



BF BETTER FINANCE

The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

BETTER FINANCE Position Paper

Pan-European Personal Pension - PEPP Level 2

BETTER FINANCE Position on the PEPP Level 2 Implementing Provisions

EXECUTIVE SUMMARY

The objective of the PEPP is to offer pension savers a simple, trustworthy and cost-efficient product that at least protects the purchasing power of lifetime savings at retirement. The PEPP should represent “**a quality label for EU personal pension products and increase trust among consumers**”.¹

PEPP Key Information Document (KID)

The PEPP KID should enable savers understand and compare PEPPs, in particular:

- It must be short, simple, clear and easily understandable;
- It must be digitally interactive and machine-readable;
- It must contain a clear investment objective and recommended holding period;
- It must present simple and accurate indicators:
 - **long-term past performance in comparison with a market benchmark;**
 - costs under the form of a Reduction-in-Wealth;

Cost cap for the Basic PEPP

The basic PEPP must represent a simple and cost-efficient default option for pension savers. The cost cap is designed as **an all-inclusive 1% limit for all costs**, including distribution fees.

Risk-mitigation techniques

EU legislation must address the current misunderstanding of “risk” for long-term savings products and ensure that the risk-reward approaches reflect the nature and objective of long-term and pension products. Risk-mitigation techniques for the basic PEPP require more standardisation at EU law level.

PEPP Benefit Statement (PBS)

The benefit statement must give the information and help the saver decide whether the product is still suitable for his retirement objectives and whether to continue or switch to another PEPP. As such, it must disclose the progress on reaching the objectives disclosed in the PEPP KID, the costs and how close the PEPP saver is in achieving his retirement goals.

Digital distribution

As the target clients for the PEPP will be the younger generations first, the demand for digital and online distribution may be higher and may therefore be an incentive for them to consider investing in a PEPP. Online distribution of PEPP is possible and would bring significant gains in terms of cost-efficiency, in particular relevant for the basic PEPP.

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¹ European Commission introduction to the proposal for PEPP (COM(2017) 343 final), emphasis added.

The EU has the unique window of opportunity to create a quality label that addresses both the pensions “time-bomb” and the persistent lack of trust of consumers in financial services.

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INTRODUCTION

We can no longer use future tense when speaking about the state's future ability to provide the necessary retirement replacement income. If our contributions still provide for today's pensioners, we don't believe that our successors' will prove enough for ours. Therefore, European citizens are becoming more responsible for their retirement income.

Considering also the shift from defined-benefit (DB) to defined-contribution (DC) plans, savers are also responsible for making the appropriate financial decision. However, the market is very complex, the product offering is vast, and it's very difficult for them to discern what these products will cost them. Past performance is only available for "mainstream" investment funds, so individual investors can't know if a product manager should be trusted or not.

Nowadays, we pay with our smart watches, but we can't compare pension products online. Distribution channels are – mostly – captive networks, where savers are either sold a product or "non-independently" advised to buy the same (probably) unsuitable product. Markets are performing well, but some of our pension products are not, and some asset managers blame "negative interest rates". Moreover, too often the "money illusion" is ignored despite the fact that due to inflation on 40 years of savings we can lose more than half of our purchasing power.

We need a change, and the "tool" to deliver it is already laid down via the Regulation on the Pan-European Personal Pension (PEPP) product. PEPP must take off as an **EU quality label for retirement savings products**, providing value for money (decent real net returns) and restoring consumers' trust in capital markets. The PEPP must be safe, simple, transparent and cost-efficient. The PEPP must be accessible to all, even to those who cannot or do not want to make a financial decision right away. The PEPP must allow simple, direct investments in capital markets and embody optimal risk-mitigation techniques.

The window of opportunity is now, and the EU must make the best of it.

This Position Paper of BETTER FINANCE on PEPP and the Level 2 implementing provisions sets out the key elements that would allow the PEPP to deliver on its inherent promise to savers: **to ensure real net long-term and sustainable returns for retirement**.

The need to protect against inflation

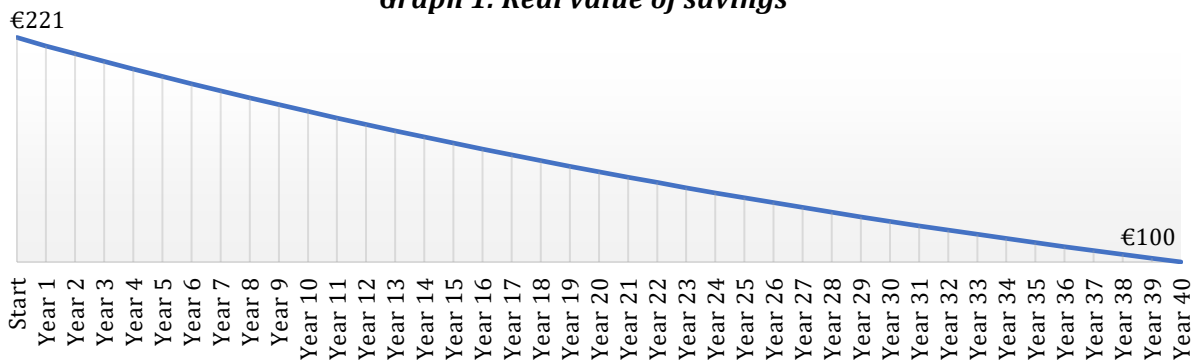
The "money illusion"² is still not accounted for by many savers. Planning for old age implies a long-term investment horizon, most often of 40 years,³ in which the effect of inflation can have a significant negative impact on the real value of savings. Assuming a modest average inflation rate of 2%,⁴ the cumulative effect in four decades will decrease the present value of savings by more than a half (56%). Put simply, for each €100 we would want to use in 2049, we must save today €221, as shown in Graph 1 below.

² The term "money illusion" was coined by Fishner in describing that most people think of money in nominal terms (inscribed value) instead of considering its real value, i.e. what quantity of goods and services can a certain amount of money buy at a certain date - See Irving Fishner, *The Money Illusion* (2011) Martino Publishing.

³ Assuming that the saver starts investing at the age of 25 and decumulates at the age of 65.

⁴ Which is below the last 19 years' average and currently the target of the European Central Bank.

Graph 1. Real value of savings



Source: BETTER FINANCE own composition

Therefore, protecting against inflation is crucial for any retirement planning. BETTER FINANCE,⁵ the CFA Institute⁶ and other academic publications⁷ have acknowledged that inflation-protection is an essential feature of any retirement planning and pension systems.

