



Financial Services User Group's (FSUG)

Response to

EIOPA

Discussion Paper on a possible EU-single market for personal pension products

About FSUG

The Financial Services User Group (FSUG) is an expert group set up by the European Commission following the core objective "to secure high quality expert input to the Commission's financial services initiatives from representatives of financial services users and from individual financial services experts". The mandate of the group is to:

- advise the Commission in the context of the preparation of legislative acts or other policy initiatives affecting users of financial services, including consumers, retail investors and micro-enterprises;
- provide insight, opinion and advice concerning the practical implementation of such policies;
- proactively seek to identify key financial services issues which affect users of financial services;
- where appropriate, and in agreement with the Commission, liaise with and provide information to financial services user representatives and representative bodies at the European Union and national level, as well as to other consultative groups administered by the Commission, such as the European Consumer Consultative Group, the Payment Systems Market Expert Group, the European Securities Markets Expert Group and the Expert Group on Financial Education.

General remarks

The FSUG welcomes the EIOPA Discussion Paper on a possible EU-single market for personal pension products and finds the topic of the document extremely important for strengthening competition among PPPs with the ultimate goal of securing adequate retirement income for all EU citizens. FSUG recognizes that the long-term savings financial products, whose aim is to secure adequate income of savers for the future, needs to be adequately promoted all across Europe and more importantly provided by well-managed, cost-effective and transparent providers. Single market for pension savings products has been emerging only particularly and very slowly, which is in contrast with the development in certain Member States. However, significant differences in transparency and information disclosure and consumer protection measures at national level creates need for building unified EU framework for PPPs provision, as it is clear that national frameworks and regulations create divergent approaches towards pension savings products and thus creates different levels of outcomes. On top of this, current

findings on poor performance of private pension products sold to consumers accompanied with above equilibrium fees and charges under the information asymmetry calls for urgent regulatory interventions on EU level. This can be viewed not only in the area of pension set-up frameworks, but also charges (through the whole value-chain), investment strategy regulations (qualitative and quantitative limits), information disclosure and savers (investors) protection standards.

At their simplest, PPPs are a form of savings (deferred wages) where a future pensioner saves now in order to pay for his/her consumption in the future with expectation to achieve a certain level of replacement ratio. To achieve this ultimate goal, adequate savings ratio is needed, but even more important is the vehicle the savers use to achieve the goal. Most of the vehicles take place in special structured financial products and are based basically on two principles: insurance vs. investment. However, to persuade individuals to undertake such savings and choose one of the long-term vehicles, most EU countries use either fiscal incentives and/or compulsion to encourage this type of saving, and have created special regulatory and other structures relating specifically to these pension savings. The application of these incentives or requirements means that the resulting pension systems in EU countries are relatively complex in their nature, and their individual set-up varies significantly between individual countries and also within one Member State. This implies relatively complex requirements on savers to understand every aspect of the respective pension set-up and its consequences on its final outcome in a future from the perspective of the consumer. This is in a direct contrast with the known low level of financial literacy of most savers participating in such complex systems.

Until the recent development of DC-funded pension schemes in Europe, most traditional pension provisioning involved little need for consumers to make decisions. Most retirement income came from state pension systems (pillar 1) and that from the private sector often involved company-run DB schemes based simply on years of employment and final salary. However, the growing role of personal DC pension schemes has increased the need for consumers to make decisions with regard to vehicles (personal pension products - PPPs). In many 3rd pillar pension schemes, employers still arrange, administer and contribute towards pension schemes, but consumers now tend to have a greater say in buying pension products and investment decisions since they face the investment risk directly during accumulation phase and longevity risk during the pay-out phase. Latest movements from the financial industry successfully separated these two phases and left the consumers exposed to many risks without relevant (or hidden in highly complex legal terms) information and mechanisms (contractual and legal) to deal with the risks.

Are consumers well placed to face these risks and make optimal decisions? For consumers to make good decisions, they need access to the right information at the right time, they need unbiased advice from independent financial advisors (not intermediaries), and they need to have tools and mechanisms allowing them to successfully face the risks, while their needs should be considered as a priority by those controlling the pension system. There is much

evidence suggesting that consumers are often not well placed to make good decisions about long-term financial products, and therefore this is an important topic not only for protection standards, but also for a wider pension debate across Europe.

There is a considerable quantity of information available to consumers on general pension system set-ups and there are some notable similarities between some countries in terms of the set-up of their private pension systems (especially the 3rd pillar pension schemes). However, the (unbiased) information provided to consumers regarding the suitability, cost-effectiveness, risk taking and resulting expected adequacy (in term of real value) of particular pension products is missing and blurred by the financial industry. This gives a lot of space for misselling practices and overall predatory selling techniques experienced in many countries without fully understanding the needs and savings abilities of consumers where the adequacy, internal rate of return and overall cost-effectiveness of private pension products suffer.

Questions

Q1: Do you find the list of common features of PPPs identified by EIOPA complete? Would you add any other features (e.g. periodic income)?

The FSUG recognizes the need for a broader definition of private pension products. A general overwhelming definition is needed in order to cover most of the pension products sold (with short-term incentives) and financed (on long-term beliefs) on the individual basis regardless of any additional sources flowing into the product (employer, government contributions and incentives). However, the FSUG think that from the position of savers, several key aspects of private pension products should be recognized even within the definition.

FSUG suggests recognizing additional features of PPPs:

- savings scheme in term of cost-averaging,
- investment scheme in term of buying a pot (valued periodically, eg. daily, weekly, monthly),
- investment risks transfer to the member (saver),
- no longevity risk coverage during accumulation phase,
- scheme is explicitly split into 2 parts: accumulation and pay-out phase with different products for both schemes.

Q2: Do you think that EIOPA should focus more on DC or DB PPPs? What elements should be regulated for both types of PPPs in order to create a single market for PPPs?

Since there is a trend to phase out DB schemes and as the DC schemes generally shift more risks onto the savers (members) as well as recent development trends toward introducing pure DC schemes, the FSUG recommends focusing in a first stage on the DC schemes.

The DB schemes should be analyzed and decomposed from the view of guarantees offered to the members and cost of these guarantees.

Q3: Do you think that future regulation of PPPs should also include additional prudential requirements in cases where the provider of certain PPPs is already subject to European prudential regulation?

In order to create a more efficient and competitive single EU market for PPPs, future regulation of PPPs should seek to bring better coherence in prudential requirements across schemes and across Member States (not only those introduced by IORP).

Q4: What advantages do you see in creating/improving a single market for PPPs?

We expect several key advantages from the creation of a well-functioning single market for PPPs:

1. increased competition that will benefit the savers,
2. diversification of investment strategies that will better fit the diversity of needs of savers,
3. increased value for savers resulting from the various fee strategies introduced by the providers,
4. enhanced mobility of capital (savings) which not only follows the carrier path of the members, but members (savers) can participate in different schemes (or new EU regime) across EU based on their preferences and needs,
5. support to cross-border mobility of workers through a harmonized single market for PPPs.

Q5: Do you think that these definitions fully reflect the EU personal pension landscape? If the answer is negative, what changes would you suggest in the wording of the definitions? Which of the definitions is better?

FSUG suggest modifying the definition for PPPs to recognize that a PPP is a “financial product sold to a consumer in a form of a pension plan that hosts members only on an individual basis”. Any definition of PPPs should include both a legal and a socio-economic view. The legal part of the definition needs to include the commitments of contracting parties to contribute to the product (consumer) and to manage the savings towards achieving the socio-economic goal of adequacy of the retirement income, i.e. to ensure the best possible outcome for the saver

(financial provider). The definition of these specific financial products should take into consideration these three dominant aspects:

1. it is a product (any definition should clearly recognize, that the subject of any relation between the saver and provider is based on a product basis - vehicle);
2. it is a contract (any definition should impose that the legal relation between saver and provider is on a contractual basis whose subject is a pension product SOLD to the end-users) defining clearly the obligations of both parties;
3. it has a clear primary objective or purpose (any definition should recognize, that the main socio-economic objective or purpose of buying, holding and financing such product by a consumer and managing the savings by financial provider is to contribute to secure adequate stream of income during the retirement).

These three main features should appear in any definition of such complex structured financial products. Therefore, the FSUG suggest the following definition of private pension products (PPPs):

“PPPs are defined as any type of financial products sold to a consumer on an individual basis whose primary objective is to contribute to secure adequate income during the retirement.”

