Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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5 October 2015

Dear Sir, Madam,

Financial Services Consumer Panel response to the consultation paper on the creation of a standardised Pan-European Personal Pension product

Introduction

The Financial Services Consumer Panel welcomes this opportunity to comment on EIOPA's consultation on a future EU-wide personal pension product (PEPP).

The Consumer Panel is an independent statutory body, which represents the consumer interest by advising and challenging the UK's Financial Conduct Authority (FCA) on how its policy and rules affect consumers. The Panel represents the interests of all groups of financial services consumers.

The emphasis of the Panel's work is on activities that are regulated by the FCA, although it may also look at the impact on consumers of activities that are not regulated but are related to the FCA's general duties (including the work of the European institutions).

Towards a standardised Pan-European Personal Pension product

The Panel understands the need for action to make pension products more transparent and accessible for consumers, and recognises that the demand for a '2nd regime' for a PEPP is likely to be beneficial to certain groups of consumers, especially where existing domestic markets are not well developed.

However, the Panel is concerned that the regime as described in the consultation paper could increase the risk of consumer detriment. A parallel '2nd regime' could make it more difficult for consumers to make an informed choice in a very complex market by introducing different regulatory regimes for different types of personal pensions (PPPs) within individual Member States. Moreover, careful consideration will need to be given to the issue of taxation, which would pose a significant obstacle in creating a product that can easily be traded cross-border.[1]

While these challenges have already been identified by EIOPA, they are not substantively discussed in the consultation. We believe these will need to be explored in more depth prior to deciding whether legislation is needed to ensure a high-quality product that can benefit consumers across the EU.

As regards the development of the product, the Panel would draw EIOPA's attention to the UK "Simple Products" initiative[2] and Stakeholder Pensions.[3] Based on this experience, we would caution that it may be difficult to persuade firms to develop and market simpler and more transparent investment products.

[1] Commission Expert Group on European Insurance Contract Law (2014), Final Report.
[2] https://www.gov.uk/government/news/simple-financial-products-a-step-closer
[3] http://www.thepensionsregulator.gov.uk/employers/about-stakeholder-pensions.aspx

As regards the inclusion of the PEPP in the Capital Markets Union (CMU) initiative, the Panel would note that the provision of savings vehicles for European citizens which offer value for money and a decent income in retirement, and which are properly regulated and transparent, should never be a secondary consideration to the use of capital generated by these products.

Yours sincerely,

Sue Lewis
Chair
Financial Services Consumer Panel

Consultation Questions

Q1: Do stakeholders think there is a need for a stand-alone authorisation requirement or would existing Union law sufficiently cover all potential PEPP providers, including those who would issue PEPPs but who are not already authorised by another existing authorisation regime?

The Panel believes that most PEPP providers would already have been authorised under an existing Single Market Directive, but believes that a stand-alone authorisation requirement would still be necessary. Consumers across the EU should be able to trust that their pension provider meets all the necessary requirements, and is fit and proper to be entrusted with their pension savings.

Existing EU law, including in particular the Markets in Financial Instruments Directive (MiFID II) and new Insurance Distribution Directive (IDD), explicitly exclude pension products from their scope. Stand-alone authorisation is necessary to prevent new providers entering the market and selling the new PEPP without having been vetted by the regulator in their home Member State.

In addition, the consultation paper seems to indicate that PEPP providers will be subject to a specific set of product- and conduct-specific requirements that are different from those contained in existing EU Single Market legislation. Authorisation under Directives such as MiFID II or the IDD may therefore not be suitable to assess compliance with the specific requirements of a future PEPP Directive.

However, it will be important that the PEPP Regulation requires equivalent standards of solvency and conduct from providers who obtain a stand-alone authorisation to market PEPPs as compared to firms who have to abide by the conduct and prudential standards set by existing Single Market Directives.

Q2: Do stakeholders agree that a highly prescriptive 2nd regime will achieve the policy objectives of ensuring a high minimum standard of consumer protection and encouraging more EU citizens to save for an adequate retirement income?

Encouraging EU citizens to save for retirement

The Panel is not convinced that the PEPP would lead to an increase in the amount citizens save for their retirement.

