

# Methodology to assess value for money in the unit-linked market

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## BACKGROUND

Following the publication of the Supervisory Statement on Value for Money in November 2021<sup>1</sup>, as highlighted therein, EIOPA has worked on a methodology to ensure a consistent and convergent approach towards the implementation of said Supervisory Statement.

As a result, also taking into account the comments received in the two public events organized by EIOPA and stakeholders inputs, this document provides an overview of EIOPA's methodology on how to address value for money risks of unit-linked and hybrid<sup>2</sup> products (both referred hereby as "unit-linked products")<sup>3</sup>.

While the methodology is for support and use by National Competent Authorities (NCAs), this document aims at providing more clarity for insurance manufacturers and distributors on the supervisory approach to addressing value for money risks when supervising product oversight and governance (POG) requirements.

In addition the work is not yet finalised and the document should be read as a work in progress where further refinements and improvements would be developed after NCAs start implement it in practice. EIOPA will review this methodology on a regular basis and in case substantial changes take place the methodology would be re-published.

The methodology can be of useful support for insurance manufacturers and distributors when implementing their own POG policies and when performing their value for money assessments to determine whether their products are aligned with the target market's needs, objectives and characteristics before they bring them to the market or when performing product reviews.

The methodology aims at fostering a common convergent approach, with the aim of achieving consistent consumer outcomes in all European markets, while allowing for flexibility. Moreover, it is important to note that the NCAs can use this methodology as a basis to assess value for money. This methodology is a common basis for all NCAs and EIOPA welcomes and encourages approaches which, taking into account market specificities and supervisory experiences and practices, develop further indicators to ensure value for money risks are sufficiently addressed in their markets, taking into account also emerging risks such the raising inflationary trends.

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<sup>1</sup> [supervisory statement \(europa.eu\)](#)

<sup>2</sup> Products mixing a traditional component with a unit-linked component.

<sup>3</sup> The scope of the value for money assessment cover all unit-linked and hybrids products, including those different from IBIPs (if relevant).

The approach is divided into three layers:

- Market wide assessment (**Layer I**) through which NCAs would identify products requiring higher scrutiny;
- Enhanced supervision (**Layer II**) through which NCAs would assess different indicators and determine whether products offer value or not;
- Assessment of Product Oversight and Governance (POG) documents (**Layer III**) for those products for which the enhanced supervision performed in the previous layer does not point at products clearly offering (or not offering) value for money but results in identifying products which may offer value only to some target markets.

After the finalisation of the three layers analysis, it is expected that a conclusive decision on whether products offer value for money to their identified target market would be reached. Finally, it is important to note that this approach, in particular Layer III, is not meant to replace manufacturers' assessment of value for money. It rather aims at determining whether manufacturers have sufficiently and adequately tested that their products offer value to a given target market.

## 1 LAYER I – MARKET WIDE ASSESSMENT

The first layer of assessment of the methodology focuses on the market wide assessment. Namely, supervisory authorities should perform a market wide assessment to identify relevant outliers in each market, undertakings or their products (depending on the tool used<sup>4</sup>), which should be subjected to higher supervisory scrutiny.

The products in scope of the analysis should be currently commercialised ones to make sure the analysis is representative of the current market environment.

In this context the methodology assess undertakings or products (depending on the tool used) to monitor the trade-off between costs and returns. Costs and performance should be always considered jointly, regardless of the tool used, as the focus of this approach is on ensuring value for money and some higher costs may not be un-due because of the services offered and/or because of the possibility of seeking higher performance. Moreover additional extrinsic factors may matter when assessing product value for money. Such a factor could be inflation. Inflation is not part of the costs and performance that at least to a certain degree can be influenced by the manufacturers; nevertheless inflation is a factor of importance as it affects the 'real' value of the product's return and therefore it needs to be taken into account.

Regarding costs it should need to be determined whether the specific product includes costs for the product's distribution or whether such costs – according to the undertaking's distribution strategy – are borne separately by the customer and paid directly to the intermediary. This should be taken into account when assessing value for money.

