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Link to paper:

<https://eiopa.europa.eu/Publications/Consultations/Consultation%20Paper%20on%20PEPP.pdf>

BETTER FINANCE Response

Executive Summary

General approach and review	BETTER FINANCE welcomes the holistic approach adopted by EIOPA and agrees with the working premise (trends, challenges, principles) to develop a truly efficient and performing PEPP.
Information documents	The PEPP KID and BS should avoid information overload, be clear, accurate, reliable and comparable. BETTER FINANCE agrees with EIOPA's proposal to think "digital first" and design the information documents to take advantage of interactive tools, layering and online distribution.
Past performance & Pension projections	Past performance, presented in comparison with an objective benchmark, must be presented on long-term horizons, i.e. at least 20 years (already 10 year minimum required) for the UCITS money market funds). Pension projections must be made under the form of illustrative scenarios, in order to reduce the confusing and misleading effect on consumers of erroneous quantified future scenarios.
Cost Cap	The PEPP Regulation is clear and explicit in requiring an "all-inclusive" basic PEPP annual fee cap. The cost of distribution and the cost of the capital guarantee must be included in the annual 1% fee cap for the basic PEPP (meaning closer to 30 or 40% accumulated fee cap for the providers over the life of the PEPP contribution), and there must be no doubt about this legislative choice. Two fair solutions are provided for the cost of the guarantee and distribution under question 4.
Risk-mitigation Techniques	EIOPA should consider establishing simple, short and intelligible rules for the risk-mitigation techniques and clear benchmarks on how can PEPP providers ensure that the latter are in line and reasonably expectable to reach the PEPP investment objectives.
Cost indicator	A meaningful summary cost indicator should reflect the effect of charges on the monthly or annual pension income for the saver (in the case of a pay-out phase in the form of life-long annuities). Therefore, we propose to use the Reduction-in-Wealth (RiW) or Charges Ratio (CR) to disclose the total costs of a PEPP.
Basic PEPP	The basic PEPP must be standardised in order to embed a conservative investment approach (risk-reward profile) to protect the vast majority of savers that cannot or do not wish to make a particular financial decision.
Automated advice	Online distribution of PEPP might prove more suitable and, certainly, cheaper than traditional channels. We fully support EIOPA's approach to tap the potential of automated investment platforms to enable the PEPP to "take off".
Supervisory reporting	EIOPA should also include data from distributors or advisers on how many times the basic PEPP has been advised to the total number of clients for a certain PEPP and the same information but aggregated at product manufacturer level. EIOPA should develop a publicly accessible interactive database for PEPPs.

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About BETTER FINANCE

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

Instructions on how to read this paper: this document contains the response of BETTER FINANCE to the EIOPA’s Public Consultation but it is not the actual response form submitted.¹ Each section contains a **short summary** of the corresponding section in the Consultation Paper (CP) and of the questions analysed so the reader can understand the context. Each section aims to replicate the names and order of the CP’s sections and topics.

The general comment below represents BETTER FINANCE’s assessment on the drafting process and holistic approach adopted by EIOPA for the Regulatory Technical Standards.

Table: Question classification by topic

SUBJECT	Question #	Topic/ Section
	1	Information documents: form and presentation
Information documents (KID and PBS)	10	Information documents: digitalisation
	2	Information documents: risk approach and calculation
	3	
	4	Information documents: past and future performance
EIOPA powers	5	Product intervention powers
PEPP design	6	Basic PEPP design: costs
	7	PEPP design: risk mitigation techniques
	8	Reduction-in-Wealth (RiW) indicator
	9	Additional topics
Additional topics	Add 1	Investment rules
	Add 2	Freedom of pay-outs

Background information

The **Pan-European Personal Pension (PEPP)** product is an EU-label for a new retirement provision vehicle that will fulfil several standards or quality features that promise safer, cost efficient, flexible, mobile and more profitable pension savings.

The first purpose of PEPP is mobility and passporting. A saver opening a PEPP account would be able to continue contributing (and benefiting) to his PEPP whenever and wherever moving throughout Europe as his accumulated savings would be simply moved – **free of charge** – to the new national compartment with the same provider.

EU policy makers and stakeholders also see this initiative as an opportunity to create a new, much more efficient, individual voluntary savings product to alleviate the pressure of generating a proper retirement income and also restore trust in the finance industry.

In a nutshell, what is new and different about PEPP:

¹ The ESAs JC require to fill in a pre-formatted, standardised response form; we have chosen to change the format to make it more reader-friendly, to include background information and summaries for less knowledgeable readers and streamline comments, where possible.

Feature name	Description
Investment options	today, the PEPP will come in at least two options: (i) the basic PEPP, for those who do not wish to take an active decision in choosing and adapting their investment decision; (ii) at least one and maximum other five alternative investment options.
Risk mitigation	The PEPP(s) should embed at least one of the four risk-mitigation techniques: capital guarantee, life-cycling, reserves and smoothing.
Information documents	the PEPP providers should present potential clients with a PEPP Key Information Document (KID) and current clients with a PEPP Benefit Statement (BS).
Costs	the novelty is that, for the basic PEPP (the so-called <i>default investment option</i>), the overall cost is capped at 1% per year of the total accumulated capital.
Portability	For free, you can continue savings and benefitting from your PEPP wherever you live in the EU.
Switching	You can switch PEPP providers at any time for a maximum cost of 0.5%
Uniform taxation	If national Governments will allow it (hopefully!), you will benefit from your tax break anywhere you go.

Source: BETTER FINANCE

The PEPP Regulation (Level 1) has been adopted by the European Parliament and the Council of the EU in 2019 and sets out principles, purposes and high-level provisions concerning the PEPP. The implementing details will be prepared by EIOPA by 14 August 2020 through Regulatory Technical Standards (RTS) proposals for the EU Commission to adopt as a Delegated Regulation.

The purpose of this consultation is to seek stakeholders' views on what and how EIOPA believes the "fine-tuning" details of the PEPP should look like.

1. General comment

BETTER FINANCE welcomes the excellent and concise exposé of EIOPA on the current challenges and trends in the occupational and private retirement savings market in Europe. We believe that EIOPA managed to adequately capture inefficiencies of the current retirement provision systems, which set up the proper premise for discussion.

In particular, BETTER FINANCE is very happy to see that EIOPA acknowledged:

- the shift from Defined-Benefit (DB) to Defined-Contribution (DC) pension plans, in particular unit-linked products;
- that savers are passive, unaware or procrastinate with regard to the necessity to save for pension;
- that savers do not take into account the risk of outliving one's savings; and, finally,
- that the PEPP must be a simple, cost-efficient and profitable product.

Although we feel that circumstantiation in certain areas identified by EIOPA is still needed, and that some other important factors may have been overseen, our view is that the discussion starts well and it seems to be headed in the right direction.

However, the process of developing the Regulatory Technical Standards (RTS) must keep up with the good start and must always bear in mind:

- the context in which the PEPP appeared;
- the desired purpose and results of the PEPP.

It is also very important for policy makers, and for EIOPA as well, to understand that PEPP will not be the silver bullet in addressing the pensions gap and “time bomb”, nor will it be for restoring trust in capital markets and increasing financial literacy.

EIOPA notes that the PEPP – through transparency, standardisation, benchmarking etc. – is the solution “[t]o overcome consumer’s behavioural tendencies, such as procrastination, loss aversion or simplistic <<rules of thumb>>”. However, these behavioural tendencies stem from two interlinked factors:

- first, a general low level of financial literacy and education among the adult population in the EU;² and
- second, complexity and opacity of personal pension products, and complexity and jargon that characterises the vast majority of information communicated to non-professional investors.

Financial education is fundamental for proper investment choices as the main imbalance – and lacking feature of efficient and frictionless markets – is *information asymmetry*, in these cases the very basics of finance and investments. Increasing financial literacy and savers’ ability to make financial judgments by themselves – thus reducing “blind trust” in investment advice - should be a primary and long-term priority for policy makers at national and EU level, including EIOPA. However, for the PEPP this is an adjacent purpose. While we believe that behavioural patterns cannot be corrected through the PEPP only, the product and its information documents are key instruments for:

- drawing attention and visualising the effects of certain product or market characteristics, such as the long-term effect of costs or of inflation; and
- restoring trust and incentives to reorient capital from low- or negative yielding products to more performing choices.