Any additional aspects of a PPPs definition should fit under above mentioned definition features and in addition should stress out the inner structure of the products and clarification of economic obligation of contracting parties. These additional features should take into consideration the risks shifted on to consumers.

Q6: In some countries when a Personal Pension contract is chosen by an employer, the pension remains under the regulatory regime for consumer financial services rather than falling wholly under the regime for workplace pensions. Do respondents believe that such pensions are personal pensions?

Certainly YES. Features of PPPs mentioned above (Q5) define the personal aspect of PPPs. Regulatory regimes applied for the PPPs are not the appropriate feature and should not be used for recognizing the features of PPPs.

Q7: How could a single market be developed for PPPs unregulated at EU level (e.g. cases where the IORP Directive is voluntarily applied to PPPs)?

In FSUG view an efficient single market for PPPs cannot be developed without specific EU regulation on PPPs.

Q8: Do you think that EIOPA should consider developing a framework for transferability of accumulated capital for passported PPPs? What obstacles to transferability can you identify and how can they be overcome? Can you identify the benefits of a transferability framework in the context of PPPs?

Certainly YES.

The key obstacle is the complexity of PPPs and diversity in taxation regime across MS. Additional obstacle is tied to the uncertainty about valuing the accumulated savings (valuation date and method) at the transfer (at time of exiting one PPP as well as at moment of buying in into second PPP).

Q14: Do you consider that transferability requires harmonisation of the tax treatment of pensions across MSs? In your view, are such changes feasible?

The key aspect that should be taken into account and understood by regulators is the need to enforce real freedom of movement of capital. This has been applied mostly only on providers. Increasing transferability might certainly improve the movement of capital (savings) and increase the freedom also for consumers (savers). Therefore, the issue of diversity of tax treatment between MS should be addressed either through harmonization of tax regimes across the EU or a mechanism that would organize tax treatment at the moment of transfer to another MS. Creating a 2nd regime (used to be called 28th regime) would avoid those problems and might speed-up the process toward full harmonization across the EU.

Q16: Do you see the need of the creation of a single market for products 1st pillar bis? What would be the benefits of creating a single market for 1st pillar bis products? How could the challenges posed by existing social and labour law be overcome, in particular in the Member States which have no products 1st bis?

As mentioned in the Q5, PPPs have some features than are common, even when they are classified under different „pillars“. For consumers, „pillar“ classification has no real meaning, as they consider other aspects of the products. Creating the single market even for 1st pillar bis PPPs might increase the competition and reveal the best practices applied under national regulations.

Q18: Taking into account the fact that the contributions to the 1st pillar bis products, come from diverting part of the contributions of the traditional public 1st pillar PAYG system, would it be feasible to create a passporting regime for providers of 1st pillar bis PPPs?

In particular do you think that EIOPA should consider the possibility to create a framework for cross-border management of 1st pillar bis schemes.

If the answer is positive, do you think that EIOPA should consider the possibility to create a framework for cross-border management of 1st pillar bis schemes based on the principles of UCITS Management Company passport? (Art. 16 to 21 of the Directive 2009/65/EC).

If the answer is positive, how would the UCITS Management Company passport need to be modified for 1st pillar bis managers to take into account specificities of 1st pillar bis?

FSUG thinks that the 1st pillar bis schemes and PPPs provided within these schemes should be open to more competition from abroad. Any passporting might increase the competition and bring additional value to consumers. On the other hand, the feasibility of such steps is rather questionable taking into account the nature of 1st pillar bis schemes and protection of such schemes by national interest.

Q20: Would passporting alone be sufficient a framework for the cross-border provision of PPPs or should EIOPA work on a 2nd regime as well? Which approach do you consider more appropriate to develop a single market in the field of PPPs?

Taking into account the various obstacles on national levels, the FSUG thinks that creating the 2nd regime might be a more efficient way for developing efficient and well-functioning single market for PPPs.

Q21: How should the 2nd regime be designed so that it becomes a standard that can compete with other PPPs and attract a critical mass of demand from providers and individuals?

There are some good examples and practices that can be used as inspiration for creating a 2nd regime. We refer to the paper of Kevin Dowd and David Blake¹ (2013), Blake, Cairns and Dowd² (2009) and OECD³ Roadmap for the Good Design of Defined Contribution Pension Plans which was published in June 2012. Some good examples can be taken from the national schemes implemented in Sweden, Estonia, Slovakia or Romania. Additional good example is a 401(k)

¹ Dowd, K., Blake, D. 2013. *Good Practice Principles in Modelling Defined Contribution Pension Plans*. Discussion Paper 1302. The Pension Institute. [online] <http://pensions-institute.org/workingpapers/wp1302.pdf>

² Blake, D., Cairns, A., and Dowd, K. (2009) Designing a Defined-Contribution Plan: What to Learn from Aircraft Designers, *Financial Analysts Journal* 65 (1), 37-42.

³ OECD Roadmap for the Good Design of Defined Contribution Pension Plans. [online] www.oecd.org/finance/private-pensions/50582753.pdf

scheme applied in USA. Some interesting findings on a good design and operation of PPPs can be found in the OXERA⁴ Study on Position of Savers in Private Pension Products (2013).

Q23: How would you design the main elements of the 2nd regime, in particular:

- rules applicable to providers
- accumulation phase (pure DC, DC with guarantees, DB or hybrid?)
- pay-out phase including benefits (e.g. should the benefits include only annuities, or also programmed withdrawals and lump sum payments?)
- product design (e.g. investment rules)
- consumer protection aspects.

See response and sources presented in Q22.

Q24: Should the 2nd regime comprise product rules only or product and providers rules? Should the 2nd regime prefer only certain types of risk sharing arrangements, e.g. DC? If the answer is positive, what would be the implications for the design of the 2nd regime?

Regulation of the product is the key task of any regulation. Most of the regulatory attention should therefore be paid to the design, back-testing, forward-testing, projections, distribution, switching, termination and transparency of particular products as they are directly sold to consumers. Simultaneously with the main, product oriented, regulation, the regulation of providers derived from the product regulation (rules) should be applied. This combined approach with clear focus on the product regulation should ensure that poor value products are not engineered and distributed on the single market.

Q25: If a 2nd regime for PPPs were to include prudential rules, do you think that it is possible to define a common way to calculate technical provisions for different types of providers? Do you think the capital needed for such activities could be the same for the different type of providers?

In order not to create arbitrary and speculative behavior from the side of providers, single level-playing field should be applied to all providers under the 2nd regime.

Q26: What information requirements are needed to protect PPP holders? What information should be presented in order to help them make sensible decisions and when and how should this information be presented? What are the differences to be considered with respect to the advice given by EIOPA to COM for the revision of the IORP Directive (occupational pensions)?

⁴ Oxera study „Position of Savers in Private Pension Products“. Research study prepared for behalf of FSUG and EC. 2013

FSUG thinks that this question is the most important when starting the debate on PPPs.

Research has shown over and over again that people are naturally poor pension planners. Financial skills are in general not well developed, and especially retirement is a difficult topic as it is so very far away in the future. As time and motivation are scarce resources, individual consumers buying or holding PPPs are unlikely to actively plan for retirement. This is even more the case when information remains difficult to read and understand (EIOPA, 2011).

However, the empirical research is divided regarding the question, whether the poor planning ability of consumers is more a result of low financial knowledge or a result of rational ignorance due to the missing and/or inadequate information (what is concerning the scope, quality, readability and timing). If the second one prevails, solving this problem could help to improve the first one.

