activity. However, the prevailing regulation in most countries sets out rules of conduct to ensure that the information provided is correct and not misleading. In SK, these rules also include a cap on the advertising expenses. Finally, the rules can include prohibition of practises such as promises based on future rates of return, promises of gifts, etc.

The organisation of these statutory schemes falls within the exclusive competence of the MS concerned. Additionally, assets are often owned by the government and participation is not always voluntary.

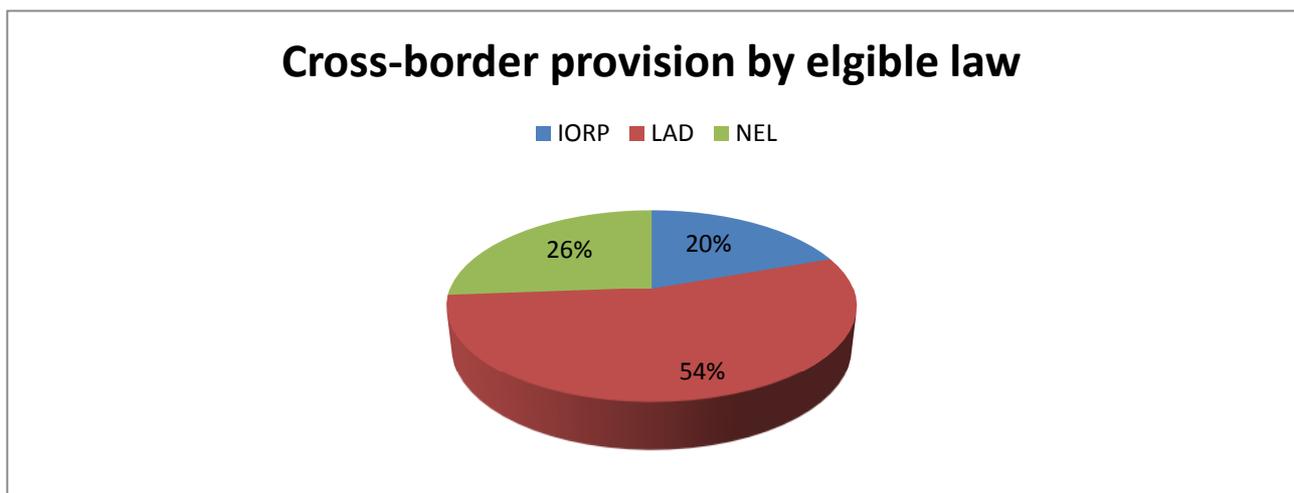
Annex V: Cross-border activities

To analyse the current situation, EIOPA has conducted a quantitative study amongst its members identifying cross-border requirements for third pillar products. EIOPA has collected data from 13 Member States with regards to cross-border contracts. Other Member States could not provide detailed information with respect to cross-border services.

Only 4% of the assets under management of these 13 countries results from cross-border business. However, as shown in the graph below, there are large differences between countries. In countries such as Bulgaria and Malta, more than 75% of the assets under management results from products provided by cross-border entities. In Bulgaria all contracts are provided by foreign companies establishing a branch, whereas in Malta all contracts are closed with foreign providers not benefiting from an EU passport.



More than half of the cross-border contracts are subject to LAD. 20% are subject to the IORP Directive and 26% have no applicable prudential EU law.