In more developed markets, a PEPP has the potential to lead to worse consumer outcomes if people were encouraged to switch from schemes with guaranteed employer contributions to a PEPP that relies on individual contributions.

At this stage, we think that further in-depth analytical work is required to establish the impact of the proposal on consumers, particularly in Member States with well-established domestic markets for PPPs, or where second-pillar alternatives are widely available.

A highly prescriptive regime: Simple and transparent products

The Panel agrees that PEPPs should be simple and transparent, and ensure a high standard of consumer protection. There is plenty of evidence that consumers find interaction with investment-based products and providers difficult.[4] [5]

One of the main barriers to consumers' engagement with their pension is the opacity of investment costs. The Panel believes that a key component of the PEPP should be the requirement for a clear cost structure that does not allow asset managers to defray their expenses directly against the funds invested in by the consumer.

Bringing greater clarity to the costs and charges of saving into a pension would make it easier for people to plan for their retirement, and alleviate the deep-seated distrust of the asset

[4] Ron Sandler, 'Medium and Long-Term Retail Savings in the UK', 2001.

[5] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191721/sergeant_review_simple_products_final_report.pdf

management industry that has persisted over the years. The European Commission's own Consumer Markets Scoreboard in 2014 ranked investment products among the lowest for trust and comparability of all consumer markets.[6] We elaborate further on this issue in response to question 19.

Q3: Do stakeholders agree that EIOPA has identified the correct challenges associated with introducing a 2nd regime? If so, how might these challenges be overcome? If not, what do stakeholders believe might be other challenges associated with introduction a 2nd regime?

The Panel agrees that there are a number of challenges to be overcome to make the PEPP successful and guarantee good outcomes for consumers. We set out our position on the most important challenges below.

Clarity for consumers

The "2nd regime" would operate in parallel to existing national legal frameworks for PPPs. This could create confusion for consumers when faced with a choice between non-standardised national personal pension products with regulated sales processes, and competing "2nd regime" products. In effect, consumers will have to understand that different product requirements and consumer protection standards apply depending on the type of PPP they choose.

The Panel is concerned that the regime could in effect transfer risk to the consumer because they may not understand the existence of parallel legal regimes. Accordingly, the Panel questions the presumption put forward in the consultation paper that the PEPP will "help to enhance legal clarity" from a consumer perspective.

The Panel agrees that the underlying principle for the PEPP should be simplicity, but we would caution that the market for pension products generally does not have a good record in achieving this.

Harmonising consumer protection standards

The PEPP Regulation should have clear regulatory rules on standards for consumer protection.

However, the question should not be whether the PEPP Regulation offers a 'high minimum standard' of consumer protection. In some Member States this will be easier to achieve compared to existing personal pension products than in others. For those Member States which already have a high standard of consumer protection related to PPPs, the Panel wants to emphasise that the PEPP initiative should categorically *not* lead to the marketing of a pension product which offers a lower level of protection than those afforded by the pre-existing national legal framework.

Encouraging firms to develop simple products

The simplicity of the PEPP, and a high level of consumer protection, are important to stimulate consumer engagement and understanding of the product prior to sale. This does, however, raise some issues on the supply side.

Much work has already been undertaken in the UK on developing simple long-term savings products. The Sandler Review in 2001 called for a range of "Stakeholder" savings products that were simple, low-cost and risk-controlled, including a medium-term investment product related to collective investment schemes.[7]

The Review led to the creation of the "Stakeholder Pension".[8] This was a type of personal pension which employers were required to offer their employees between 2001 and 2012, and which had

[6] http://ec.europa.eu/consumers/consumer_evidence/consumer_scoreboards/10_edition/docs/consumer_market_brochure_141027_en.pdf

[7] http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/Sandler_Consultation(240Kb).pdf

[8] http://www.thepensionsregulator.gov.uk/employers/about-stakeholder-pensions.aspx

to meet some minimum standards set by the government.[9] Notably, Stakeholder Pension management charges could not be more than 1.5% of the fund's value for the first 10 years, and only 1% subsequently. Consumers could also switch providers without being charged.