### 1.1 Set of tools

#### **Tool 1 – Approach based on PRIIPs KID data**

The PRIIPs KID document is based on a standardised methodology described in the PRIIPs Delegated Regulation<sup>5</sup> and it is publicly available for all the commercialised products.

PRIIPs KID shows information on both:

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<sup>4</sup> As described below in this paragraph, Tool 1 and Tool 2 allow to directly identify outlier products, while Tool 3 and 4 are at undertaking level.

<sup>5</sup> [EUR-Lex - 32017R0653 - EN - EUR-Lex \(europa.eu\)](#)

- ▶ Performance – in absolute terms and in percentage terms, as expected rate of return (“IRR”) according to different scenarios and different recommended holding periods;
- ▶ Costs - expressed both in absolute values and in relative terms as Reduction in Yield (“RIY”) at different point in time.

This information can be interpreted jointly and combined to rank products and identify the least profitable (lower IRR) jointly having the highest RIY according to a value for money perspective.

Once such information is mapped, the products showing the poorest performance vis-à-vis costs could be selected as products requiring higher scrutiny and further explored and tested in the enhanced assessment carried out in the Layer II of the methodology.

### **Tool 2 – Approach based on product national reporting**

In the context of the national market supervision, national authorities run regular or *ad hoc* data collection on products. Moreover, the vast majority of NCAs collects additional *ad hoc* product-related information on costs and past performance (on a sample-basis) in the context of the EIOPA Costs and Past Performance Report.

National product reporting on costs indicators jointly with performance indicators can be used to compare products in terms of value for money. Namely costs and performance indicators can be analysed jointly to collect a distribution of value and analyse outliers.

Costs and past performance data collection could also be used as a proxy, despite leveraging on a (representative<sup>66</sup>) sample of products. Namely the 5-year past performance together with the information on the reduction in yield (RIY) at recommended holding period (RHP) could be analysed jointly to identify products whose performance is lower and costs are higher in relative terms with respect to the sample.

### **Tool 3 – Approach based on Solvency II retail risk indicators**

EIOPA’s methodology on retail risk indicators based on Solvency II data<sup>7</sup>, despite a number of known caveats, has the advantage of being standardized. The methodology envisages some indicators based on unit-linked return (looking at the return of the assets backing unit-linked products) and costs (commission rate). A joint analysis of two variables allows for some initial consideration in terms of value for money at the level of the unit-linked line of business as undertakings can be ranked according to these metrics to identify manufacturers characterised by higher commission

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<sup>66</sup> The sample is based on the most representative products in term of GWP per undertaking. The undertakings in scope represent ca. 60% of the market in term of GWP per relevant line of business.

<sup>7</sup> [Retail risk indicators: methodology update | Eiopa \(europa.eu\)](#)

rate and jointly lower return in the assets underlying unit-linked products. The further work – envisaged in the Layer II – would then aim at refining the consideration made at undertaking level.

#### **Tool 4 – Approach based on the quality of funds underlying unit-linked products**

The value for money of unit-linked products is determined in part by the quality of the underlying funds. NCAs would not analyse all underlying funds available, but rather, if they choose this approach, they should make an assessment at the level of the manufacturer.

Using available data NCAs may select the top 5 largest funds in terms of invested amount in which unit-linked products invest. In this way the most relevant funds by undertaking are selected and assessed. Undertakings offering less profitable unit-linked products can be shortlisted and further explored in Layer II.

In particular the following checklist is suggested:

<b>Quality Checklist on unit-linked underlying funds</b>	
Do any of the 5 largest funds in which the unit-linked is invested charge entry fees?	Y/N
Do any of the 5 largest funds underperformed (net returns) their benchmark by more than a total of 10% over the past 5 years?	Y/N
Do the assets issued by affiliated entities represent more than 10% in the 5 largest funds? (e.g. there are instances of self-placement)	Y/N

### **1.2 Selection of outliers**

The products or undertakings (depending on the tool used) to be shortlisted for enhanced monitoring (Layer II) are the outliers (both in terms of low performance and high costs) according to the different metric corresponding to one (or a combination) of tools used.