If, in most defined-contribution (DC) pension arrangements the saver can choose a higher or lower level of risk and return that would cover for inflation as well, the default investment option should have standardized characteristics that would build a safe and efficient retirement provision vehicles in absence of choice. As such, it should be inflation indexed.

The fact that the basic PEPP, as prescribed by the PEPP Level 1 Regulation,⁸ does not protect accumulated contributions against inflation (and fees) **and does not include a prominent warning**, misleads the pension saver and constitutes a scam.⁹

The capital guarantee alternative of the default investment option, or “basic PEPP”, must ensure that, upon reaching retirement age (usually, 65 years old), the saver will at least benefit of real value the accrued contributions during the vesting period.

The need to protect against negative returns

PEPP manufacturers can choose to provide the basic PEPP under one of two risk-mitigation techniques: life-cycling or a capital guarantee. **The essence of both alternatives is to protect savings against negative performances**, in other words to ensure the saver that will at least receive his contributions at retirement.

Whereas it is debatable whether a life-cycling technique without a mandatory return can protect against negative performances,¹⁰ **it is beyond doubt that a capital guarantee can and should.** A capital guarantee promises the PEPP saver that, no matter the performance of the markets, the provider will pay out at least his accumulated contributions **but net of fees and inflation**.¹¹ The following graph (Graph 2) shows the effect of fees and inflation under the current “capital guarantee” under the PEPP Level 1 Regulation.

⁵ BETTER FINANCE Pension Savings Report 2013, 2014, 2015, 2016, 2017, 2018.

⁶ Mercer LLC, *An Ideal Retirement System* (March 2015) prepared for the CFA Institute, page 20.

⁷ See A. Berardi, C. Tebaldi, F. Trojani, ‘Consumer Protection and the Design of the Default Option of a pan-European Pension Product’ (1 February 2018) Milano, hereinafter “the Bocconi Study”.

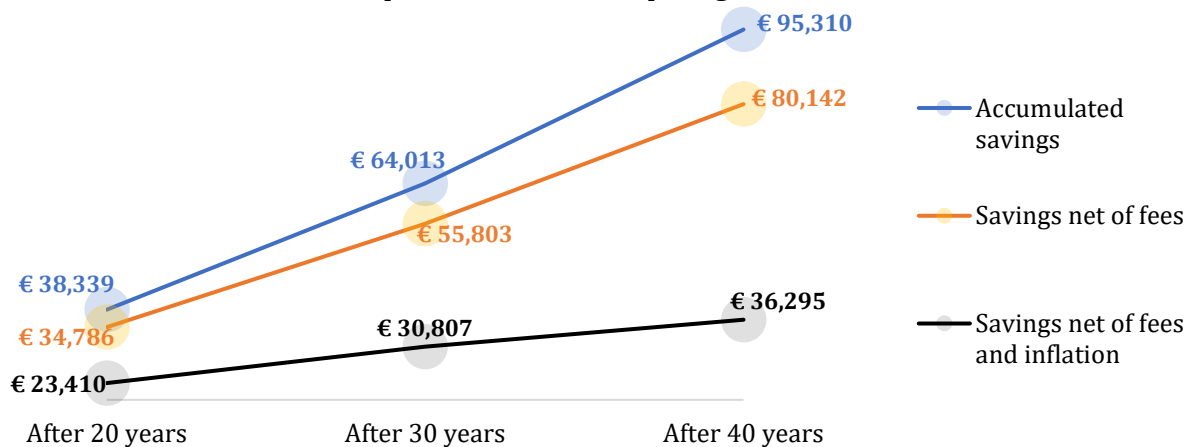
⁸ Regulation EU no. 2019/1238 on PEPP, Article 32.

⁹ See here BETTER FINANCE Video on the “Stop the Capital Protection Scam” - <https://www.youtube.com/watch?v=q-JUucArdcs>.

¹⁰ According to the Bocconi Study (footnote 7 above), “life-cycle strategies allow savers to recoup the capital invested with a probability of well above 99%” – page V; however, since it is subject to capital market fluctuations, there will always be a risk of losing money.

¹¹ According to Article 28(3), letter c), pt. (iii), the capital guarantee or the other risk mitigation technique must allow the PEPP saver to recoup the capital.

Graph 2. Basic PEPP “capital guarantee”



Source: BETTER FINANCE own computations

Graph 2 above assumes the situation of the average EU citizen: using the average net disposable income¹² at the age of 25, the saver contributes 10% of his monthly salary¹³ to a capital guaranteed basic PEPP, accumulating after 20 years €38,339, after 30 years €64,013 and at 65 years his savings accrue to €95,310. However, considering the 1% fee, inflation and a **negative performance**, the PEPP saver is not entitled to receive his accumulated savings, but only €34,786, €55,803 or €80,142 (after 20, 30 or respectively 40 years).

Taking into consideration the real purchasing power of his savings, after a lifetime of contributions to a capital guaranteed basic PEPP, the retiree will only benefit of 38% of his savings (or €36,295).

The PEPP Regulation should in no way be interpreted as not allowing for full capital protection, in particular for the basic PEPP as it in **fact encourages providers to cover both fees and inflation. According to Recital (56) of the Regulation, risk mitigation techniques under the form of a guarantee “could also cover the fees and charges and could provide for full or partial coverage of inflation”.**

However, there is **no prominent warning** of any of these aspects in the PEPP KID, nor in the PEPP Pension Benefit Statement, reason for which BETTER FINANCE considers this feature highly misleading and a “scam”. **Therefore**, the capital guarantee of the basic PEPP should protect the saver’s contributions **before fees and inflation**.

PEPP Key Information Document (KID)

The key information document (KID) is one of the most important documents for the average individual, non-professional and small investor. It should present in a summarised, comparable and simple manner:

- the investment objectives of the product;
- the risk-mitigation technique;
- the actual cost of the product; and
- the past performance of the product, if available.¹⁴

¹² The Eurostat term is *median equivalised net income*, expressed in Euros, ilc_di04 http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=ilc_di04&lang=en.

¹³ The salary projections assume an average 2% increase per year.

¹⁴ This is also a requirement for both PEPP KIDs under Article 26(9) PEPP Regulation.

The PEPP must be simple, clear and concise and avoid information overload. The Technical Working Paper series on PEPP (1/2020) attached to this position paper explains in more detail the disadvantages of having too much and complex information.

In short, “enough” information is not better information. Regulators and policy makers incorrectly assume that the non-professional investor can make an investment decision if “sufficient” information is provided. However, what really matters is information that is simple, clear (avoiding ambiguous, technical language) and layered based on the difficulty of information (first layer – simplistic, short, concise – second and third layers more detailed and technical).