The Stakeholder Pension thus provided clear benefits in terms of cost transparency and consumer choice. To incentivise uptake of the Stakeholder Pension, the UK's Financial Services Authority (FSA) introduced a rule (known as RU64), which required advisers, when recommending a pension that was *not* a stakeholder pension, to explain in writing why the recommended product was "at least as suitable as a stakeholder pension".

We suggest that EIOPA and the Commission consider whether the PEPP (on the condition it provided the high level of consumer protection set out in the consultation paper) would benefit from an EU-level equivalent of such a regulatory rule to ensure that consumers, when seeking advice about their retirement options, are signposted to the PEPP if it provided benefits above and beyond the alternative personal pensions products being considered. It would also make the PEPP into a benchmark product across the EU.

The UK has also pursued other schemes to bring more simple financial products to the market. In 2013, the Government launched a "Simple Products" initiative[10], a voluntary certification scheme to tackle the problems consumers face when buying financial products. However, to date no investment product has received certification under the 'Simple Products' initiative.

We believe EIOPA and the Commission should examine these reviews in detail, because the success of the PEPP initiative would rely entirely on the willingness of the industry to develop and market PEPPs. It is clear from the UK experience that it is difficult to persuade firms to do this voluntarily.

The Panel has concerns that parts of the asset management industry are keen to maintain complex and opaque cost structures for the management of funds invested in pension products, as these are often more profitable. We might go so far as to say that the level of simplicity and transparency of the PEPP will be inversely proportional to firms' willingness to offer the product to the market, a key challenge to be overcome to make the PEPP a success.

Taxation

In addition to the potential challenges we have already highlighted, the major inhibitor to a successful cross-border regime for personal pensions are rooted in Member State competences in areas of taxation and insurance contract law. Divergent national practices in these areas reduce the likelihood of success of a simple cross border product.

The European Commission's own expert group on insurance contract law concluded in 2014 that "the differences between Member States' tax laws have a significant bearing on the portability of insurance pension contracts and form the main obstacle, which cannot be ignored, for cross-border pensions".[11]

In absence of harmonisation of relevant national legislation, an uneven playing field could emerge that does not benefit the Single Market. To prevent consumers from opting for a PEPP from a Member State with the most generous tax relief on pension contributions, they would presumably be required to purchase a PEPP in the Member State in which they are resident for tax purposes. This would undermine the cross-border trade in PEPPs that EIOPA envisages.

The consultation paper also does address the technical difficulties in making PEPPs transferable across national borders. The measures required to avoid the possibility of tax evasion arising from varying tax treatments currently applicable to pension contributions in different Member States would also increase complexity for savers seeking to move their pension to another country.

EIOPA proposes that PEPPs should receive beneficial tax treatment where these benefits are also granted to existing 'national' PPPs. We would welcome more clarity on whether such harmonisation

[9] Stakeholder pensions are still available in the UK, but the requirement for employers to offer a Stakeholder was discontinued in 2012.
[10] https://www.gov.uk/government/news/simple-financial-products-a-step-closer
[11] http://ec.europa.eu/justice/contract/files/expert_groups/insurance/final_report_en.pdf

of taxation is politically feasible under the current Treaty framework, as it is a precondition to make the PEPP competitive.

Q4: Do stakeholders believe that an investment option containing a guarantee, e.g. a 0% minimum return guarantee, does not in addition require a life-cycling strategy with de-risking?

No comment

Q5: Do stakeholders agree to limit the number of investment options, e.g. to five?

Yes. A multitude of investment choices does not in reality generate choice, as is illustrated by consumers' widespread use of default options.

Q6: Do stakeholders agree that the default investment option should either be based on a life-cycle strategy with de-risking or be assisted by a guarantee, e.g. a 0% minimum return guarantee?

In an ideal world, consumers would exercise choices to drive the market and make informed decisions based on knowledge and experience. In reality however, consumers want simple guidance and defaults. The success of the PEPP will require the creation of sensible defaults, which have been tested on consumers.

