Insurance Europe follow-up to the ESAs workshop on PRIIPs: further comments on performance scenarios and presentation of costs

As a follow-up to the workshop on potential changes to the PRIIPs Regulatory Technical Standards (RTS) on 15-16 July 2019, Insurance Europe would like to provide the ESAs with additional feedback on the issues of performance scenarios and the presentation of costs and stands ready to provide further comments whenever needed or appropriate.

Insurance Europe would also like to invite the ESAs and the European Commission not to rush the PRIIPs review. The ESAs should take the necessary time to develop sound, meaningful and workable solutions and methodologies that are proven to improve consumer understanding effectively and to fit the diverse PRIIPs.

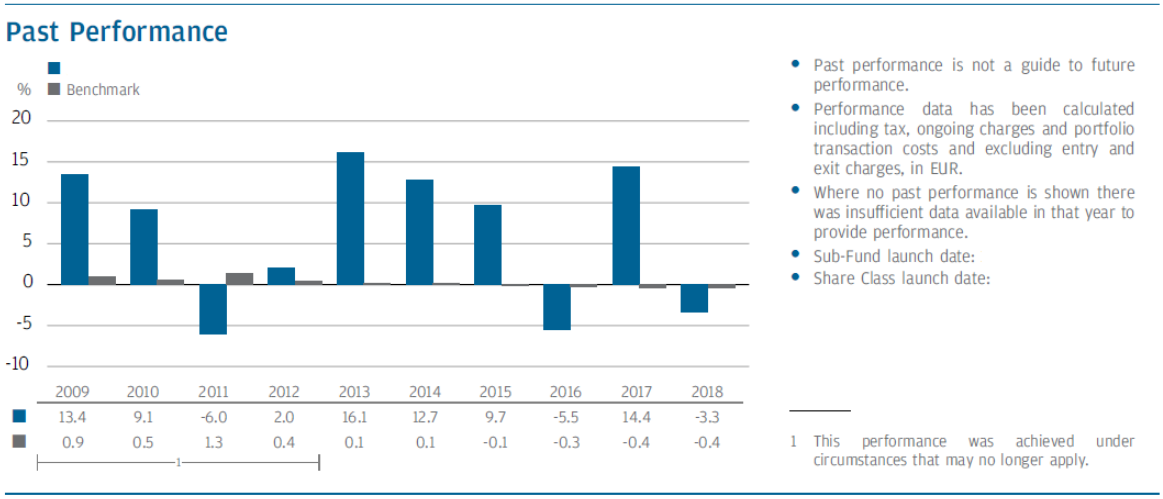
Insurance Europe does not support interim solutions. Interim solutions would increase legal uncertainty for companies and create additional compliance costs, without giving consumers a substantially better understanding of the products. Furthermore, successive interim changes risk further significantly undermining consumer trust in the PRIIPs KID.

Use of future performance scenarios (probabilistic approach) + past performance in the PRIIPs KID

One of the options under ESAs' consideration for the review of PRIIPs Level 2 is to include in the PRIIPs KID an additional table on past performance scenarios, in addition to the (possibly revised) future performance scenario table (probabilistic approach).

However, Insurance Europe is concerned that including two performance scenarios tables in the PRIIPs KID would not help consumers understand the product features. In contrast, it will result in overloading consumers with further information. Such an overload of figures, obtained through different methodologies, would only confuse consumers, and not simplify their choice.

Moreover, the example of the fund below shows that the display of past returns together with a moderate future performance scenario could provide inconsistent indications and, therefore, it could confuse consumers further.



Performance Scenarios

This table shows the money you could get back over the next 12 years, under different scenarios, assuming that you invest EUR 1 000 per year. The scenarios shown illustrate how your investment could perform. You can compare them with the scenarios of other products.