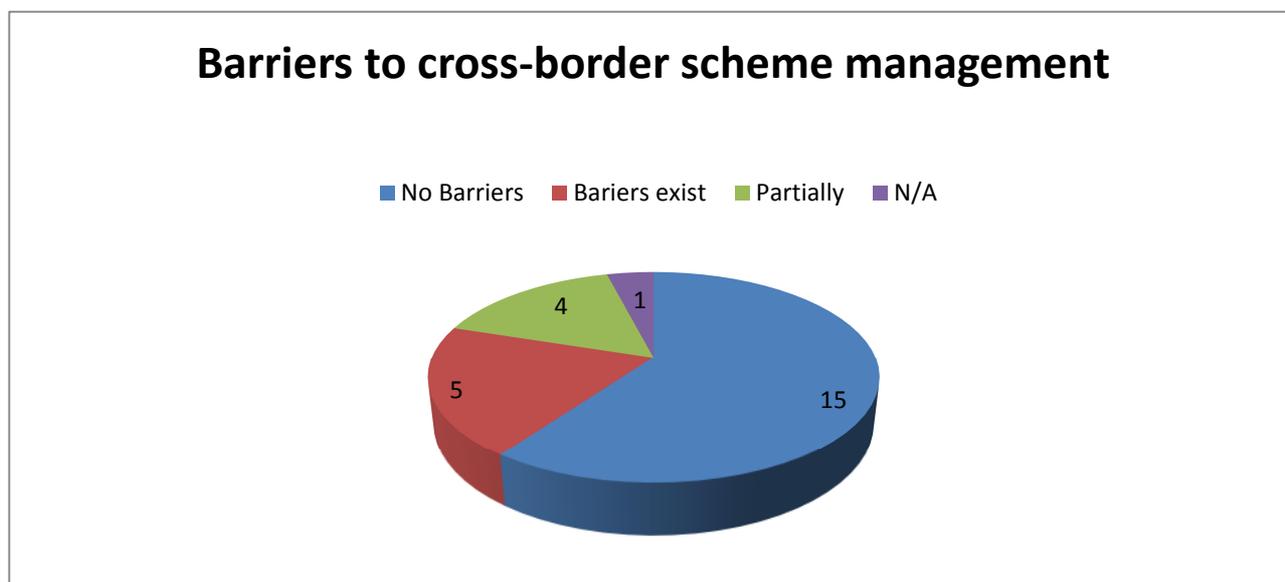
Cross-border scheme management

Additionally, EIOPA has conducted a qualitative study amongst its members identifying cross-border obstacles for third pillar pension products. From the 31 EIOPA

⁹² Please note that this graph is based on estimates.

members, 25 markets provided a response. Two markets (Cyprus and Greece) indicated that no PPPs are currently provided in their markets and therefore could not respond to the survey.

From the 24 responses received to this question, 15 countries indicated that their national law did not prohibit cross-border management of pension schemes.



Four out of the five countries identifying barriers have stressed that it is a legal requirement to have an office registered in the country where the PPP is provided. Often the national supervisory authority needs to provide the licence but only to companies maintaining a registered office in the country. However, in Croatia foreign PPP providers can be allowed to directly pursue core and ancillary activities of closed-ended voluntary pension funds.

Poland indicated that there are no rules in Polish law that enable the cross-border management of PPP schemes. Therefore they believe that cross-border management of PPPs is not allowed.

In Belgium, Czech Republic, Estonia and Italy the national supervisory authority considered the obstacles to be insignificant. In Belgium, Italy and the Czech Republic, PPPs provided by insurance companies can freely provide PPPs on cross-border bases. This is not the case for PPPs provided by other providers. Please note that in Italy assets of non-insurers may be invested cross-border and their management may be outsourced to entities in other EU Member States. However, products can only be provided where a branch has been established.

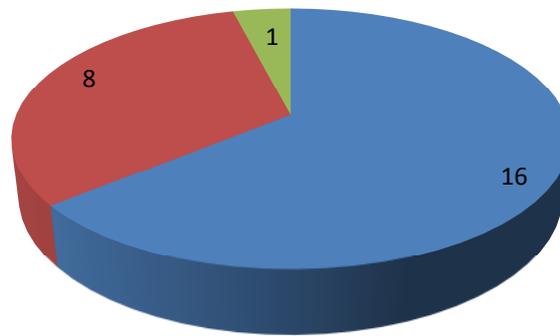
In Estonia, PPPs in the form of third pillar products can be provided by foreign asset managers without establishing a branch in the country but not for PPPs in the form of pillar 1bis funds.

Cross-border investments or investments in foreign currencies

From the 24 responses received to this question, 16 countries indicated that their national law did not prohibit cross-border investments or investments in foreign currencies.

Barriers to cross-border PPP investments

■ No barriers ■ Barriers exist ■ N/A



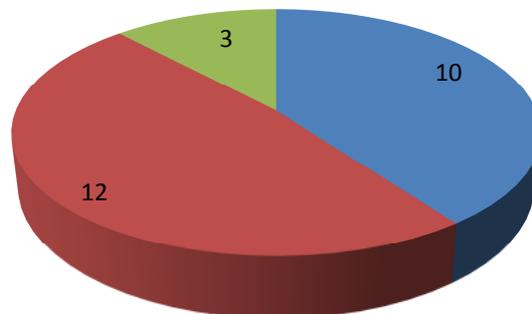
In the Czech Republic, PPP providers have limited possibilities to invest in foreign currencies so as to limit the currency risk. Also in Bulgaria, the maximum amount allowed to be invested in foreign currencies is restricted to prevent excessive exposure to currency risks. In Iceland restrictions have been imposed disallowing all foreign investments within contracts established after 2008. Countries such as Estonia, Ireland, Portugal and Poland also imposed limits on cross-border investments and investments in foreign currencies. Those depend on the type of product (3rd pillar or pillar 1bis etc). In France, at least 80% of the liabilities need to be matched by assets of the same currency. However, this rule is not applicable to providers applying the Solvency II Directive.

Cross-border transfers of PPP schemes

From the 21 responses received to this question, only ten countries indicated that their national law does not provide a barrier to cross-border transfers.

