

Connecting EU regulations for transparent IORPs cost disclosures

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1. Starting Point: IORPs II directive – current provisions

Recital 63 of *IORPs II Directive (EU) 2016/2341* clearly stipulates that "in particular, information concerning accrued pension entitlements, projected levels of retirement benefits, risks and guarantees, and costs should be given." But additional provisions for cost disclosures can only be found in subparagraphs of two articles of Title IV: Information to be given to prospective members, members and beneficiaries:

- Article 37, "General information on the pension scheme", paragraph 1 (h): the structure of costs borne by members and beneficiaries, for schemes which do not provide for a given level of benefits;
- Article 39, "Pension Benefit Statement", paragraph 1 (g): a breakdown of the costs deducted by the IORP at least over the last 12 months.

So only with regard to the beneficiaries of DC pension schemes and to the annual Pension Benefit Statement (PBS) there are any mandatory information disclosure requirements by the IORPs II directive, but without specifying any further details of the information on costs to be disclosed (cost categories, indicators etc.).

In consequence for the debate on desirable cost disclosures it must clearly be differentiated between those requirements which are stipulated by this EU minimum harmonisation, those requirements which have been added by some EU member states on the national level, and those requirements which can be considered as voluntary additional information given by the IORPs.

2. Cost disclosure requirements: what is needed?

Recently EIOPA introduced the new concept of "Value for Money" for the harmonized supervision of cost and charges with regard to the product oversight and governance requirements and the cost reporting by life-insurance and pension product providers:

"EIOPA considers that products offer value for money where the costs and charges are proportionate to the benefits (i.e., investment performance, guarantees, coverage and services) to the identified target market and reasonable taking into account the expenses born by providers and in comparison to other comparable retail solutions on the market." (cf. EIOPA consultation paper on the framework to address value for money risk in the European unit-linked market, 13 April 2021, no. 1.7, p. 18).

We fully support this approach. The concept of "Value for Money" should be applied to all categories of life-insurances / insurance-based investment products and pension plans (occupational and private ones) for reasons of transparency, reliability, comparability and understandability not only for supervisors but for the retail investors, policyholders and long-term pension savers as well.

Given the judicial limitations by the IORPs II directive as pointed out above, we advocate the following fundamental differentiations with regard to cost disclosures by IORPs:

- cost categories (obligatory / optional)
- cost calculation / disclosure indicators (obligatory / optional)

The relevant categories and indicators of costs which should be taken into consideration by IORPs during the different phases of the contract (pre-contractual, contribution / accumulation and payout / decumulation phases), should be specified as much as possible.

3. Cost disclosure regulations on EU level in other financial sectors

As EU cost disclosure requirements are already stipulated in other sectors of the financial services (fixed interest rate products, structured products, investment funds, life-insurances etc.), there is no need for "reinventing the wheel". Therefore it should be asked what can be learned from the already existing regulations which may be used as exemplary templates for cost disclosure requirements of pension products (private and occupational) as well.

IDD like *MIFID II* are focused on distribution procedures, in consequence their information duties are linked to the pre-contractual phase (entry or distribution costs). In article 29 (1) *IDD* ("Information to customers") it is clearly stipulated that

"the information about all costs and charges, including costs and charges in connection with the distribution of the insurance-based investment product, which are not caused by the occurrence of underlying market risk, shall be disclosed in aggregated form to allow the customer to understand the overall cost as well as the cumulative effect on the return of the investment, and, where the customer so requests, an itemised breakdown of the costs and charges shall be provided. Where applicable, such information shall be provided to the customer on a regular basis, at least annually, during the life cycle of the investment."

These two basic information duties with regard to cost disclosure (total costs, including distribution costs, and itemised breakdown) have not explicitly been included into the IORPs II directive. Maybe some of the national legislators of EU member states added them, as IORPS II directive is a minimum regulation. For reasons of level playing field with regard to consumer

protection measures applied to pension products it should have been included as mandatory disclosure at least for those IORPs which do not have a limited number of sponsors and which therefore are competitors as product providers in the EU retirement provision markets.

In the *PEPP regulation* (EU/2019/1238) there are three articles which require cost disclosures by the product providers:

- PEPP KID: article 28 (3) (f): "under a section titled 'What are the costs?', the costs associated with an investment in the PEPP, comprising both direct and indirect costs to be borne by the PEPP saver, including one-off and recurring costs, presented by means of summary indicators of those costs and, to ensure comparability, total aggregate costs expressed in monetary and percentage terms, to show the compound effects of the total costs on the investment."
- PEPP PBS: article 36 (1) (f): "a breakdown of all costs incurred, directly and indirectly, by the PEPP saver over the previous 12 months, indicating the costs of administration, the costs of safekeeping of assets, the costs related to portfolio transactions and other costs, as well as an estimation of the impact of the costs on the final PEPP benefits; such costs should be expressed both in monetary terms and as a percentage of contributions over the previous 12 months";
- PEPP switching service: article 56 (1) (c): "the fees and charges charged for the switching process".

