IRSG

INSURANCE AND REINSURANCE STAKEHOLDER GROUP

Advice on the methodology to assess value for money in the unit-linked market

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1. SUMMARY

The IRSG thanks EIOPA for the opportunity to give feedback as an own initiative to this highly important work regarding the advice on the methodology to assess value for money in the unit-linked market. We believe that meeting consumers' needs is essential to the success of the insurance industry. Unit-linked and hybrid products can offer a variety of additional features and benefits (e.g. biometric risk covers, financial guarantees, risk mitigation techniques, investment choice, services, etc.) to meet different customers' demands and needs, and match their risk propensity. This variety of choice is positive for consumers and requires a flexible Product Oversight and Governance (POG) process. It also requires a holistic assessment of the qualitative and quantitative product features in the value for money assessment, avoiding fixed, quantitative benchmarks.

The IRSG is of the opinion that as to the overall legal framework, the Insurance Distribution Directive (IDD) already establishes rules for the design, distribution and review of unit-linked and hybrid products. However, some of the IRSG members believe that there is some inconsistency between current IDD rules and supervisory practices and more work should be done here by EIOPA. These IRSG members would like to point out also the possible challenge of mixed supervisory practices: unit-linked product is by essence linking underlying units (mostly funds), which are governed by other EU value for money rules and supervision, with an insurance wrapper contract, where already ESMA practices exist.

The rules already established under IDD include POG requirements, rules on professional advice, distributors' training, demands and needs/suitability/appropriateness test, transparency, conflict of interest, and product review. National Competent Authorities (NCAs) have powers and tools to monitor the market and take action if existing rules are poorly enforced. In order to effectively cater for rights and interests of consumers, it is also important to preserve the IDD flexibility to adapt to diverse markets and consumers, and to keep the offering of retail investment products easy and accessible, without excessive bureaucracy. We would also point out that EIOPA's work on the value for money methodology is not about disclosures for consumers.

We appreciate that EIOPA is proposing in the methodology a layered approach, which focuses on the outliers in the market and where both quantitative and qualitative elements are assessed. We also welcome that EIOPA's approach allows for flexibility, as this is the nature of the POG framework. Moreover, it seems important that value for money is assessed in relation to the needs of the identified target market, as this is the most appropriate level of granularity.

The IRSG believes that most European consumers prioritise security when considering investing. For example, the 2021 Pan-European Pension Survey performed by Insurance Europe – based on interviews with 17,000 people across 16 countries – shows that, when asked to choose between safety and performance of investments, 83% of respondents preferred safety. Also the October 2022 Eurobarometer Survey on Retail Financial Services and Products shows that 21% of respondents who do not have any investment products had concerns about the risks involved with investment products. Moreover, we believe that given their varied nature, unit-linked and hybrid products can provide to small savers a certain degree of financial protection or guarantees, without which they may actually not invest at all. Therefore, additional value that can be provided by financial guarantees or other risk mitigation techniques should be factored into value for money assessment, as well as their additional cost if any.

2. GENERAL COMMENTS

In general, the IRSG believes that the concept of a three-layer approach to value for money (VfM) analysis by NCAs has the merit of efficiency, both for NCAs and undertakings, in that it allows high level analysis at market level, with more specific and detailed analysis at undertaking level only for those products which are identified as potentially offering poor VfM. We believe that it would be important that each layer would be well constructed and operate effectively, reflecting national specificities, in order to ensure discerning product screening and VfM analysis.

Since POG rules are intended to ensure that consumer interests are taken into account both during the product design stage and throughout the product life cycle, and also that products are distributed only within the right target market, with adequate supervision by EIOPA and the NCAs, the POG rules should improve consumer outcomes in the unit-linked market.

The IRSG also welcomes EIOPA's work around the qualitative part of the identification on VfM. In the absence of a material role for non-monetary elements in the VfM assessment, we welcome the presence of a qualitative check-list as a set of mitigating factors after the analysis of the quantitative indicators. We welcome in particular the qualification of sustainability features as non-monetary value since they go beyond calculating the financial value for individual customers (value created at society level).