The PEPP KID should aim to make full use of digital tools. This would not only allow information to be structured in a manner that enables comprehension by the PEPP saver, but also online distribution and advice for automated investment platforms (robo-advisors) which may bring significant cost-efficiency gains.

BETTER FINANCE wishes to highlight the extensive evidence gathered from the *Robo-advice papers*¹⁵ in which we analyse the conditions and divergences in algorithms from start-ups and small automated or semi-automated investment advice platforms.

This recurring research activity on robo-advisors confirms for several years in a row that, while for some providers of such services it may not be clear whether the platforms fully comply with the suitability and personalisation requirements of MiFID II framework, the market is mature enough in order to take on this task. In particular, we refer to the already established platforms of large asset managers, which are an important addition to the smaller and newer “start-ups” providing robot-advice and execution.

As the target clients for the PEPP will be the younger generations first, the demand for digital and online distribution may be higher and may therefore be an incentive for them to consider investing in a PEPP. Younger customers are likely to favour conducting business in this manner in and especially on cross-border situations.

Therefore, **online distribution of PEPP is possible**, and already a standard practice in several European markets depending on local rules and customs. However, online distribution of PEPP will indeed need to consider the mandatory duty of advice applicable to the Basic PEPP as required by the PEPP regulation.

Capital protection techniques

According to Article 42(2) of the PEPP Regulation, all investment options of the PEPP must embed either a guarantee on the capital or a risk mitigation technique, with the aim of enabling the saver to recoup the capital invested. In any of the forms it may take, i.e. a life cycling strategy, reserves or appropriate guarantees,¹⁶ the PEPP KID must clearly disclose:

- how the capital protection technique is designed;
- a prominent warning of the limitations of the capital protection technique; and
- a simple and clearly comprehensible graph showing how the technique would protect the saver's contributions or investment gains.¹⁷

¹⁵ BETTER FINANCE 2019 Robo advice report: <https://betterfinance.eu/wp-content/uploads/Robo-Advice-Report-2019-FINAL.pdf>.

¹⁶ See Article 46(2) of the PEPP Regulation.

¹⁷ Article 28(3), c(iii), requires PEPP manufacturers to state whether the basic PEPP provides a guarantee or risk mitigation technique that allows the saver to recoup the capital. However, this is not sufficient, as the concept of capital in the PEPP Regulation has a significant limitation.

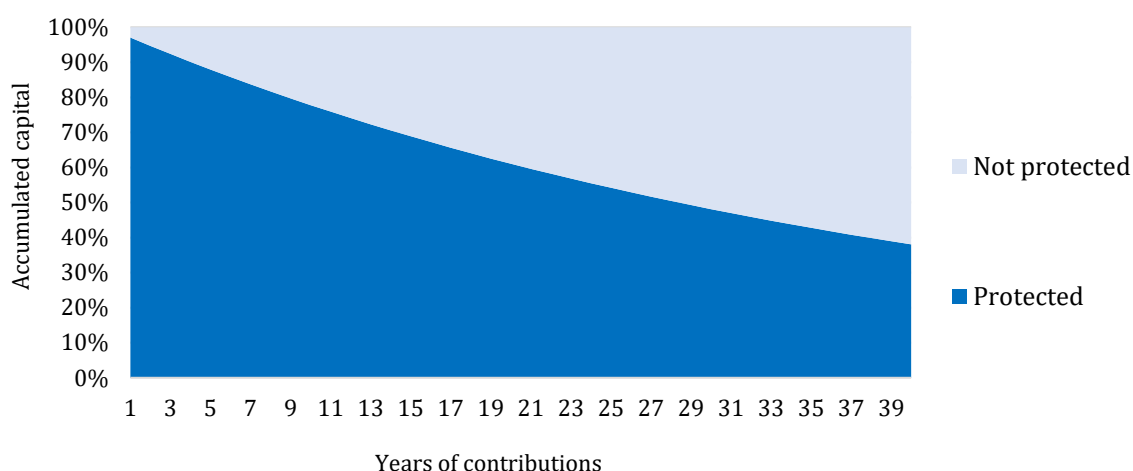
The proposed solutions for all three options, including the accompanying text, are presented below. These are designed for a digital PEPP KID, to be included in the second layer of information. The prominent warnings should be present in the second layer as well, and the descriptions in the third layer or in a pop-up/ hover bubble feature.

1. [Capital guarantee](#)

The capital guarantee must show graphically how much of the accumulated capital of the PEPP saver will be protected at all stages of the accumulation phase. For reasons of simplicity, the time unit should be annual and start with the longest period available (in Graph 3 below, 40 years). The description should be as follows:

“This product guarantees that you will recoup your [net/nominal/real] accumulated capital upon retirement, representing the sum of all your contributions and investment gains [minus or not] the fees and charges taken each year, [minus inflation].”

Graph 3. Capital guarantee



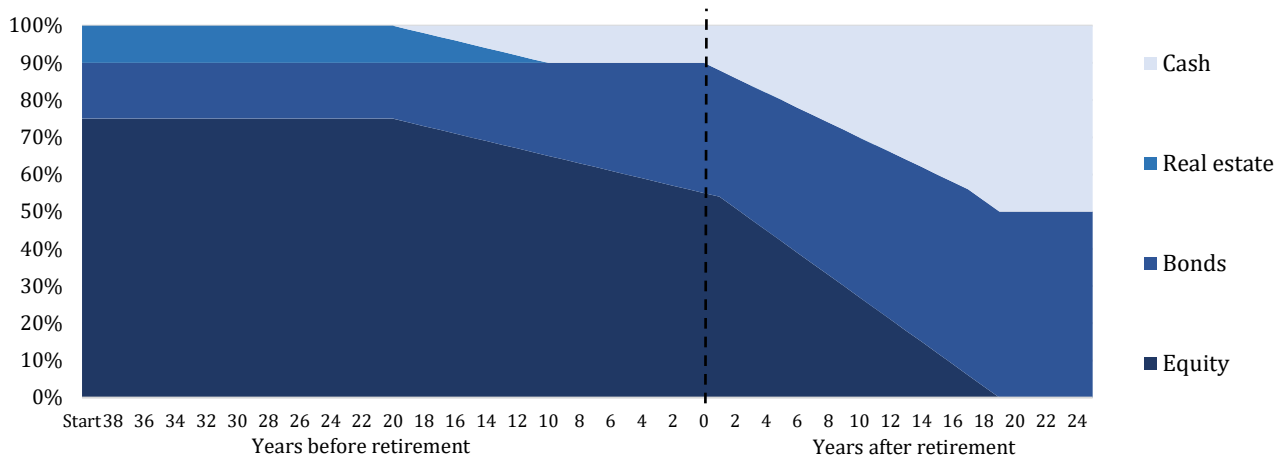
Source: BETTER FINANCE own composition

2. [Life-cycling](#)