The Panel has not taken a position on the most desirable default investment option. A 0% guarantee may provide a psychological boost to the customer's confidence in the product and thus increase the propensity to save, but it would be expensive and reduce eventual returns.[12] Life-style provides some measure of security for people approaching retirement, but its effectiveness is limited by the fact that retirement age is increasingly fluid, and being linked to longevity. EIOPA should also analyse whether there are other options for generating an adequate retirement pot for those (likely to be a majority) who do not make an active choice of fund.

Q7: Do stakeholders agree that providers should have a duty of care concerning the suitability of investment options? What should be its extent? Should for example providers prevent switching to high-risk investment options close to retirement?

Yes, the Panel agrees that providers of PEPPs should have a duty of care towards their customers. This should be the case even in the case of a simple product that can in principle be sold without regulated advice.

Such a duty would oblige providers to avoid conflicts of interest and act with the best interests of the customer in mind. The extent of the duty of care should not be laid down in great detail in the legislation, as it should be incumbent on a firm marketing a PEPP to apply its duty of care taking account of both the complexity and risk of the product being offered, and the level of financial knowledge and understanding of the individual customer.

The incorporation of a duty of care into a possible future PEPP Regulation would also ensure consistency with other EU legislation, including MiFID II, the IDD and the Mortgage Credit Directive.

However, EIOPA and the Commission should give special consideration to how this duty of care will apply to, and can be enforced for, online sales of PEPPs. Digital-only sales are likely to present difficulties for firms in adequately assessing a (potential) customer's knowledge and understanding of the product.

[12] Antolín, P. et al. (2011), "The Role of Guarantees in Defined Contribution Pensions", OECD Working Papers on Finance, Insurance and Private Pensions, No. 11, OECD

Q8: Alternatively, would it be better for all investment options to contain either a life-cycling strategy with de-risking or a guarantee?

[See answer to Q6]

Q9: Could you elaborate on whether PEPP providers, offering a PEPP with minimum return guarantees, should be subject to one identical solvency regime to back these guarantees or whether it would be sufficient that different, but equivalent, solvency rules apply?

For the consumer the question is the outcome, namely that the provider has sufficient assets and liquidity to meet its minimum return guarantee. The nature of the provider and which set of solvency rules would be applicable is not a consideration ordinary consumers would take into account.

Q10: Considering the fact that the PEPP aims to maximise returns outweighing inflation, should retirement savers be allowed to buy a PEPP if the remaining duration of the product is, e.g., only 5 years?

Yes, provided that the consequences of investing in the product (in terms of potential returns) for a relatively short period of time is made clear to consumers pre-sale.

Q11: What is stakeholders' view on the desire of PEPP holders on the one hand to have the comfort of knowing they can switch products or providers compared with the desire on the other hand to maintain the benefits of illiquid, long-term investments?

The Panel believes that consumers should be free to switch their funds between products or providers, as competition benefits from demand side pressure. In any event, the use of prohibitive exit fees should not be allowed.

Q12: Under what conditions do stakeholders think that the concepts of periodically switching providers and illiquid, long-term investment are reconcilable?

[Repeat the answer to question 11]

Q13: What do stakeholders believe is an appropriate interval for switching without incurring additional charges?

The Panel is not in a position to comment on what would be an appropriate interval for switching to or from a PEPP free of charge.

However, in all cases exit fees should not discourage switching and should therefore reflect the true frictional cost of switching. They should not be used as an additional source of profits at the expense of consumers. This may require a regulation capping exit fees

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The Panel would like EIOPA to clarify whether restrictions on exit fees would also apply to providers of other PPPs where a consumer wants to switch into a PEPP. This would require further changes to domestic legislation, as pension scheme exit fees are not regulated at EU-level at present.

Q14: What do stakeholders think of the proposition that the starting point for disclosure during the pre-contractual phase should be the PRIIPs disclosure elements? Please explain any aspects of these which you believe would be specifically unsuitable for PEPPs?

Yes. The Panel believes that the key features of the PRIIPs Regulation should be extended to cover products developed under any future PEPP Regulation. This will ensure consistency in the pre-sale disclosure consumers receive and avoid regulatory arbitrage.