Outliers may be identified using relative thresholds, i.e. relative to the figures observed in the market, or on the basis of fixed thresholds. Regarding the thresholds it should also be kept in mind whether the specific products under scrutiny include costs for their distribution or whether such (additional) costs – according to the manufacturer’s distribution strategy – are borne separately by the customer:

- ▶ **Relative thresholds** entail selecting a proportion of undertakings/products which are in the tail of the distribution according to the indicators corresponding to the different approach, for example undertakings/products belonging to the 10%, 5% or 1% of the tail of the distribution of the indicator could be shortlisted. The number of outliers to be identified could vary depending on the market concentration and NCA's available resources.
- ▶ Alternatively supervisors may choose to use **fix thresholds**, namely fixed levels for indicators beyond which further scrutiny would be triggered. The fixed threshold should be consistent to the type of data used to calculate the thresholds and the type of data used in the different tools (KID data, national reporting, Solvency II data and underlying funds)<sup>8</sup>. Subject to data availability, the fix thresholds should be defined for similar products in terms of RHP, risk class and product category (hybrid vs. simple unit-linked) as these are relevant factors.

### 1.3 Remarks on flexibility – Layer I

The different tools presented are indicative and should be adapted by NCAs. Therefore they represent a methodology for possible more precise and refined monitoring. For example the following improvements could be envisaged:

- ▶ Screening products according to costs and profitability features taking into account their relative size with respect to other products (for example in terms of GWP or number of contracts) to take into account the scale of instance of poor value for money.
- ▶ Refining the analysis by risk group and/or RHP and/or the product category (i.e. whether the product is a pure unit-linked or a hybrid), as products with different features influence the level of costs and return.

In addition supervisory authorities might choose one of the tools proposed, or a combination of these, for example:

- ▶ Tool 2 (The national product reporting) might be combined with Tool 1 (PRIIPs KID information) in case from the national reporting only partial information on costs or performance could be used or to complement information deriving from the costs and past performance data collection.
- ▶ Tool 3 (Solvency II retail risk indicators) might be used to identify problematic undertakings and then the Tool 4 (performance of the main funds underlying unit-linked products) can dig deeper to achieve a more precise understanding.

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<sup>8</sup> Examples of indicative thresholds for the unit-linked and hybrid market at the EEA level and national level can be found in EIOPA annual publication on: [Cost and past performance report 2022 | Eiopa \(europa.eu\)](#) and [Consumer Trends Report 2021 | Eiopa \(europa.eu\)](#)



Finally if qualitative information are also available at market-wide level, these should also be considered to further fine tune the assessment.

## 2 LAYER II – ENHANCED SUPERVISION

The second layer of assessment of the methodology aims at defining tools to perform an enhanced product analysis to identify instances where products do not offer value in general or to their specific target market. Namely, more precise evidence should be collected, both quantitative and qualitative, to be able to draw more detailed conclusions. Indicators to test independently the Value for Money would focus on both the “surrender scenario” and the “biometric risk scenario” as two independent events. The biometric risk scenario in this context represents a simplification of any biometric insured event offered by the insurance policy. This includes especially the risk of death<sup>9</sup>.

At this stage, the assessment should be carried out at individual product level, specifically testing product profitability and not undertakings’ lines of business, different from some possibilities envisaged in Layer I (market wide assessment), where the Tool 3 and 4 were still at undertaking level. In these cases, supervisors would need an additional step to define a sample of representative products commercialised by the undertakings for which possible concern emerged in the Layer I analysis. Criteria which might be used include the most sold products by the undertaking or, if available, products marketed by the undertaking which are already known to the supervisor as possibly problematic.

In the context of this work, the notion of product refers to the policyholder’s perspective, meaning that product is considered as an option (or a given combination of options) plus the wrapper. This perspective might at time differ from the manufacturer’s perspective, whereby a product might be considered as the set of all the possible available combinations of options as a whole.