Since life-cycle techniques are based on a strategic reallocation of the portfolio holdings from riskier to safer assets, it is essential that the PEPP saver sees gradually in what the product invests and how it de-risks. Life-cycling techniques should continue in the decumulation phase, extending further the target retirement date with the number of years representing the mean life expectancy of the saver. The description should read as follows:

“This product uses a strategic reallocation of your capital from riskier to safer assets in order to maximise returns in the earlier stages of the product and ensure stability in the later stages of the product. The de-risking glidepath may look as follows:”

Graph 4. Life-cycling glidepath



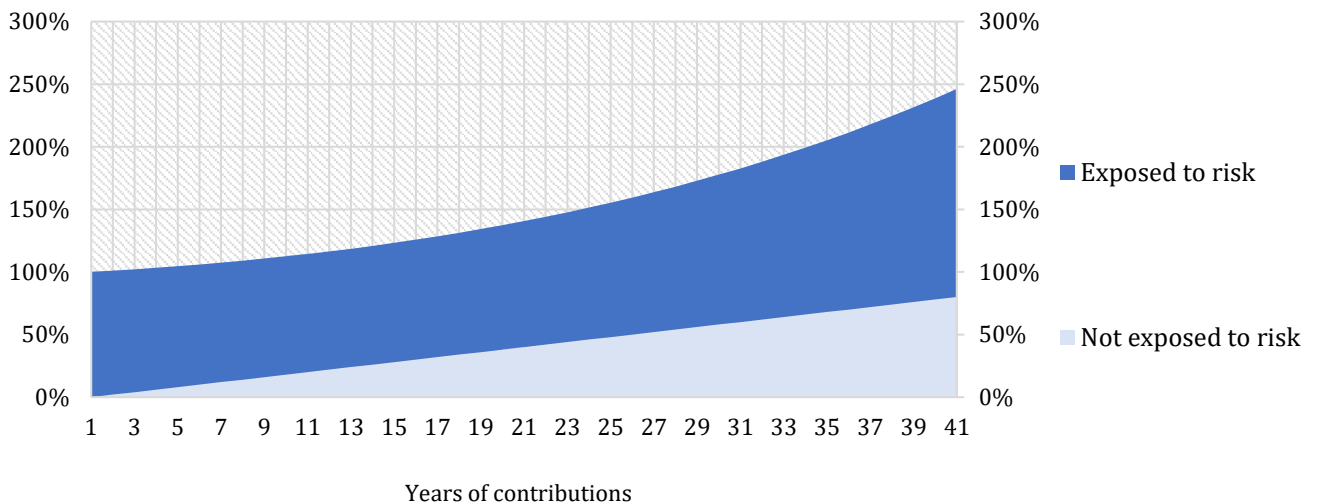
Source: BETTER FINANCE own composition

3. [Investment reserves](#)

Reserves can be built up in several ways. Product manufacturers should be free to describe how the reserve will be constituted, with the objective of keeping the description as short and concise as possible. The graph should be accompanied by the following warning:

*“This product aims to protect your contributions and investments by building up a [mathematical/technical] reserve. **Warning: this product does not offer any capital protection or inflation indexation**”.*

Graph 5. Technical Reserves



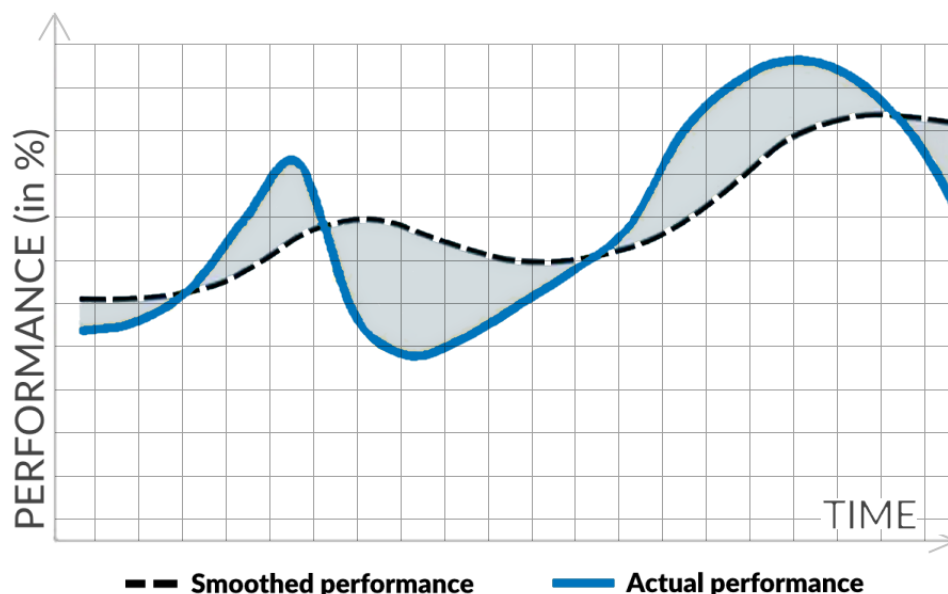
Source: BETTER FINANCE own composition

4. [Smoothing](#)

Smoothing of returns may also facilitate an optimal risk-reward profile for the PEPP. However, it requires additional explanations, proper investor protection rules and transparency of the technique in order to align the interests of the manufacturer with those of beneficial owners and reduce arbitrary allocation of reserves. The warning should read:

“With smoothing we aim to cushion periods of poor returns and stabilise your performance by using a part of the good returns as reserves. The description of the smoothing policy can be found here”.

Graph 6. Performance smoothing



Source: BETTER FINANCE

Performance presentation

1. Past performance

Neither past, nor future performance scenarios are a reliable indicator of future returns. However, the advantage of past performance is to show whether the manager has met its investment objectives in the past. Therefore, past performance, in particular for products with a long-term nature like the one of PEPP, is a key disclosure element. Past performance should be displayed in comparison with an objective benchmark, in order to shed better light on the returns of the product and to allow comparisons with the market. Comparison of past performance with a capital market index chosen by a provider is key to understand the performance and risks. For majority of savers presenting the risk via numbers only is hardly understandable. The comparison with a benchmark will enable them to understand that the value of savings is a subject of volatility over time and to see by how much the value of savings can fluctuate (therefore ideally the presentation should take the form of a graph).