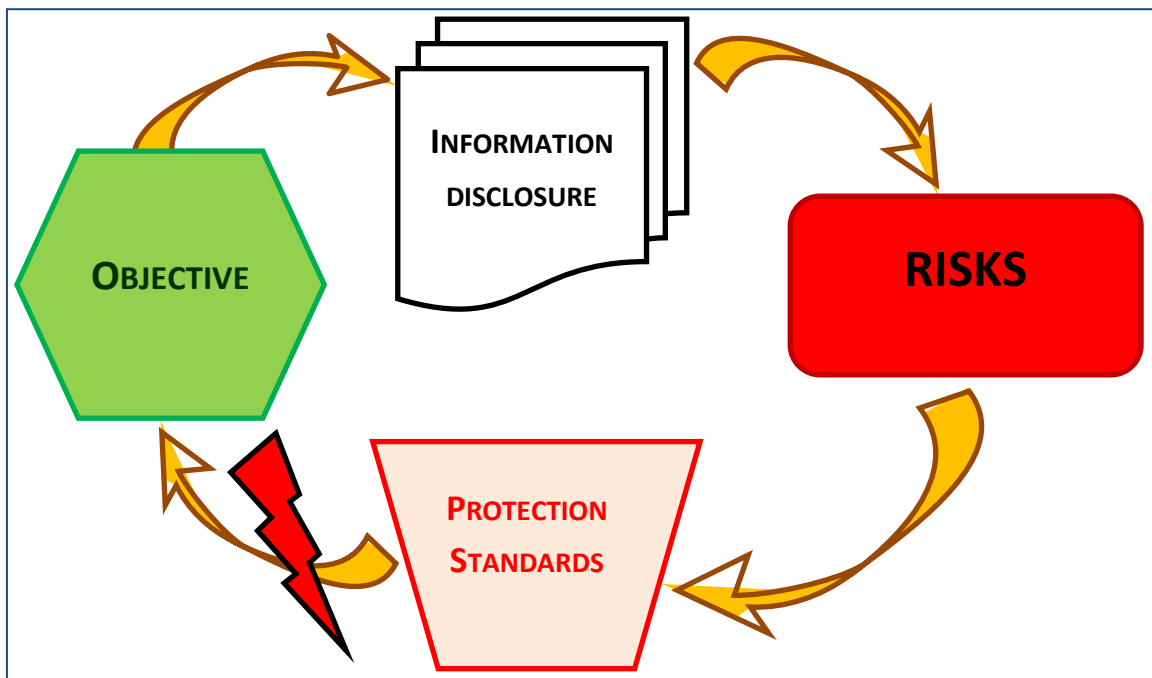
The key aspect that should be taken into account and understood by regulators when creating transparent PPPs and information requirements for PPPs is the misalignment between the speed of decision taken on buying financial product and the long-term features of savings schemes and duration of the contract (or holding the financial product). Most of the potential clients face significant pressure from financial intermediaries to sign the contract without having sufficient time to analyze and compare products, contract conditions (obligations, expected added value, etc.) and to consider individual socio-economic impact of such decision (aligning individual preferences with long-term objective, product features and contract obligations).

The **enforcement** of information disclosure (transparency) and protection standards is one of the weakest points of regulatory and supervisory activities of existing local, national and EU bodies.

There have been several regulatory attempts to introduce and formalize information and protection standards in the area of financial services, which can be used as a lesson.

The rationale of information disclosure and protection standards can be displayed as a decision-making cycle (see figure below).

Figure 1 "Objective-information/Risk-protection" decision-making cycle



Source: Own elaboration

The rationale for integrated approach towards EU certification scheme of PPPs on the information disclosure and protection standards follow the results of EIOPA Report (2011) and EIOPA Good Practices⁵ (2013) and suggest that:

- information disclosure should be layered (see EIOPA, 2013) according to the phase as well as objective(s) of this phase to ensure, the consumer is provided with adequate, understandable and timely information on the level of achieving his/hers objective;
- protection standards should be tied to the risks shifted to the consumers, so the regulatory and protection mechanism do not allow the detrimental cumulative effect of several risks to occur at the same time that would jeopardize the achievement of the ultimate goal (minimum level of adequacy);
- each information disclosure should follow the particular risk so the consumer has timely, accurate and understandable information for making decision on how to deal on individual basis with particular risks.

The basic “objective-information/risk-protection” scheme for PPPs that can be used as a framework for potential EU certification scheme is presented below.

Table 1 "Objective-information/Risk-protection" scheme for PPPs

Phase	Objective	Information disclosure	Risk	Protection standards
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⁵ EIOPA „Good practices on information provision for DC schemes - Enabling occupational DC scheme members to plan for retirement“. EIOPA-BoS-13/010. 24 January 2013.

1. Pre-contractual (Joining)	Adequacy Ability to align the product features with obligations and the objective (adequacy)	1. Individual stochastic modeling of the consumer life-cycle under the different PPPs (including all charges during the whole life-cycle)	A. Understanding of the PPPs by consumer	Obligation of industry (provider, intermediary) to present individual stochastic based model of adequacy under different PPPs life cycle
		2. Structure, source and availability of information (What? Where? How to read?)	B. Contribution level	Right to change the contribution level
			C. Information availability	Obligation of PPPs provider to disclose information on all phases prior to signing
			D. Investment (savings) strategy	
2. Contractual (Accumulation)	Path-tracking Convergence with the modeled life-cycle path	1. Regular, time specific and retrievable data on respective risks and parameters of particular PPP	A. Market risk B. Inflation risk C. Investment strategy	Right to switch the PPP for another PPP during the accumulation phase (not withdrawal)
		2. Benchmarking	D. Long-term poor performance	
		3. Full disclosure of charges (TER)	E. Charges	Capping the TER based on industry average ratio
		4. Individual replacement ratio modeling (career path vs. performance of savings)	F. Contribution level G. Added-value risk	Right to change the contribution level Right to suspend/pause the PPP for a certain period of time (e.g. due to unexpected unemployment) Supervision fines for "poor" added-value (banning the product)
3. Pay-out (Retirement)	Pension needs Ability to align the product features with the adequacy and individual preferences	1. Life tables and actuarial calculations	A. Longevity risk	Supervision of actuarial models and calculations (under existing regulation)
		2. Comparison tools (e.g. Chilean SCOMP)		
		3. Regular, time specific and raw data on respective risks of particular pay-out products (annuities vs. PW)	B. Inflation risk C. Market risk D. Interest risk	Right to switch the product for another during the pay-out phase

Source: Own elaboration

The FSUG positively recognize the latest EIOPA work on the information disclosure in DC pension products and recommend building any future regulation on these findings. Interesting findings that could be taken as good discussion point for increasing the protection standards

especially at the very end of the accumulation phase, just before the decisions on pay-out phase, can be found in the Harrison⁶ (2012).

Ability of consumers to assess the risks during the accumulation phase is based on the ability to create their individual life cycle savings projections, which can be then tracked in later phases. The best approach to convey uncertainty and increase the involvement of consumer into the process of decision-making may be to provide projections (based on unified and prudent methodology) of expected adequacy (e.g. present value of future pension benefits, individual replacement ratio, etc.) including a range of probabilities for different pension outcomes (see for example Blake, Cairns and Dowd⁷, 2002; Antolin and Payet⁸, 2011; Dowd and Blake⁹, 2013).

It can be argued that these types of projections are too complex to prepare and can be difficult for consumers to interpret and understand. However, if designed appropriately, projections on future pension benefits including a range of probabilities (probability distribution) for different outcomes could convey the most valuable information on uncertainty and risks, if provided in a consumer “language”. The best tool to provide this information on uncertainty about future pension benefits may be a pension risk simulator. On-line pension projection tools enable individuals to input assumptions for future values of several key parameters (e.g. contributions, retirement age, returns on investment) to obtain projected retirement income. However, they require a high level of knowledge about assumptions, but have the advantage that the individuals who choose to use them are more likely to understand the results and follow the path. Additionally, on one hand obtaining a wide variety of results could add another layer of confusion that, on the other hand, would serve to further underline the message that projection results should not be considered as definite or relied on exclusively (Antolin and Fuentes¹⁰, 2012).

Q27: In the pre-contractual phase, what ‘must’ PPP holders know about the personal pension product before purchasing it and what “should” they know? What further information should be available and easy to find?

The facts presented in response to the Q26 signify the risks associated with the pre-contractual (joining) phase as presented in a figure below.

⁶ Harrison, D. 2012. *Treating DC scheme members fairly in retirement?* NAPF and Pensions Institute Research Report, February 2012.

