



# Selected issues in the PEPP Level-2 Regulation

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- A. Potential role for the PEPP in EU Pension Systems
- B. Issues around the Cost Cap for the Basic PEPP (B-PEPP)
- C. A Risk Indicator for the PEPP

# Potential Role for the PEPP in EU Pension Systems

Roles emphasized by European Institutions:

- ✓ to develop sources of LT Capital in the context of CMU
- ✓ to facilitate labour mobility in the EU

...but for the PEPP to have a key role in contributing to better pension systems (and so to deserve tax allowances by national Laws!) it may be more important not to focus on (usually higher-income) mobile workers :

- ✓ to develop funded, cost-efficient pensions in countries/sectors where occupational plans do not develop
  - Central–Eastern European Countries
  - the self-employed (everywhere)
- ✓ to foster competition in existing national EU markets for Personal Pension Products (PPPs)
  - PPP costs are often (too) high
  - ...the more so in the context of the low-yield environment

# Potential Role for the PEPP in EU Pension Systems (2)

To achieve a key role in EU pension systems, the PEPP (the B-PEPP) should be able to become a mass product.

- This does not exclude more personalized PEPPs for the better-off
  - a dual market may develop

## → cost-efficiency will be a critical aspect

- the functioning of the cost cap
  - The cost of guarantees to be included (see below)
- information and advice to be made consistent with mass distribution
  - the default option (B-PEPP) should be put well at work
    - ✓ important role of the web, robo-advice, ecc.
    - ✓ definition of «target market» loses importance
    - ✓ suitability / appropriateness not really relevant, the B-PEPP should fit anyone

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# Issues around the Cost Cap for the B-PEPP: arguing about the cost of return guarantees

1. Legal Reasoning
2. Lack of Evidence that Ensures the Feasibility of excluding the cost of return guarantees
3. Evidence that guaranteed products priced at or below 1% do exist
4. Implications for the Supervision of PEPPs
5. Implications for the development of the B-PEPP market in the EU and the risk of segmentation

# Issues around the Cost Cap for the B-PEPP

## arguing about the cost of return guarantees

### 1. Legal reasoning

- the Cost Cap at 1% is set by Level-1 Regulation (art 45.2) as the primary tool for the protection B-PEPP savers
  - a watered-down level-2 Regulation would not be consistent with level-1 : excluding the return guarantees from the cost cap would entail that many B-PEPP sold in the market would have a total cost higher – even much higher – than the cost cap
- the «Level Playing Field» requirement (art.45.3) can be read in different ways: one (the most obvious?) is that cost items that are typical only of one kind of B-PEPPs should not be excluded
- in the case that the inclusion of return guarantees would initially entail the crowding-out of guaranteed products from the market, the built-in remedy of Level-1 Regulation is the 2-year revision of the level of the cost cap (art.45.4)

## Issues around the Cost Cap for the B-PEPP: arguing about the cost of return guarantees

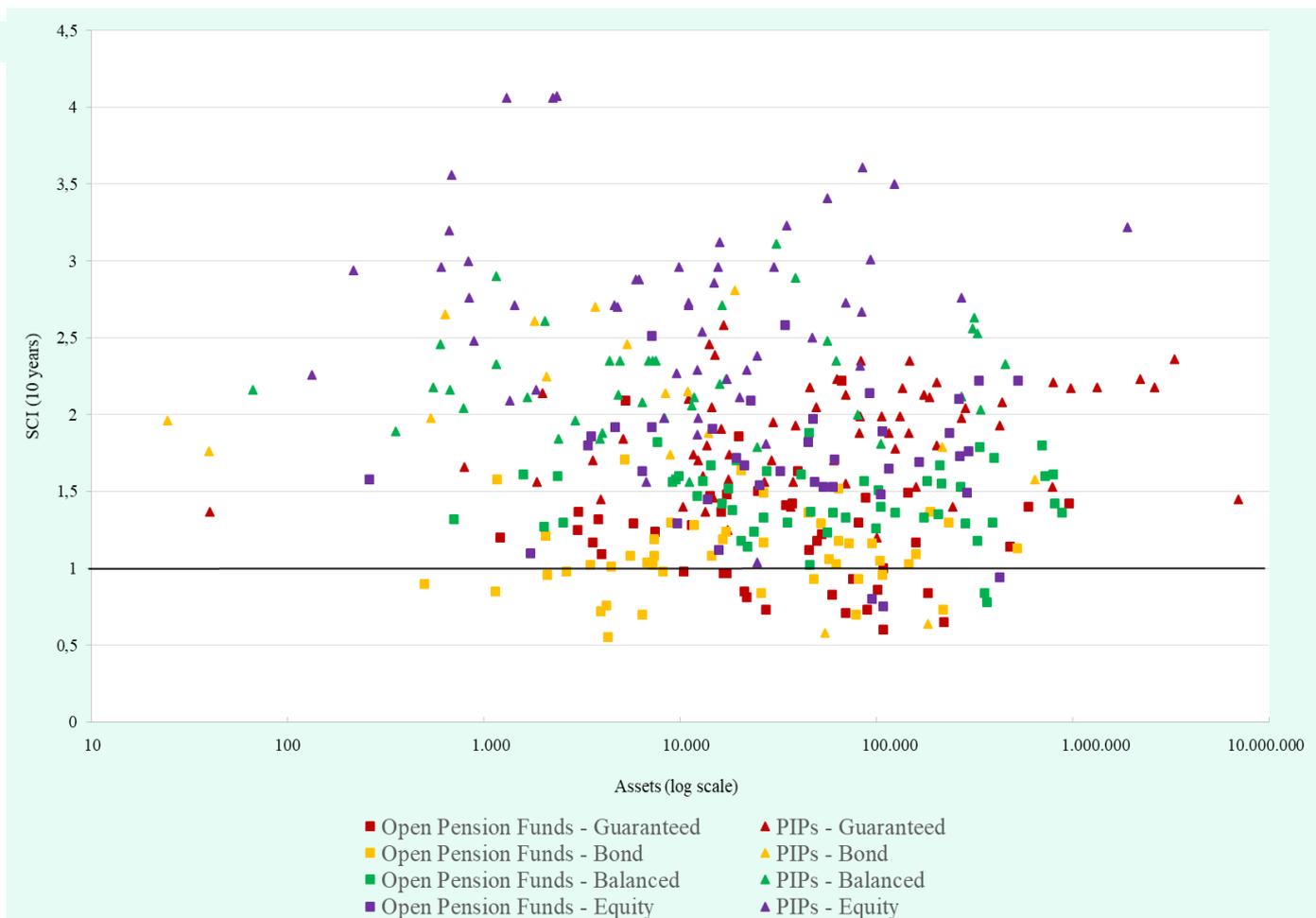
### 2. Lack of Evidence that ensures the Feasibility of excluding the cost of return guarantees

- While cost caps are in place in a number of jurisdictions, to our knowledge there is no experience of a cost cap that excludes the cost of return guarantees
- More in general, there is a lack of evidence that a fair and objective pricing of guarantees would be easy to obtain.
  - Please note that:
    - If the cost of guarantees is included in the cost cap, the access to the market of B-PEPPs would be granted on the basis of the total cost of the B-PEPP; the pricing of the guarantee would not play a role (actually, its disclosure would not be necessary)
    - Viceversa, if the cost of guarantees is excluded, it is essential that the cost of guarantees is determined in an objective way. Indeed, in this case the feasibility of having a fair and objective pricing of becomes a prerequisite for ensuring a fair access to the market of the B-PEPP

# Issues around the Cost Cap for the B-PEPP: arguing about of the cost of return guarantees

## 3. Evidence that guaranteed products priced at or below 1% do exist

**Italy – Year 2108 - Open Pension Funds (OPFs) and PIPs – Synthetic Cost Indicator (SCI) of individual sub-funds**  
Symbols and colours indicate different kinds of sub-funds - see below; SCI refers to a membership horizon of 10 years



# Issues around the Cost Cap for the B-PEPP: arguing about the cost of return guarantees

## 3.1 Other Evidence from the Italian market for PPPs (used as a «sandbox» for the future market of PEPPs)

- There is a large dispersion of prices charged for PPPs with similar characteristics
  - Economies of scale on average are not shown in prices charged to customers
  - On average, OPFs are less costly than PIPs (see table below)
    - OPFs are UCITS-like pension plans open to individual and occupational membership; they can be manufactured both by financial and insurance undertakings;
    - PIPs are individual pension plans manufactured by insurance undertakings, as with-profit or as unit-linked life insurance products
  - On average, equity-oriented sub-funds are the most expensive, followed in order by balanced products, by guaranteed products and by bond-oriented products
  - On average, the difference between the price of guaranteed products and of bond-oriented products is small
- Evidence suggests that dispersion in prices is determined by different profit margins and distribution costs; on average, guaranteed products are not significantly more costly than non-guaranteed products with similar asset allocation (i.e. bond-oriented products); however, dispersion is large and therefore an objective way to determine the fair pricing of guarantees may be lacking

Italy – Year 2018 - Total Costs of Personal Pension Products – Averages (Synthetic Cost Indicator, membership horizon of 10 years)				
	Guaranteed	Bond-oriented	Balanced	Equity-oriented
OPFs	1,22	1,12	1,47	1,59
PIPs	1,88	1,91	2,24	2,30

## Issues around the Cost Cap for the B-PEPP: arguing about the cost of return guarantees

### 4. Implications for the Supervision of PEPPs

- When the cost of guarantees is excluded from the cost cap, the supervision over the PEPP market becomes difficult. Indeed, there is a risk of opportunistic behaviour by the providers. They may try to access the market of the B-PEPP with an expensive product simply by declaring a cost of the guarantee that is higher than its fair price.
- PEPP savers have to be protected from being sold products that should not be marketed to them as B-PEPPs (e.g. because they would exceed the cost cap, if their guarantee would be priced fairly), and PEPP providers should be ensured a fair access to the market of the B-PEPP.
  - As a consequence, as part of their supervisory tasks, NCAs would have the duty to check the fairness of the price of the guarantees charged by providers.

→ We conclude that, when considering to exclude the cost of guarantees from the cost cap, for the NCAs and EIOPA it would be necessary to assess the feasibility of developing a methodology to be used in order to objectively assess the fairness of the pricing of guarantees declared by PEPP providers. To our knowledge, so far no initiative has been taken in this respect.

## Issues around the Cost Cap for the B-PEPP: arguing about the cost of return guarantees

### 5. Implications for the development of the PEPP market in the EU

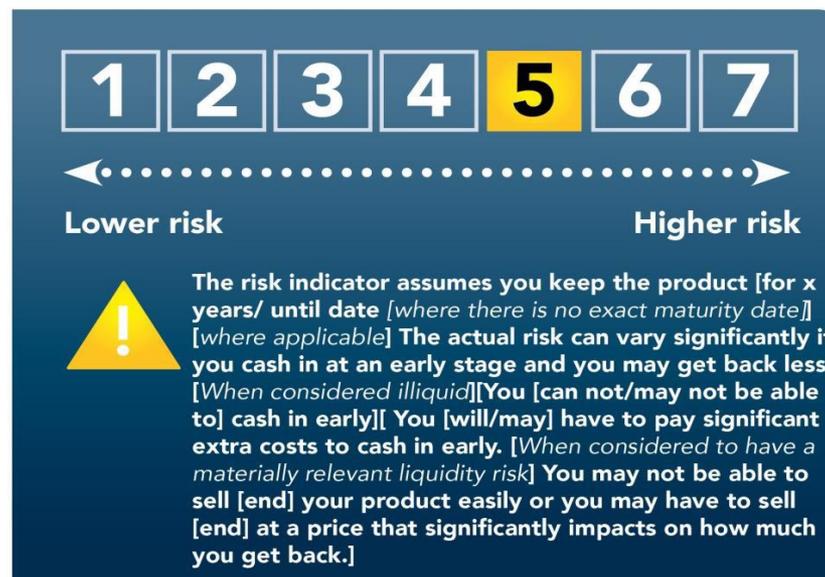
- In the previous slide, we have concluded that, if the cost of guarantees is excluded from the cost cap, there is a duty by NCAs to supervise over the fairness of the pricing of guarantees by the providers.
  - There is an additional issue. Considering the deadlines to be respected for the drafting of the level-2 Regulation, the possibility to develop a standardized methodology at EU level for pricing the guarantees looks fairly slim. Therefore, if the level-2 Regulation would entail the exclusion of guarantees from the cost cap, the individual NCAs would need to develop their own methods and practices for checking the fairness of the pricing of these guarantees.
  - In this case, it is not unrealistic to predict that different methods could and would be used by different NCAs, with different results. Each NCA may use its own supervisory powers to intervene in different ways. These powers include product intervention powers ex art. 63 of Level-1 Regulation, powers that may be used by each NCA both on home and on host-based PEPPs. B-PEPPs allowed to access the market in the home country may not get access in other countries' markets.
- We conclude that the exclusion of the cost of guarantees from the cost cap would entail a high risk of segmentation of the PEPP market across the national markets.

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# The Risk indicator for the PRIIPs

Figure 6: Summary Risk Indicator for PRIIPS as defined by the EU Regulation



Source: ESAs (2016)

- ✓ We argue that such an indicator is not appropriate for pension plans like PEPPs, because in this case risk level depends on time horizon to retirement
  - We suggest a two-dimensional risk indicator

# A proposed risk indicator for the PEPP

<b>Time to retirement</b>	<b>Risk indicator for Investment Option “Long-Term Growth” (SAA: 70% Equities)</b>						
>30 Y			3				
20-30 Y			3				
15-20 Y				4			
10-15 Y					5		
5-10 Y						6	
2-5 Y							7
<2 Y							7

→ *risk increasing* →

- ✓ In order to assess the level of risk for every given portfolio, emphasis is put on the need to consider the time left to retirement
- ✓ To take into account the upside potential and not only the downside, risk should be measured as the dispersion at retirement around a target accumulated capital in real terms
- ✓ Therefore, when far from retirement, a conservative strategy could be characterized by higher risk than, for instance, a life-cycle strategy

# A proposed risk indicator for the PEPP

Time to retirement	Risk indicator for Investment Option “Long-Term Growth” (SAA: 70% Equities)						
>30 Y			3				
20-30 Y			3				
15-20 Y				4			
10-15 Y					5		
5-10 Y						6	
2-5 Y							7
<2 Y							7

→ risk increasing →

Time to retirement	Risk indicator for Investment Option “High Liquidity” (SAA: 100% Short-Term Bonds)						
>30 Y						6	
20-30 Y					5		
15-20 Y				4			
10-15 Y			3				
5-10 Y		2					
2-5 Y	1						
<2 Y	1						

→ risk increasing →

Time to retirement	Risk indicator for Investment Option “Long-Term Income” (SAA: 100% Long—Term Bonds)						
>30 Y					5		
20-30 Y				4			
15-20 Y			3				
10-15 Y		2					
5-10 Y		2					
2-5 Y			3				
<2 Y				4			

→ risk increasing →

Time to retirement	Risk indicator for Investment Option “Targeting 2060” (SAA: variable approaching the target date)						
>30 Y			3				
20-30 Y			3				
15-20 Y			3				
10-15 Y			3				
5-10 Y			3				
2-5 Y		2					
<2 Y	1						

→ risk increasing →

# thank you

...questions / comments welcome

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