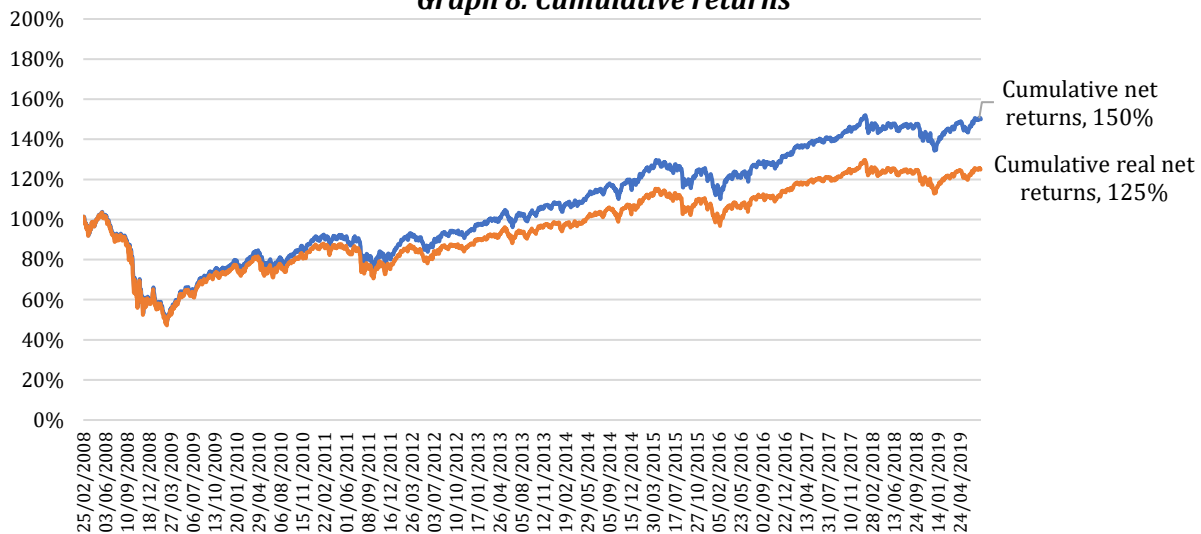
Past performance could be disclosed in two easily understandable models:

- a table showing the average net return of the product on the past 1 year, 3 years, 10 years and since inception (*Table 7*); or
- a graph showing the cumulative performance since inception (*Graph 8*);

Table 7. Average returns				
Time period	Last year	3 years	10 years	Since inception
Average net return	1.67%	5.65%	8.00%	3.59%
Average real net returns	0.10%	3.87%	6.36%	1.95%

Source: BETTER FINANCE own composition based on fund data and Eurostat HICP (prc_hicp_midx)

Graph 8. Cumulative returns



Source: BETTER FINANCE own composition based on fund data and Eurostat HICP (prc_hicp_midx)

The past performance sub-section must be accompanied by a prominent warning that reads:

“Performance is not constant over time and is not a reliable indicator of future results”.

2. Performance scenarios

In relation to future performance forecasts (“*appropriate performance scenarios*”, as required by Article 28(3), letter d), point iii) BETTER FINANCE wishes to express again its sheer disappointment concerning the fact that non-professional investors will once again be presented with confusing and misleading information on future returns by virtue of EU law.

Nothing can predict market performances. However, in light of the adopted abovementioned provision, BETTER FINANCE wishes to propose a solution that reduces the detrimental effect of this provision, i.e. illustrative scenarios.

In order to deter PEPP savers from believing that return forecasts are exact and/or a guarantee, the pension projection must not contain figures, which are susceptible of being hyperbolised by individual savers, but rather explain what to expect in different market conditions.

However, should EIOPA choose to present pension projections under the form of cumulative return estimations, BETTER FINANCE strongly advises EIOPA to use the following methodology – explained in more detail in the Technical Working Paper attached (1/2020).

3. Presentation of performance scenarios

Information overload: The PEPP KID and BS should not be overloaded with information or unnecessary legal waivers or disclaimers. The primary purpose of a key pre-contractual disclosure document is to provide informational reliability for the consumer and reduce reliance on third parties to comprehend and form a decision.¹⁸ If EIOPA allows inclusion of information that, by essence, requires caveats or warnings, this would:

- reduce the added value of the document;
- make it unattractive or deterring for the consumer to read.

The space and attention span of the consumer should be used to highlight more information on ESG-factoring, target clients, investment strategy and capital protection, or past performance.

¹⁸ See BETTER FINANCE’s remarks in this sense in the response to the PRIIPs KID Consultation Response (n 7).

Moreover, use of digital tools or innovative elements in the KID could be a significant improvement. For instance, illustrative example B of the EIOPA PEPP KID mock-ups contains at the top of the first page a [product dashboard](#), which enables the optimal cognitive process for the PEPP saver and facilitates digital interaction (QR-code that can be scanned by the majority of smartphones or tablets and directs to the online version).

PEPP KID: Illustrative example B

Pan-European Personal Pension Product (PEPP) Key Information Document

Placeholder for
PEPP EU label

This document provides you with key information about this pan-European Personal Pension Product (PEPP). It is not marketing material. The information is required by law to help you understand the nature, risks, costs, potential gains and losses of this personal pension product and to help you compare it with other PEPPs.

Risk indicator:

Low
Medium
High

Performance indicator:
Assuming monthly contributions of 100€ over a 40 yrs time period

☀️
€92,600

☁️
€59,000

☁️
€39,600

Cost indicator:
Ongoing annual costs:

€95

Placeholder for
company logo

Product name: <Name>
Company: <Name> PEPP provider
Registration Number: 123

Product type: Basic PEPP (Y/N)
Competent authority: <Name>
Date: <Publication date>

Access to online version

The retirement product described in this document is a long-term product with limited redeemability, which cannot be terminated at any time.

What is this product?

Redeemability
Ability to exchange contract for a particular amount of money.

Source: EIOPA PEPP KID illustrative example B, p. 1

BETTER FINANCE strongly supports this innovative approach of EIOPA and considers the two elements to be essential for reaching the objectives pursued through the PEPP KID. However, a strict reading of the PEPP Regulation (Art. 28) would lead to the conclusion that such an addition would not be possible.