Investment 1 000 EUR yearly **Scenarios**		**1 year**	**6 years**	**12 years (Recommended Holding period)**
Stress scenario	**What you might get back after costs**	796 EUR	4 620 EUR	8 497 EUR
	Average return each year	-20.37%	-7.43%	-5.44%
Unfavourable scenario	**What you might get back after costs**	962 EUR	6 297 EUR	14 233 EUR
	Average return each year	-3.87%	1.38%	2.60%
Moderate scenario	**What you might get back after costs**	1 051 EUR	7 270 EUR	17 455 EUR
	Average return each year	5.06%	5.51%	5.64%
Favourable scenario	**What you might get back after costs**	1 147 EUR	8 423 EUR	21 331 EUR
	Average return each year	14.65%	9.78%	8.58%
Accumulated invested amount		1 000 EUR	6 000EUR	12 000 EUR

The scenarios presented are an estimate of future performance based on evidence from the past on how the value of this investment varies and are not an exact indicator. What you get will vary depending on how the market performs and how long you keep the investment/product. The stress scenario shows what you might get back in extreme market circumstances, and it does not take into account the situation where we are not able to pay you. The figures shown include all the costs of the product itself. The figures do not take into account your personal tax situation, which may also affect how much you get back.

The inclusion of an additional performance scenarios table would not only overload consumers with information, but it would also lengthen the PRIIPs KID. In practice, it would make it even more challenging, and at times impossible, to include all the required information within the 3-pages mandatory limit imposed by the Level 1 PRIIPs Regulation. The example hereafter taken from ESAs "PRIIPs - performance scenario options for consumer testing (Annex)" of 23 May 2019 shows that, in case both past and future scenarios are included, more than one page could be necessary only to include readable information on the performance scenarios.

In addition to potentially confusing consumers with additional figures obtained through different methodologies, introducing new performance table would result into additional cost for insurers due to, among others, the collection and elaboration of data according to the new approach as well as additional training for the distributors.

Consumer testing

Insurance Europe believes that the overall process adopted for the PRIIPs Level 2 review is not streamlined and could be significantly improved to ensure a better consumer outcome as follows:

- The EC will perform a consumer testing on performance scenarios presentation in Q4, while the ESAs will run a separate and parallel public consultation on the performance scenarios methodology, with no holistic approach despite the clear link between performance scenarios presentation and the underlying methodology. The ESAs will be able to consider the outcomes of the consumer testing only at the end of their public consultation, with a possible misalignment between the findings on performance scenarios presentation and the work done on the methodology. In Insurance Europe's view, the PRIIPs review process should start with a proper testing of consumers' understanding of the performance scenarios. Only after the analysis of the consumer testing's outcomes, a public consultation on the performance methodology should be launched, in order to properly leverage on the findings already collected through the consumer testing.
- In terms of scope, we understand that only 5 markets and 3 types of products (out of which, 1 IBIP) will be tested. That is not sufficient to represent the whole EU insurance market, in particular as IBIPs under the current scope of PRIIPs are very heterogeneous (e.g. unit-linked, with profit, hybrids, funeral insurance, annuities, etc.) and even similar types of IBIPs have different specific features across the various EU markets. We believe that consumer testing should be run for additional types of IBIPs in more markets to ensure that the proposed options are meaningful and effectively improve consumers understanding for the different IBIPs falling within the scope of the PRIIPs Regulation.
- We understand that the performance scenarios presentation will be tested stand alone and not within the overall PRIIPs KID. In contrast, Insurance Europe believes that the performance scenarios presentation should be tested in the context of the whole KID document, where the consumer already receives information on the overall features of the product. This would better allow measuring the potential impact of information overload on consumer understanding.

Option 3 Revised performance scenario table (probabilistic approach) with "past performance" graph (3 elements)

What is this product?

This is an insurance-based investment product that is intended to be held for 15 years. You invest a regular amount or premium per year with the aim of achieving an investment return.

From the amount that you invest we take a certain amount in order to provide your insurance coverage and to cover our initial administrative costs. The remainder is invested into a fund (Bond Fund B) managed separately by our insurance company that is composed mainly of bonds.

At the end of each year we decide on the amount of a bonus (or return) to be paid to you based on the performance of this fund. When deciding on this bonus we retain some of the returns of the fund to cover our ongoing costs and so that we have a reserve in case of poor performance in the future. We will not decrease the value of your investment. This means that at the end of the recommended holding period you are guaranteed to receive back at least the amount of premiums you have paid minus the costs.

At the end of the contract you can decide whether to take a lump sum payment or an annuity.

It is only possible to end your investment after 3 years. However, if you exit after 3 years but before the end of the contract you will pay a penalty, and you are not guaranteed to receive back the amount that you invested.

If you were to die before the end of the 15 year contract, the beneficiary of the policy is entitled to receive the value of your investment at that time net of costs.

Performance scenario examples

- **What you will get from this product depends on future market performance. Market developments in the future are uncertain and cannot be accurately predicted**
- **The scenarios shown are only estimates of some of the possible returns that you could get based on the long-term performance of financial markets**

Recommended holding period (15 years)

Example Investment Amount: EUR 1.000 per year and EUR 15.000 in total
Example Insurance premium: EUR 20 per year and EUR 300 in total

Scenarios

Survival scenarios	What you might get back after costs after 15 years	Rate of return per year	Estimated chance this scenario occurs
Minimum	14.500 €	-0.42%	
Unfavourable	16.450 €	1,14%	10 in 100 chance you do worse

Moderate	17.600 €	1,97%	50 in 100 chance you do worse
Favourable	18.150 €	2,35%	90 in 100 chance you do worse
	What your beneficiaries might get back after costs		
Death scenario Moderate	17.900 €	2,18 %	50 in 100 chance they will do worse

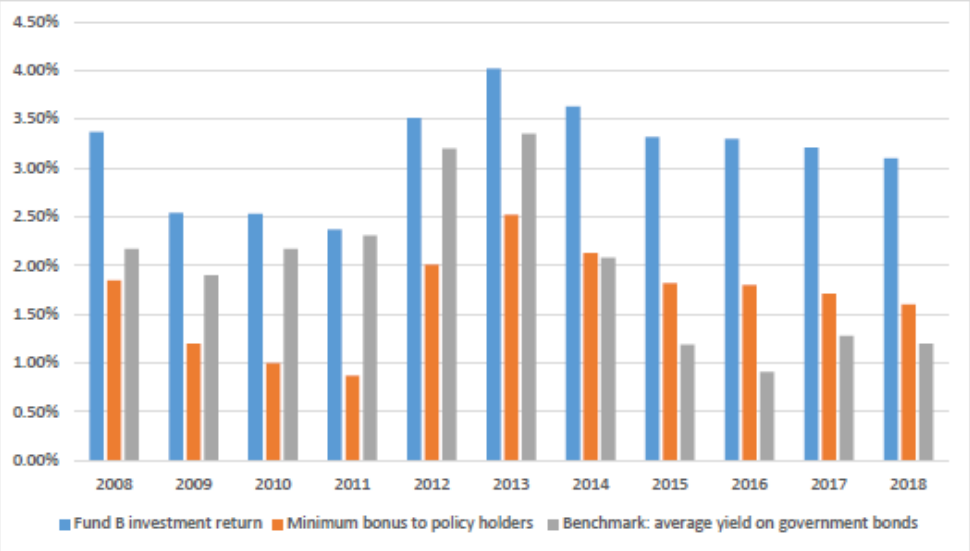
- The figures shown include all the costs of the product itself, but may not include all the costs that you pay to your adviser or distributor. The figures do not take into account your personal tax situation, which may also affect how much you get back.

Investment returns in the past

The tables below shows:

- The investment returns of Bond Fund B over the last 10 years
- The **minimum** annual bonuses that were paid to policy holders based on these investment returns. The bonuses paid to individual policy holders varies depending on their individual contract features, for example the length of the holding period.
- The returns of government bonds as a benchmark

- **Past returns are not a reliable indicator of future returns. Markets could develop very differently in the future.**
- **The figures can help you to assess how the fund has been managed in the past compared to a benchmark**



RIY as cost indicator

At the workshop, the ESAs explained that some stakeholders challenged the use of Reduction in Yield (RIY). As a result, the ESAs are considering whether to use a cost indicator different from the RIY in the KID table 2 on costs. The ESAs have also proposed a new version of table 2 on composition of costs, with different cost structures and an additional column with narrative explanation of how the different costs are calculated.

Insurance Europe strongly believes that RIY is a robust and meaningful indicator applicable to all PRIIPs.

Comparison of the Reduction in Yield (RIY) vs Total Cost Ratio (TCR) methodology

- Both RIY and TCR methodologies relate the cost deduction to the development of the value of the underlying assets during the term of the contract.
- However, the **RIY is a more robust, realistic and accurate cost indicator** because it takes into account the impact of i) cost structure, ii) cost timing, iii) product duration on the internal rate of return (yield), while the TCR does not. Furthermore, RIY works equally well for single and regular premium payments. These properties are particularly important to properly represent **long term products** (IBIPs, pension products, PEPP) and products with **ongoing premiums**. Thus, RIY is equally comprehensible and uniformly defined for all types of products.
- As demonstrated by the following simulation that compares RIY and TCR[1] methodologies (see next page), **TCR is misleading since it does not take into account the timing of costs** (an analogous example can be constructed with single premium payments):
    - In both examples the sum of cost deductions is 1,200 EUR. In the first example, these costs are distributed evenly over the years. In the second example these costs are charged up-front.
    - If a performance greater than zero is assumed, the performance at maturity is lower in the second example. Thus, the cost indicator of the second product should be higher than the cost indicator of the first product. While the TCR is almost the same in both examples, the RIY is as expected higher in the second example reflecting the negative impact of up-front cost deductions on the performance at maturity.

[1] From "ESAs Technical Discussion Paper - Risk, Performance Scenarios and Cost Disclosures In Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs)" 23 June 2015

Perfromance before costs		4.0%				Perfromance before costs		4.0%			
up-front costs		0.0%	of sum of premiums			up-front costs		4.0%	of sum of premiums		
costs in premium		4.0%	of each premium			costs in premium		0.0%	of each premium		
running costs		0.0%	of net investment			running costs		0.0%	of net investment		
Year	Premium	Cost Up front	Cost in Premium	Running costs	End MV	Year	Premium	Cost Up front	Cost in Premium	Running costs	End MV
1	1,000.00	-	40.00	-	998.40	1	1,000.00	1,200.00	-	-	(208.00)
2	1,000.00		40.00	-	2,036.74	2	1,000.00		-	-	823.68
3	1,000.00		40.00	-	3,116.61	3	1,000.00		-	-	1,896.63
4	1,000.00		40.00	-	4,239.67	4	1,000.00		-	-	3,012.49
5	1,000.00		40.00	-	5,407.66	5	1,000.00		-	-	4,172.99
6	1,000.00		40.00	-	6,622.36	6	1,000.00		-	-	5,379.91
7	1,000.00		40.00	-	7,885.66	7	1,000.00		-	-	6,635.11
8	1,000.00		40.00	-	9,199.48	8	1,000.00		-	-	7,940.51
9	1,000.00		40.00	-	10,565.86	9	1,000.00		-	-	9,298.13
10	1,000.00		40.00	-	11,986.90	10	1,000.00		-	-	10,710.06
11	1,000.00		40.00	-	13,464.77	11	1,000.00		-	-	12,178.46
12	1,000.00		40.00	-	15,001.76	12	1,000.00		-	-	13,705.60
13	1,000.00		40.00	-	16,600.23	13	1,000.00		-	-	15,293.82
14	1,000.00		40.00	-	18,262.64	14	1,000.00		-	-	16,945.58
15	1,000.00		40.00	-	19,991.55	15	1,000.00		-	-	18,663.40
16	1,000.00		40.00	-	21,789.61	16	1,000.00		-	-	20,449.93
17	1,000.00		40.00	-	23,659.60	17	1,000.00		-	-	22,307.93
18	1,000.00		40.00	-	25,604.38	18	1,000.00		-	-	24,240.25
19	1,000.00		40.00	-	27,626.96	19	1,000.00		-	-	26,249.86
20	1,000.00		40.00	-	29,730.43	20	1,000.00		-	-	28,339.85
21	1,000.00		40.00	-	31,918.05	21	1,000.00		-	-	30,513.45
22	1,000.00		40.00	-	34,193.17	22	1,000.00		-	-	32,773.99
23	1,000.00		40.00	-	36,559.30	23	1,000.00		-	-	35,124.95
24	1,000.00		40.00	-	39,020.07	24	1,000.00		-	-	37,569.94
25	1,000.00		40.00	-	41,579.27	25	1,000.00		-	-	40,112.74
26	1,000.00		40.00	-	44,240.85	26	1,000.00		-	-	42,757.25
27	1,000.00		40.00	-	47,008.88	27	1,000.00		-	-	45,507.54
28	1,000.00		40.00	-	49,887.63	28	1,000.00		-	-	48,367.84
29	1,000.00		40.00	-	52,881.54	29	1,000.00		-	-	51,342.56
30	1,000.00		40.00	-	55,995.20	30	1,000.00		-	-	54,436.26
	(55,995.20)				3.77%		(54,436.26)				3.61%
	TCR	0.26%					TCR	0.26%			
	RIY	0.23%					RIY	0.39%			

