

EIOPA Q&A: A paradigm shift

Interview Gabriel Bernardino for European Pensions

Duncan Ferris chats with European Insurance and Occupational Pensions Authority (EIOPA) chairman, Gabriel Bernardino, about the Pan-European Personal Pension Product (PEPP), improved data harvesting and the organisation's future projects.



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EIOPA delivered a set of draft regulatory and implementing technical standards to the European Commission back in August. What were your key considerations

while drawing up these standards?

I think this was a very important step for us towards the finalisation of the framework of the PEPP, and our focus during the development of the standards was to make sure that we deliver a true paradigm shift in the framework of personal pensions within the European Union (EU). We started doing this work on the PEPP because the landscape of personal pensions in the EU is quite complex, quite fragmented, costly, and many times far from transparent for consumers.

The products are not designed for retirement objectives, there is a high fragmentation in the market, the cost of distribution is too high, which clearly detracts from returns, and there is also not enough competition. This was the basis that we had when we started to develop the PEPPs. We needed to deliver on mainly three areas. Firstly, on creating a simple product, second on creating a transparent product and thirdly on creating a cost-effective product. When you look at the standards and the advice that we sent to the European Commission on the regulatory framework, these elements were very important.

For example, on simplicity we really want to have a well-defined default option, which is called the basic PEPP, which is tailored to most consumers. This will help to build a quality label for the PEPP and has the scale to reach cost-efficiency as well. On transparency we have created two standardised information documents, dubbed the PEPP key information document (KID), which are pre-contractual documents and an annual information document in the form of the PEPP Benefit Statement. The paradigm shift here is really the focus on engagement with citizens, using behavioural science, using questions and avoiding just dumping text and numbers on consumers, as is very often the case. We are also focusing on digital and smartphone screens, as these are the ways in which people interact more and more.

Finally, on cost-effectiveness, there is now a clear definition of the costs and what is included in the administrative costs, distribution costs, investment costs, and then also the separation with the cost of the guarantees. So, this will become fully transparent and will allow comparability between the different personal pension products for consumers. Also, we have an all-inclusive approach to the cost cap, which will stand at 1 per cent of the annual accumulated capital.

How will the standards help to protect savers from market volatility caused by events like the Covid-19 pandemic?

This was a fundamental concern in the development of the PEPP because at the heart of its design there was always the idea that we want to have a true retirement savings product. This is not a normal investment product; it is a way to save for retirement. As such, the idea of providing stable and adequate retirement incomes and protecting against inflation, as well as having an effective link between accumulation and decumulation, was there as a concern.

The method we have developed to mitigate the impact of market volatility is regulating what we call risk mitigation techniques. In practical terms, this means that every product provider needs to choose what kind of risk mitigation technique and risk management they are going to use to ensure that market fluctuations do not have a negative effect on the overall outcome of consumers' long-term retirement savings.

These risk mitigation techniques can be of three varieties. One is a life cycling approach where consumers have higher risk investments in their early years and then the risk is lowered when they are approaching retirement. The second is the possibility to build reserves and buffers like with some products in the insurance industry, which sees parts of contributions built up in reserves. The third is the possibility of having minimum return guarantees.

Every provider of the basic PEPP needs to use at least one of these three, or a combination of them. What we have done from a regulatory perspective is to ensure that there are clear investment strategies and location mechanisms that allow for the consistent monitoring of the effectiveness of these risk mitigation techniques. We developed a stochastic simulation and are looking at different scenarios, such as expected shortfalls.

Retirement savings need to be focused on delivering long-term returns and this is a paradigm shift that the PEPP provides. Retirement savings are not, and should not be, liquid products. I would actually say that the main risk to our retirement savings right now is not the short-term volatility of the market, but is the low interest rate environment that makes it very difficult to deliver real returns above

inflation in the future.

Why could the digital distribution of the PEPP be key to its success?

We wanted the PEPP to really address European citizens' expectations looking ahead. Digitalisation is part of our lives and so anything that relates to communication with future PEPP users' needs to address this change. We also need to focus on the younger generations that need to start to save for their retirement.