In case of multi-option products the assessment might happen at the option / combination of options level. The impact of the insurance wrapper should be considered as it generally carries extra costs.

The products in scope of the analysis should be currently commercialised ones to make sure the analysis is representative of the current market environment (so run-off products should be excluded, without prejudice to the manufacturer’s obligation of product monitoring and review).

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<sup>9</sup> The longevity risk of annuity products is not addressed by the tool-kit described in this document. In markets with high relevance of such products NCAs could extend the methodology in order to cover annuity benefits, too.

## 2.1 Set of tools

### Tool 1 – Product Profitability Testing

The enhanced supervision on identified products should imply a product profitability testing exercise to gain a full picture of the impact of costs and, depending on the target market, other factors like inflation, versus the performance following a consumer perspective. Supervisors could leverage of the product pre-contractual disclosure, such as terms and condition, the product technical specification, the PRIIPs KID and/or on other possible national source of information available or requested ad hoc. The aim of such testing would be to challenge the manufacturer and engage in a dialogue. The product profitability testing could be carried out by supervisors or they could leverage on the work performed by the undertakings as part of the product testing they are required to perform under POG. In the latter case, NCAs should challenge the assumptions used by the manufacturer also by providing their own sets of hypothesis to be applied in the profit test such as those of the returns of the underlying funds.

The product profitability testing should also verify whether the investment strategy and general functioning of the product (e.g. if there are triggers affecting the performance calculation or automatic switches) lead to satisfactory performance.

A number of indicators derived from the product profitability testing on value and costs should therefore be jointly considered. The list of illustrative indicators aims, on one hand, at better understanding products' features and functioning, collecting a sound basis of evidence (more granular and precise than the market wide analysis previously carried out). On the other hand it also allows to compare in relative terms selected products amongst each other's. Nevertheless it is also envisaged that NCAs could also consider additional indicators which could specifically fit national market ultimately assessing consumers' net value (after costs and when relevant inflation).

The list of indicators is grouped in the following way:

- 1) Indicators to assess, at different points in time, the policy value in case of surrender, i.e. "surrender value", against the amount of premium paid. Jointly the amount of costs paid on the total premium paid should be considered:

**Table 1 – Quantitative Indicators – Surrender Scenario**

Quantitative Indicators – Surrender scenario	
Value	Costs

1. Surrender value / premium paid - after 1Y	1.a RIY <sup>10</sup> – after 1Y, and/or 1.b Total costs paid / premium paid– after 1Y (when comparing products with similar RHP)
2. Surrender value / premium paid - after half RHP <sup>11</sup>	2.a RIY - after half RHP, and/or 2.b Total costs paid / premium paid – after half RHP (when comparing products with similar RHP)
3. Surrender value / premium paid - at RHP	2.a RIY – at RHP, and/or 2.b Total costs paid / premium paid - at RHP (when comparing products with similar RHP)

While the above are minimum common indicators, some NCAs could use additional indicators for example considering the annual net real return after the first year, at half of the RHP and at the RHP.

- 2) Indicators to assess, at different points in time, the policy value in case that the biometric event insured is triggered, i.e. to test the “Biometric risk benefit”<sup>12</sup>, against the total amount of premium paid and jointly the amount of costs paid on the total premium paid in these events.

**Table 2 – Quantitative Indicators – Biometric risk scenario**

Quantitative indicators – Biometric risk scenario	
Value	Costs
1. Biometric risk benefit/premium paid - after 1Y	1.a RIY – after 1Y, and/or 1.b Total costs paid / premium paid– after 1Y (when comparing products with similar RHP)

<sup>10</sup> Reduction in yield “RIY”

<sup>11</sup> Recommended Holding Period “RHP”

<sup>12</sup> The Biometric risk benefit refers to the total benefit paid in case of the biometric event, e.g. if the benefit correspond to € 10.000 plus the accumulated capital the risk benefit to be considered correspond to the sum of the two elements and not only to € 10.000

2. Biometric risk benefit/premium paid after - at half of the RHP	2.a RIY - after half RHP, and/or 2.b Total costs paid / premium paid – after half RHP (when comparing products with similar RHP)
3. Biometric risk benefit/premium paid - at RHP	2.a RIY – at RHP, and/or 2.b Total costs paid / premium paid - at RHP (when comparing products with similar RHP)

3) Additional indicators to improve the quantitative analysis.