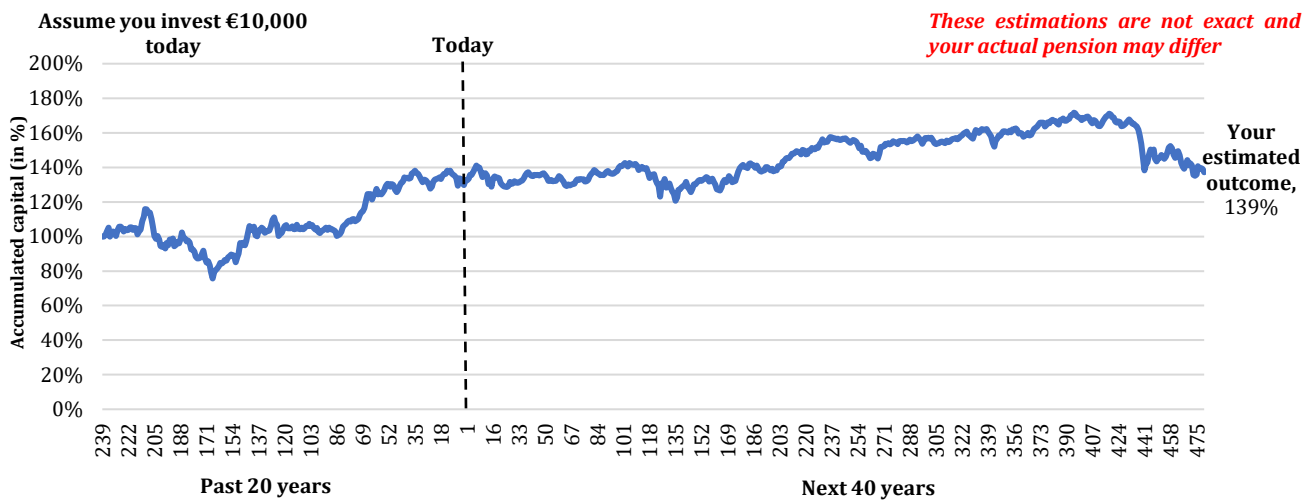
Therefore, we firmly advise policy makers and the European Commission to allow this derogation – by tacit endorsement or explicitly – in the Level 2 provisions.

Presentation: Regarding the presentation of performance scenarios, BETTER FINANCE suggests one of two possibilities:

- present real net past and future projections linked together in a graph;
- present past and future projections separated with different approaches.

Under the first option, the saver would be prevented from making the mistake of hyperbolising past returns and projecting them similarly in the future.

Graph 9. Past and future performance presentation



Source: BETTER FINANCE based on fund data (data is used only to make the graph realistic)

Under the second option, the approach for past performance would be the same. Regarding performance projections, these should be calculated and presented under different scenarios using two types of figures in monetary terms:

- the estimated total real net accumulated capital (e.g. €90,000) at retirement; and
- the monthly value of the estimated total real net accumulated capital based on a longevity assumption (e.g. €80/month).

Showing the monthly distribution of the accumulated capital brings certain benefits for the individual, non-professional investor. First, most pension benefits (pillar I/II) come under the form of monthly payments, making the PEPP KID easy to refer to by the saver. Second, this would better help the saver quantify whether and how much the PEPP is contributing – with other benefit sources - to reaching his retirement goal, i.e. achieving a certain amount of income replacement. Third, it highlights the risks of outliving the accumulated pension capital. Last, it enables the saver to understand whether a more aggressive/defensive strategy is needed and whether more/less contributions are required. However, should EIOPA consider alternatives as well, annualization would also be a viable solution, embedding different types of pay-outs.

What is important to make this section accessible and comprehensible for the non-professional investor is to use clear language, avoid methodological descriptions and reduce the amount of information as much as possible. As pension estimations are complex, this section must not deter the saver from contextualising it and seeking to understand it. Graphical illustrations should be used in order to promote user engagement. We argue based on existing research that the PEPP KID must stimulate question-formation and create ease in looking for answers.

The PEPP Regulation does not ease the process, as Art. 28(3)(d)(iii) requires disclosure of “*appropriate performance scenarios and the assumptions on which they are based*”. Requiring disclosure of the assumptions used to model projections is a poor policy choice since:

- explaining the methodology behind both stochastic or deterministic models to estimate future returns will create a Key Information Book;
- only disclosing concepts, such as “these estimations are based on one million Monte-Carlo bootstrap simulations” does nothing more than confusing the savers or demotivating them from further searching for answers.

While we clearly observe the regulatory requirement, we believe that the texts proposed by EIOPA in the PEPP KID mock-ups neither fulfil it, nor make it easier for PEPP savers to see the clear, simple message: the figures are estimated and we are unsure about their accuracy or reliability. Further below we give an example on how this type of disclosure can be enhanced.

The illustrative example A of the PEPP KID mock-up provides in section 2:

RIS	Performance scenario assumptions	<p>This table shows the money you could get back at retirement under different scenarios and depending on your respective age, assuming a monthly contribution of €100 until retirement.</p> <p>The scenarios shown illustrate how your outcome at retirement could look like. You can compare them with the scenarios of other PEPP products.</p> <p>The scenarios presented are an estimate of future performance based on evidence from the past on how the value of your retirement income varies, and are not an exact indicator. What you will get will vary depending on how the market performs and how long you keep the product (i.e. whether you will hold it until you have reached retirement age). The bad weather scenario shows what you might get back in extreme market circumstances, and it does not take into account the situation where we are not able to pay you.</p>
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Source: EIOPA PEPP KID illustrative example A, page 3

Instead, BETTER FINANCE proposes a simplification of the narrative as follows:

This table shows **estimates of** the money you could get back at retirement under different scenarios and depending on your respective age, assuming **you contribute monthly €100 until retirement. a monthly contribution of 100 until retirement.** These estimations are not exact and may differ from the actual outcome.

~~The scenarios shown illustrate how your outcome at retirement could look like. You can compare them with the scenarios of other PEPP products.~~

~~The scenarios presented are an estimate of future performance based on evidence from the past on how the value of your retirement income varies, and are not an exact indicator. What you will get will vary depending on how the market performs and how long you keep the product (i.e. whether you will hold it until you have reached retirement age).~~ The bad weather scenario **shows what you might get back in extreme market circumstances, and it** does not take into account the situation where we are not able to pay you.

As indicated above, for reasons of simplicity, regulation should not sacrifice warnings that are truly necessary, i.e. the prominent warning that *past performance is not a reliable indicator of future results*.

The future performance forecasts sub-section must be accompanied by a prominent warning indicating that those are estimations and the actual result may differ.

Costs

1. Basic PEPP Cost Cap

The purpose of the basic PEPP is to be a cost-efficient default investment option. Considering the high costs of investment products in the EU and the detrimental effects these have been proved to have on the returns of investment products,¹⁹ a cost cap for the passive basic PEPP is of absolute importance.