Barriers to cross-border PPP transfers

■ No Barriers ■ Barriers exist ■ N/A



Bulgaria and Poland have indicated that cross-border transfers of PPP regulation are not explicitly regulated in their national or EU legislation and are therefore considered to be not allowed. In the Czech Republic, Croatia and Lithuania nationally recognised PPPs (non-insurance based) cannot be transferred due to restrictions on cross-border

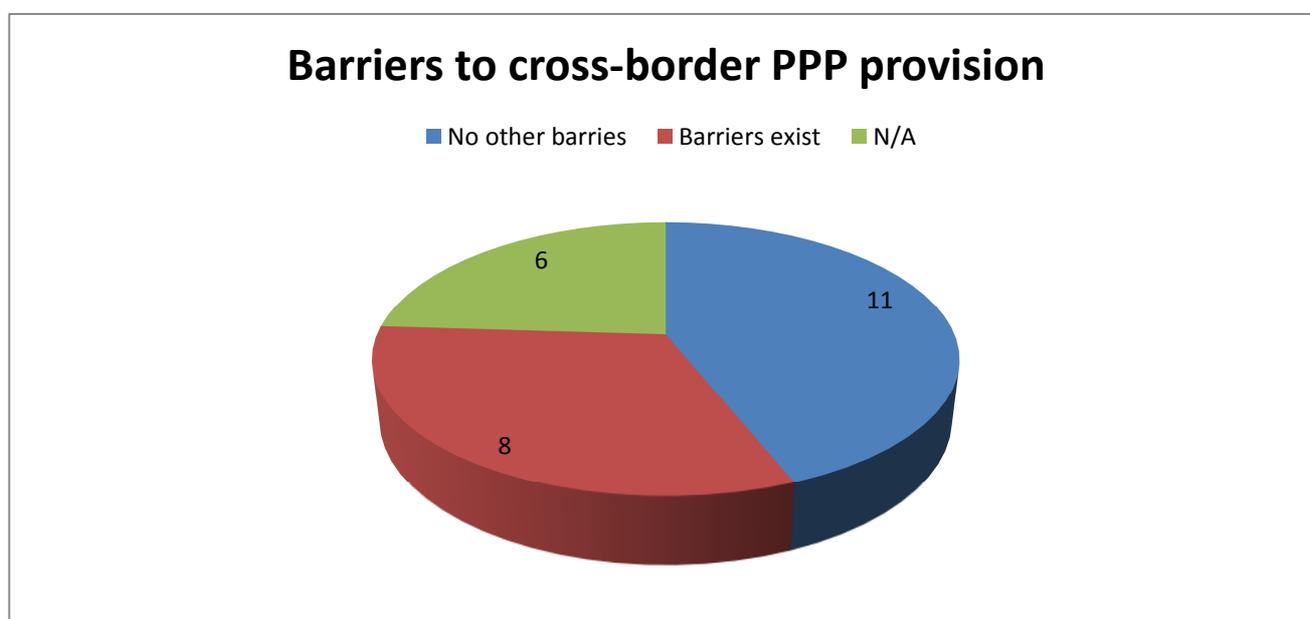
scheme management. Additionally, while being allowed for Estonian third pillar products, it is unclear how potential conflicts between Estonian and other countries legislation would work.

In Spain, transfers are permitted between national pension products. However there is no such possibility for foreign products. Reasons can be found in taxation and the prohibition of cross-border scheme management. In France, certain products (PERP) can be transferred to another PERP product. However, it is not possible to transfer a PERP to a different product applying a different social and tax treatment. In Luxembourg, the insurance secrecy rules could be an obstacle if a contract was to be transferred from Luxembourg to another country. However, this problem can be solved by giving up this privilege.

In the UK, benefits may be transferred into a UK pension scheme from any overseas arrangement; but a registered pension scheme may only make a transfer into an overseas pension scheme that is approved for the purpose by HMRC. A transfer to an overseas scheme which is not approved, or which has lost its status will be an unauthorised payment with associated tax charges (40%). In Ireland transfers are allowed, but for certain products (PRSAs) only under certain conditions.

Obstacles to cross border provision of PPP schemes

From the 19 responses received to this question, eight countries indicated barriers to cross-border provision of PPP schemes. These barriers related to social and labour law, contract law or non-legal issues such as language and cultural differences. Some countries also mentioned difficulties in assessing the competences of the home and host countries.



Barriers perceived by market providers

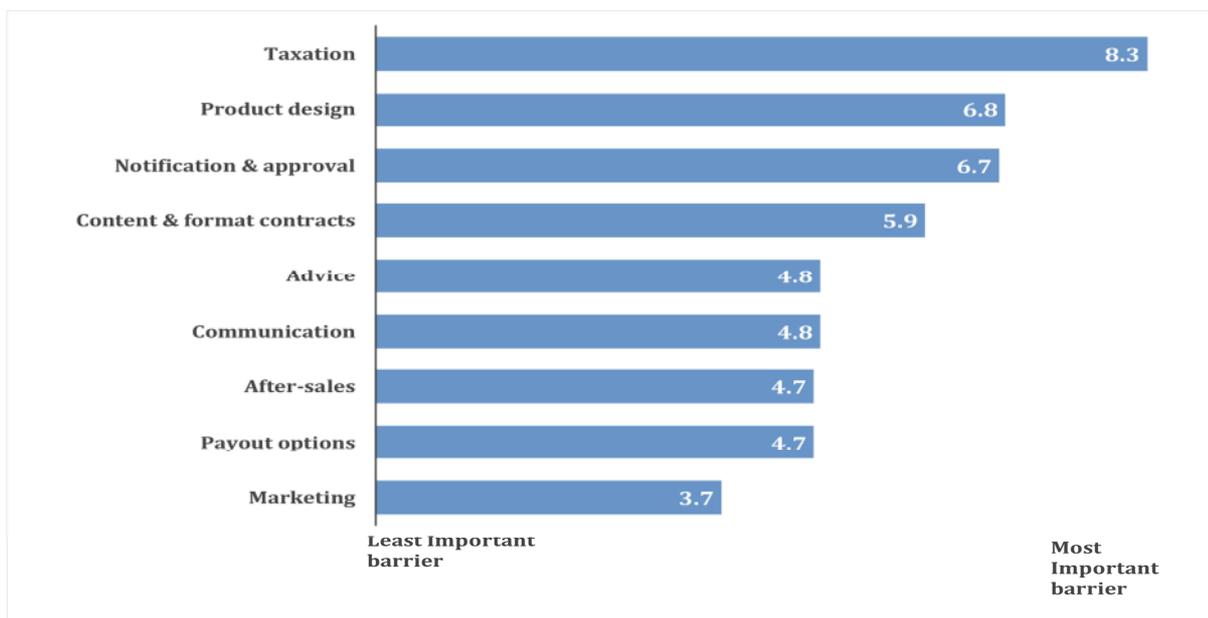
In 2014, a study was conducted at the Vrije Universiteit Brussel (VUB)⁹³. The study assessed barriers to the cross border activity of personal pension providers within the EU perceived by market participants and their preferred solutions. By means of a

⁹³ Breda, A.T.: An EU Single Market for Personal Pensions, 2014, <http://www.scriptiebank.be/sites/default/files/webform/scriptie/Thesis%20-%20Ana%20Breda%20-%202014%20Complete.pdf>.

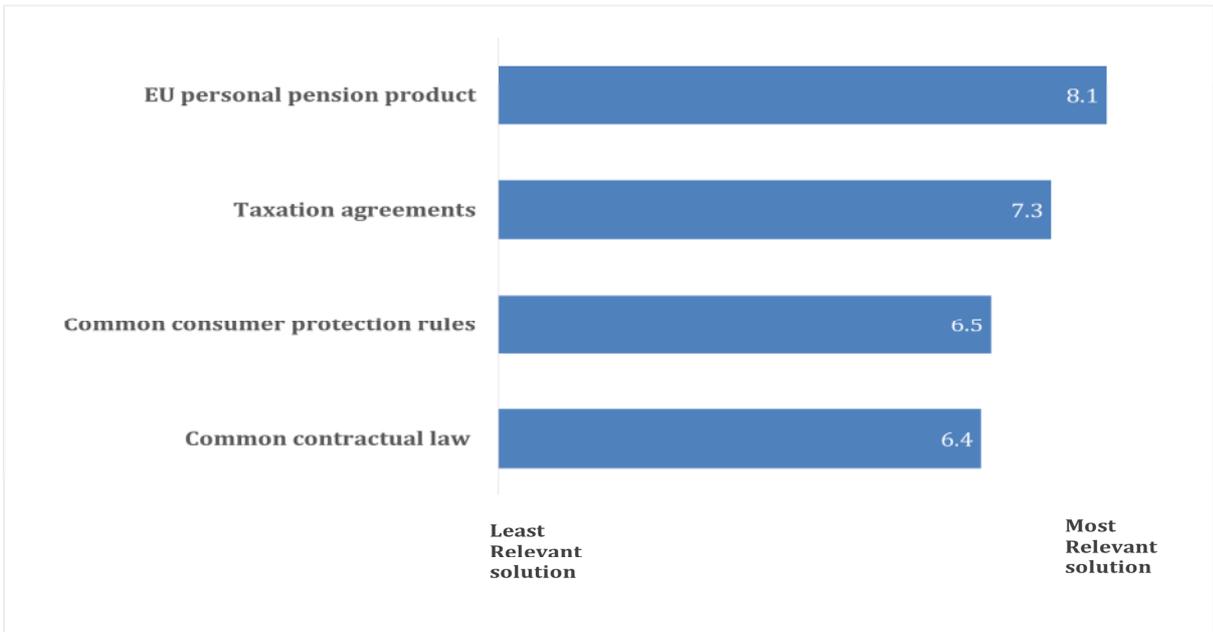
survey, this study has collected the views of 29 personal pension providers operating in the EU.

It was no surprise that the majority of the respondents believed that different taxation regimes for personal pension products between Member States regarded the main barrier to the cross border provision of personal pension products in the EU. The second most indicated barrier was different regulations forcing the provision of different products in different Member States. Such differences in national laws mean that providers need to adjust their contracts to meet local requirements. This is an important issue as the contract itself is the product. Therefore, providing a harmonised framework is necessary to facilitate cross-border distribution of pension products, as the lack of a common legal framework as shown above is one of the major barriers to a common market.