**Table 3 – Additional quantitative indicators**

Additional Quantitative Indicators
1. Surrender costs/ surrender value – 1 year before the RHP
2. Entry costs/total costs paid - cumulated until 1 year before the RHP
3. Minimum average yearly return required to break-even at RHP with and without biometric risk deduction
4. Break-even of surrender value with average yearly return equal to a given set of return rate <sup>13</sup>
5. Sum of fair values of biometric risk premiums during contract term <sup>14</sup> / Sum of biometric risk premiums paid during contract term – at half RHP and RHP (pending data availability)

In relation to the additional quantitative indicators (Table 3) it is important to highlight that:

- ▶ The first two indicators assess the impact of specific costs item:
  - 1.surrender costs are paid under any circumstances of surrender (unless surrender costs are null); and
  - 2.entry costs are certain costs paid immediately after the product subscription, regardless of the future events and market development,

<sup>13</sup> The set return rate of the used in the product profitability testing should be of the moderate scenario or a benchmark return corresponding relevant asset classes

<sup>14</sup> The fair value of the biometric risk premiums is calculated using best estimate assumptions on biometric risk (e.g. best estimate mortality tables).

therefore it is of relevance to understand their impact with respect to the total costs.

- ▶ Indicators n.3 and n.4 are more holistic indicators, aiming at testing the value for money of the product as whole:

3. The minimum average yearly return of the underlying asset allow to understand the minimum required underlying's performance for products to break-even (i.e. the surrender value is higher than the premium paid) at RHP possibly to be computed with and without biometric risk deduction to consider both instances. Such break-even should be also considered in light of a reasonable assumption of future inflation (e.g., the ECB's Target Inflation); and

4. Break-even point: given a set return of the underlying assets it is possible to compute the point in time when the product breaks-even. The return of the moderate scenario of the PRIIPs KID and the illustrative return shown in the ESMA annual publication on the performance of retail products<sup>15</sup> can be used as a reference value, bearing in mind that past performance would differentiate from the future performance. Nevertheless considering such levels should prevent to model disproportionately high return.

- ▶ Pending data availability, indicator n. 5 represents an additional indicator to compute the value for money of the biometric risk scenario, comparing the biometric risk premium (i.e. the amount of the premium used to finance the biometric risk benefit) to their fair value according to the Best Estimate assumption.

## **Tool 2 – Enhanced PRIIPs KID analysis**

Alternatively to the Product Profitability Testing (Tool 1), some other indicators provided in the PRIIPs KID might be used and jointly interpreted to perform an enhanced supervision while also investigating the assumptions backing the PRIIPs KID information

The illustrative quantitative indicators shown in Table 1 and Table 2 can be also developed leveraging on the PRIIPs KID and hence can be applied to the Tool 2. The additional indicators shown in Table 3, conversely, go beyond the information disclosed in the PRIIPs KID and cannot be applied.

## **2.2 Interpretation of the indicators**

While this work represents the basis to start assessing value for money, the below considerations on the indicators can be made to interpret and use them. It is important to also take into account

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<sup>15</sup> [esma 50-165 1677 asr performance and costs of eu retail investment products.pdf \(europa.eu\)](#)

that while inflation is not part of the product features where appropriate reasonable assumptions on inflation should also be considered.