Additionally in EIOPA's advice on the level 2 regulation of PEPP of 14 August 2020 more precise stipulations can be found with regard to the PEPP KID in article 5 ("What are the costs?" section). The following major cost categories shall be disclosed following to paragraph 2 of this article: administrative costs, investment costs, distribution costs and, where applicable, costs of guarantees. It is obvious that for IORPs costs of guarantees should be excluded, as they are integral part of the asset allocation of DB schemes. The disclosure of distribution costs should be optional (only where applicable), but administrative and investment costs are clearly relevant for IORPs as well.

One of the most comprehensive summaries of cost categories of different financial products can be found in the *PRIIPs KID* regulation, especially in the Delegated Regulation 2017/653/EU of 8 March 2017. Annex VI fixes the "Methodology for the Calculation of Costs" by setting up three "lists of costs" to be disclosed (for AIFs and UCITs, other PRIIPs and IBIPs).

In the "list of costs" for IBIPs (Insurance Based-Investment Products) there are three main categories of costs:

1. One-off costs (costs of marketing, acquisition, operating, biometric risks, holding required capital - cf. No. 49 of Part 1 of Annex VI of this DR),
2. Recurring costs (costs of structuring, distribution, management of insurance cover, deposit fees, new investments etc. - cf. No. 52 of Part 1 of Annex VI of this DR)

3. Biometric costs (primarily risk coverage like death and longevity; cf. No. 54 of Part 1 of Annex VI of this DR).

Based on these PRIIPs KID cost categories EIOPA publishes its annual "Costs and Past Performance Reports" for IBIPs and private and occupational pension products including several cost definitions (cf. EIOPA's 2021 Report on Costs and Past Performances: administration / distribution costs, box 5, p. 36/37, and definitions of one-off and ongoing costs, p. 57/58; EIOPA's 2020 Report on Costs and Past Performances: "Cost Mapping", Annex II, p. 37):

1. Distribution costs (like one-off/entry costs)
2. Administrative costs (part of recurring costs)
3. Investment management costs (part of recurring costs)
4. Biometric costs (optional coverage for capital, death, disability...)

As private pension products like annuities are part of IBIPs, these four main cost categories seem strongly to be adequate for occupational pension products as well.

With regard to summary cost indicators there are two main indicators which can be found in PEPP Delegated Regulation (EU/2021/473) of 18 December 2020: „Methodology for the calculation of costs, including the specification of summary indicators“ (cf. Annex III, Part III, no. 29 and no. 30):

- *Reduction in Yield (RiY)*: „In the PEPP KID, the PEPP provider shall present the total annual costs, comprising all costs incurred and chargeable within 12 months in monetary terms and as a percentage of the projected accumulated capital after 12 months. Where necessary, these amounts may be calculated as the average total annual costs over the term of the PEPP contract. The calculation of the compound effect of the costs shall be based on a 40 years' accumulation period, based on monthly contributions of EUR 100 and on the projected accumulated capital in the best estimate scenario.“
- *Reduction in Wealth (RiW)*: „In the PEPP Benefit Statement, the PEPP provider shall present the estimated impact of costs on the final PEPP benefits by using the 'Reduction in Wealth' approach. The 'Reduction in Wealth' shall be calculated as the difference between the projected accumulated savings at the end of the accumulation and the projected accumulated savings at the end of the accumulation period in a cost free scenario. The difference shall be disclosed in monetary and percentage terms relative to the projected accumulated savings. The calculation shall be based on the personalised contribution level of the individual PEPP saver and based on the best estimate scenario of point 10.“

The RiY cost indicator is additionally outlined in Part 2 („Summary cost indicators and compound effect of the costs“) of Annex VI of Delegated Regulation 2017/653/EU of 8 March 2017. For reasons of consistency and comparability this bipartite approach of cost indicators (RiY for pre-contractual KIDs; RiW for annual PBS) may be maintained by IORPs as well, as long as no other unitary approach is implemented. For reasons of understandability the RiW approach seems to be better placed for consumers, because it is more directly linked to their actual contributions. For both cost indicators it should generally be required to disclose the assumed growth rate (average percentage) of the accumulated capital from which costs are deduced or compared with.