There are no elements of the PRIIPs Key Information Document the Panel believes would especially unsuitable for PEPPs, although certain elements may have to be modified to take account of the specific features of the PEPP (e.g. decumulation options) as these will differ from other investment products. The Regulation should also take into account the disclosure requirements under the second Occupational Pensions Directive (IORP II) to ensure consistency across different pieces of EU pension legislation. Further consumer testing will be required and the details resolved.

Q15: What do stakeholders think of facilitating sales of PEPPs via the internet? What should be the consumer protection requirements for internet sales?

The Panel believes that digital sales channels are likely to increase their overall market share, and many consumers will want to be able to purchase their retirement product online. However, most sales over the internet are likely to take place without regulated advice.

The Panel looked at non-advised sales of pension products when it commissioned research into the UK market for annuities in 2013.[13] This suggested that the increase in non-advised sales of pension products appeared to be driven by lighter touch regulation and higher profit margins, not consumer demand.

Non-advised sales often have opaque costs and give greatly reduced consumer protection if things go wrong. Ensuring the applicability of the MiFID 'appropriateness' test would put a greater responsibility on firms to ensure the customer understands the product and the associated risks.

However, the Panel would ultimately like protection of consumers in case of execution-only sales to be strengthened further. Consumers do not understand the difference between advised and non-advised sales, and at the very least must be alerted to the loss of protection if they choose the non-advised route. The risk of consumer detriment is real and immediate.

Ultimately, the Panel believes guidance for the non-advice market is required, which could be developed by EIOPA as a separate project. This would include standards that guarantee high professional standards, the transparent disclosure of charges, and a clear explanation of the implications of non-advice for consumer protection in the relevant Member State.

At a minimum, the MiFID II standards for both advised (suitability assessment) and non-advised (appropriateness assessment) sales should equally apply to purchases of PEPPs conducted over the internet. However, EIOPA should consider this aspect in further detail to establish whether these assessments are sufficient to protect consumers when considering the purchase of a PEPP.

Q16: Where advice is not given what are stakeholders views on requiring the distributor to apply an appropriateness test to the sale of a PEPP?

Yes, the Panel thinks the distributor should apply an appropriateness test in the case of a non-advised sale. The Panel is would welcome the extension of the MiFID II "appropriateness test" to the sale of a PEPP.

The Panel looked closely at non-advised sales of pension products when it commissioned research into the UK market for annuities in 2013.[14] This suggested that the increase in non-advised sales appeared to be driven by lighter touch regulation and higher profit margins, not consumer demand.

Non-advised sales often have opaque costs and give greatly reduced consumer protection if things go wrong. The applicability of the 'appropriateness' test would put a greater responsibility on firms to ensure the customer understands the product and the associated risks.

[13] https://fs-cp.org.uk/sites/default/files/annuities_position_paper_20131203.pdf

[14] Idem.

However, the Panel would ultimately like protection of consumers in case of execution-only sales to be strengthened further. Consumers do not understand the difference between advised and non-advised sales, and at the very least must be alerted to the loss of protection if they go the non-advised route. The risk of consumer detriment is real and immediate.

Ultimately, the Panel believes a code of conduct for the non-advice market is required. This would include mandatory standards that guarantee high professional standards, the transparent disclosure of charges, and a clear explanation of the implications of non-advice for consumer protection.

Q17: What are stakeholders' views on the level of standardisation of the PEPP proposed in section 4.1 and 4.2 of this paper? Is the level of standardisation sufficient bearing in mind the objective to achieve critical mass, cost-effectiveness and the delivery of value for money?

Standardisation of any product that is considered to be simple is a key issue. Consumer testing will be required prior to adoption.

Q18: With regard to offering biometric risk covers should providers offering a PEPP with biometric risk cover be subject to identical or equivalent solvency requirements? Please motivate your answer.

Biometric risk covers could be offered to the consumer as an optional element, if the provider chooses to make such an option available. Providers should not be allowed to make biometric risk cover compulsory, effectively tying the PEPP to an insurance product and increasing costs without giving the consumer a choice.

In any case, equivalent solvency requirements should apply. For the consumer the question is the outcome, namely that the provider is guaranteed to be secure. Consumers who purchase a PEPP should be confident of the protections they have in case of the insolvency of their pension provider prior to purchasing the product. The nature of the provider and which set of insolvency rules would be applicable is not a consideration ordinary consumers would take into account.