The third highest rated barrier was the different notification and approval procedures required by each local supervisor to authorise the selling of a personal pension product in its domestic market, with contract law being the fourth biggest hurdle.



In their response to actions that could be taken by EU policymakers to facilitate cross border activity in personal pensions, respondents revealed a clear preference for the introduction of an EU personal pension product that could be authorised by the supervisory entity in one Member State and then be sold across the EU, competing with national personal pension products. A second preference was the introduction of taxation agreements. This would be a response to their primary concern but on the other hand would not solve any of the other barriers. Furthermore, feedback given showed some interest in common consumer protection and contract law. However, only a single European pension product would solve more than one of the barriers raised by market providers.



Annex VI: Legal requirements and ESA work on conduct of business requirements

Non-advised distribution requirements: MiFID II appropriateness tests for non-advised sales

For non-advised sales, MiFID firms can only sell 'complex' products to a retail client if they have first undertaken an appropriateness test. MiFID II will narrow the types of products considered 'non-complex' and this is likely to capture products such as some structured deposits.

The appropriateness test requires firms to collect information about the client's knowledge and experience relevant to the type of investment they are looking to buy to enable the firm to assess whether the product is appropriate for the client. If, after assessing the client's knowledge and experience, a firm believes a certain product or transaction is inappropriate for a client, it is required to warn the client that it believes the transaction to not be appropriate. Where no or insufficient information is provided by the client, firms are also required to warn the client that it is not in a position to determine the appropriateness of the product. Firms are required to maintain records of appropriateness assessments, including details of the result of the assessment, whether any warnings were given and the outcome.

Non-advised distribution requirements: IDD appropriateness tests

The revised Insurance Mediation Directive (now named Insurance Distribution Directive, IDD) regulates all types of insurance products and covers all methods of distribution (direct sales or intermediated) by insurance intermediaries or insurance undertakings. It contains similar requirements to MiFID II relating to the appropriateness test for sales of insurance-based investment products where no advice is provided.

EIOPA Opinion on sales via the Internet of insurance and pension products

EIOPA concluded in its January 2015 opinion that the fact that distributors carry out online distribution should not affect their ability to comply with existing and future requirements applicable in the European Union for the provision of such services to consumers. With this in mind, EIOPA recommended that NCAs ensure that:

- Online distributors comply with a duty of advice, if such a duty exists in national law or when sales are so promoted; and
- Consumers are provided with appropriate information on the selling process of the online distributor.

Advised distribution requirements

None of the existing directives specify a requirement to give advice in a given circumstance. Rather it is left as a matter of choice for the individual. Instead, the directives to a greater or lesser extent define what must happen in circumstances where advice is given to the individual.

Advised distribution requirements: MiFID II suitability requirements for advised sales

MiFID II builds on the MiFID suitability requirements for advice. It will require firms, when undertaking a suitability assessment, to assess both a client's ability to bear losses and a client's risk tolerance. Firms must also provide clients with a suitability report specifying how the advice given meets the client's circumstances and needs.

When providing advice, firms will be required to obtain information about the client's (i) knowledge and experience (relevant to product or service), (ii) financial situation including his ability to bear losses, and (iii) investment objectives (including risk

tolerance) so as to enable the investment firm to recommend a suitable product, in particular, that is in accordance with the client's risk tolerance and ability to bear losses.

In addition to general reporting obligations (which should include, amongst other things, information on the type and the complexity of products, and the costs associated with the transaction), firms will need to provide the client, pre-sale/pre-contract, with a statement on suitability specifying the advice given and how that advice meets the preferences, objectives and other characteristics of the retail client.

Advised distribution requirements: IMD

In IMD the provisions are articulated in the context of the provision of advice to the consumer. Where an intermediary gives advice to the consumer as part of the sale there is a requirement to inform the consumer of the basis on which the advice is provided, in other words whether it is based on a fair analysis of the market, and whether or not the intermediary is under any contractual obligations with insurance companies.

Where advice is given on the basis of a fair analysis, the intermediary is obliged to base it on an analysis of a sufficiently large number of insurance contracts available on the market. This will enable him to make a recommendation, in accordance with professional criteria, regarding which insurance product will meet the consumer's needs. Before concluding a contract, the intermediary will collect information from the consumer, and this information must be used to identify the demands and the needs of that consumer. The intermediary is also obliged to give the underlying reasons for any advice given to the consumer on a given insurance product. The level of detail in the information collected has to be modulated according to the complexity of the insurance contract being proposed.

Advised distribution requirements: IDD

The IMD will soon be replaced by the Insurance Distribution Directive (IDD), which will for the first time also introduce key consumer protection requirements for Insurance Undertakings. The requirements in the IDD will mean that there will be very close alignment of consumer protection in the insurance and securities markets. A key part of this consumer protection is what is required when providing advice to consumers.

Joint Committee Discussion Paper on automation in financial advice

The Joint Committee of the ESAs is currently undertaking work looking at market developments including the emergence of new business models that provide online independent financial advisory services that use algorithms to select pension investments for savers ('robo-advisers').

The Joint Committee paper will present a preliminary assessment of the potential benefits of automated financial advice, such as a potentially wider access for consumers to financial advice; a provision of advice at lower cost; and the potential to deliver a highly consistent consumer experience when seeking financial advice. On the other hand, the potential risks include the possibility that consumers could misunderstand advice provided to them without the benefit of a human advisor to support the advice process, and the potential for limitations or errors in automated tools that may not be easily identifiable for consumers or financial institutions.

Other requirements: Distance Marketing Directive obligations

Directive 2002/65/EC concerning the distance marketing of consumer financial services lays down fundamental rights for consumers. Where means of distance communications are used, the consumer should be able to make a well-informed

choice. For example, the Directive establishes: an obligation to provide consumers with comprehensive information on the provider, the financial service, the distant contract and means of redress, before a contract is concluded; the consumer's right to withdraw from the contract during a cooling-off period; a ban on abusive marketing practices seeking to oblige consumers to buy a service they have not solicited ("inertia selling"); and rules to restrict other practices such as unsolicited phone calls and e-mails ("cold-calling" and "spamming").

Other applicable EU legislation

It should also be noted that, depending on their particular business model, distributors using online channels must comply with applicable European and national legislation. Other relevant EU legislation may include (but may not be limited to): the Unfair Commercial Practices Directive⁹⁴, the E-commerce Directive⁹⁵; the Data Protection Directive⁹⁶; the Misleading and Comparative Advertising Directive⁹⁷; the Consumer Rights Directive⁹⁸ and the Online Dispute Resolution (ODR) Regulation⁹⁹.

Other applicable EU legislation: MiFID II conduct of business rules

The organisational rules (including compliance, complaints-handling, conflicts of interest, record-keeping, product governance) are found in Article 16 of MiFID II Level 1 (previously mainly Article 13 and 18 of MiFID 1 Level 1, and various sections of the MiFID 1 Implementing Directive). The general principles and conduct of business rules (including fair, clear and not misleading information, independence and investment advice, costs and charges information, suitability, appropriateness, remuneration, third party inducements) are now found in Articles 24 and 25 of MiFID 2 Level 1 (previously Article 19 of MiFID 1 Level 1, and various sections of the MiFID 1 Implementing Directive).

⁹⁴ Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council ('Unfair Commercial Practices Directive'), OJ L149, p. 22.

⁹⁵ Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce'), OJ L 178, 17.7.2000, p. 1.

⁹⁶ Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, OJ L281, 23.11.1995, p. 31.

⁹⁷ Directive 2006/114/EC of the European Parliament and of the Council of 12 December 2006 concerning misleading and comparative advertising (codified version), OJ L 376, 27.12.2006, p. 21.

⁹⁸ Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council Text with EEA relevance, OJ L 304, 22.11.2011, p. 64.

⁹⁹ Regulation (EU) No 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Regulation on consumer ODR), OJ L165, p. 1.

Annex VII: Summary of selected international standards on provider governance

In principle 2 of the OECD Core Principles¹⁰⁰ it is recommended that within pension institutions there should be a functional governance system in place comprising the adequate legal, accounting, technical, financial and managerial criteria, without excessive administrative burden. The pension fund and sponsor must be legally separated or such separation must be guaranteed through appropriate mechanisms. Additionally, principle 6 of the OECD Core Principles states that the governance structure should ensure an appropriate division of operational and oversight responsibilities, and the accountability and suitability of those with such responsibilities. To encourage good decision making, proper and timely execution, transparency and regular review and assessment, appropriate control, communication and incentive mechanisms should be in place.

The OECD Guidelines for Pension Fund Governance, June 2009, identify as part of a governance structure a clear identification of responsibilities, the existence of a governing body, the accountability of the governing body, the suitability of the members of the governing body, the possibility to delegate functions and to get expert advice from external sources, the appointment and performance of an auditor, an actuary for defined benefit plans and a custodian. Furthermore, there should be a risk based internal control system and appropriate reporting and disclosure mechanisms.

According to Good practice 2 in the OECD/IOPS Report on Good Practices for Pension Funds' Risk Management Systems, January 2011, the governing board is responsible for defining, implementing and improving the risk management system as well as determining and regularly reviewing the risk management strategy. Responsibilities should be clear and reflect the nature and extent of risks, and different people are to be assigned for decision making, execution and checking functions. There should be a strong internal control culture within the organisation including communication of information between levels of management. A policy for conflict of interests as well as a code of conduct policy for all staff should be in place. Policies and practices (including compensation) that may provide incentives for inappropriate activities should be avoided.

Fit and proper

Equally, principle 2 of the OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009, stipulates that members of the governing bodies of the pension entity should be subject to fit and proper requirements. Furthermore, the OECD Guidelines for Pension Fund Governance, June 2009, identify as part of a governance structure inter alia the suitability of the members of the governing body.