- 1) In relation to the quantitative indicators related to the Surrender Scenario (Table 1) – relevant for both Tool 1 and Tool 2:
  - The surrender value in real terms, particularly for products with long recommended holding periods, should be higher than the premium paid at least during the last years of RHP, as consumers may face unexpected liquidity need and more generally after having contributed for almost the complete duration of the contract, the product should pay out more than what has been contributed in the form of premium. However, for products with very long recommended holding period, this should be at around half of the recommended holding period and also there shouldn't be significant difference in the surrender value between the last year and the second/third to last year – i.e., for RHP 30 the higher surrender value between 25 and 30 should only be proportional to the premium increase.
  - It is expected that products have surrenders values higher than the premium paid at the RHP, as at the end of the contract indicated life any product should pay out more than what was contributed. In other words it is expected that all products break-even at RHP with moderate scenarios analysis.
  - On the other hand it is reasonable to expect that at the inception (e.g. after 1 year) the ratio between surrender value and premium paid is lower than 1 (i.e. that the product has not yet broke-even).
  - The costs indicators should be as low as possible as the RIY, by definition, represents the size of the missed return due to costs. Similarly the ratio between costs paid on the total premium should be as low as possible for products with similar RHPs as it shows how much of the premium paid is ultimately allocated to costs and not invested in funds that should generate a positive return. However, some proportionality considerations need to be taken into account depending on the investment strategy of the underlying assets.
  
- 2) In relation to quantitative indicators on the Biometric Risk Scenario (Table 2) – relevant for both Tool 1 and Tool 2:
  - Unit-linked products have often low biometric risk coverage, nevertheless this is usually available, differentiating pure investment products and insurance based investment products (IBIPs).
  - Regardless the level of costs and the level of biometric risk coverage of the products it is expected that the ratio between biometric risk benefit and premium paid at RHP is positive (the higher the better). Pending products' feature (i.e. more relevant for products with higher biometric risk coverage) it is also expected a ratio above 1 already at half of the RHP as the biometric event is independent from consumer choices and possibly triggered also in the first years of the contract.

- Similarly to the surrender scenario, also under the biometric risk event the costs paid with respect to the total premium should be as low as possible, as the RIY, by definition, represents the size of the missed return due to costs and the ratio between costs paid and premium paid show how much of the premium paid is ultimately allocated to costs for products with similar RHPs.
- 3) In relation to the quantitative indicators on the additional indicators (Table 3) – relevant only for Tool 1:
- Surrender costs should be as minimal as possible, in particular for products with longer RHPs as it is likely that in longer time horizons unexpected event could trigger liquidity needs and exposing to surrender costs;
  - The impact of entry costs at the end of the RHP should be minimal. These costs are certain as they are paid as soon as the product is subscribed. Also the impact of entry costs in the event of early surrender should be considered.
  - The average yearly return to allow the product to break-even should be as low as possible to allow some resilience in adverse market development;
  - To compare – all conditions being equal – the value for money of a set of products it can be envisaged to set the assets return to a minimum level so to compare products performance in terms of break-even points. The return of the PRIIPs KID moderate scenario or a set return corresponding relevant asset classes (as in the ESMA annual publication on the performance of retail products<sup>16</sup>) can be used as proxy. The indicator can be computed with and without biometric risk deduction to assess independently the two instances;
  - A fair value of the biometric risk premium much smaller than the biometric risk premium paid (and so a ratio far below 1) could point at low value for money. Ratios near 1 mean a good value for money at both half of the RHP and at the end of the RHP as the fair value corresponding to the amount paid is higher.

The indicators might be used to compare the products in scope of the analysis. It is expected that with the implementation of the methodology more evidence would be gathered and benchmarks for relevant cluster could be gradually considered.

### 2.3 Qualitative check-list

In addition to the tools described above, further refinement could be performed bearing in mind a qualitative check-list that might mitigate the findings.

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<sup>16</sup>[esma 50-165 1677 asr performance and costs of eu retail investment products.pdf \(europa.eu\)](#)



Non-monetary value do also represent a source of value when looking at the value for money trade off. The following check-list represents an illustrative list of items that supervisor could investigate to better understand the products under their higher supervisory scrutiny. The list should be considered after having analysed the outcome of the quantitative indicators and it represents a set of mitigating factors.