4. Obligatory and optional cost disclosures by IORPs

Occupational pensions and IORPs as product providers are essential players in the EU retirement provision markets. Therefore comparability of costs and returns with regard to private pensions products are crucial for customers.

Unfortunately EU regulations on these issues in other pension product sectors (mainly PEPP and PRIIPs) are very complex and not always consistent. By taking this „status quo“ as point of departure, nevertheless it seems to be possible to stress those detailed elements of asset allocation, contract management and return/cost calculation which are similar to all financial institutions involved in occupational and private retirement provision (mainly investment funds, life-insurers and IORPs).

We clearly advocate that the PEPP regulation (EU/2019/1238) should primarily be taken by IORPs as guidance for their own cost disclosure. This approach should be supplemented by the more detailed definitions of cost categories and cost indicators which can be found in the PEPP Delegated Regulation of December 2020 (EU/2021/473) and the PRIIPs KID Delegated Regulation of March 2017 (2017/653/EU) as outlined above.

As pointed out in our introduction the IORPs II directive leaves some gaps with regard to cost disclosure. Therefore obligatory and voluntary elements have clearly to be distinguished.

- *Pre-contractual Phase:*

The IORPs II directive does not contain an obligatory pre-contractual KID, but in some EU member states such an obligation might be introduced on the national level. But even without using a KID, any IORP will use a kind of pre-contractual information sheet on projected returns, risk-reward-profiles and cost parameters during its distribution and contract conclusion procedures. That is why cost categories and cost indicators to be used during the pre-contractual phase should mainly be aligned with the forthcoming PEPP KID following to article 28 (3) (f) of PEPP regulation (EU/2019/2088).

- *Accumulation Phase:*

Following to article 39 paragraph 1 (g) of IORPs II directive EIOPA has developed and finally published in March 2020 two models of "Pension Benefit Statements" for IORPs. The OPSG had approved these models which are not obligatory in themselves, but they contain all obligatory information elements. At least in one of the models there is a breakdown of costs (administrative costs, investment and transaction fee, taxes, death coverage premium) as stipulated by the aforementioned article.

If an IORP wishes to give voluntary additional information, it would be very useful – for reasons of comparability and understandability for the customers – that it refers to the PEPP regulation on PBS including the Reduction-in-Wealth methodology (following to article 36 (1) (f) of PEPP Regulation (EU/2019/1238) and to article 11 and Annex II („Template for the PEPP Benefit Statement“) of PEPP Delegated Regulation of December 2020 (EU/2021/473)).

- *Decumulation Phase:*

In contrast to many investment products at the beginning of the decumulation phase there are no exist costs for insurance or pension products. Distribution costs occur only in the case of private annuities not including the accumulation phase, which is of course not the case for occupational pensions. In consequence the only costs which occur and therefore should be disclosed are ongoing administration costs (for contract management, benefit participation etc.). The disclosure of these costs should be proceeded in the same way as shown by the PBS (following to article 43 (1) IORPs II directive).

5. Conclusion

In his speech Gabriel Bernardino, for the last time as EIOPA Chair at the EIOPA Annual Conference of 4 February 2021, has stressed the need for a "new approach to consumer disclosures": "Profound re-assessment is needed to replace all existing information requirements stemming from a range of legislative contexts (e.g. Solvency II, IDD, PRIIPs) with a unique set of information that consumers will actually use."

By identifying four major cost categories and two major cost indicators and by making the clear differentiation between obligatory and voluntary cost closures for each of the different contract phases (pre-contractual, accumulation, decumulation phase) as outlined above, consumers / beneficiaries should be enabled to take well-informed decisions with regard to pension products offered by IORPs.

Table:

Disclosures	obligatory		voluntary / optional	
Contract Phases	Cost Categories	Cost Indicators	Cost Categories	Cost Indicators
Pre-contractual (KID)	For DB: Distribution, Administration, Investment	Reduction in Yield (RiY) <i>or</i> Reduction in Wealth RiW)	For DC: Distribution, Administration, Investment	Reduction in Yield (RiY) <i>or</i> Reduction in Wealth (RiW)
Accumulation (PBS)	For DB and DC: Distribution, Administration, Investment, Biometric (if included)	Reduction in Yield (RiY) <i>or</i> Ongoing charges (OGC) <i>or</i> Reduction in Wealth (RiW)		
Decumulation (PBS)	For DB and DC: Administration, Biometric (longevity)	Reduction in Wealth (RiW)		

KID = Key Information Document; PBS = Pension Benefit Statement