¹⁹ BETTER FINANCE Study on the Correlation between Cost and Performance of EU Retail Investment Funds (2019), <https://betterfinance.eu/wp-content/uploads/BETTER1.pdf>.

As such, BETTER FINANCE proposed a cost cap for the basic PEPP of 1% that **includes distribution costs, transaction costs** and other traditional fees, such as management costs, administrative costs, performance fees.

In other words, the basic PEPP cost cap must represent the total expense ratio that will be incurred by the PEPP saver from his accumulated capital. Excluding cost categories from the basic PEPP cost cap will render inefficient and even redundant the upper limit of this particular limit.

According to the PEPP Regulation, Art. 45(2) states: “*The costs and fees for the Basic PEPP shall not exceed 1 % of the accumulated capital per year*”. Whereas EIOPA has been delegated power through Art. 45(3) to decide what categories of costs should be included in the fee cap, that exception refers only to features inherent to the product.²⁰ Therefore, **distribution costs** (selling and investment advice) **are an integral part of the 1% fee cap** for the basic PEPP.

2. Table of Costs

Regarding the alternative investment options for the PEPP, BETTER FINANCE firmly advises public authorities (European Commission, ESAs) to align the methodology with the MiFID II and IDD requirements. If the PEPP delegated regulation will prescribe again a different methodology (definitions, categories) for aggregating costs, it may arrive to represent the fifth different key investor disclosure document with regards to fees, next to the UCITS KIID, the PRIIPs KID, MiFID II and IDD. Therefore, BETTER FINANCE suggests:

- for insurance-based investment products, the table of costs methodology replicates the one contained in the PRIIPs KID Delegated Regulation (Level 2);²¹
- for all other savings products, the MiFID II Level 2 prescriptions on disclosure of costs.²²

With regards to the presentation format of the table of costs for the alternative investment options of the PEPP, BETTER FINANCE proposes a solution that would align the PEPP KID with the principle of providing *fair, clear, and not misleading information*: disclose only the costs in percentage (%) terms of the net asset value:

- in the past year, so the saver can see how much the product actually costed;
- according to the PEPP contract, so the PEPP saver would know how much or the limits of costs that will or might be taken from his capital.

These models represent the only **fair** and **reasonable** manner to inform the prospective saver on how much an investment product costs. The summary cost indicator proposed by BETTER FINANCE is exhibited in Table 10 below.

3. Summary Cost Indicator (all PEPP)

Concerning the Summary Cost Indicator (SCI), the model adopted by the PRIIPs KID to express the impact of costs on returns – Reduction-in-Yield (RiY) – is highly misleading as it is incomparable from one product to another, it is based on an arbitrarily picked estimation of which the retail investor is not aware of and it diminished the effects of fees.

First, the PRIIPs RiY represents a cost estimation based on the moderate future performance forecast, which is not only dependent on the recommended holding period, but also represents an

²⁰ See Recital (57) read in conjunction with Art. 45(3) PEPP Regulation.

²¹ Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents, C/2017/1473, OJ L 100, 12.4.2017, p. 1–52.

²² Annex II of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, C/2016/2398, OJ L 87, 31.3.2017, p. 1–83.

estimation of an estimation and dilutes one-off charges, such as entry or exit fees. Therefore, besides not being reliable, it is neither comparable with other products.

The only way to make the summary cost indicator meaningful for the retail investor is to present how much the fees have weighted from the gross return – see example below in Table 10.

The Charges Ratio (CR) would show the difference between the gross and net returns, providing an accurate image of how much fees have eaten into profits, regardless of the recommended holding periods.

$$\text{Charges Ratio} = \left(\frac{\text{Net compound return}}{\text{Gross compound return}} - 1 \right) \times 100$$

This indicator can use both monetary or percentage terms in the computation formula as the result will always be expressed in percentage terms and would not differ.

The CR can be further circumstantiated based on the expected duration of the decumulation phase. Depending on the drawdown choice of the retail saver, the CR would be presented:

- simple;
- as an expression of the Wealth Reduction Ratio, for periodic instalments.

Since many savers wish to use their personal pension products to provide steady monthly income during retirement (periodic instalments), the most meaningful manner to present the effects of costs on one's savings is to show how much of the monthly replacement income generated by the PEPP has been reduced by fees. Albeit some PEPP which may generate further returns on the remaining savings during the decumulation period, the Wealth Reduction Ratio will not change as it will concern a pre-determined situation at the beginning of retirement.

The formula to calculate the WRR is simplistic and based on three assumptions:

- first, that the saver will wish to benefit from monthly instalments;
- second, that the saver's life expectancy after retirement is the average published by Eurostat for the PEPP's country of domicile and the saver's age cohort;
- last, the future performance estimations used in the previous sub-section.

The Wealth Reduction Ratio (WRR), or *Reduction-in-Wealth* (RiW), will be calculated as the difference in the gross and net monthly payment during the assumed life expectancy period of the PEPP saver after retirement and expressed **in monetary terms**. For example, if a saver which would retire in 2060, the life expectancy at retirement for his age cohort will be of 26 years, then the WRR will be calculated as follows:

$$WRR = \frac{(\text{Gross compound return} - \text{Net Compound return})}{26 \times 12}$$

The rationale for expressing the WRR in monetary terms only and the CR in percentage terms relies on the general level of financial literacy and comprehension of the average retail saver. Whereas investors do not have an accurate scale of size for investment and compound returns, especially on long-term products, the differences between the gross and net returns will turn out incomparable if the PEPPs have different expected returns at the target retirement date. Therefore, the manner to provide comparability across products is to transform in percentage terms as a common denominator.

Table 10. Reduction in Wealth - best estimate scenario		Amount
Gross accumulated savings at retirement		€ 95,000
Monthly gross income at retirement		€ 316.67
Net accumulated savings at retirement		€ 80,000
Monthly net income at retirement		€ 266.67
Real net accumulated savings at retirement		€ 44,800
Monthly real net income at retirement		€ 149.33

Source: BETTER FINANCE, own composition

Otherwise, the RiW can be disclosed in annual terms as well, in order to stimulate simplicity. However, with the RiW, since it concerns a monthly income which directly adds to the level of *pension adequacy* of the saver, it would be much more meaningful for the average EU citizen to see how much money he would be losing per month from his pension benefits with one product from another. The common comparator across products will be given by the standardised number of months on which the periodic instalments will be executed. In this case, presenting the WRR in monetary terms would bring much more comprehensibility for the retail PEPP saver than showing a percentage figure, which may be involuntarily minimised by the saver.