However, we do also have some concerns in relation to the following aspects:

- The level of risk coverage of the product for the customer, including the existence of financial guarantees, life risk coverage or risk mitigation techniques, is not appropriately considered in the methodology. The level of risk, existence of a financial guarantee or risk mitigation technique need to be taken into account in the Layer II product profitability, as these are benefits valued and needed by consumers. EIOPA's Supervisory Statement indicates guarantees among the different product benefits ("i.e. investment performance, guarantees, coverage and services") and this is not appropriately reflected in the methodology.
- Inflation is a highly relevant factor because, by definition, it lowers the value for all goods and services for consumers. However, using inflation to generate either assumptions for projections or benchmarks and pinpointing it as a single factor, seems not to be meaningful, especially for long-term products. Inflation is outside the control of product

manufacturer and has an impact on all financial and non-financial assets. In its Cost and Past Performance report 2022, EIOPA states that "inflation is an exogenous factor, i.e. outside the control of manufacturers". We believe that any attempt to model inflation in the VfM work would not increase consumer protection. On the other hand, other levers exist which can be used by product manufacturers to mitigate certain types of risks (e.g. financial market fluctuations) and bring protection and therefore value to clients who are interested.

- We find that it would be most important to focus on the VfM assessment on the end of the recommended holding period (RHP) measure. The holding period is defined ex ante and covers a medium to long term time horizon. Consumers fully realise the benefits of the product they have chosen if they hold it until maturity.
- Some IRSG members believe it would also be important to use measures that would help to assess VfM at earlier durations than RHP to generate a more holistic picture of value. For example, in an extreme case severe penalties could be imposed on early leavers to ensure apparently strong VfM at the RHP. In this case, restricting analysis to the end of the RHP would give a misleading picture.
- The focus on profitability does not allocate non-monetary elements, inter alia level of advisory / assistance services at the point of sale, any material role in the VfM assessment, relegating it to the background as a mitigating factor.
- While we understand the quantitative focus of EIOPA's approach, we would also note that IDD has very strict requirements for selling a product under "execution only", as a legal corollary of the crucial value allocated to advice. Moreover, we also observe that the remuneration of advice counts as product cost, subject to the profitability test, under a commission remuneration model, in contrast with a fee remuneration model, where it is charged as a separate service to the customer. That approach may undermine the level playing field across the two remuneration models and we suggest that a level playing field should apply as far as possible.
- On the cost and performance assessment based on the PRIIPs KID methodologies we see that, as the PRIIPs KID framework is still subject to review, caution should be applied in drawing conclusions from the PRIIPs KID. For example, more needs to be done to improve the display of the insurance benefits in the PRIIPs KID, like clear YES/NO questions at the top of the document to help the user understand if the product offers a financial guarantee or other forms of protection, with sufficient explanations. PRIIPS KID information certainly is one of the sources of information which is available to support analysis of VfM. RIY for instance is a very useful piece of information relating to VfM. So, as with other available information, KID information should form part of the picture but its shortcomings in the context of VfM analysis should be identified and reflected in the way in which the information is used.
- We find the scope and definitions not completely clear; "The scope of the value for money assessment cover all unit-linked and hybrids products, including those different from IBIPs

(if relevant).” Some members of the IRSG believe that even though the definition of value for money is provided in EIOPA’s Supervisory Statement and further explained in the Supervisory Statement and in EIOPA’s methodology, it would need further clarification.