In fact, EIOPA mentions in the Consultation Paper³

How much challenging is it for an individual to understand the effects of inflation and the risk of outliving one’s savings [...] which are the two main exposures a pension solution has to tackle?

However, until informational asymmetry and bargaining power is addressed through independent financial education and advice resulting in higher financial literacy, the PEPP – as EIOPA correctly noted – has “an obligation to deliver on the inherent promise to consumers”. To deliver on that promise, the PEPP must:

- be different:** there is a whole market for pillar III (or II, sometimes) retirement provision vehicles; there is another whole market for investment products that can be used for retirement;
- be simple(r):** from information documents to product characteristics, the savers should be able to understand the PEPP;
- be trustworthy:** savers must believe that the PEPP will alleviate the risk of poverty at retirement;

² BETTER FINANCE own computations based on The Atlas, ‘Global Financial Literacy Ranking’ (2016) <https://theatlas.com/charts/VJDhtA8Xe>.

³ EIOPA Consultation Paper on the proposed approaches and considerations for EIOPA’s Technical Advice, Implementing and Regulatory Technical Standards under Regulation (EU) 2019/1238 on a Pan-European Personal Pensions Product (PEPP), hereinafter “CP”.

- iv. **be comparable:** other pension products, including the IORP, should be easily comparable for the saver;
- v. **be efficient:** the costs and risk mitigation techniques should deliver an optimal results for pension savers, and the investment options should allow for investing in simple securities, such as shares and bonds.
- vi. **be tax efficient:** uniform rules on taxation, preferably through incentives, should have been agreed for the PEPP.

Unfortunately, some of these key characteristics of the PEPP have already been compromised at Level 1, such as the misleading “capital guarantee”⁴ or the possibility to construct a simple portfolio based on plain vanilla shares or bonds as an alternative investment option.

Happily, some other key features can be achieved through these Level 2 RTS prepared by EIOPA. For this reason, BETTER FINANCE welcomes the EIOPA proposals and this public consultation. As a bottom line, inflation, costs, risks and sustainability of investments are fundamental to a rational pension savings decision. More information can be found in BETTER FINANCE’s PEPP Position Paper⁵ or on our dedicated [webpage](#).⁶ Our main positions, expressed herein and in the Position Paper, are further substantiated in the PEPP Technical Working Document.⁷

2. Information documents: form and presentation

Short summary: EIOPA proposes to use layering of information (in the context of “digital first” and online distribution) in order to enhance the presentation of the PEPP KID and BS. EIOPA also made two illustrative examples of a PEPP KID and one for the BS in order to highlight the chosen approach.

Q1. Do you have any comments on the presentation of the information documents? Do you find the preliminary, illustrative examples of the mock-up PEPP KID and PEPP Benefit Statements are translating well the outlined objectives?

Objectives and overarching principles

To begin with, BETTER FINANCE affirms its strong support for the objectives and majority of proposals put forward by EIOPA for the PEPP information documents. We believe that the product offering, in general, has become overly complex and difficult to understand for the individual, non-professional investor.⁸ The multiplication of products marketed to the layman savers and the inherent “technicalisation” leads to a situation where the investor will either be confused, potentially making poor investment decisions, or will actually be deterred from making the decision due to a lack of understanding. In turn, the detrimental nature of these outcomes speaks for itself, especially in the context of a CMU wishing to better use the available capital of EU citizens.

Therefore, EIOPA correctly identified the overarching principle that must govern both the substance and the format of the PEPP KID and BS, to:

⁴ See BETTER FINANCE’s simple video on the PEPP Capital Guarantee Scam: <https://www.youtube.com/watch?v=XyABzZd5-0I>.

⁵ <https://betterfinance.eu/publication/pepp-position-paper/>.

⁶ <http://betterfinance.eu/pepp/>

⁷ <http://betterfinance.eu/PEPP-TWP-1-2020/>

⁸ See also BETTER FINANCE Key Priorities for the next 5 years 2019-2024 <https://betterfinance.eu/wp-content/uploads/BETTER-FINANCE-Key-Priorities-2019-2024-with-Infographic.pdf>.

“provide relevant, simple and understandable information that engage consumers to actively plan...”

Disclosure for individual, non-professional investors **has increased, but has not improved its quality**. What is more, in the context of sustainable finance, information will further increase. This is why it’s paramount to simplify the manner in which information is communicated and attempt to streamline and reduce it so as to not disincentivise the non-professional investor to become active in investment decisions.

Behavioural and cognitive processes of consumers

The BETTER FINANCE [Technical Working Paper on PEPP](#) argues why the current mandatory disclosure requirements provide savers with more than enough information, but which does not allow them to “process it and make an optimal” investment decision. This is due to a policy belief that *savers will be able to make the right financial decisions* if providers disclose enough information.

The issue stems both from the inability to select important information and the demotivating effect information overload has on non-professional investors.⁹ Moreover, most of the information comprised in these disclosure documents is either legal in nature or legal waivers and disclaimers, which are not only “difficult for an ordinary saver to understand and use”, but also lack added value for making a financial investment decision. In turn, the demotivating effect makes savers postpone or not take the decision at all. BETTER FINANCE received input from its national member associations suggesting that many savers would like to save more in pillar III products but have no sensible choice due to increased complexity of products.

BETTER FINANCE also made the argument against information overload in the response to the PRIIPs Public Consultation,¹⁰ highlighting research showing that information overload:

- reduces the attention and likelihood of investors to read the KID,¹¹
- reduces their ability to understand the product,¹² and
- reduces the “*perceived usefulness*” of the KID.¹³

These elements are pivotal in achieving the stated purpose of the KID, i.e. to enable the saver compare products and make an informed investment decision. As research has shown, non-professional or non-specialised consumers will address the information in the KID and form questions in one of two ways. On one side, consumers will subconsciously approach complex and large bodies of information, triggering cognitive tensions that “reduce the motivation to solve the

⁹ N. Gentile, N. Linciano, C. Lucarelli, P. Soccorso, ‘Financial Disclosure, Risk Perception and Investment Choice: Evidence from a Consumer Testing Exercise’ (2015) CONSOB, page 10, hereinafter “CONSOB CTE”, available at:

<http://www.consob.it/documents/11973/204072/qdf82.pdf/58dc22f8-504b-4bad-9679-610306359dfc>

¹⁰ BETTER FINANCE Response to the ESAs JCP (16/10/2019) on amendments to the PRIIPs KID, available here

<https://betterfinance.eu/publication/better-finance-response-to-the-esas-jcp-16-10-2019-on-amendments-to-the-priips-kid/>, hereinafter PRIIPs KID Consultation Response.

¹¹ European Commission, ‘Impact Assessment Accompanying the document Proposal for a Regulation of the European Parliament and of the Council on Key Information Documents for Investment Products, COM(2012) 352 final, page 18, available here <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012SC0187&from=EN>.

¹² European Commission, ‘Final Report: Consumer Testing Study of the Possible New Format and Content of for Retail Disclosures of Packaged Retail and Insurance-based Investment Products’ (2015) 18, hereinafter “PRIIPs CTE 2015” available https://ec.europa.eu/info/sites/info/files/consumer-testing-study-2015_en.pdf.

¹³ Gentile, Linciano, Lucarelli, Soccorso, ‘Financial Disclosure, Risk Perception and Investment Choice: Evidence from a Consumer Testing Exercise’ (n 6); see also.

problem and reach a decision". On the other, consumers will be stimulated to adopt a logical and rational thinking, allowing them to thoroughly examine it, look for context and estimate impacts.¹⁴

Therefore, we argue that the PEPP KID must stimulate question-formation and create ease in looking for context and generating answers. In order to achieve this process, EIOPA must pay attention not only to the amount of information, but also to its clarity.

Clarity is achieved by avoiding the use of jargon as much as possible and by avoiding ambiguity, which on most occasions derives from attempting to provide unnecessary explanations. EIOPA correctly identified in the CP that the **information documents must provide simple and understandable information to PEPP savers**, but analysing the mock KID proposals, some modifications might prove necessary.

Again, on this occasion, 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 not the optimal 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" do nothing more than confuse the saver or demotivate him to further search for answers.

On the other hand, EIOPA included half a page of explanations on the performance estimation graphs for the PEPP KID illustrative example B (below an excerpt from the

Performance scenario assumptions	<p>The graph above 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 unfavourable 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 B, p. 3

While we clearly observe the regulatory requirement, we believe that the text proposed by EIOPA neither fulfils it, nor does it make it easier for PEPP savers to take away 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 first step is for EIOPA to ensure that the PEPP KID and BS is not overloaded with information, including unnecessary legal waivers or disclaimers. The primary purpose of a key pre-contractual

¹⁴ See BETTER FINANCE Technical Working Paper 1/2020, p. 63 et seq.

disclosure document is to provide informational reliability for the consumer and reduce reliance on third parties to comprehend and take an investment decision.¹⁵ 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.

What is more, according to the founding regulation, EIOPA has the obligation to promote simplicity. Unfortunately, regulation does not ease this task, as Art. 28 of the PEPP Regulation has already created – on paper – the longest so far key disclosure document for retail investment products.

Both EIOPA's mock PEPP KIDs¹⁶ and BETTER FINANCE's mock PEPP KID¹⁷ are 5-pages long documents, almost twice than the PRIIPs KID and threefold than the UCITS KIID. Information such as applicable law (pt. xiii), consequences for early withdrawal (pt. vii), applicable tax regime (pt. d-v), consequences for stopping contributions (pt. viii), cooling off periods (pt. xiv) or conditions for the modification of the chosen investment options (pt. xi) should not be detailed in a **key information document**.

This is not to be understood that the aforementioned are not important for the saver, but we wish to highlight that they are very specific contractual characteristics – that should be found in the contract or in the Prospectus - and a simple reference would have sufficed, potentially coupled with a highlight where to find more information.

On the contrary, space and the attention span of the consumer could have been better used to highlight more information on ESG-factoring, target clients, investment strategy and capital protection, or past performance. In this sense, we welcome any suggestion of EIOPA to reduce the presentation and enhance the format or the amount of unnecessary details included in the PEPP KID, which is starting to look rather like a summary prospectus.

For instance, illustrative example B contains at the top of the first page a *product dashboard*, which we believe to cumulate all the above mentioned characteristics that enable the optimal cognitive process for the PEPP saver and facilitate digital interaction (QR-code that can be scanned by the majority of smartphones or tablets and directs to the online version).

¹⁵ See BETTER FINANCE's remarks in this sense in the response to the PRIIPs KID Consultation Response (n 10).

¹⁶ See EIOPA webpage (<https://eiopa.europa.eu/Pages/News/Consultation-concerning-technical-advice-implementing-and-regulatory-technical-standards-for-the-PEPP.aspx>), Illustrative example A (https://eiopa.europa.eu/Publications/Consultations/PEPP%20KID_Illustrative%20example%20A.pdf) and illustrative example B (https://eiopa.europa.eu/Publications/Consultations/PEPP%20KID_Illustrative%20example%20B.pdf).

¹⁷ BETTER FINANCE – <https://betterfinance.eu/wp-content/uploads/PEPP-Key-Information-Document-current-requirements.pdf>

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> **Product type:** Basic PEPP (Y/N)

Company: <Name> PEPP provider **Competent authority:** <Name>

Registration Number: 123 **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.

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

What is this product?

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.**

Another potential solution is to require product manufacturers to compress categories of information in the same bulk of text. For example, the illustrative example A of the PEPP KID provides in section 2:

RISK & RETURN

	50-60	100€	12,600€	70€	€21,800 €14,000 €12,600 €11,400	
	60 and older	100€	6,200€	30€	€6,500 €6,200 €5,900	

Performance scenario assumptions

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.

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.

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, EIOPA should not sacrifice warnings that are truly necessary, i.e. the prominent warning that *past performance is not a reliable indicator of future results*.

ESG considerations

BETTER FINANCE welcomes the inclusion of obligations concerning ESG-factoring in the PEPP Regulation. This constitutes a large step ahead as it would be – save other legislative developments – the first pan-EU product which will be explicitly required to take into account and consider risks and long-term implications on ESG factors.

However, the PEPP Regulation’s provisions regarding ESG-factoring in the investment process and the disclosure thereof are not well aligned and may lead to confusion among product manufacturers and consumers. EIOPA has the opportunity to temporarily clarify this topic through a proper reading of the Level 1 legislation.

Whereas recital (51) states:

“ESG factors should be taken into account. PEPP savings should be invested taking into account ESG factors such as those set out in the Union’s climate and sustainability objectives”

Article 41(1)(b) on investment rules for PEPP providers imposes the prudent person rule, which incorporates the obligation to

“take into account risks related to and the potential impact of investment decisions on ESG factors”,

which is further circumstantiated through recital (47) explaining that PEPP providers

“should take into explicit consideration the role played by ESG factors in the investment process”.

In our view, there is no doubt as to the fact that PEPPs will necessarily be sustainable long-term retirement provision products since Art. 41 demands compliance with ESG factors, rather than merely the *comply or explain* rule.

However, Article 2(33) neither contains an organic, nor a functional definition of ESG, but only makes references as to what may be considered ESG. In the current context where a taxonomy or a definition in EU law does not exist, market participants (product manufacturers, issuers, rating

agencies) have widely divergent understandings and screening processes of ESG or sustainability factoring.¹⁸ What is worse, on certain occasions many products are green washed.¹⁹

Therefore, EIOPA should take the opportunity to at least harmonise – for the moment – an ESG definition by establishing one of the existing charters as a benchmark. This prescription, or other more ambitious, could be covered by a sunset clause effectively replacing it with any other taxonomy or definition adopted at EU level. In this sense, divergent labelling and risk considerations would be avoided and consumer understanding would be enhanced.

However, if a choice were to be made, we prefer illustrative example A.

We agree with EIOPA's approach to the costs section to outline absolute figures and to the use of the accumulated capital as a reference point.

PEPP Benefit Statement

An additional comment dedicated to the PEPP BS is laid down below. Without further going into detail, EIOPA should focus in drafting the RTS on generating a benefit statement that is as similar as possible to the IORP PBS, in order to ensure comparability.

Whereas additional elements, as explained above, may organically differentiate the two, we believe that the quality features of the PEPP should be clearly visible for the PEPP saver, in contrast to those of an IORP. We refer EIOPA to our [Technical Working Paper on PEPP 1/2020](#) where we have suggestions on how the PEPP BS could look like.

3. Information documents: digitalisation

Short summary: EIOPA proposed to have a “digital first” approach in designing the PEPP KID and BS. This is to make use of electronic tools that would increase the efficiency of the information documents and enable the potential of online distribution, which would bring cost-efficiency gains.

Q10. Do you have any views on the opportunities for PEPP in a digital environment, for example regarding digital information provision and online distribution?

Layering and use of digital tools

The response to Question 1 above highlights most guidelines in formatting and presenting the PEPP KID. Layering is another very important element in reaching the stated purpose of the KID. Explained at large in the Technical Working Paper (1/2020), layering of information using digital tools should achieve several functions:

- include more complex information;
- structure information from simpler to more technical;
- combine text with graphical or other interactive features;
- incorporate other digital features.

EIOPA rightly identifies in the Consultation Paper that the format, content and presentation of PEPP information documents must be approached “digital first”. BETTER FINANCE agrees with the EIOPA proposals on layering the information and making the document interactive online.

¹⁸ See BETTER FINANCE study on sustainable investments (March 2019)

¹⁹ See SCM Direct, ‘Greenwashing: Misclassification and Mis-selling of Ethical Investments’ (November 2019) <https://scmdirect.com/wp-content/uploads/2019/11/SCM-Direct-Greenwashing-Report.pdf>.

This would also facilitate online distribution of the PEPP, which would significantly reduce costs and stimulate competition.

An easily implementable solution to address this strong deterrent for savers is to make use of digital tools and layering techniques (both for the KID and PBS) so as to maintain focus or engagement of consumers with information documents and also stimulate the cognitive process of question making. As indicated in the Technical Working Paper (1/2020), an online or digital presentation of the PEPP KID, BS and distribution of the product would allow use of digital tools that ease comprehension for the non-professional investor. Moreover, layering allows to still include complex information – such as abstract, legal or technical details – at the lower levels and “substantially improve information efficiency”.

EIOPA Central Registry

In this context, BETTER FINANCE firmly supports EIOPA in developing machine readable PEPP KIDs and BSs and make full use of the powers granted in Art. 13 PEPP Regulation in order to create a public-authority online web-comparison tool for individual, non-professional investors. As the requirements of Art. 13(1) are minimum requirements, EIOPA should take a supplementary step in asking national competent authorities to either communicate the information documents to the central registry or share the data therein to EIOPA for this purpose.

As BETTER FINANCE highlighted on many occasions and was included in the EU Commission’s Mid-Term Review of the CMU Action Plan, consumers of financial services and products are in dire need of objective and comprehensive web comparison tools for investment products. Although these platforms exist at national levels, they differ in scope of coverage or information provided. This also the subject of an ongoing action taken by the EU Commission in order to stimulate the emergence of such platforms.

We firmly believe that an online, publicly available registry provided by EIOPA that includes machine-extracted information from PEPP KIDs and BSs would bring a significant improvement in terms of consumer awareness, engagement and comprehension of PEPPs. Moreover, by essence, it would stimulate non-professional savers in their active decision-making process for retirement provision planning and add an additional incentive to trust. This registry would also be available through the websites of ESMA and EBA, and national competent authorities, in order to promote accessibility and outreach to savers across the EU.

Online distribution through robo-platforms

Currently, key information documents are distributed in a document-format, which may still be unattractive for savers. We agree with the analysis of the Consultation Paper that:

“the PEPP Regulation thereby explicitly permit fully digital disclosure and distribution regime, including automated investment advice without any human intervention, which can support significant gains in cost-efficiency”.

BETTER FINANCE wishes to highlight the extensive evidence gathered from the *Robo-advice papers* 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.

We reiterate the findings of the 2019 Robo-advice report²⁰ in this sense:

“Considering the low quality and suitability of some algorithms assessed in this report and the increasing use of Artificial Intelligence in our the society, in particular in the financial sector, we believe that legislators should propose a legislative framework that ensure that Automated-Decision Making (ADM) systems as Robo-advisors are accountable, transparent and fair for EU citizens. The algorithms of Robo-advisors need to be developed on criteria that comply with the legislation (MiFID II) with regards to the investment advice process, in order to ensure a harmonised, minimum level of quality.”

BETTER FINANCE has developed a mock digitally enabled PEPP KID, available here: <http://betterfinance.eu/pepp-kid-mock-up-proposal/>.

4. Information documents: risk approach and calculation

Short summary: In order to define the methodology to quantify and calculate the risk-reward profile of the PEPP, EIOPA proposed a “holistic approach” by which the three metrics of a product (past, future performance and SRI) are used together to determine whether the PEPP achieves its target.

Q2. Do you agree to approach the areas of risk/ rewards, performance and risk mitigation for the PEPP in a holistic manner?

Yes, we also believe that the three product indicators – risk, performance and risk-mitigation – should be consistent with one another, reason for which we welcome the EIOPA holistic approach. In addition, we believe that EIOPA also correctly identified the objectives and long-term nature of the PEPP, which are pivotal for designing the three parameters. Further comments on the holistic approach are provided below (Question 3).

²⁰ BETTER FINANCE, ‘Robo-Advice: A Look Under the Hood 2.0’ (November 2019) <https://betterfinance.eu/wp-content/uploads/Robo-Advice-Report-2019-FINAL.pdf>.

Q3. Do you agree to measure the risk inherent in PEPP as the dispersion of pension outcomes and to link it to objective of reaching at least the long-term risk-free interest rate?

We agree with EIOPA's assessment that "*the main risk of a pension product is not reaching the individual's retirement objective*", with a single note that the "*potential inability to outperform inflation*" is, in our view, inherent to the main risk indicated above. BETTER FINANCE made this point under Question 4 below as well: the retirement income objective must be considered in real terms, i.e. maintaining the purchasing power of the potential pension.

However, while we believe it's just a manner of expression, we slightly disagree with the statement that the riskiness of a pension product can also be measured by it "*not being sufficiently aggressive*" in order to compensate for a lower level of contributions or to reward a higher risk tolerance. Conceptually, those two aforementioned are not a risk *per se*, but potentially a mis-categorisation or mis-assessment of the product's risk/reward profile in comparison with that of the PEPP saver. Put simply, if the product is not "*aggressive enough*" it means that the PEPP saver needs a more aggressive product.

We are also aware of criticism brought to EIOPA's formulation that the PEPP's riskiness resides in a potential inability to reach "*an individual's*" pension objective, as it was held by stakeholders that the PEPP is more generalist, whereas individual pension targets are very specific. First, we believe the statement to be accurate as a PEPP may be tailor-made for one individual in particular. Second, pension products generally follow fairly general retirement objectives, under which the individual targets of savers are incorporated. Therefore, if the PEPP does not reach it's stated retirement objective, *qed* it will not reach the savers' individual retirement objectives either.

With regard to the building blocks, we agree with the targets identified by EIOPA around which the risk profile of the PEPP will be determined. However, it is not very clear – at this stage – how would the three be intertwined and what the valence of each would be: inflation protection, ultimate forward rate (UFR) and the dispersion of pension benefits. Nevertheless, the safeguards proposed by EIOPA to ensure transparency and an adequate level of investor protection (principle-based re-risking, transparent allocation, earmarking etc.) build to create an EU-quality label for the PEPP.

Last, we believe that EIOPA should set the technical frame (limits) for the alternative investment options (in order not to create too risky and too complex products) and allow a degree of flexibility for PEPP providers. Higher standardisation and harmonisation is needed for the basic PEPP, as we indicate under Question 7 below. The investor protection rules (transparency, disclosure, conduct of business and operational rules) should be the same for all PEPPs and reflect a high level of investor protection.

In regard to the methodology for return estimations, we support the use of the long-term risk-free rate (UFR) as appropriate.

5. Information documents: past and future performance

Short summary: EIOPA proposes to publish past performance in the PEPP KID in comparison with a benchmark, such as the basic PEPP, other investment options or another type of indicator. For performance projections, EIOPA suggests using a stochastic model and define the key assumptions necessary for this type of modelling.

Q4. To ensure consistency in the application and comparability of the information on past performance, performance scenarios, pension projections, summary risk indicator and to assess the effectiveness of the applied risk-mitigation techniques - do you agree for EIOPA to set the key assumptions and inputs used for the necessary stochastic modelling?

Past performance

Past performance, in particular for products with a long-term nature, is a key disclosure element for the PEPP. Past performance should be displayed in comparison with a benchmark, in order to shed better light on the returns of the product. Past performance is not a reliable indicator of future results, and this should be prominently stated in the PEPP KID and BS. However, past performance shows the saver whether the product manager achieved its stated investment objectives in the past and allows for comparison with the market.

“it is [the asset manager’s] skill and judgement in understanding and controlling the risk of failing to achieve the advertised investment objective or the benchmark that has been set the real test by which professional investment managers should be judged”.²¹

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).

The objective comparator for past performance should only be the corresponding market index benchmark of the product. If the product is not susceptible of having one, then no other performance should be presented.

PEPPs should be required to disclose long-term past performance, i.e. minimum 10 years. Long-term, pension savings products span over considerably large investment horizons, i.e. from 20 to 40 years or even more. In such long periods of time, inflation can have a considerable effect on the purchasing power, and savers should be clearly and prominently made aware of this.

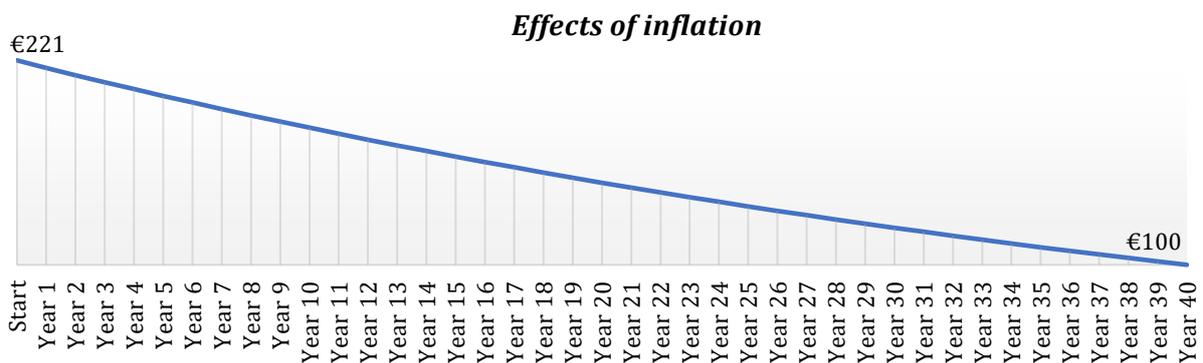
The risk of adding an additional narrative explanation in the performance section concerning inflation does not compensate the disadvantages of estimating inflation: the PEPP Regulation already requires an enormous amount of legal and technical information to be disclosed in the PEPP KID and BS, which have transformed it into a 5-page document.

²¹ Mark St Gilles, Ekaterina Alexeeva, Sally Buxton, *Managing Collective Investment Funds*, (2003) Wiley Publishing, p. 75.

This information overload will only demotivate the PEPP saver to consult and attempt to understand the KID, making the very purpose of such a document moot. Therefore, any further explanations on inflation should be removed.

Pension projections

To begin with, pension projections must be inflation adjusted to show the PEPP saver his actual purchasing power at retirement. Moreover, the “money illusion”²² is still not accounted for by many savers. Planning for old age implies a long-term investment horizon, most often of 40 years, 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%,²³ the cumulative effect in four decades will decrease the present value of savings by more than a half (56%).



Source: BETTER FINANCE Position Paper on PEPP

Therefore, protecting against inflation is crucial for any retirement planning - inflation-protection is an essential feature of any retirement planning and pension systems. In addition, to this pension projections should also be displayed in net terms, i.e. after deduction of all fees and charges.

In relation to future performance scenarios, BETTER FINANCE’s proposal is to not further confuse the saver and provide him with accurate, reliable data. Therefore, we advise EIOPA to require publication of simple illustrative scenarios that would make the PEPP saver aware of what he or she could expect during different types of market evolutions – “good weather” (bull markets or upturns), “bad weather” (bear markets or downturns) and “extreme weather” (stress scenario).

However, if EIOPA would still choose to present the improbable and highly misleading future performance estimations, BETTER FINANCE suggests to use the moving-block bootstrap method of simulating future pension outcomes. The details of this methodology are laid down in the Technical Working Paper on PEPP (1/2020).²⁴

²² 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.

²³ Which is below the last 19 years’ average and currently the target of the European Central Bank.

²⁴ <http://betterfinance.eu/PEPP-TWP-1-2020/>

6. Product intervention

Short summary: EIOPA received, by virtue of the Level 1 regulation, has been granted supervisory and product intervention powers. EIOPA seeks input from stakeholder on what type of information it should require national competent authorities to send from PEPP providers in order to carry its supervisory task.

Q5. Do you agree that PEPP's product supervision requires one set of relevant information to carry out the duties of home and host supervisors as well as of EIOPA?

BETTER FINANCE agrees with EIOPA's proposal to require one harmonised set of information to be reported and supervised on by national competent authorities and EIOPA as well. Considering the 1% fee cap for the basic PEPP, which is mandatorily subjected to investment advice, PEPP providers will naturally try to incentivise advisers or savers (through marketing communication) to sell the alternative investment options, which may not always be the most suitable choice for pension savers.

Therefore, BETTER FINANCE believes that EIOPA should include in this set of relevant information also data from distributors or advisers of PEPPs how many times the basic PEPP has been advised to the total number of clients for a certain PEPP and the same information but aggregated at product manufacturer level.

7. Basic PEPP design: costs

Short summary: The basic PEPP is required to have an 1% total fee cap, but EIOPA is delegated to determine what "costs and fees" are to be included in that limit, in order to ensure a level-playing field between PEPP providers.

Q6. Do you agree with the 'all inclusive' approach to the Basic PEPP's cost cap? Do you agree that the capital guarantee is a distinct feature, which costs should not be included?

All-inclusive approach - justification

To begin with, we believe that the PEPP Regulation is clear and straightforward in prescribing an "all-inclusive" fee cap of 1% of the accumulated capital:²⁵

"the costs and fees for the basic PEPP shall not exceed 1 % of the accumulated capital per year"

We believe that EIOPA correctly identified the legal basis and put forward the right proposal mentioning:

"it is suggested to follow an 'all-inclusive' approach that all direct and indirect, one-off (distribution, including advice) or recurring, costs and fees are included in the cost cap".²⁶

BETTER FINANCE is aware of EIOPA's concerns following stakeholders' input that the 1% limit should not include distribution costs, meaning selling and advice fees, as it is alleged that PEPP manufacturers will not "be able" to provide a PEPP as such.

We believe that this argument is not substantiated and is counter-lucrative towards achieving better performing pension savings products.

²⁵ Article 45(2) PEPP Regulation.

²⁶ Page 28 of the Consultation Paper.

To begin with, Recital (55) of the PEPP Regulation clearly explains the purpose of Art. 45(2). Then, it continues justifying the provisions of Art. 45(3):²⁷ EIOPA must take into account the relevant cost-factors related to different types of PEPPs (investment, pension funds, unit-linked or insurance-based etc.), their specific features and structure of costs in order to ensure a level-playing field.

As such, the PEPP Regulation only considers the costs inherently linked and particular to different types of retirement provision vehicles, not of distribution, which are common for all PEPPs.

All-inclusive approach - evidence

Second, BETTER FINANCE has gathered evidence that many pension plans, both occupational and voluntary individual, in EEA Member States do charge annual total costs below the 1% cap **including the costs of distribution**.

To begin with, the OECD Pensions Outlook (2018) shows that an increase of 1% in the cost of the product (from 0.5% to 1.5%) would decrease 25x times the pension “pot” of the saver at retirement (from 1.2% to 30%).²⁸ Thus, all the more reason to at least attempt containing the costs for the basic PEPP.

Moreover, evidence from the Norwegian Consumer Council on a sample of 68 pension funds shows that 70% of the funds charge a fee lower than 1%, with an average at 0.89%, as described in the table below.

Percentile	Fee level	Sample characteristics
99%	1.92%	Number of funds 68
90%	1.26%	Highest fee 2.15%
75%	1.10%	Lowest fee 0.29%
70%	1.00%	Average fee 0.89%
50%	0.85%	Average risk 4/5
25%	0.56%	Avg. eq. alloc. 48.6%
10%	0.48%	Corr. Fee - EQA 40.4%
lowest	0.29%	<i>source: BF own composition based on NCC²⁹ data</i>

**Avg. eq. alloc. = average equity allocation (EQA); Corr. Fee – EQA = correlation coefficient between the level of fees and the equity allocation of the fund*

The vast majority of pension funds in the above sample charge less than 1%, although the average equity allocation is close to 50% (balanced) and the average risk profile is 4 on a scale from 1 to 5, showing that smaller fees in pension funds does not entail passive investment strategies.

In the most recent statistics published by OECD,³⁰ 7 out of 8 EU Member States covered charged operating expenses below the 1% fee cap, the only exception being Spain, which is slightly above.

²⁷ Art. 45(3) PEPP Regulation provides that “EIOPA shall develop draft regulatory technical standards specifying the types of costs and fees referred to” in paragraph (2).

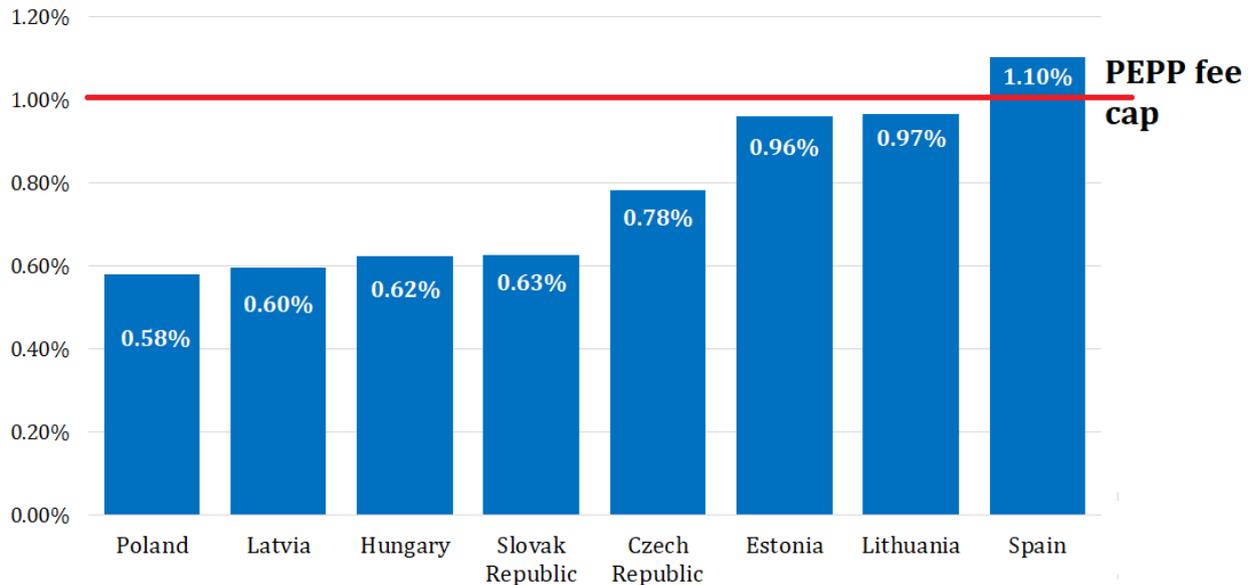
²⁸ See OECD Pensions Outlook 2018 (<https://www.oecd.org/finance/oecd-pensions-outlook-23137649.htm>); see the Final report of the High Level Group of Experts on Pensions, p 82, available here

<https://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupMeetingDoc&docid=38547>.

²⁹ Norwegian Consumer Council: <https://fil.forbrukerradet.no/wp-content/uploads/2019/10/rapport-kombinasjonsfond-og-fondsprofiler.pdf>.

³⁰ OECD, *Pensions at a Glance 2019*, https://www.oecd-ilibrary.org/social-issues-migration-health/pensions-at-a-glance-2019_b6d3dcfc-en.

Operating fees (funded & private DC plans)



Source: BETTER FINANCE own composition based on OECD data

In addition, a 2009 publication reported that the operating costs (administrative and investment) in the Netherlands of about 458 pension plans ranged between 0.2% and 1.3%,³¹ but the fact that many of them charged too high fees lead to the closure of over 300 funds over the course of 1992-2004.³² In the U.S. market, a 2014 report³³ on 401(k) plans reported that the average fee 52 million U.S. contributors paid for their retirement provision was 1%, others noting in this connection that “anything above 1% [...] is a rip-off”.³⁴

Building on the stated reasons in the PEPP Regulation and EIOPA Consultation Paper to create a cost-efficient basic PEPP, coupled with BETTER FINANCE’s ample scientific evidence that charging more will only reduce more the annual returns,³⁵ BETTER FINANCE believe that the crucial element of the basic PEPP is to keep in place an **all-inclusive 1% fee cap**.

Additionally, there is a **significant risk** that allowing cost categories to be excluded from the fee cap will severely **backfire** against the PEPP project. This is because the basic PEPP label will be sold with the highlight that “**all the costs you pay are...**” but, in reality, savers will find out that they have to pay more.

This would cause a severe **erosion of trust** in the PEPP and the incentive or attractiveness for savers to buy this product.

However, a breakeven solution for EIOPA would be to allow exclusively **independent advice** to be excluded from the fee cap, provided the following:

³¹ Range of 0.1% to 1.2% administrative cost plus 0.1% average investment costs, regardless of number of participants and fund size.

³² See Jakob A. Bikker, Jan de Dreu, ‘Operating Costs of Pension Funds: The Impact of Scale, Governance, and Plan Design’ (2009) PEF 8(1) Cambridge University Press 63 – 89.

³³ Jennifer Erickson, David Madland, ‘Fixing the Drain on Retirement Savings: How Retirement Fees Are Straining the Middle Class and What We Can Do about Them’ (11 April 2014) Center for American Progress, available here <https://cdn.americanprogress.org/wp-content/uploads/2014/04/401kFees-brief3.pdf>.

³⁴ Ian Ayres, Quinn Curtis, ‘Beyond Diversification: The Pervasive Problem of Excessive Fees and “Dominated Funds” in 401(k) Plans’ (2015) 124 The Yale Law Journal 1476-1550, available here https://www.yalelawjournal.org/pdf/c.1476.Ayres-Curtis.1552_6gag5s3c.pdf.

³⁵ BETTER FINANCE, *Study on the Correlation between Cost and Performance in EU Equity Retail Funds* (June 2019), available here: <https://betterfinance.eu/wp-content/uploads/BETTER1.pdf>.

- the product manufacturer does not charge sales or distribution fees;
- advice is provided by an independent financial advisor (no inducements, kick-backs, retrocessions applied or any other non-monetary benefit);
- the exclusion is clearly stated in the KID due to the fact that the product manufacturer does not charge any cost of sale or distribution, therefore the saver must bear the cost of independent advice.

Cost of the guarantee

In relation to the cost of the guarantee, we believe that the PEPP Level 1 Regulation is sufficiently clear in the sense that it must be included in the 1% fee cap. Moreover, input from our German member association working on the protection of the insured (Bund der Versicherten) indicates that, so far, there are no demonstrated actuarial methodologies to clearly calculate the cost of this financial guarantee. Therefore, we fear that if EIOPA would choose to exclude a cost that cannot be accurately calculated, it will open the door for product manufacturers embedding a capital guarantee to take out much more costs than what would be necessary for this risk-mitigation technique.

Second, contrary to the stated objective of ensuring a level-playing field, we believe that excluding the cost of the guarantee would mean an unjustified competitive advantage for life-insurance products – as these are the most common to include such technique – compared to other PEPP providers. The other risk-mitigation techniques may also have “specific” costs to implement them into a financial product, therefore EIOPA cannot justify this exception from the 1% fee cap. Moreover, excluding the cost of the guarantee could create confusion among PEPP savers, following the same rationale for the costs of distribution (selling and advice).

Last, this would add “insult to injury” as we have seen that the *capital guarantee* for the basic PEPP, is excluding accumulated fees and the very negative impact of inflation on the real value of “capital”, so actually PEPP savers will be misleadingly informed that they must pay an **extra cost** for the basic PEPP for a very **fractional** capital guarantee– as the situation currently stands. In addition, the prominent warning requested by BETTER FINANCE that this “capital guarantee” does not cover accumulated fees and the negative impact of inflation is not foreseen in the PEPP KID, thus violating an essential information rule of MiFID.

As a consequence, **EIOPA must keep all costs, including the cost of the guarantee, in the 1% fee cap.**

However, again BETTER FINANCE proposes a breakeven solution for EIOPA. Pursuant to the justification laid down by EIOPA in the consultation paper, additional features to the basic PEPP (i.e. additional to the minimum required by the Level 1 Regulation) should be paid by the PEPP saver.

Indeed, the Level 1 Regulation imposes, in respect to a financial guarantee, a minimum of the nominal net accumulated contributions to be protected. This is embedded in the basic PEPP and falls into the 1% fee cap. The level playing field is ensured as all manufacturers must incorporate a certain risk mitigation technique, which bears its own costs.

If the PEPP manufacturer decides to accord a higher level of protection for savers within the capital guarantee, e.g. real net guarantee or nominal gross guarantee etc., EIOPA could allow

exclusion only of the difference between what is minimally required by the Level 1 Regulation and what is accorded extra.

This should not be construed as a loophole for PEPP providers to unload costs into the “extra guarantee feature” and circumvent regulation. EIOPA must carefully assess this exception. Moreover, such an exception requires particular attention, supervision and enforcement from EIOPA and national competent authorities as, indicated above, if the cost of a financial guarantee cannot be precisely calculated, then it would prove difficult to calculate the difference of the two.

However, such academic finding should not pre-empt innovation and product manufacturers which do find a viable solution to calculate the cost of the guarantee. Moreover, we believe that this exception would incentivise PEPP providers to go above the minimum required by Level 1 Regulation in this time of low interest rates.

Below we give a very simplistic example of how this exception could work in practice: assuming two providers who offer a basic PEPP with a capital guarantee:

- provider A:
 - management fee: 0.5%
 - sales & distribution cost: 0.25%
 - cost of the **minimum** guarantee (nominal net accumulated contributions): 0.25%;
 - total cost: 1%

- provider B:
 - management fee: 0.5%
 - sales & distribution cost: 0.25%
 - **real gross guarantee: 0.5%**
 - minimum guarantee: 0.25%
 - **additional guarantee: 0.25%**
 - **total cost: 1% + 0.25%**

We believe that Article 45(1), read on conjunction with recital (53) of the PEPP Regulation, justifies such an exception.

We reiterate the sensitivity of the topic: this exception should be allowed only for the PEPP providers who go above the minimum required for the basic PEPP; the costs must be clearly distinguished and *justified* (direct relationship / causality with the extra guarantee only) and under no circumstance should be construed as a mean to exclude more or entirely the cost of the guarantee from the basic PEPP.

8. PEPP design: risk-mitigation techniques

Short summary: One of the selling points of the PEPP are the risk-mitigation techniques, which could³⁶ make it better in terms of risk-reward trade-off. EIOPA is seeking input on what criteria it should apply in order to define the parameters of those risk-mitigation techniques.

Q7. Which criteria should be added to foster the application and development of superior risk-mitigation techniques? Which research and learnings should EIOPA consider in its further work?

To begin with, BETTER FINANCE welcomes the idea and mandatory inclusion of the basic investment option into the design of all PEPPs as this would ensure more accessibility and participation of European savers to these products. The basic PEPP, previously named the *default investment option*,³⁷ is a feature that normally complements lack of knowledge, of understanding, indecision or passiveness of savers in making an investment choice and, therefore, should receive closer supervision from policy makers and supervisors.³⁸ BETTER FINANCE, as well as other international organisations,³⁹ acknowledge that any retirement provision system (and plans, in our case) require a default investment option, as long as it is safe and intelligible.

Default investment options (hereinafter DIOs) have appeared as a consumer protection response to automatic or mandatory enrolment pension systems for those savers who couldn't or didn't want to actively engage and take an investment decision. As a result, the DIO supplements the passive behaviour of the saver either for organic purposes⁴⁰ or to ensure that all savers will benefit from an investment strategy at retirement.

Academic and specialised literature is rich in showing most of pension plans participants are “by default” assigned to a DIO as they may not have the “*willingness or ability to engage*” in making an active choice⁴¹ and that this system substantially increases participation rates in pension plans.⁴² However, most of the examples – and articles analysing them – concern *occupational pension plans*, where automatic enrolment may stem from the employer or by virtue of law. On the other side, pillar III products – alias *individual voluntary products* – are usually subscribed by savers after seeking advice⁴³.

³⁶ See BETTER FINANCE's risk-reward table long term vs. short term demonstrating that often the low reward products are may be riskier over the long term.

³⁷ In the proposal text published by the European Commission and the one after the European Parliament's position in first reading.

³⁸ See EIOPA, ‘Survey of EU Practice on Default Investment Options’ (EIOPA-BoS-13/033, 8 April 2013).

³⁹ Since an auto- or mandatory-enrolment pension system cannot properly function if savers who do not make an active choice are not assigned to any asset allocation and investment strategy; see Jakub Fodor, Juraj Cenker, ‘Default Strategy in Pension Saving: The Case of Slovakia’ (March 2019) Institut Finančnej Politiky, 11.

⁴⁰ As academic literature shows, and BETTER FINANCE's national members' experience as well, many savers wish to save for retirement, but do not do so for reasons that sum up in the inability to choose.

⁴¹ See EIOPA, ‘Survey of EU Practice on Default Investment Options’ (EIOPA-BoS-13/033, 8 April 2013); see Theo Nijman, Niku Määttänen, Andres Vork, Magnus Piirits, Robert. I Gal, ‘Analysis of the Standardized Pan European Personal Pension (PEPP) Product and its Impact in Four European Countries: the Netherlands, Estonia, Finland and Hungary’ (2015) NETSPAR Academic Series, DP 11/2015-064; John Beshears, James J. Choi, David Laibson, Brigitte C. Madrian, ‘The Importance of Default Options for Retirement Savings Outcomes: Evidence from the United States’ (February 2006) NBER Working Paper No. 12009; Julie R. Agnew, Lisa R. Szykman, ‘Asset Allocation and Information Overload: The Influence of Information Display, Asset Choice, and Investor Experience’ (2005) 6(2) Journal of Behavioural Finance 57-70; Gur Huberman, Wei Jiang, ‘Offering vs. Choice in 401(k) Plans: Equity Exposure and Number of Funds’ (September 2004) Columbia Business School, Finance and Economics Division; see Pablo Antolin, Stephanie Payet, Juan Yermo, ‘Assessing Default Investment Strategies in Defined Contribution Plans’ (2010) 1 OECD Journal: Financial Market Trends, <https://www.oecd.org/finance/financial-markets/46010869.pdf>; see Heinz P. Rudolph, ‘Building Voluntary Pension Schemes in Emerging Economies’ (2016) World Bank Group, Policy Research Working Paper WPS 779.

⁴² More or less all the precited authors (n 39), in particular: ; Beshears, Choi, Laibson, Madrian, ‘The Importance of Default Options for Retirement Savings Outcomes: Evidence from the United States’ (n 39); Jeffrey W. Clark, Jean A. Young, ‘Automatic enrolment: The Power of the Default’ (March 2018) Vanguard Research.

⁴³ Exceptionally not, but it depends whether the product manufacturer allows to buy a product in absence of advice or contrary to the advice received.

However, as highlighted above and following input from one of our German member organisations (Bund der Versicherten), there can be many savers who wish to save, but have difficulties to choose the investment option,⁴⁴ for whom the DIO may be the bridge between passiveness and additional retirement savings.⁴⁵

We believe this short justification creates a bridge for the following proposal regarding *the need for standardisation of the basic PEPP*.

Need for standardisation of the basic PEPP

Pension savings are pivotal both for the individual and for society as building an adequate income at retirement is essential.⁴⁶ We understand the argument that a defensive DIO may not provide the highest of returns, but it would allow most PEPP savers achieve the purpose of the PEPP: “to recoup the capital”. At the same time, we acknowledge the need to protect the PEPP savers that do not have a loss absorption ability (risk averse, low-income etc.), reason for which we do not exclude the conservative approach.

We argue that EIOPA should standardise the risk-reward profile, through the Level 2 measures, for the basic PEPP for all product manufacturers. Naturally, the default investment option (the “basic PEPP”) is one **out of a finite number** of options to which the saver is automatically assigned in absence of active choice – as we indicated above. Therefore, the basic PEPP should have a neutral investment strategy (**a one-size-fits-all**), but it can only be neutral in comparison with the alternative investment options. If law would allow all PEPP providers to self-define their basic PEPP, the basic PEPP will no longer be basic, but a **PEPP-provider-specific-basic PEPP**. As such, we fear this may create confusion for individual, non-professional investors, and also lead to mis-selling on certain hypotheses.

EIOPA should seek to harmonise the investment targets or risk-reward profile for the basic PEPP, while also allowing PEPP manufacturers a certain degree – although limited – of flexibility in their designs. To mitigate the chances of abnormal dispersions of risk tolerances among European individual investors, EIOPA could allow for a small range/interval of risk-reward profiles, such as from lowest to balanced, or from 1/7 to 3/7, which could also start from a higher level at the beginning of the investment horizon and gradually decrease towards retirement or maturity date.

As we mentioned in the BETTER FINANCE Position Paper on PEPP L2 measures, the risk-reward profile – whether defensive, balanced, or dynamic – must take into account the long-term nature of the product, the years left until retirement, and the type and duration of the drawdown choice. For ease of reference, we insert below an excerpt concerning the summary risk indicator and the financial risk tables.

“ 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*

⁴⁴ See potential reasons in Agnes, Szykman, ‘Asset Allocation and Information Overload: The Influence of Information Display, Asset Choice, and Investor Experience’ (n 32) above.

⁴⁵ Of course, the DIO may be actually the preferred and chosen option by an active saver.

⁴⁶ See also EIOPA ‘Survey of EU Practice on Default Investment Options’ (n 32) acknowledging the need to supervise and regulate the DIO.

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

Risk and return level	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)

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

In terms of legal feasibility, whereas the PEPP Regulation (Level 1) does not prescribe one risk-mitigation technique in particular to be used, we believe that EIOPA can establish through the RTS a risk-reward profile or a range in which PEPP providers can design their risk-mitigation techniques. Our experience, backed by academic research, shows that most regulated DIOs invest mainly or only in bonds, which is neither efficient, nor particularly safe. Therefore, EIOPA should consider regulating a DIO harmonised strategy based on the risk-mitigation techniques that is optimal for savers. For instance, it could prescribe the maximum allocation in equities for life-cycling, it could require a certain return guarantee or a certain smoothing level.

Standardisation approach for the basic PEPP

We believe that a DIO should have a conservative or defensive approach. In essence, since the DIO is primarily designed for all savers who do not take an active decision regardless of the risk tolerance, it should therefore embody a risk-reward profile that represents a “one-size-fits-all” approach. Whereas the “safest” way not to cause detriment to the financial interests of savers by exposing to too much risk is to choose a defensive strategy and asset allocation – creating the lowest risk of loss, both from a probability and magnitude standpoint – we believe that a two-stage approach could also be useful.

International experience can also be useful. An older article (2006) noted that the U.S. Department of Labour prescribed three “qualified default investment alternatives”, i.e.: a conservative, a balanced and a life-cycle fund.⁴⁷ While the author noted that the conservative fund was more likely to outperform the life-cycle one, it exposed the pension plan participant to loss at the near-retirement stages of his investments, making the life-cycle approach more suitable from a hedging and yield point of view. Although an OECD publication argued that there wasn’t a “one-size-fits-all” DIO – view which is shared by several authors - since all researched investment strategies have merits in different simulations, numerous publications propose the *life-cycling strategy* as the optimal one,⁴⁸ although there is still a lot of discussion on the actual composition of it.

However, BETTER FINANCE’s research on life-cycle pension funds demonstrated that allocation styles (initial composition, glidepath and final composition) vary very much in the European market. The initial allocation by asset class varied from 50% to 100% in equities and in the portfolio re-adjustment rate, portraying very different strategies. Some funds use formulas for de-risking (e.g. initial equity allocation of 75% and a 1.25% reduction in favour of bonds over the next 40 years), some “block” the allocations for a certain period etc.⁴⁹ Therefore, the French model we describe below (*good practices sub-section*) is all the more relevant and useful in this context as it would help streamline and harmonise – to an extent that still encourages competition, diversity, but accommodates the requirement of simplicity – allocation strategies for life cycle pension products.

Some authors argue that the de-risking strategy in a life-cycle plan should be modelled by the age of the pension saver,⁵⁰ while others claim that the optimal strategy depends on the type of payouts.⁵¹ A study done in 2019 for the Slovak Ministry of Finance shows that, while “*piecewise and dynamic strategies are almost always dominated by other strategies*”, stepwise life-cycling strategies are safer but yield lower expected returns than accumulation ones.⁵² The same authors found that the **cost of a guarantee** for positive nominal returns would be only 4 basis points.⁵³

⁴⁷ Gaobo Pang, Mark J. Warshawsky, ‘Default Investment Options in Defined Contribution Plans: A Quantitative Comparison’ (2008) 13(4) Pensions: An International Journal 221 – 226, available at: <https://link.springer.com/article/10.1057/pm.2008.23>.

⁴⁸ see Ibid; see Antolin, Payet, Yermo, ‘Assessing Default Investment Strategies in Defined Contribution Plans’ (n 32) 2; see Andrea Berardi, Claudio Tebaldi, Fabio Trojani, ‘Consumer Protection and the Design of the Default Investment Option of a Pan-European Personal Pension Product’ (1 February 2018) SDA Bocconi School of Management by the European Fund and Asset Management Association, page v; see Jakub Fodor, Juraj Cenker, ‘Default Strategy in Pension Saving: The Case of Slovakia’ (March 2019) Institut Financnej Politiky, 11;

⁴⁹ See BETTER FINANCE, ‘Dispersion of Risk Mitigation Techniques in Life Cycle Pensions’ (June 2018), available here: https://betterfinance.eu/wp-content/uploads/The_Dispersion_of_Risk_Mitigation_Techniques_in_Life_Cycle_Pensions_-_Final_Report_-_130618.pdf.

⁵⁰ See Fodor, Cenker, ‘Default Strategy in Pension Saving: The Case of Slovakia’ (n 46), 12.

⁵¹ See Antolin, Payet, Yermo, ‘Assessing Default Investment Strategies in Defined Contribution Plans’ (n 32) 24.

⁵² Fodor, Cenker, ‘Default Strategy in Pension Saving: The Case of Slovakia’ (n 46), 18.

⁵³ Ibid, 24.

However, we contend that the de-risking strategy must take into account the type and duration of the pay out, as a lump sum drawdown will require a different strategy from an annuity strategy which could allow a fairly higher risk-capital allocation near-retirement in consideration of the longer investment horizon.

In our view, the risk-reward profile of the DIO should be placed in the lower part of a risk scale (lowest to balanced, or 1/7 to 3/7 etc.).

Good practices example

We wish to highlight a real-case example of risk-reward profile standardisation for the default investment option. In France, following the legislative reform for personal pension products (PPPs) last year (2019), the disclosure and methodology for PPPs' risk-mitigation techniques have been standardised in order to be clear and intelligible for pension savers, and streamline investment strategies. This standardisation is limited, so as to allow diversity for pension product providers, as it requires minimum asset allocations by the type of strategy. As such, if the saver does not make a choice with regards to the pension products' investment profile (which can be either prudent, balanced, or dynamic), by law he will be automatically assigned to the "balanced pension horizon", which represents a low risk investment profile. Moreover, this investment profile is prescribed under a few, simple, investment and de-risking guidelines. Therefore, the capital of the pension plan must be allocated into "low-risk" (as defined in EU rules) assets:

- At least 20%, starting 10 years before the planned retirement date;
- At least 50%, starting 5 years before the planned retirement date;
- At least 70%, starting 2 years before the planned retirement date.⁵⁴

We call on EIOPA not to suffer from the "NIH" ("not invented here" syndrome, like the Level I EU Authorities, who barely looked at the much simpler, efficient, effective, and time-tested US solution (the IRA – Individual Retirement Account) when drafting the PEEP Regulation.

Also we wish to remind EIOPA about its legal mandate to promote simplicity, and not to "reinvent the wheel", by drawing upon other PPP experiences that work and that are intelligible by pension savers the French PPP risk mitigation technique takes 3 lines of text in the rules: Can EIOPA live up to its simplicity mandate and do as well?

9. Other issues

Short summary: EIOPA conducted impact assessment analyses for the purpose of this Consultation Paper and is seeking advice on research gaps or new topics to focus on.

Q8. Do you have any comments on the draft Impact Assessment? Do you have any evidence which could further enrich the draft Impact Assessment?

BETTER FINANCE strongly supports policy option 2 for the cost section by which the summary cost indicator would be expressed as a Reduction-in-Wealth (otherwise referred to as *Wealth-Reduction-Ratio*, WRR, or *Charges Ratio*, CR). More information on the design and methodology of the RiW can be found in the BETTER FINANCE Technical Working Paper on PEPP (1/2020).⁵⁵

⁵⁴ Arrêté du MINISTÈRE DE L'ÉCONOMIE ET DES FINANCES du 7 août 2019 portant application de la réforme de l'épargne retraite, Journal Officiel de la République Française, 11 août 2019.

⁵⁵ BETTER FINANCE Technical Working Paper PEPP Series 1/2020.

Q9. Do you have any other general comments to the proposed approaches?

BETTER FINANCE wishes to highlight four more additional comments.

Additional 1: Investment rules

BETTER FINANCE would like to point out that, as part of the CMU Action Plan, EU citizens need to be brought closer to capital markets and need to be allowed to invest in simple, plain vanilla transferable securities, such as equities or bonds.

Although the Level 1 Regulation on PEPP does not preclude it, we believe it would have much added value if EIOPA would clearly specify that individual, non-professional investors should be allowed to choose the investments of their PEPPs and allocate at least a certain part of their capital into transferable securities.

Additional 2: Freedom of pay-outs

It should be specified that PEPP savers have the freedom to choose what type of pay-outs they wish to receive during the accumulation phase. One of BETTER FINANCE's German member association, the German Federation of the Insured, highlighted that in many life-insurance contracts (designed for retirement provision), savers are forced to take annuities, which are intransparently and incorrectly calculated to the detriment of the client. In addition, we suggest either higher standardisation or closer supervision on the mortality tables (life expectancy at retirement) for annuities in order to ensure that PEPP savers are not unduly cut a share of their benefits.

EIOPA should specify that all pay-outs are possible and that PEPP providers cannot limit or impose a fee or a penalty on types of pay-outs. At the same time, when PEPP providers recommend or offer pay-outs under the form of monthly payments or annuities, they should observe conduct of business requirements developed by EIOPA with regards to longevity assumptions, whilst prominently disclosing that after a certain period of time – *ceteris paribus* – the saver may run out of capital in his PEPP product.