This kind of shift is not only about providing information in a digital way, but also about making sure that we use the opportunity that digital interactions allow us to take advantage of this engaging way of communicating. Instead of just giving consumers tonnes of phrases and numbers on paper, we can use behavioural science and present documents in an engaging way. This is only possible through digital interaction.

Finally, for us, digital is important because it will help ensure that the PEPP will be cost-effective. We know that distribution costs and administrative costs have been one of the important elements in pension products' poor returns, so we need to bring down these expenses. Digitalisation is a fundamental element of this and so our expectation is that costs can be reduced.

Can you tell me about some of the feedback you have received from providers and other industry members since submitting the technical standards?

The process of developing the standards was quite an inclusive and transparent one. The work we have developed at EIOPA together with national supervisors saw us consulting with EIOPA's stakeholder groups, which are made up of people from industry and consumer backgrounds. On top of that we set up a dedicated expert practitioner panel and that also helped us a great deal. We cooperated with the European Central Bank (ECB) and the OECD, as well as publicly consulting on the standards and had consumer testing.

This was key, as we had to make sure that consumers would understand the product and the drawing up of the PEPP KID, which helped us to establish our three main questions of 'what are the costs', 'what can I expect to receive' and

‘what are the risks to my retirement objective’. This scored very well in our consumer tests and people seemed to understand much better than with other kinds of similar documents.

I’m quite proud of the work and the result. Overall we have a very good level of support from consumer representatives throughout Europe and a good level of support from the industry side, with all of this engagement having helped us to work out where the issues were, to discuss them and to find solutions. All in all, I think we had very positive feedback and we now hope that the European Commission will proceed with their plans and that we will have possibility to start to see the first PEPPs by the beginning of 2022.

EIOPA’s website notes that its recent work on pensions statistics has allowed it to improve its capabilities. How was this achieved and why is it so important?

I think this is a structural change that has been worked on for several years. Back in 2018, we started with this important project, together with the ECB. The objective was to improve the occupational pensions data availability within the EU and the result has been the development of a comprehensive package of reporting templates.

This was a huge step forward with three main points. Firstly, because it has replaced a fragmented landscape of requests that were in place, both from our side and the ECB side. It has avoided an extra burden to pension funds by ensuring that our templates are common, so I think it is an excellent outcome from the cost perspective.

It also enables us to gather much more granular data and will improve analysis and monitoring for our policy work, stability work and our efforts on supervision. We received the first data submissions this year, which were up to the third quarter of 2019, and now the data quality is improving step by step. This will allow us to not only publish much better statistics, but also will help towards our own project of building our own dashboard for occupational pensions over the coming months and years.

Can you tell me anything about EIOPA’s other upcoming projects and goals?

Firstly, and still related to the issue of having better data, one of the projects involves the new data allowing us to look at pension funds in three different ways. We will be able to look at them as institutional investors, which will allow us to look at the environmental, social and governance profiles of pension funds. Secondly, we will also be able to look at pension funds as risk bearers and their impacts on sponsors and the real economy. Thirdly, we will also be able to look at pension funds as a vehicle that can deliver future returns to members and beneficiaries.

The second project that I can mention is related to occupational pensions in Europe. You may have noted that the European Commission has put in place several elements on their action plan that relate to pensions. We have been involved in these discussions and we are very supportive of it. We need to recognise that the role of occupational pensions in Europe is still sub-optimal. They are still either inexistent or insignificant in about half of the EU member states and this needs to change because they can play an important role in providing adequate income for our citizens in the future.

There needs to be much more focus and it needs to be subjected to much more mainstream pressure. I think the linkage to the capital markets union is also a good one. The first objective should be to provide more adequate pensions but then we can support the capital markets union, because this can be a benefit for the citizens.

EIOPA will be ready to work on these issues and there are a couple of elements of the European Commission's action plan that we have touched on in the past. These include a pensions dashboard and to identify best practices of national pension tracking systems. We have also seen that the European Commission is now putting in place a study on auto-enrolment. This is something which is quite important as it will increase coverage, as we have already seen in the UK, we can learn from different systems and in EIOPA we are aware of the different issues. We think that it is important to see the experience: the dos and don'ts.

I believe this is something that should be supported and EIOPA will be ready to work that.

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