- We believe that in most cases there are sufficient sources of information in place already to enable general VfM assessment without additional information being required. Information already available includes PRIIPS KID documents, POG outputs and other product literature including pre-contract disclosure. We consider Solvency II reports to be unlikely of significant value in VfM analysis as these are mainly collected for prudential purposes and require further analysis in a value for money assessment, to properly interpret and contextualize them. Additional information from undertakings should only be required where NCAs might have specific questions in Layer II or III analysis, e.g. in relation to benchmarks, target markets, investment risk or biometric insurance, which are not answered by information which is already available.
- Proportionality is a relevant consideration but should be carefully used, e.g. size of entity should never be a justification for offering poor VfM.
- Value decisions should not be made solely on the basis of past investment performance, which may not be a good guide to the future. For instance, past performance may reflect an allocation of assets which has not performed well but could have exciting future potential. We also find that, in order to be valid, cost comparisons should always reflect total costs to be borne by the customer, including all distribution costs (see comment re “level playing field” above).
- On the IDD/POG coverage of value for money aspects, we believe that value for money aspects are established by the IDD and already well covered by the POG Delegated Regulation. To this end, EIOPA acknowledged in its Supervisory Statement on assessment of value for money of unit-linked insurance products under POG from November 2021 that “[i]n particular, Article 25 of the IDD and the POG Delegated Regulation require manufacturers to test whether products are aligned with the target market’s needs, objectives and characteristics. In fact, value for money aspects are included in what EIOPA already defined as ‘fairness testing’ when outlining its approach to the supervision of product oversight and governance” Therefore, it is important to emphasise that product decisions cannot be shifted from the product manufacturer to the supervisor.
- The IRSG believes that it is important as a first step that national competent authorities make use of the methodology and that it is assessed whether adjustments to the methodology are needed on the basis of practical experience. Some IRSG members are of the opinion that more work is needed to ensure that the current regulatory framework works properly and supervision to be consistent across EU, especially:
    - These members believe it might be needed to compare the IDD/POG related work on VfM to EU rules for MIFID-covered investment products. In particular; manufacturers of UCITS and AIF investment funds cannot charge “undue costs”. Investment firms must assess, while taking into account cost, whether equivalent investment services or financial instruments can meet their clients’ profile. For

these members, this might be particularly relevant for unit-linked life insurance products, as they are linked to the products mentioned above (UICTS and AIFs), and add another layer of costs and product features to those of the units themselves. But the unique benefits of unit-linked products should also be carefully taken into account.

- For these members, another challenge is also that a "unit-linked" product is by essence linking underlying units – mostly funds - (governed by different EU VfM rules and supervision - ESMA) with an insurance wrapper contract. The building blocks of the UL contracts, i.e. the units themselves, are mostly investment funds. And those follow different EU VfM related rules[1]. It is therefore necessary (both for supervisors, industry and consumers) not to ignore and/or having inconsistent rules and supervision for UL contracts between the contracts themselves and the underlying units. Therefore, EIOPA should address this issue of inconsistency that may arise in the VfM framework between the EU rules (of Mifid, UCITS and AIF) and supervision (ESMA work) that both apply to the units and the insurance ones that apply to the wrapper contract. Other member would like to point out that the term "insurance wrapper" is inappropriate. Unit linked and hybrid products can offer biometric risk covers and other types of protection that are integrated in the product design. It is the product as a whole that is distributed to consumers. Also, the value for money rules cannot be defined as more precise and protective for MiFID products, for which there is not a framework like the one developed by EIOPA.
- Regarding the complexity of the products in relation to the regulatory framework and supervisory aspects, some of the IRSG members would like to point out that unit-linked products can never be classified as non-complex products (unless they are linked to funds which offer guarantees, which is rarely the case) according to the current rules, since they do not include "a contractually guaranteed minimum maturity value which is at least the amount paid by the Client after deduction of legitimate costs". Yet certain funds can actually be classified as non-complex under MIFID[2] but not under the IDD[3] definition, even though, the intention was of aligning the regulation of IBIPs under the IDD to the regulation of other investment products under MIFID II. This adds on to the requirements during the sales / advice

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[1] UCITS and AIFM frameworks provide that the UCITS, the AIFs or their investors in these AIFs are not charged "undue costs", a notion that is contained in Article 22(4) of Commission Directive 2010/43/EU ("UCITS Level 2 Directive") and in Article 17(2) of Commission Delegated Regulation No 231/2013 (AIFMD Level 2 Regulation. Also investment firms must "*assess, while taking into account cost… , whether equivalent … financial instruments can meet their client's profile*" **(EU Regulation 2017/565 art.54.9)**

[2] Definitions under MIFID (UCITS are considered non-complex) https://www.esma.europa.eu/sites/default/files/library/2015/11/09_559.pdf

[3] Definitions under IDD (unitised funds in a unit linked product are considered complex) https://www.eiopa.europa.eu/rulebook/idd-insurance-distribution-directive/article-7213_en

process which, in some cases, is in relation to products offering funds with relatively straightforward structures but which don't offer any guarantees.

Finally, the IRSG would also like to bring out certain aspects that might be useful for EIOPA to consider in the future work:

- National reporting should be structured to enable comparison of performance and costs for products and funds with similar comparable characteristics.
- Where possible, biometric coverage together with associated costs, and investment coverage together with associated costs should be disaggregated for effective VfM analysis.
- The presence of particular non-financial aspects or benefits as listed in Table 4 should not be allowed to unduly influence the analysis of VfM. There may be some exceptions to this, for instance where charges might be limited in some ways, and this feature would not be evident from quantitative VfM analysis.
- We believe that the aim of the Retail Investment Strategy is to encourage more retail investors to engage with confidence in financial markets. To achieve this goal, it will be key to ensure that the sales process does not become overly long and bureaucratic. Moreover, the regulatory and supervisory framework needs to be balanced and proportionate to take into account different market practices, consumers' preferences and needs, distribution systems, etc.
- We believe that the (Life) insurance business model in relation to measuring VfM should need to be captured more holistically. (Life) Insurers have a lot of legal and supervisory requirements but also requirements from the customer base and other key stakeholders like investors, rating agencies etc. The products offered for customers need to take accounts a variety of different aspect and be balanced in a long term. Quantitative value for money measures easily might ignore the broad range of matters to be considered.
- Regarding the EIOPA approach on company level (Layer 1, Tool 4) the approach based on the quality of funds underlying unit-linked products seems quite narrow. Fundamentally, VfM considerations may be different as between a unit-linked product and the funds which are offered as part of that product and EIOPA should consider this distinction in the way it makes the rules. At fund level, it seems not clear that EIOPA would be addressing the right questions to assess value for customers and the risks at fund level. For instance, entry fees, where charged, may be charged at product rather than fund level and so a question focused on fund level may not provide insight. Additional questions which may be appropriate include:
    - are benchmarks consistent with how funds are communicated to the customer?

- are asset allocations consistent with how funds are communicated to the customer
  - are fund risk positions consistent with communicated risk ratings?
  - are reasons for underperformance or outperformance understood?
  - is there evidence of the insurer monitoring the performance and risk of funds and overseeing managers?

  Also, when using a methodology to select the outliers (with a given measure) it seems unclear whether the intent is to discover the products, funds or companies one should be interested in. There seems to be a risk of maintaining a process that doesn't give the answers that were of interest in the first place, which would create inefficiency.
- On the Product Profitability Testing (Layer II, Tool 1), the surrender value and risk benefit as the key indicators might not give a sufficient answer. We believe that also other indicators might be used to better be able to draw more correct conclusions. There's a wide set of different UL & Hybrid products in EU with a lot of national specificities (national insurance policy law, taxation, market practice). This makes it difficult to find a single method to assess some quantitative answers to whether certain category of products offer enough value for money or not. And if no single method could be found then it should be asked how to actually ensure a harmonized supervisory practice. For instance, the methodology document mentions RIY. RIY is a good tool for comparing charging structures between products but not necessarily for assessing "profitability" in that it doesn't incorporate the undertaking's own costs.
- Some IRSG members finds it useful that EIOPA's work on establishing a regime to address value for money in the unit-linked market should have regard to work which is ongoing in other relevant jurisdictions. In particular, and even though being in early stages, the UK Consumer Duty, to be implemented and applicable from July 2023, is dealing with the concept of value. One of the four outcomes to be considered by undertakings which are subject to this requirement relates to price and value. This will require value assessments to be carried out for all products, including unit-linked and including for advice elements. In assessing whether price charged represents fair value, manufacturers will be required to consider at least:
  - the nature of the product or service
  - any limitations that are part of the product or service
  - the expected total price, and
  - any characteristics of vulnerability in the target market

  Findings from this work may also be useful in considering required modifications to Product Oversight and Governance frameworks.
- Other members believe that it is premature to assess the functioning of the Consumer Duty framework. Moreover, as a first step, EU national competent authorities should make use of EIOPA's methodology and on the basis of practical experience, it should be assessed whether adjustments to the methodology are needed.