Q19: What do stakeholders think of requiring a cap on the level of costs and charges of PEPPs, or a cap on individual components of costs and charges?

Costs and charges should be transparent, comprehensive and understandable. Member State rules may already have an element of capping enshrined in law, as is the case in the UK for default arrangements within most occupational pension schemes.[15] However, if the PEPP costs cap relates only to some of the costs and charges that reduce the yield for the consumer it will create a 'water-bed' effect in charges, with no benefit to the consumer.

The Panel has long-standing concerns about cost opacity in the asset management industry. If the European Commission goes ahead with a proposal the PEPP Regulation offers an opportunity to set a cost transparency benchmark for other long-term savings products.

For millions of EU citizens, a final pension pot depends largely on the level of contributions and net investment returns achieved by asset managers. Individuals are therefore dependent on the asset management industry to deliver good outcomes at an acceptable cost.

However, Consumer Panel research in 2014[16] confirmed findings from earlier studies that full costs incurred by consumers when making long-term investments are neither consistently and comprehensively defined, nor understood.

Fund managers too frequently exercise poor control of costs, which are not necessarily visible to investors and which managers can deduct directly from the value of funds, rather than treat as a business cost that they meet out of their own pockets.

[15] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/420215/charge-cap-guidance-apr-2015.pdf
[16] https://fs-cp.org.uk/sites/default/files/investment_report_executive_summary_for_the_fscp.pdf

In 2012, the UK's Financial Services Authority found that few firms exercised the same vigilance in their expenditure on research and execution services – costs deducted directly from the value of funds under management and therefore hidden from view to investors – as they exercised over payments made from the firms' own resources.

These weaknesses matter greatly. Over extended periods, apparently small differences in the cost of investing can make a material difference to the value of individuals' long-term savings: over a working lifetime, a 1% annual charge could slice the value of a pension pot by a quarter.

Furthermore, without a clear idea of the comparative costs and charges of different investment vehicles, individuals and their financial advisers cannot make informed judgements about value for money. The widespread and persistent nature of the problems of cost opacity and control suggest underlying structural deficiencies in the fund management industry.

These were identified in the 2012 Kay Review of UK equity markets[17], which described 'the decline of trust and the misalignment of incentives throughout the equity investment chain'. The review recommended "full disclosure of all costs, including actual or estimated transaction costs, and performance fees charged to the fund".

The Panel agrees with this assessment, but considers that disclosure is only effective if those to whom the details are provided can understand and act on the information; overly complex disclosure to consumers would be counterproductive in many cases.

Therefore, the Panel has recommended that asset managers should be required to quote a single investment management charge.[18] This would go beyond current headline figures such as the Annual Management Charge (AMC) or Total Expense Ratio (TER) because it would include estimated transaction costs, which are often significant. Under this proposal, all other intermediation costs, charges and expenses incurred by the investment manager would be borne directly by the firm.

The Panel believes any future PEPP Regulation could include a requirement for a provider to use such a comprehensive single annual investment charge, providing transparency to consumers, incentivising asset managers to control costs (and thus increase the eventual income available to the customer in retirement) and increase competition by making competing offers comparable on price. This would also set a benchmark for providers of other investment products. This should not be a 'flexible' (i.e. optional) feature, but rather a key component of any PEPP product.

Q20: Do stakeholders agree with the concept of a "product passport" comprising notification/registration of PEPPs? If not what alternative would they suggest?

The notion of making the PEPP passportable from one Member State should be carefully considered in light of the functioning of the passporting regime for other products under existing Single Market legislation. Consumers should not be subjected to potential detriment by providers who choose to base themselves deliberately in jurisdictions with supervisors who are less well-resourced. Product passporting should not be allowed if there are Member State regulators who are less well equipped to manage potential consumer detriment.

Q21: Do stakeholders agree with the concept of a "product passport" comprising notification/registration of PEPPs? If not what alternative would they suggest?

Yes, regulatory arbitrage should be avoided.

[17] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf
[18] https://fs-cp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf