16.7.2021
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FFI response to EIOPA consultation on framework to address value for money risk in the European unit-linked market

Consultation paper:
https://www.eiopa.europa.eu/sites/default/files/publications/consultations/consultation-paper-framework-to-address-value-for-money.pdf

Q1: Do you agree with the definition of value for money presented in paragraph 1.7?

A definition is not necessary. Existing rules on POG already provide a toolkit for national supervisory authorities to monitor that products' characteristics, including costs, are tested to ensure that they are aligned to the target market. It is not the task of the supervisory authorities to replace the competitive market in determining which product is favourably priced. E.g., article 8 of the Delegated Regulation on POG under the IDD makes clear that POG does not imply an interference with the insurers freedom to set premiums and prices.

The objective to develop a single, simple definition is not realistic. The proposed definition is problematic e.g., because the term "reasonable" used in the definition can be interpreted widely.

Furthermore, the definition's wording "in comparison to other comparable retail solutions on the market" would require comparing with competitors' products, which definitely reaches too far as a requirement. Insurers, including SMEs, would need to set up tools that can compare a constantly updated range of unit-linked and hybrid products offered by other insurers in the market. As a company is not supposed to know the target market and distribution strategy identified by competitors, the current POG principles seem more adequate, focusing on the appropriateness of the product for the target market *per se*. A product may well be compatible with the needs and objectives of the target market but still have higher costs than other retail solutions.

Q2: Do you share EIOPA's concerns about value for money in certain areas of the UL-market?

No. Unit-linked products have been a dominating product for insurance saving in Finland for a long time. Unit-linked products are a familiar and respected form of retail saving among both customers and sellers, and have been mostly free of problems. EIOPAs assumption that unit-linked products come with high costs is merely an opinion with no data provided as evidence.

EIOPA's consultation paper also highlights some potential COVID-related risks that have not been observed by Finnish life insurance companies (e.g. lapses and surrenders).

Q3: Do you believe that more emphasis on value for money considerations as part of POG, in particular through product testing, will ultimately improve the value propositions in the unit-linked market?

There are already several essential requirements for insurers to identify, assess and monitor target markets, initial and on-going disclosure requirements, and requirements for regular statements. In order to ensure the best outcomes for consumers and for the overall European market, NCAs should focus on the effective enforcement of the existing rules at national level.

Q4: Based on the framework presented below, do you believe there may be principles you feel are missing? Please explain.

No, the effective enforcement of POG and IDD rules, coupled with an active and pragmatic supervision by NCAs, are already sufficient to ensure that customers receive products that are suitable. A robust supervisory oversight in place and no evidence of flaws in the current POG rules do not warrant further EU-wide regulatory intervention in this area.

Q5: What additional measures could EIOPA facilitate to advance value for money in unit-linked and hybrid products?

It is important to ensure that unit-linked insurance products continue to be broadly and easily available to consumers. A limitation on the possibility to offer consumers unit-linked and hybrid products would significantly restrict life insurers' product offering, thereby restraining their ability to respond to their consumers' demands and needs, notably in terms of investing in a wide range of underlying investments and in terms of protection against certain risks (e.g., longevity risk).

There is a deep concern associated with the possible introduction of price restriction and otherwise reducing an undertaking's freedom of action. This all would have a negative effect on healthy competition among insurers.

Q6: Do you agree that costs and charges need to be due?

As part of the POG process, the manufacturer already ensures that the product's costs do not frustrate the needs and objectives of the target market. Within this principle the manufacturers should be allowed to set costs and charges as they deem fit.

According to EIOPA, due costs are those which "*can be clearly linked to services rendered or expenses made, and which are proportional to the efforts and expenses incurred by the manufacturer or distributor*". However, some expenses cannot be directly connected to a contract or product (e.g. salaries, training, overhead expenses, rental fees, IT or call centre costs, the cost of capital etc).

POG requires products to be in line with the objectives and needs of the target market. A requirement to offer products at a similar price as those offered by competitors would go far beyond POG. In fact, it would run counter to the basic principles of a competitive market. To preserve a market with fair competition, also the level of business profit should not be the same for all manufacturers. Furthermore, a company is not supposed to know the design of the product, target market and distribution strategy identified by competitors.

Regarding previously sold products, adjusting costs and premiums is often not possible and a value for money comparison with new products would not work, as the circumstances under which the old products were on the market would not be considered. Previously sold products need to be out of scope.

Q7: Do you agree that for evaluation purposes, costs and charges should be assigned to specific benefits and services?

It is the product as a whole which is distributed to the consumer, and therefore the POG process should also consider the product as a whole. If the product is suitable to the target market, manufacturers should be free to calculate the costs as they see fit.

Assigning costs and charges to specific benefits and services is complex and artificial. Costs and charges cannot always be allocated precisely: the various costs borne by the insurance company (including and not limited to payroll, IT tools, infrastructure, cost of regulatory developments, cost of capital, etc.), do not have a straightforward assignment to such specific items. On the other hand, some specific costs related to specific operations or services may be isolated (e.g. arbitration fees, management fees under mandate).

Transparency of cost disclosures ensures that consumers receive appropriate information on the total costs. The focus should remain on the streamlined and meaningful information.

Q8: Do you agree that the costs which cannot be directly linked to a specific product component, should be assigned to the dominant product feature? If not, do you have an alternative proposal?

In general, it is complex and artificial to assign costs and charges to specific benefits and services. Assigning costs which cannot be directly linked to a specific product component to the dominant product feature is a practical solution for a tick-the-box compliance exercise, but it brings no real value in terms of costs analysis.

Another concern is represented by the possible introduction of controls regarding the prices set by insurers, if too granular standards of costs and charges within the framework of these definitions were to be set, reducing an undertaking's freedom of action and more broadly, negatively influencing healthy competition among insurers.

Q9: Do you agree that active investment management involves additional costs and benefits?

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Q10: Do you agree that each product feature should deliver Value for Money as well as for the product as a whole?

The product as a whole is distributed to the consumer and should be considered as such in the POG process.

Q11: Do you agree that value for money is dependent on the target market's characteristics, needs, and objectives?

Yes, the overall product's suitability to the target market's characteristics, needs, and objectives and their evolution over time is the first priority. IBIPs for instance are usually long-term products, and they are sufficiently flexible to adapt to changing demands and needs of consumers. A product's suitability to the target market can be ensured and supervised based on existing IDD and POG rules, without the need of additional requirements trying to artificially dissect the offering and assess each element in isolation.

Also, the value of a product for consumer depends not only on quantifiable aspects (such as risks, performance and costs about which the consumers are informed well through the PRIIPs KID), but also on qualitative aspects such as being insured well, having trust in their insurance policy and provider, and having a peace of mind.

Q12: Do you agree that active and passive investment management have different target markets?

It depends on the overall product design and thus these considerations strongly overlap to the target market assessments required under POG rules.

It is also important to notice that the same unit-linked product can be used to hold active or passive funds or a combination of the two.

These considerations strongly overlap to the target market assessments required under POG.

Q13: Do you agree that distribution costs which are charged to the consumer as a percentage of the premium paid or the performance of the units can create a risk of being poor value for money?

No. It would go beyond supervisors' role to discourage such charges through additional compliance burdens.

Distribution and advisory processes are services that create value for consumers and naturally come at a cost. This should be compensated according to insurance company's strategies. It is more important for the consumer to understand the overall impact on the returns and to be protected against mis-selling. Distribution costs are not directly related to the performance of the underlying funds. IDD as well as the Delegated Regulation (EU) 2017/2359 provide rules on the detection and prevention of conflicts of interest, and already set out the criteria for assessing whether a remuneration or remuneration scheme complies with the obligation to act honestly, fairly and professionally to the client's best interests. These rules are already enforced.

There are different ways to charge distribution costs. Proportional commissions distribute the charges between contracts more evenly than the case of a flat (fixed) commission, which is not necessarily linked to a higher product quality or a more sophisticated advice. Forcing fixed, non-proportional costs could make the costs too high when the amount of money invested is low.

Q14: Do you agree on the assumptions to be made when assessing the reasonableness of the expected break-even point and of the expected returns?

No. It is not clear how EIOPA proposes to assess the break-even point.

Due to extremely low interest rates, high volatile equity and forex markets, soaring regulatory requirements and increasing longevity, reaching the financial targets of customers while generating sustainable long-term growth is becoming increasingly challenging. The implementation of a standard model and methodology to determine the appropriateness of the expected break-even point and the expected returns might prove impossible.

Q15: Views on other criteria / ways to assess reasonableness are sought.

A model to better define what reasonable costs are is not necessary. No list of criteria can be fully comprehensive. The definition of principles would generate lengthy bureaucratic requirements during the product design and review phases without improvement in the service offered to the client. This could lead to higher compliance costs.

Q16: Do you agree that manufacturers have a duty to review costs and charges, performance and the services offered on a regular basis?

Based on Article 7 of the Delegated Regulation (EU) 2017/2358, manufacturers shall continuously monitor and regularly review insurance products they have brought to the market and assess whether the insurance products remain consistent with the needs, characteristics and objectives of the identified target market. This is sufficient to ensure that remedial action is taken in case of any product non-compliance.

The introduction of potentially duplicative requirements under a separate framework would be contradictory to the principles of Better Regulation which aims to design EU policies and laws to achieve objectives at minimum cost and seeks to avoid overregulation and administrative burden.

Q17: Do you agree that policyholders should expect returns that are in line with market returns over the long run?

Performance should be in line with the client's appetite for risk, liquidity and/or collateral needs and objectives, and investment horizon. If policyholders are satisfied with the overall consumer experience, they keep relying on the same insurance company for their savings and insurance needs. This is the decisive factor and the first interest of the insurance company.

Q18: Do you agree that actively managed underlying funds should be reviewed in relation to their performance against that of their related benchmarks?

Based on Article 7 of the Delegated Regulation (EU) 2017/2358, manufacturers shall continuously monitor and regularly review insurance products they have brought to the market and assess whether the insurance products remain consistent with the needs, characteristics and objectives of the identified target market. This is sufficient to ensure that remedial action is taken in case of any product non-compliance. While the POG requirements provide for effective consumer protection, they do not oblige insurers to offer the cheapest products on the market. Whether a product is attractively priced or not, and whether the underlying options offer attractive investment yield or not, are determined by the customers in a competitive market. This includes the selection of funds offered as part of unit-linked insurance products.

It should be noticed that there are no clear benchmarks for multi-asset funds, which are the most popular choice in some markets. In addition, it is not clear which benchmarks should be used for long-term products. Furthermore, a benchmark is not necessary for a good performance.

Q19: Do you agree that mass marketed UL products should provide a limited number of options?

No, Finance Finland does not agree that mass market should receive only so-called “simple” products with limited options or passive management. We see no connection between many underlying options and high costs and the complexity of the product. The whole idea of a “complexity assessment” and “complexity scales”, based on assumptions such as the number of calculation formulae and number of underlying funds, goes beyond the IDD definition of “complex” products in Article 16 and EIOPA guidelines. Also “mass market” is another concept not clearly defined.

In our view, a wide selection of available investments is an excellent aspect of a product. It is useful for the customer, it improves the customer experience, and it does not make the product complex or expensive. UL products offer a good way for retail investors to enter European capital markets. Consumers appreciate and demand the possibility to choose between many underlying investments options. Keeping the customer satisfaction in mind, it would not be efficient to reduce products that satisfy the market demands.

Trying to limit the number of options or define the most appropriate number of options for a product would go beyond the supervisors’ role. Insurers’ and supervisors’ focus and responsibility should be to ensure the suitability of the option to the target market, maintain a diversified offering to respond to different consumers’ demands, and adapt to consumers’ changing needs over the product life by making it possible for consumers to change the underlying funds if their risk appetite changes. A product with multiple options can offer solutions in line with a client’s demands and needs, and it can be adapted during the life of the contract by switching from an option to another. As a result, a multi-option unit-linked or hybrid product allows the customers to change investment choices easily without bearing the disadvantage to exit from a certain investment and to enter in a new investment when they decide to modify asset allocation.

One of the main benefits of unit-linked products is that they can be used as a convenient way of allowing access to a wide variety of funds for different risk appetites. Consumers have a variety of objectives for their investment and different circumstances so restricting their choice would be detrimental.

Q20: Do you see alternative measures to mitigate risks associated with a high number of options?

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It is more important for the consumer to receive appropriate information and be protected against mis-selling. Finance Finland believes this is already ensured under the existing rules. We do not believe that a high number of options is a negative product feature – it is actually quite the opposite.

Q21: Do you agree that UL products require a high degree of financial literacy for consumers to understand?

Not necessarily. The IDD rules provide a robust consumer protection framework in terms of product design and distribution, professional advice, transparency, and prevention of conflicts of interests and mis-selling. Moreover, common unit-linked products are well understood.

Q22: Do you agree that products with many different options carry additional conduct risks?

Finance Finland does not believe that any potential conduct risks with unit-linked products are connected to the number of underlying options. A lack of options can result in a product that is less suitable for the customer.

The IDD requirements are sufficient to ensure that the selected options are suitable for consumers.

Q23: Do you agree with the variables to be taken into account to determine product groupings? Or do you believe more/less variables should be taken into account?

Finance Finland doubts that it would be possible to develop a predetermined model at European level flexible enough to capture all the specificities of unit-linked and hybrid products for different European markets and yet produce meaningful results even if products are grouped. A single model could prove to be unsuitable and would drive some sound products towards negative results in the market testing, thus restricting and flattening the offering.

Furthermore, EIOPA's proposed model would contain different assumptions for the evaluation of the reasonable break-even point and reasonable underlying assets returns taking into consideration different product groupings. The concepts of reasonable break-even point and reasonable returns are both very difficult to define in an objective manner.

Q24: For each of the variables identified provide views on options which EIOPA should consider

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Q25: Do you think there may be other criteria to be followed when grouping products?

We believe that even if the products are grouped, it would be impossible to specify a feasible model for heterogeneous European products.

Q26: Considerations on the model are sought

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