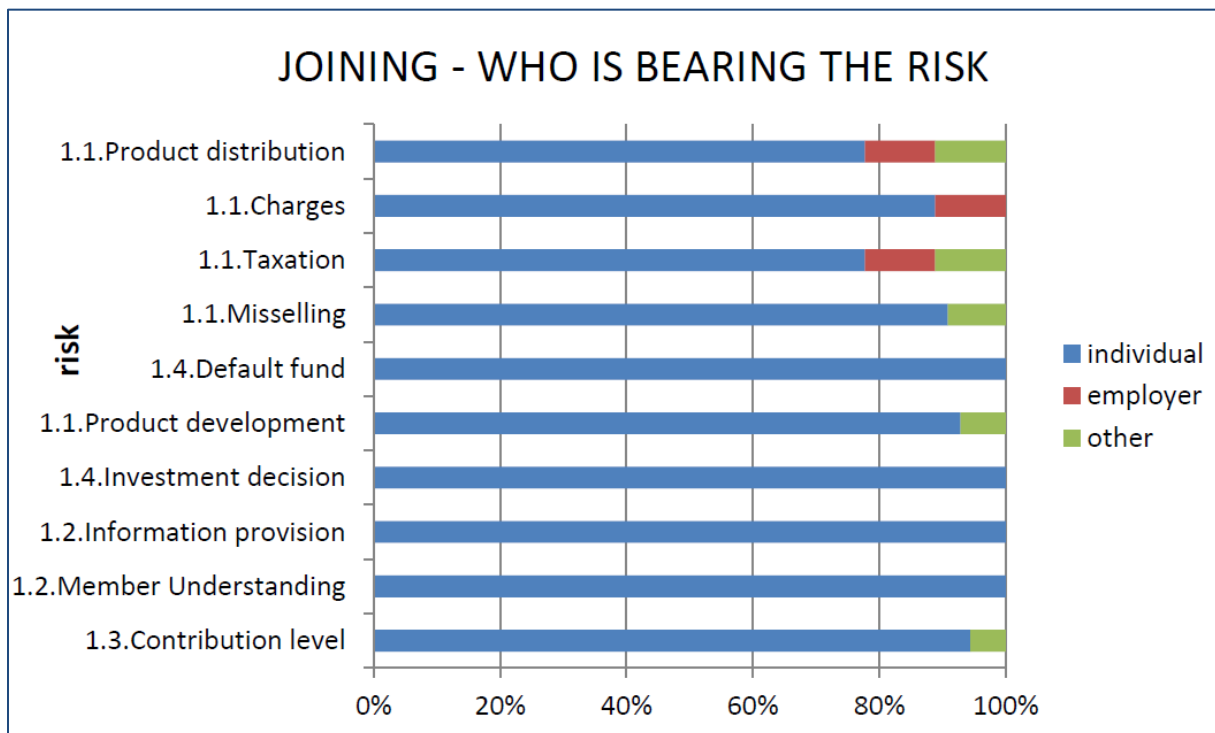
⁷ Blake, D., Cairns, A., and Dowd, K. 2003. *PensionMetrics 2: Stochastic Pension Plan Design During the Distribution Phase*. In: *Insurance: Mathematics and Economics*, 33, 29-47.

⁸ Antolin, P. and S. Payet. 2011. *Assessing the Labour, Financial and Demographic Risks to Retirement Income from Defined-Contribution Pensions*. OECD Financial Market Trends vol. 2010, issue 10 (<http://www.oecd.org/daf/financialmarketsinsuranceandpensions/financialmarkets/47522586.pdf>)

⁹ Dowd, K., Blake, D. 2013. *Good Practice Principles in Modelling Defined Contribution Pension Plans*. Discussion Paper 1302. The Pension Institute. [online] <http://pensions-institute.org/workingpapers/wp1302.pdf>

¹⁰ Antolin, P. and O. Fuentes (2012), “Communicating Pension Risk to DC Plan Members: The Chilean Case of a Pension Risk Simulator”, OECD Working Papers on Finance, Insurance and Private Pensions, No. 28, OECD Publishing. (<http://dx.doi.org/10.1787/5k9181hxzmlr-en>)

Figure 2 Ultimate bearers of the risks during the joining phase



Source: EIOPA, 2011

Existence of information asymmetry between the industry and consumers results in a transfer of above mentioned risks on the consumer due to:

- a. lack of financial knowledge and information (methodology) on how to consider the technical aspects of financial products (inability to compare products due to the lack of information on key features of PPPs),
- b. lack of ability to assess his/her contributory capacity over a long-period (most of the contracts expect fixed or increased level of contributions, which do not reflect or allow changes in a contributions over time),
- c. lack of time and ability to match the financial product features with the long-term savings objective (assess the adequacy) as there are limited information and tools to match these two aspects, which leaves a lot of room for misseling practices and recommending PPPs that do not suit the needs of consumers.

Overall, the key risk consumers' face in a pre-contractual phase is the lack of information (on the methodology of assessing the product features as well as information needed for comparison of real value of PPPs with regard to the individual situation/preferences and the expected adequacy).

Every PPP offered to a consumer within a certain scheme should have personalized projections using a model based on plausible, transparent and internally consistent underlying

assumptions. The model must be stochastic and be capable of dealing with quantifiable uncertainty. (for further reference see Dowd and Blake, 2013¹¹)

Q28: If a layering of information is introduced, what information should be included in the different layers outlined above (“must know”)? What information should be included in the subsequent layers (“should know” and “nice to know”)? What is the best way to make it easy for PPP holders to find their way through the different layers?

see the response in Q40 with regard to the presented Table 1 under the Q26.

Q29: What key questions identified in the area of occupational pensions (“Will my pension be sufficient for my demands and needs? If not, how much will the shortfall be and what can I do to improve the situation?”) might be relevant for personal pensions?

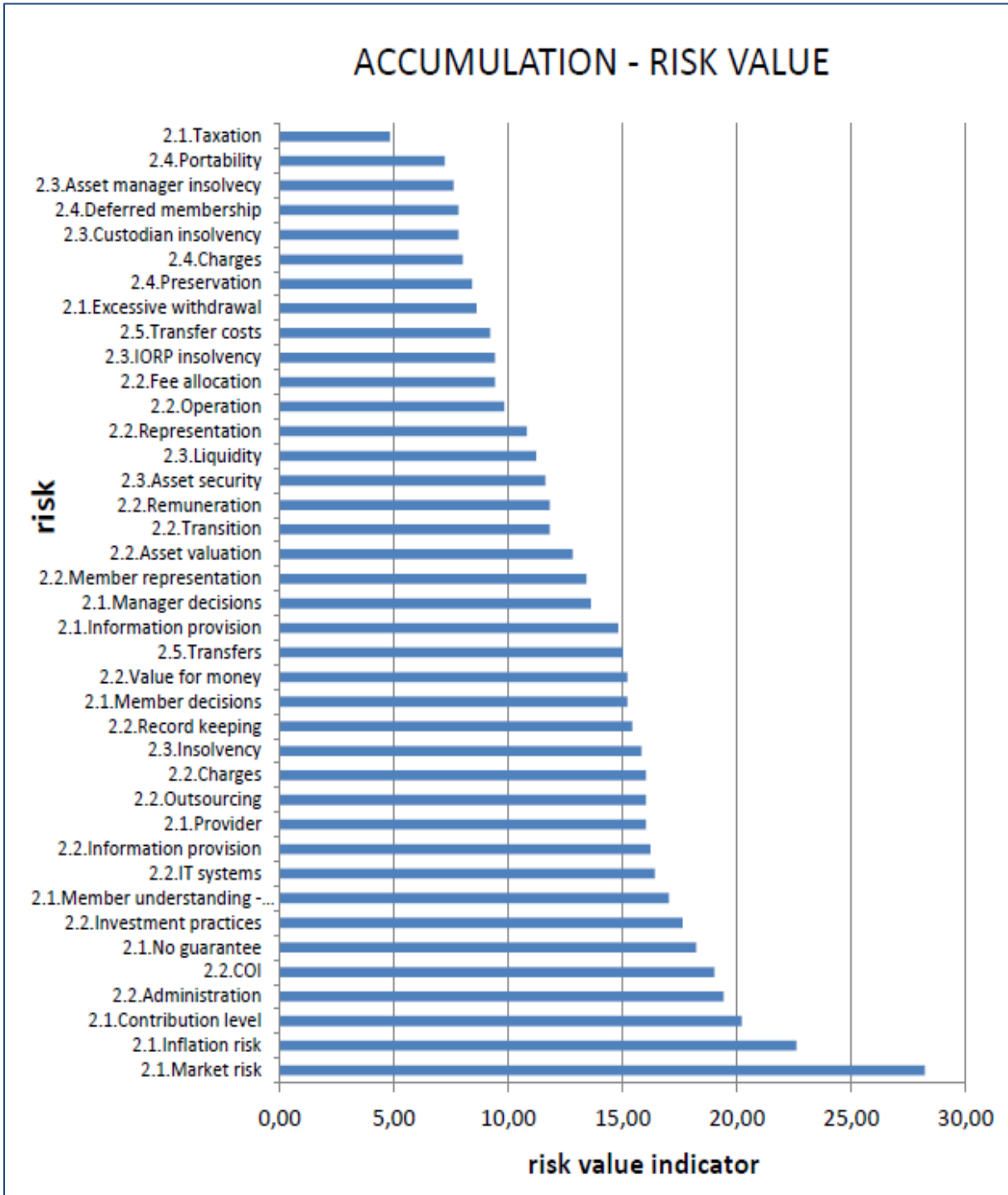
During the pre-contractual phase, personalized projections oriented on answering adequacy questions should include stochastic approach and IRR (individual replacement ratio) calculations under different assumption of variables (pessimistic, realistic, optimistic).

More broadly, the second (contractual) phase is the main part of the consumer life-cycle, where all the risks associated with PPPs might emerge. The FSUG thinks the EIOPA Report¹² provides a quite comprehensive overview of risks the consumer face when buying DC based PPPs. Figure 2 below provides an overview of the main risks connected to the accumulation phase. The risks with the highest value are market risk, inflation risk, risk of stopping or reducing payment of contributions, administration, charges, information availability to consumers, investment strategies (practices).

¹¹ Dowd, K., Blake, D. 2013. *Good Practice Principles in Modelling Defined Contribution Pension Plans*. Discussion Paper 1302. The Pension Institute. [online] <http://pensions-institute.org/workingpapers/wp1302.pdf>

¹² EIOPA Report on RISKS RELATED TO DC PENSION PLAN MEMBERS, CEIOPS-BOS-11/024 (final), 8 July 2011

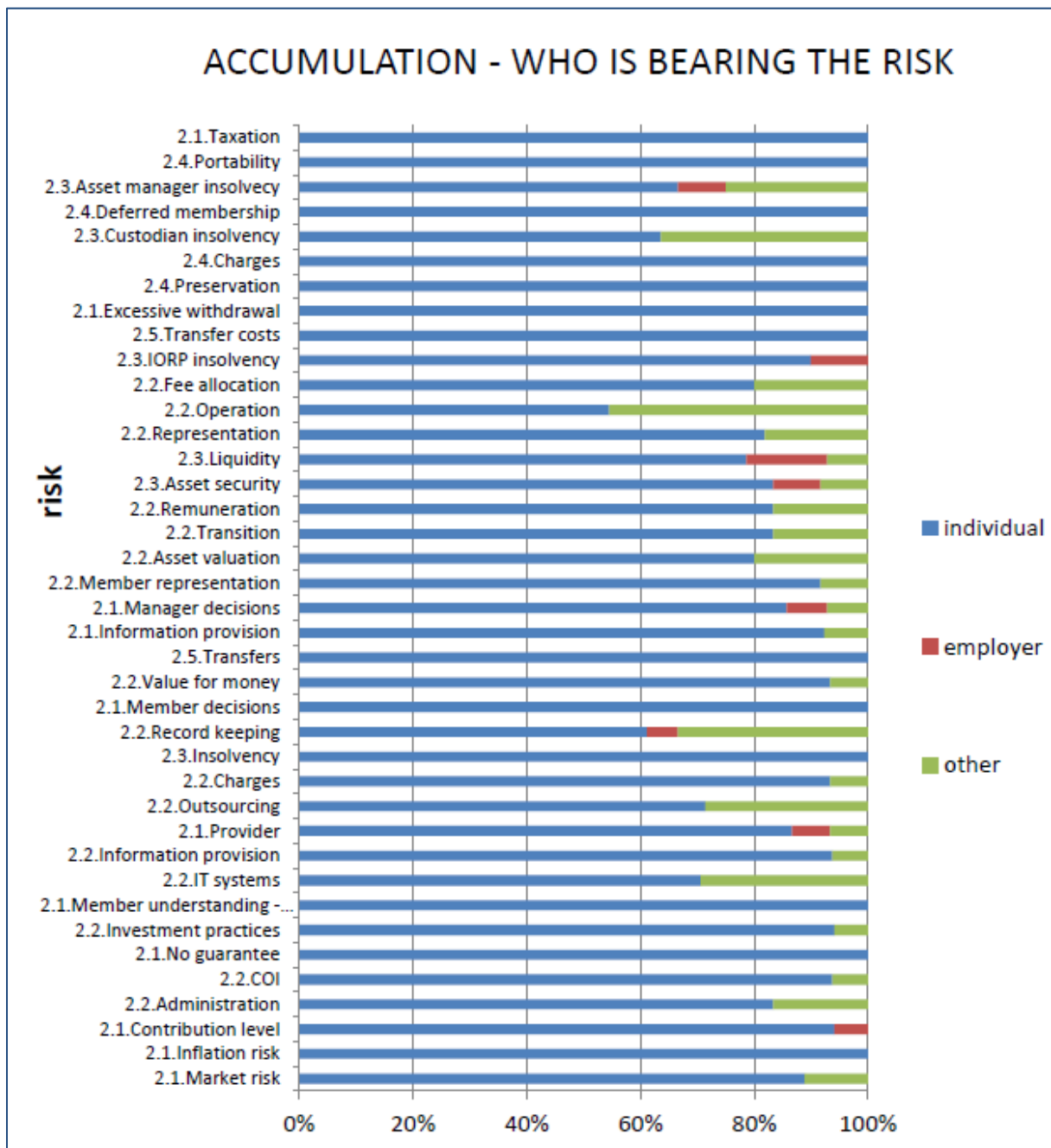
Figure 3 Accumulation Phase Risks



Source: EIOPA, 2011

The bearers of risks associated with the contractual (accumulation) phase are presented in a figure below.

Figure 4 Ultimate bearers of the risks during the accumulation phase

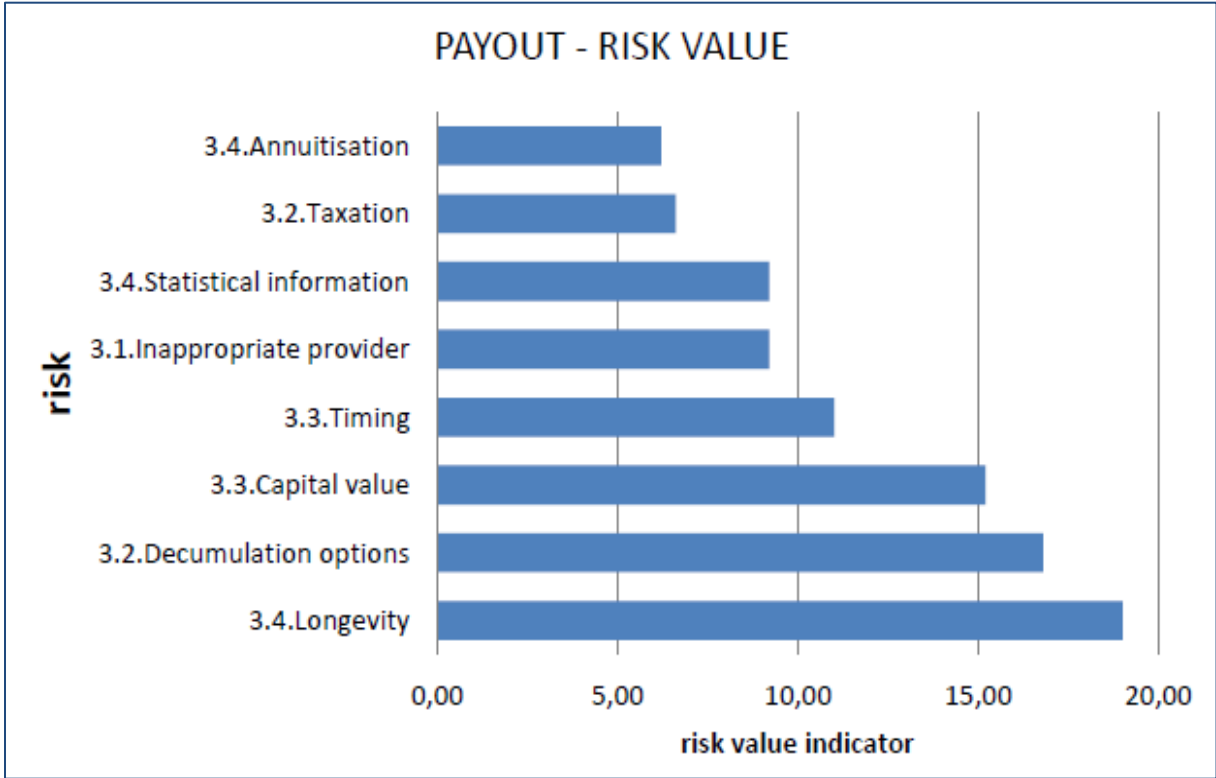


Source: EIOPA, 2011

The FSUG thinks, that separating the accumulation and pay-out phase could create significant detriment to consumers as the PPPs most often do not cover the pay-out phase. Thus, this negative development trend all over the EU has significant consequences by leaving the consumer in a risk of not being able to assess the PPP towards the ultimate retirement goal (adequacy).

In order to create a respectable information disclosure and consumer protection EU certification scheme, the pay-out phase should play an integral part of PPP and consumer life-cycle as there are the most significant risks present (see Figure below).

Figure 5 Pay-out Phase Risks

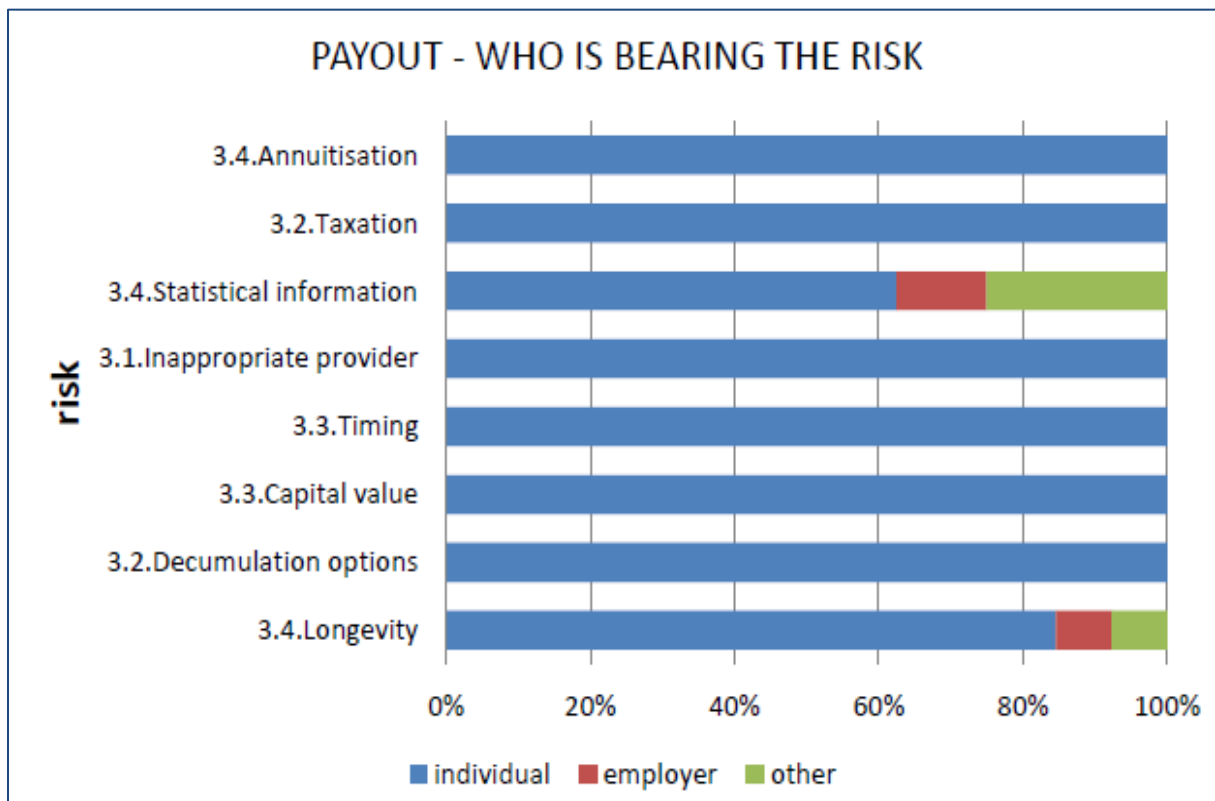


Source: EIOPA, 2011

FSUG thinks that in view of the drastic changes introduced by several MS who are looking at all possible ways to reduce their public deficit, the risk of taxation has been underestimated by many EU and national official bodies. Stability of the taxation mechanism is viewed as a crucial point when designing a EU-wide single market for long-term savings (retirement) product.

The payout phase risks point to longevity risk as having both highest level of importance and highest number of members affected. Also the risk that the decumulation option chosen is not adequate to meet the individuals needs as well as the risk that capital accumulated is not enough to purchase an annuity are showing high indicators by both impact and frequency. At the same time, annuitisation risk and taxation risk are indicated as having low level of importance and number of members affected (EIOPA, 2011).

Figure 6 Ultimate bearers of the risks during the pay-out phase



Source: EIOPA, 2011

Similarly to the joining and accumulation phase risks, payout phase risks are mostly borne by individual consumers (figure above) while decisions in the payout phase are more delegated to individuals that in other phases of the life-cycle.

It is worth mentioning, that the most common product for a pay-out phase is a life annuity and for the common types of annuity the decision taken by consumers is one-off and irreversible.

Q30: Will a KII/KID like document be appropriate for personal pensions as has been advised by EIOPA on the review of the IORP Directive? What would be the behavioural purpose?

KII/KID like documents should be significantly improved in order to serve the needs of consumers efficiently. The “life-cycle” approach should be used when presenting the information to the consumers.

Q31: Could a good reference for risk-reward profiles be defined for personal pensions? To what extent do you find the risk reward used in the UCITs Directive appropriate for PPPs? What other examples could be considered?

Presenting the “risk-reward” profile of a PPP is in general based on the historical data and therefore uses a wrong principle (deterministic). At the same time, it is clear that the “risk-

reward” of any PPP is not consistent with the “risk-reward” profile of individual saving account or value of savings. Using this approach is often misleading for consumers and might create irrational behavior and decision-making.

Q32: For PPPs, could the investment horizon (as in “data target” funds) provide a better guidance for potential members, against the risk-reward ranking that is used for UCITs?

Any projections or simulations of the investment horizon including the influence of all risks (known) and uncertainty should be based on a dynamic projections approach and updated regularly (best solution is to implement a web tool for the projections updated on a daily or monthly basis via access to the individual savings account).

Q33: What information should be provided in respect of costs? Should it be consistent between ex-ante and actually levied costs? Should it include investment transactions costs? What is the best way to present this information?

A study performed by Oxera¹³ (2013) on behalf of FSUG and EC as well as a recent EuroFinuse study¹⁴ (2013) show, that the impact of charges have been largely underestimated not only by consumers, but also by regulators and should be one of the key information parameters provided to consumers during all three phases (joining, accumulation, pay-out). Moreover, this parameter should remain on the priority list of all regulators and supervisors regarding the consumer protection standards.

Any information regarding the PPP presented to the consumer should include the calculation of costs using TER indicator or “Reduction-in-Yield” calculator.

Q34: Do you consider the presentation of illustrative pension projections a useful tool to understand the risks and performance of the product? If yes, please state how and when pension projections should be provided?

Yes. See the response presented in Q27. Personalized pension projections should be part of a pre-contractual phase. During the contractual (accumulation) phase, the tool should be available for the consumers on a web site under the individual (personal) savings account.

¹³ Oxera study „Position of Savers in Private Pension Products“. Research study prepared for behalf of FSUG and EC. 2013

¹⁴ EuroFinUse Research report „Private Pensions: The Real Return“. 2013

(http://www.eurofinuse.org/fileadmin/user_upload/documents/Research_Reports/Pension_Study_EN_website.pdf)

Q35: Which tools and types of information would best ensure an optimal source of easily available and useful information with a view to providing an overview of personal pension entitlements for consumers?

See response in Q40 with respect to the Table 1 presented under the Q26.

Q36: What are the mediums through which pre-contractual information should be presented (paper, other durable medium, internet)? In which cases should the different mediums be used?

Consumers should have the possibility to select the mediums which should include fully accessible mediums for persons with visual impairments (WCAG 2.0 guidelines¹⁵). There should be at least two different types of simple, known and already used formats (paper and online, PDF, CSV or XLS format). Simple format and mediums should be based on standardized set-up and layout. Pre-contractual information delivered via electronic means should be accompanied with secured signature. The minimum period for the legal validity of pre-contractual information should be set to 2 months in order to compare the PPPs feature from the side of consumers.

Q37: To what extent should the format of information be standardized? What features and/or choices that can be made determine the need for a more flexible presentation of pre-contractual information?

Several features should be standardized:

1. mediums (see response to the Q36),
2. content (see response to the Q40 and Q26),
3. structure (every pre-contractual information should have standardized place of appearance),
4. visualization (every pre-contractual information should have standardized color according to the layer - see response in the Q40).

Q38: What should be the requirements with respect to promotion materials/marketing communications/advertising of PPPs?

In this respect, providing the fair practices are enforced by the regulators, PPPs providers should be free in designing promotion materials, marketing communications and advertising. Promotion materials should include relevant (fairly disclosed) information regarding the:

- adequacy of the savings (savings objective from the view of consumers),

¹⁵ <http://www.w3.org/TR/WCAG20/>

- costs and fee structure (fee policy),
- types of risks involved with regard to the savings objective,
- performance/returns during different time periods not only PPPs but also example savings account.

Q40: What information should be actively provided during the accumulation phase?

Referring to the response presented under the Q26, the information (static as well as dynamic presentation) disclosed on a regular basis (daily) should be accessible through personal savings account (web application) and should include:

Basic personal and financial information on PPP

- Name, age, address, contract number (ID number),
- Identification of PPP and PPP provider
- Date of the statement,
- contribution base (salary, income)
- Amount of contributions paid by a consumer to the scheme,
- savings value (individual NAV),
- pension fund(s) used as a vehicle for the PPP,
- actual value of the PPP (accounting value of pension unit),
- number of pension units owned under the PPP,
- initial projections towards the savings objective (projected Individual Replacement Ratio - IRR)

Information on PPP performance and fees

- absolute and relative return (performance) of contributions
- absolute and relative return (performance) of PPP toward benchmark
- PPP performance with comparison to the individual savings account performance
- Maximum draw-down (risk) of PPP and individual savings account
- fee structure of every PPP used for the savings
- amount of fees paid by the consumers (in Euro) from the beginning of the accumulation phase,
- Reduction-in-Yield (actual and projected)
- Benchmark (composition, valuation and performance)
- actual projections towards the savings objective (actual IRR)

Information on the activity of the saver and peer PPPs

- date of entry into the scheme (date of PPP purchase)
- saving period in days or months (projected and actual)
- amount of contributions and periodicity of contributions (actual and projected)
- switching among PPPs (pension funds)
- frequency of switching (measured as a number of switching and saving period)
- non-contributory period (number of non-contributing months)
- performance of peer PPPs (selected information from the previous layer)

- taxation (deferred, paid,...)

Q41: If a layering of information is introduced, what information should be included in the first layer (“must know”) and in the subsequent layers (“should know” and “nice to know”)? What is the best way to make it easy for PPP holders to find their way through the different layers?

Recognizing the proposed layering of information by EIOPA¹⁶, the structure of information presented in Q40 should be layered as first layer (red color), second layer (orange color) and third layer (green color). Visualization of such information based on the standardization of personal savings account layout would not only increase the readability of such information, but on the other hand decrease the IT costs for providers.

Q42: Do you consider the presentation of illustrative pension projections a useful tool to understand the risks and performance of the product? State how and when pension projections should be provided if you think they would be useful.

Projections based on a stochastic approach and well-calibrated models using plausible assumptions (see the response to the Q26) should be part of the pre-contractual as well as ongoing information (accumulation phase). However, presenting such projections requires sound methodology for the simulation models and ability to present the information in a understandable way.

Projection (simulation) models based on a deterministic approach should not be allowed by product regulation.

Q43: What information should be provided on switching and before termination?

Switching information should be presented in a confirmatory statement including this information:

1. first layer information (see Q40),
2. exact description of the change made by the consumer (including the amount of transferred savings in Euro).

Before termination of the contract (or before entering the pay-out phase), first and second layer information should be presented in the statement, including:

1. exact day of contract termination (entering the pay-out phase),

¹⁶ EIOPA „Good practices on information provision for DC schemes - Enabling occupational DC scheme members to plan for retirement“. EIOPA-BoS-13/010. 24 January 2013

2. options and consequences for termination of the contract (entering the pay-out phase),
3. rights and duties of the parties (PPP providers, saver, annuity providers, etc.).

Q44: Should/could information cover the other pillars (i.e. overview of the first, second and third pillar pension)? Can this be achieved? If so, how?

Yes. It can be achieved by the standardization and layering the information.

Q45: What do you think of tracking services? What are good examples of tracking services?

Tracking services should be arranged and operated directly by the regulator and should be publically accessible, transparent, periodically updated (daily) and should include information on PPPs according to the second layer presented in Q40. Good examples can be found in Sweden, Poland, Estonia, Romania and Slovakia, where regulators track the schemes and present key information on the PPPs (pension funds) on a daily basis.

Q46: To what extent should the format of information be standardized? What features determine the need for a more flexible presentation of on-going information?

To a maximum possible extent. See response to the Q37.

Q47: What are the mediums through which on-going information should be presented?

PPP providers web sites, individual savings accounts (accessible through web applications of PPP providers). For the rest of the information, see response to the Q36.

Q48: What is the appropriate frequency for presenting on-going information (e.g. annually)?

Daily.

Most of the CEE and Nordic countries implemented daily reporting standard and this standard should be used as a proxy to all PPP providers across Europe.

Q49: Which circumstances can require specific information provision (e.g. life events, contractual, taxation or regulatory changes, etc.)?

Regulation changes that affect the projected saving targets, including changes of:

1. PPPs status and information prospectus,
2. PPPs fee structure,
3. Termination, merger of PPPs (providers),
4. Changes in the investment structure,
5. Changes in the guarantees,
6. Changes in the PPP administrator and/or fund management company,
7. any kind of sanctions, levies and fines charged by the regulator.

Special attention from the side of PPP provider should be paid to the consumer in case of entering the pay-out phase. Dedicated information (including all layers) should be presented to the saver before entering the pay-out phase (at least 6 months before).

Q50: Is there any kind of information (or additional information) that should be provided on request?

There are several areas of transparency, which should be improved by this kind of information, especially:

1. full disclosure of the PPP portfolio and asset structure,
2. VaR of the PPP portfolio,
3. portfolio leverage,
4. valuation methods used for different asset classes,
5. life-tables used by the annuity providers,
6. cost of the guarantees.

Q51: Can on-going information requirements be connected with the implementation of tracking services? How?

They should be. Implementing daily reporting standards used for pension schemes in CEE countries and Sweden might help to standardize the tracking service and provide information disclosure on a daily basis.

Q52: Should there be additional disclosure requirements for PPP holders that are approaching retirement? If so, what information should be provided (e.g. regarding benefit payment options, taxation implications)?

see response to the Q43.

Q53: If a layering of information is introduced, what information should be included in the first layer ('must know') and in the subsequent layers ('should know' and 'nice to know')? What is the best way to make it easy for PPP holders to find their way through the different layers?

See response to the Q40.

There should be a comprehensive auction (comparison) tool implemented in order to help consumers to take rational and well-informed decisions. This tool can be based on an example of Chilean SCOMP or OMO (in England).

At the same time, every option for a pay-out product selection should be benchmarked via the risks that are involved and risk that are covered by the respective pay-out product. For more detailed information, see responses to the Q26 (Table 1) and Q29.

Q54 - Q55

See response in the Q40.

Q56 - Q63

see the FSUG response to the "Review of the Markets in Financial Instruments Directive" (available at: http://ec.europa.eu/internal_market/finservices-retail/docs/fsug/opinions/mifid-2011_03_15_en.pdf)

see the FSUG response to the "Use of Alternative Dispute Resolution (ADR)" (available at: http://ec.europa.eu/internal_market/finservices-retail/docs/fsug/opinions/adr-2011_04_08_en.pdf)

see the FSUG response to the "Towards a coherent European approach to collective redress" (available at: http://ec.europa.eu/internal_market/finservices-retail/docs/fsug/opinions/collective_redress-2011_04_29_en.pdf)

Q64: What professional requirements would be appropriate? Is there a need for high level principles or more detailed regulation?

The FSUG thinks that the predominant pension-specific consumer protection issue that should be covered in more details under the EU certification scheme is the **advice on PPPs**. Drawing from the Oxera research study (2013), comparison of advice given to savers confirmed the overall low quality of advice; advisors have not followed all MIFID guidelines when approached by researchers posing as consumers aiming to buy a low-risk investment product. Advisers spent little time assessing their customers' needs and risk profiles and there was concern over

due diligence in the recommendations given, although the more developed markets (e.g., UK, France) had higher proportions adhering to guidelines. Combining the above mentioned findings and recommendations with the behavior of advisors create the urgent need to standardize the requirements for presentation of information and advisory activities.

Q65: What should be the scope of these requirements? Should they apply on a continuous basis with a requirement to update them regularly?

The market for intermediaries should require the highest professional standards, which should apply to all financial advisors and counselors on a continuous basis. At least following conditions must be continuously satisfied for keeping the license:

1. credibility of the advisor (no conflict of interest),
2. the highest level of professional qualifications of the advisor, which means university degree, several years of practice, thorough knowledge of financial markets and financial products (proven by written and oral exams),
3. technical and organizational aspects of providing advisory services (internal management standards, risk models, projection models, complaints handling systems, remuneration structure disclosure, certification of technical and managerial procedures, etc.).

Q68: What could be the role of product regulation in the context of PPPs?

Q70: Would you consider it useful if certified products are introduced in the context of personal pensions? Should they be introduced at a European or a national level? What initiatives at European level would you consider to be useful?

Q71: What role could be played by product authorization and or product banning, in order to protect holders against certain PPPs that are more likely to lead to poor pension outcomes?

The FSUG favors, under the recognition of the recent EIOPA initiative in the area of a possible EU-single market for personal pension products, the creation of an EU certification scheme.

Having in mind the value of the “EU” brand, introducing such mechanism on EU level, backed by the supervision of one or more ESAs (either EIOPA or ESMA), might have a significant impact on achieving a higher transparency of PPPs for consumers.

FSUG thinks it would be unrealistic to expect that the PPPs providers would give up the advantage of information asymmetry and voluntarily provide more information (increase transparency) and/or create comprehensive tools allowing consumers to compare the PPPs features and assess the value of PPPs. At the same time, it has been proven by many empirical researches, that self-regulatory codes are not sufficient tools for increasing transparency and introducing the measures allowing clients to easily compare the products or assess the real

value of products including the added value (returns, performance), fees and charges, guarantees, etc. Most studies have confirmed that obtaining relevant information for comparison of PPPs key features is in most cases an impossible task even for regulators on national level. Therefore we claim that expecting that the self-regulatory code would increase the level of transparency regarding the PPPs is rather naïve.

Based on the results of EU Consumer Markets Scoreboard, the financial services (especially investment, retirement and savings products) do face lowest consumers' confidence and satisfaction. Introducing an "EU" label for PPPs with strong, clear and consumer "friendly" information disclosure, a high level of transparency and fair consumer protection mechanisms would strengthen the consumer confidence in such products and thus lead to higher savings rate (contribution ratios), which in turn might increase the overall savings. As a secondary market effect, this will prompt the creation of an EU wide single market for PPPs, increase competition and thus decrease the systemic risk the financial sector still faces.

On the other hand, it is worth mentioning, that introducing an EU certification scheme will open a new area of supervision and impose larger duties on ESAs (especially EIOPA and ESMA). Introducing an EU certification scheme, if introduced properly based on fair approach and recognition of the need for transparency, might be viewed as guarantee of quality for such products.

Q69: Would you consider it useful if principles are established for the steps and considerations the industry should take into account before launching a new product or modifying existing products? If so, what would, in your view, be the main considerations that should be taken into account? Could these initiatives help develop "critical mass" and economies of scale, and/or the development of auto-enrolment mechanisms?

The FSUG thinks that transparent reporting and information disclosure to PPP holders all over the EU is one of the key prudential principles that should be tracked by the proposed document. The level of transparency and ability to compare PPPs is alarmingly low and this fact directly forces consumers to buy and/or hold "poor value products", which might in near future create unrecoverable detriment to the consumer. Having an EU level information database providing high-quality data on PPPs is viewed as a major step towards transparency by FSUG. The FSUG suggests starting with the unconditional reporting of information, especially:

- 1. costs and fee structure (fee policy),**
- 2. individual savings/retirement account statements,**
- 3. performance/returns during different time periods.**

Based on the FSUG members' experience and knowledge supported by findings of Oxera research study (2013), there is a lack of public data availability resulting in low transparency of PPPs. At the same time, the FSUG observes ongoing divergent development in this area, which

requires urgent measures from national and supra-national bodies to revert this trend. More specifically, the following areas do require more attention from EU regulatory bodies in order to provide more transparency of PPPs:

1. Private Pension Schemes Portfolio Structures: The data available for personal plans would appear poorer than for the employer-arranged plans. The main issue is the lack of consistency between categories across countries. Standardization of the reporting requirements would help comparisons and thus increase the ability to compare the overall performance of PPPs under the single regulatory regime (EU certification scheme).
2. PPPs Costs and Charges: The difficulty of finding publically available charge data for thorough comparison varies significantly between the EU Member States, from detailed daily publications (e.g. Slovakia, Poland, Estonia, Sweden, Romania) to the total absence of such data. Ideally, the supra-national regulation should ensure, that the full spectrum of costs should be available to consumers for comparison and analysis, including the otherwise 'hidden' costs that result in lower returns, e.g. trading and post-trading. The costs published vary in terms of the granularity. Disclosure of costs on each of the key activities of the pension provider (management, administration, acquisition etc.) would allow for a detailed analysis of performance and 'value for money', from a consumer's perspective.
3. PPPs Returns and Performance: Typically expressed as average annual growth rates, the main issue about returns data surrounds data availability at the required level of granularity. It is even impossible to have comparable data on performance vis-à-vis respective benchmarks.
4. Private Pension Schemes Savers Behavior (Switching): The information on switching has come in a number of formats; ideally one would report a complete switch matrix detailing both the origin and destination plans, also for cross-scheme transfers. Such detail may be prohibitively complex to collate, but would shed light on the trends beyond simple portfolio re-allocations.

Results of the Oxera study (2013) do not support the proclaimed expectations, that the competition among private pension's schemes operating under the IORP Directive would bring the level of charges to the market equilibrium levels which would be comparable across schemes within and among the countries. Instead, the study findings show that there are significant differences among the charges, which varies more than 200% in some cases, even within national pension systems. Alarming results can be seen in the performed analysis of final pension pots provided by different pension schemes in particular countries, where the overall charges imposed on scheme members differ more than threefold. These findings open legitimate questions on the adequacy of final pensions and the reasonable level of charges imposed by private pension schemes on their members. Interconnecting the overall poor performance of pension funds with high-level of charges will lead to the overall decrease in the adequacy and thus increase the pressure on already troubled publically run pension schemes

and generally on public finance.

Considering the dominant risks consumers face in most of the DC (or even DB) based PPPs, FSUG sees an immediate need to increase the transparency by disclosing the possible negative scenarios and draw-backs caused by particular risks. Current regulatory requirements in most countries do not require providers to disclose any scenarios of future developments that would explain possible consequences of particular risks occurrence nor any calculations of impact of these risks on savers' final pension pots. The OXERA study (2013) showed that the 'known' information is relatively well supplied, with most schemes providing information during the accumulation phase. But this is in contrast to the provision of the 'predictive' data, which is often not supplied by personal pension schemes. On top of this, personal schemes tend to provide less predictive information regarding the expected retirement income levels or returns, when compared with employer-arranged schemes.

Regarding the overall transparency of information supplied to the private pension scheme members, several findings can be made:

- there is considerable variation across the individual Member States in the amount of information provided to savers;
- the information tends to be better for fund- than insurance-based products, which presumably reflects the likelihood that fund-based schemes are DC in nature and therefore require consumers to make more decisions (necessitating more information);
- The Netherlands, Sweden as well as some eastern EU countries (Slovakia, Romania, Poland, Estonia) can be used as a good practice for fund-based PPPs information disclosure, as they experience highest transparency and information disclosure.