Risk indicator

The summary risk indicator (Article 28(3), letter d, point i) should present two tables that allow the retail investor to understand the different risk applicable to the asset classes contained in the portfolio (Table 12) and to understand the overall risk profile of the product (Table 11).

The financial risk table (Table 12) should show the two key risk components for the retail investor: (i) the probability of loss; and (ii) the magnitude of loss, in a simple scale: very low, low, low-medium, medium, medium-high, and very high. The two dimensions of the financial risk table should take into account the risk of loss in **real terms**, that is taking into account inflation. The risk and reward indicator should be also bi-dimensional. The first dimension should consider the aggregate risk profile of the product (in accordance with the financial risk table – on the vertical axis) and the **remaining investment horizon** (horizontal axis). The temporal dimension should not end with the target retirement date and should continue in the decumulation phase with the number of years equal to the life expectancy calculated by Eurostat for the country of domicile of the PEPP provider.

Table 11. Risk and reward indicator

	Years to retirement			Years after retirement		
	>30 years	>20 years	>10 years	>10 years	>20 years	25 years
1						
2						2
3				3	3	
4			4			
5		5				
6	6					
7						

Source: BETTER FINANCE own composition

The two tables should be presented on the left-hand side of the section, and on the right-hand side the narrative explanation and the prominent warning should be disclosed.

Table 12. Financial risk table (risk of loss in real terms)

Asset class / product	Risk	Holding period		
		1 year	5 year	+ 20 years
MMF (money market fund)	MAG PROB	Low Very high	Medium Very high	High Very High
Large* equity Index fund	MAG PROB	High High	High High	High Low to medium

Source: BETTER FINANCE own composition; *Note:* MAG = Magnitude of the risk (Low: <10%; Medium <50%; High >50%); PROB= Probability of the risk happening (Low: <10% probability; Medium <50%; High >50%; Very high = 100%); *large index: hundreds or thousands of index components (as opposed to “narrow” indices such as Stoxx 50 or DAX 30 which are not representing the equity markets, and are not diversified into mid and small caps).

The summary risk indicator should contain the following warning, depending on the type of product:

“Warning! This product does not provide a capital guarantee, nor inflation protection [if applicable]. A low level of risk does not mean no risk at all. Investments are subject to market fluctuations and financial loss and you may lose all your money.”.

For long-term savings products, there should be an objective (for example: achieving a certain level of savings, certain level of individual replacement ratio or certain level of down payments – monthly benefits after reaching a defined age). For this objective, the risk is defined as a probability of not achieving this target (objective). Therefore, the risk mitigation techniques should reflect both risks – short-term investment risk as well as long-term risk of not achieving the objective (target). This approach then provides absolutely new and more transparent way of understanding the long-term savings (investment-based or insurance-based) products.

PEPP Benefit Statement (PEPP BS)

The benefit statement offered to a retail saver that already concluded a PEPP contract should concern only the chosen investment option of the PEPP. In addition, the benefit statement should mirror the information presented in the pre-contractual phase (PEPP KID) and should represent a “progress report” of the chosen investment option.

The PEPP BS should follow the same principles framing the PEPP KID in being:

- short and concise, only focusing on key information;
- intelligible, avoiding jargon;
- of limited length and standardised format.

The PEPP BS should have the adjacent utility of providing a comparison point of the current investment option with other alternatives offered by the PEPP provider and other PEPP products offered by other PEPP providers. The format of the PEPP BS should be slightly different to that of the PEPP KID in order to not be confused with the PEPP KID.

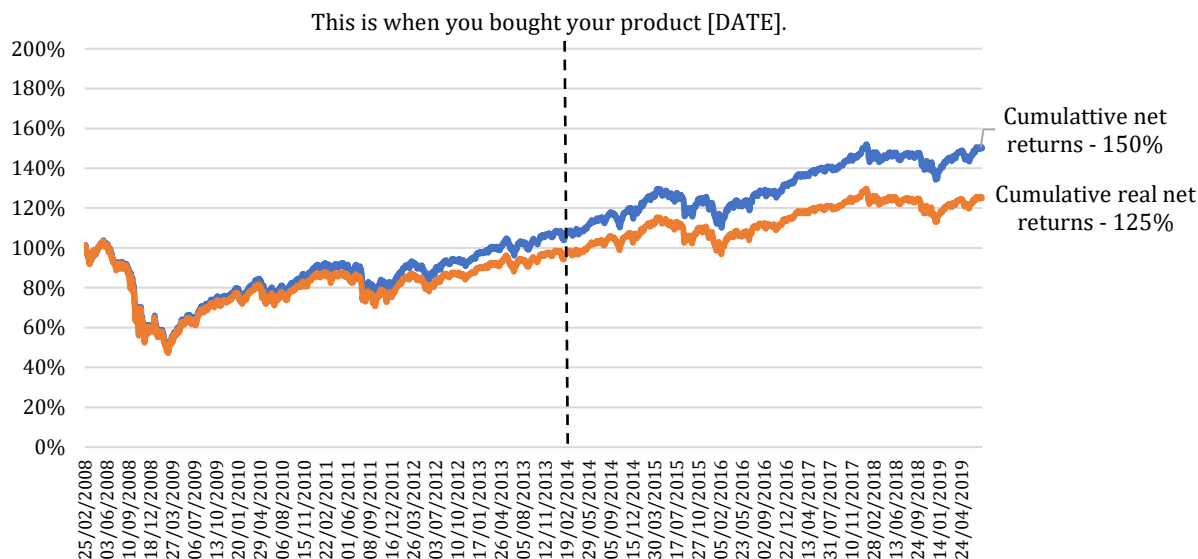
The information listed in Article 36(1) of the PEPP Level 1 regulation that is similar to that mentioned in Article 28(3) (PEPP KID) should be underlined by the same methodology and narrative explanations, including prominent warnings, taking into account the necessary differences listed below.

Past performance presentation in the PEPP BS

The graph (Graph 12 below, replicating Graph 78above) showing the cumulative net and real net returns of the product should start at the inception date of the product and clearly highlight (under the form of a line or prominent graphical indicator) the date on which the PEPP was bought, in order to show the retail investor how the PEPP performed since the conclusion of the contract.

The graphical indicator should be accompanied by a statement that reads “This is when you bought your product [DATE]”. If PEPP providers wish so, they should be allowed to indicate the cumulative net and real net performance of the product at the date when the PEPP saver bought the product, in addition to the latest cumulative performances (presented on the right-hand side of the graph). A possible example is shown below:

Graph 13. PEPP BS Cumulative returns



Source: BETTER FINANCE own composition

Further proposals on the presentation of the PEPP BS shall be published by BETTER FINANCE.

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