Functions for risk management, actuarial tasks, internal control, compliance and audit

The OECD Recommendation on the Core Principles of Occupational Pension Regulation of June 2009 stipulates in its second core principle (risk control) that pension entities should have adequate risk control mechanisms in place to address investment, operational and governance risks, as well as internal reporting and auditing mechanisms. If they manage more than one pension plan or fund, pension entities

¹⁰⁰ OECD: OECD Recommendation on Core Principles of Occupational Pension Regulation, 2009, <http://www.oecd.org/finance/private-pensions/33619987.pdf>.

should be required to maintain separate accounts and records for each of the pension funds, or where relevant, each of the pension plans that they manage.

The OECD Guidelines for pension fund governance of June 2009 states that the scope and complexity of internal control measures should be „risk-based“ and will vary according to the type and size of pension plan, fund and entity and the type and extent of risks faced. The risk management system should cover the main risks that a pension fund is exposed to, such as investment, biometric and operational risks. These control mechanisms form the basis of good business conduct, enhanced transparency, consistency as to management decisions, and for the protection of all stakeholders of the pension fund.

Good practice 1 (Appropriate Mechanisms) of the OECD/IOPS Good Practices for Pension Funds' Risk Management Systems of January 2011 recommends that pension regulatory and supervisory authorities must be satisfied - for licensing/ registration purposes and on an on-going basis - that pension plans or funds have in place a comprehensive risk management system.

Both the Core Principle 6 (actuary & delegation and expert advice) of the OECD Recommendation on the Core Principles of Occupational Pension Regulation of June 2009 and the OECD Guidelines for pension fund governance of June 2009 recommend the appointment of an actuary by the appropriate body or authority for all defined benefit plans financed via pension funds. The 'whistle blowing' responsibilities of the actuary are emphasized.

The OECD/IOPS Good Practices for Pension Funds' Risk Management Systems of January 2011 recommends in the Good Practice 3 (Funding and Solvency Risk Control) that the governing board will normally rely on the advice of an actuary when monitoring the funding level of the pension fund. Good Practice 6 stresses out that the actuary should be independent and has 'whistle blowing' responsibilities.

Although the OECD Recommendation on the Core Principles of Occupational Pension Regulation of June 2009 (Core Principle 6 (auditor)) and the OECD Guidelines for pension fund governance of June 2009 recommend adequate internal controls (cf. comments CfA 17), they are silent on the appointment of an internal auditor.

OECD/IOPS Good Practices for Pension Funds' Risk Management Systems of January 2011 (Good practice 6 (control and monitoring mechanisms)) recommends the implementation of Control and Monitoring Mechanisms. Key elements of the risk management and monitoring system are the internal audit and compliance functions – the nature and scope of which should be appropriate to the operations of the pension fund. These functions report directly to the governing board and they should not conflict with other obligations. Those responsible for internal audit and compliance require access to records and the ability to communicate freely to carry out their role effectively.

Depositories

In implementing guideline 6.8 for Core Principle 6 of Occupational Pension Regulation, June 2009, it is stated that custody of the pension fund assets may be carried out by the pension entity, the financial institution that manages the pension fund, or by an independent custodian. If an independent custodian is appointed by the governing body to hold the pension fund assets and to ensure their safekeeping, the pension fund assets should be legally separated from those of the custodian. The custodian should not be able to absolve itself of its responsibility by entrusting to a third party all or some of the assets in its safekeeping.

The OECD Guidelines for pension fund governance, June 2009, further complement the above by stating that, where appropriate, the appointment of an independent custodian may be required.

Besides holding the pension fund assets and ensuring their safekeeping, the custodian may also provide additional services such as securities lending, cash management, investment accounting and reporting, and performance measurement. In some cases, the custodian may also play an external 'whistle blowing' function similar to that of the auditor with respect to, for example, the investment of pension assets.

According to the OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011, in addition to – and working with – the internal control mechanisms, independent external parties, such as external auditors, actuaries and custodians, should be appointed as part of the risk management of a pension system.

In addition it is stated that mechanisms are needed to regularly assess the performance of the pension funds' external service providers, including those providing custody.

Annex VIII: POG requirements

Requirements for providers and intermediaries that manufacture personal pension products for sale to consumers

Each provider should establish and implement product oversight and governance arrangements that set out appropriate measures and procedures for designing, monitoring, reviewing and distributing products for consumers, as well as taking action in respect of products that may lead to consumer detriment. These should be set out in a written document which should be available for the use of all relevant staff.

The product oversight and governance arrangements should aim to minimise or preferably prevent consumer detriment, support proper management of conflicts of interests and should ensure that the objectives, interests and characteristics of consumers are duly taken into account.