According to the following qualitative check-list (Table 4), it is investigated the presence of element that usually represent a non-monetary value to policyholders who may be willing to bear extra costs, so explaining - at least partially - the presence of higher costs.

**Table 4 – Qualitative check-list**

Qualitative check-list
<b>Sustainability of the product:</b> products with sustainability features can offer a non-monetary value to policyholders valuing such features.
<b>Digitalization:</b> products allowing consumers to easily access the asset allocation or to express their preference on product design from a digital platform (e.g. a phone based app or an interactive website) could be particularly appreciated by some policyholders.
<b>Level of advisory/assistance at the point of sale and during the contract duration:</b> the presence of a customised service both at the point of sale and during the contract’s life, represents, for some policyholders, an important additional service.
Presence of <b>peculiar features</b> , such as non-monetary bonus (e.g. trainings or gift card) and more limited exclusions which represent also a source of non-monetary value to be considered.

## 2.4 Remarks on flexibility – Layer II

The different quantitative and qualitative indicators presented are meant to be adapted. Therefore they represent an illustrative methodology for possible more precise and refined monitoring.

Supervisors should choose the most adequate tool in order to perform a proportionate analysis.

As for Layer I the approach chosen might be better adapted according to national market specificities, resources and priorities. If feasible further refinement might be done, for example:

- More precise analysis could be carried out when modelling the underlying return of the assets, for example, using a stochastic distribution of return rather than fixed values.
- More granular analysis could be performed on the basis of clusters of products with similar features, for example, the risk class, RHPs, premium frequency and product categorization

(hybrid vs simple unit-linked). In this way products with similar features could be compared amongst each other's, rather than with all the sample of products in scope of the Layer II.

Products' value for money could be also interpreted in relation to products' relative weight and size (for example in terms of GWP or number of contracts) to take into account the scale of instance of poor value for money.

### 3 LAYER III – POG ASSESSMENT IN RELATION TO THE SUPERVISORY STATEMENT ON VALUE FOR MONEY

The final step of the methodology envisages to interpret the set of information gathered in the previous layers in light of the POG process followed by the manufacturers.

The objective of POG supervision is to ensure that insurance manufacturers and distributors take a customer-centric approach to their product approval, distribution, and monitoring and review process. This to ensure that products produce good consumer outcomes – i.e., that products are aligned with the needs, objectives, and characteristics of a sufficiently granular target market.

The sample of products in scope of Layer III corresponds to those considered in Layer II with the exception of:

- ▶ Products which in Layer II emerged not offering value at all – i.e., to any target market; or on the contrary,
- ▶ Products which in Layer II emerged always offering value for money.

In particular considering that no target market has as its objective receiving poor value (e.g., products for which, on the basis of historical rates of return and / or reasonable return assumptions, it is not expected that the breakeven will be reached at maturity and which at the same time do not offer further appreciable advantages for the policyholder, such as material biometric protections), it is clear that unit-linked products which offer poor or no value are not aligned with the objectives of any target market and should therefore not be marketed to consumers. Hence, if the conclusion from the previous (Layer II) assessment is that the product does not offer value at all / costs are too high for any consumers / target market to get any benefit from the product under any reasonable scenario, the layer III assessment would not be needed.

On the other hand, for those products which, based on Layer II, may offer value for money despite having high costs and / or having certain features which may not be simple / easy for any target market to understand, supervisors should assess whether:

- ▶ The costs are due – i.e., whether in the POG process a balancing of interests was duly made between the value, offered by the products, and the target market;
- ▶ The services and / or the product features to which the costs relate too are aligned with the needs, objectives and characteristics of the target market. In fact, target markets differ

substantially, hence product characteristics including features and services which may or may not offer value should be assessed vis-à-vis the target markets' needs objective and characteristics.