The provider should include in its product oversight and governance arrangements suitable steps in order to identify the relevant target market of a product. The provider should only design and bring to the market products with features and identified distribution channels which are aligned with the interests, objectives and characteristics of the target market. When deciding whether or not a product is aligned with the interests, objectives and characteristics of a particular target market, the provider should consider assessing the level of information available to the target market and the degree of financial capability and literacy of the target market, and the specific retirement planning needs of that target market.

The provider should also identify groups of consumers for whom the product is considered likely not to be aligned with their interests, objectives and characteristics. This can add considerable value to the process as it requires that relevant staff assess the potential PPP from different perspectives.

Before a product is brought to the market, the provider should conduct appropriate testing of the product including, as relevant, analysis of different scenarios. The product testing should assess if the product is in line with the objectives for the target market over the lifetime of the product. Such testing should also be carried out if the target market is changed, or indeed if changes to an existing product are introduced. The provider should carry out qualitative, and where appropriate quantitative, product testing calibrated to the type and nature of the product and the related risk of potential detriment to the consumer. The testing would identify, for instance, how the product might perform under different financial circumstances. It could also explore how specific features (fees or limitations on redemption, for instance) might impact consumers in the future.

The provider should not bring a product to the market if the results of the product testing show that the product is not aligned with the interests, objectives and characteristics of the target market.

The provider's administrative, management or supervisory body should endorse and be ultimately responsible for the establishment, implementation, subsequent reviews and continued internal compliance with the product oversight and governance arrangements.

The provider should regularly review the product oversight and governance arrangements to ensure that they are still valid and up to date, and amend them where appropriate.

The provider should ensure that relevant personnel involved in designing products should possess the necessary skills, knowledge and expertise in order to properly understand the product's main features and characteristics as well as the interests, objectives and characteristics of the target market.

Once the product is distributed, the provider should monitor on an on-going basis that the product continues to be aligned with the interests, objectives and characteristics of the target market. This is particularly important in the PPP context given the long-term nature of the relationship between the parties.

Should the provider identify product-related circumstances that give rise to the risk of consumer detriment during the lifetime of a product, the provider should take appropriate action to mitigate the situation and prevent the re-occurrence of such detriment. If relevant, the provider should notify any relevant remedial action promptly to the distributors involved and to the consumers in the case of direct sales.

The provider should select distribution channels that are appropriate for the target market considering the particular characteristics of the product and exercise appropriate care when selecting distributors.

The provider should provide clear, precise and up-to-date information of an adequate standard to distributors. The information given to distributors should be sufficient to enable them to:

- understand the product and its features;
- identify the target market and the consumers within that target market for which the product is designed and also to identify the group of consumers for whom the product is considered unlikely to meet their interests, objectives and characteristics.

The provider should take all reasonable steps to monitor that distribution channels act in compliance with the objectives of the provider's product oversight and governance arrangements. The provider should examine, on a regular basis, whether the product is distributed to consumers belonging to the relevant target market. When the provider considers that the distribution channel does not meet the objectives of the provider's own product oversight and governance arrangements, the provider should take remedial actions with the distribution channel.

The provider should retain full responsibility for compliance with product oversight and governance arrangements when they designate a third party to design products on their behalf.

All relevant actions taken by the provider in relation to the product oversight and governance arrangements should be duly documented, retained for audit purposes and made available to the competent authorities upon request.

Requirements for distributors that distribute personal pension products that they do not manufacture

The distributor should establish and implement product distribution arrangements that set out appropriate measures and procedures for considering the range of products and services that the distributor intends to offer to their consumers. The distributor should set out the product distribution arrangements in a written document and make it available for the use of relevant staff.

The product distribution arrangements should aim to prevent and minimise consumer detriment, support proper management of conflicts of interests and should ensure that the objectives, interests and characteristics of consumers are duly taken into account.

The persons within the distributor's management who are registered and responsible for product distribution should endorse and be ultimately responsible for the establishment, implementation, subsequent reviews and continued internal compliance with the product distribution arrangements.

The product distribution arrangements should aim to ensure that the distributor obtains all necessary information from the provider on the pension product, the product approval process, and the target market in order to understand the consumers for whom the product is designed, as well as the group(s) of consumers for whom the product is not designed. Furthermore, this process should aim to ensure that the distributor obtains all other necessary information on the product from the provider in order to fulfil its regulatory obligations towards the consumers. This includes information on the main characteristics of the products, its risks and costs, as well as circumstances that may cause conflicts of interest to the detriment of the consumer.

The distribution strategy of the distributor should not contrast with the distribution strategy and the target market identified by the provider of the PPP.

The distributor should regularly review the product distribution arrangements to ensure that they are still valid and should amend them where appropriate, in particular any distribution strategy. Again, this is particularly important given the long-term nature of PPPs.

The distributor should inform the provider without undue delay if he becomes aware that the product is not aligned with the interests, objectives and characteristics of the target market or if he becomes aware of other product-related circumstances that are increasing the risk of consumer detriment.

All relevant actions taken by the distributor in relation to the product distribution arrangements should be duly documented, retained for audit purposes and made available to the competent authorities on request.