In line to EIOPA's approach to the supervision of POG<sup>17</sup>, the POG Process relies on the following steps:



- 1) **Manufacturers' systems and controls** to ensure customer centric business models, ensuring product meets needs of the identified target market and mitigate consumer detriment. In particular, in relation to value for money manufacturers systems and controls should ensure costs are due and that the product pricing process is sufficiently customer-centric.
- 2) **The definition of product's target market**, namely the identification of a group of customers, with similar characteristics, for whom the product is compatible, establishing a link between the complexity of a product and the level of granularity of the definition of the target market. The more complex a product is, the higher level of detail with which the target market will have to be defined. The definition of the target market also entails defining the specific target market's needs and characteristics which correspond to the specific product features which may carry higher costs and / or to the additional services which carry higher costs.
- 3) **The product testing**, to assess if the products meet the identified target market's needs, objective and characteristics, over the lifetime of the product. In particular, the product testing, as outlined in the Supervisory Statement, should determine whether the costs are due – i.e., if a sufficient balancing between the costs borne by the manufacturer and the costs charged to the consumer has been made. The testing should also look at whether the product features which carry higher costs and/or the additional services offer value to the

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<sup>17</sup> [EIOPA's approach to the supervision of product oversight and governance | Eiopa \(europa.eu\)](#)

target market – i.e., if they correspond to specific target market’s needs, objectives and characteristics (e.g., the cost of a partial capital guarantee at maturity could be greater than the benefit it recognizes in most of the expected scenarios; furthermore, some contractual options for which costs are charged may not, in any reasonable scenario, bring a benefit to the policyholder that justifies that cost). Depending on target market’s needs, characteristics and objectives the product testing should include the effect of additional factors such as inflation for example.

- 4) **The assessment of the appropriateness of the distribution strategy**, to ensure manufacturer have appropriate processes and controls that determine the processes criteria and steps to be followed for the development of distribution strategies. This should also include whether specific advice and/or distribution related aspects justify higher level of distribution costs being charged to the consumers and whether such features are a clear need of the target market (e.g. the on-going assistance and consultancy activity of the intermediary is limited for those products that do not allow the policyholder to change the investment strategy during the life cycle of the policy. For such products, the reasons for any high remuneration of intermediaries should be investigated).
- 5) **Product monitoring and review**, to ensure that insurance products remain consistent with the needs, characteristics and objectives of the target market. It is also aimed at identifying whether products are distributed to the target market while continuously monitor and regularly review the products they have brought to the market to identify events that could materially affect the main features, the risk coverage or the guarantees of those products and have potential adverse effect on customers. In particular, this should assess whether the manufacturers ensures sufficiently products continue to offer value to the target market and whether the additional services offered provide any added value to the target market (e.g. changes in the macroeconomic environment can make the investment strategy and / or the cost and level of financial guarantees offered obsolete). Ad hoc events impacting the value products offers – such as unexpected high inflation over a protracted period of time – should also be triggered for product reviews as insurance manufacturers should ensure the products continue offering value.

In particular this process aims at supporting supervisors in ultimately drawing a conclusive decision on the aspects set out in the Supervisory Statement on value for money<sup>18</sup>, namely:

- ▶ evaluation of the product based on POG documentation and testing, including a structured pricing process and complexity analysis;
- ▶ whether the process to assess value for money is clearly identified in the manufacturers’ POG policy for unit-linked products;

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<sup>18</sup> [supervisory statement \(europa.eu\) – 3.24](#)

- ▶ costs and charges are properly identified in the POG documentation, quantified and due;
- ▶ adequate and sufficient testing has taken place on whether the product offers value for money for the target market through its lifetime;
- ▶ costs and charges, performance, guarantees, coverage and the services offered are regularly reviewed and ad hoc triggers which could indicate value for money issues are also sufficiently identified;
- ▶ product complexity and target market granularity are explicitly linked;
- ▶ adequate systems and controls are in place to ensure products are not 'mis-sold'.

### 3.1 Remarks on flexibility – Layer III

POG is by nature flexible and the calibration of the tools according to supervisors needs and market specificity is already envisaged in its functioning. Therefore such flexibility is also envisaged in the context of the tool-kit to assess value for money in line to previous layers.

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