Note: TCR for ongoing premium is based on a weighted average of the sums paid by the investor over the investment horizon as previously discussed by the ESAs.

- Moreover, in some Member States RIY has been used in national disclosure documents for life insurance products and pension products even before PRIIPs came into force. In Italy, the NCA has been using a similar approach for more than 14 years.
- In terms of consumer comprehension, RIY and TCR are both a percentage. Therefore, the **RIY does not seem more difficult to understand** than the TCR.
- It would not **make sense to use RIY in KID table 1 and a different cost indicator in KID table 2**, as:
  - There would be no correspondence between the 2 tables
  - The costs will not sum up to the total costs in table 1
  - Consumers would, therefore, only be confused as they would not understand the relation between the aggregated cost and the breakdown
- As to product comparability and level playing field, if the ESAs propose the use of RIY for IBIPs and TCR for MiFID products, there is a risk that, for an IBIP and a MiFID product that charge the same cost, the consumer gets the impression that the costs are different, because as explained above the different cost indicators can give different % results based on the same costs.

- Besides, it is useful to highlight that, before the development of the information document for so-called Riester pensions (state-sponsored private pensions), the German Ministry of Finance (BMF) commissioned the Leibniz Centre for European Economic Research (ZEW) to conduct a research on transparency of Riester pensions. In particular, ZEW analysed the comparability of costs. One of the findings was that RIY has a good interpretability and low sensitivity for different yield assumptions. In general, RIY is the most robust figure under different assumptions. RIY is a meaningful addition to EUR figures due to different costs structures (link). Riester pensions includes both insurance and fund products.

Comparison of Reduction in Yield (RIY) vs Total Expense Ratio (TER) methodology – where TER is meant as a TCR indicator excluding costs outside the portfolio (e.g. adviser remuneration, upfront costs and annual ongoing administration fees)

- RIY is a prospective cost disclosure measure and expresses the various charges on a policy as a percentage of the annual gross return. This approach is coherent with other measures in the KID (e.g. performance scenarios).
- RIY will show the policyholder how much of the gross yield (total return) is lost so as to cover all the expenses charged against the policy.
- The Total Expense Ratio (TER) is retrospective in that it shows actual past expenses as a percentage of your investment. TERs do not indicate whether a fund will give a good or poor performance, but merely how expensive a fund is relatively to its performance.
- A TER includes all expenses incurred by a portfolio (e.g. management fees, performance fees, administration costs, trustee fees, audit fees, bank charges and taxes), but it does not reflect costs outside the portfolio (e.g. adviser remuneration, upfront costs and annual ongoing administration fees).

New version of table 2 on composition of costs proposed by the ESAs

- In the current table 2, the cost breakdown is entirely based on RIY figures. The sum of the RIY of the different types of costs results in a total RIY, so consumers can understand how the different costs impact the total yield.
- In the new version of table 2 on composition of costs proposed by the ESAs (see excerpt in the next page), every cost figure has a different calculation basis:
    - Entry costs: as % of single premium/total premiums
    - Exit costs: as % of exit value
    - Ongoing, transaction costs: as % of assets
    - Performance fees: as % of [to be defined]
    - Other costs: as % of [to be defined]
- The additional column "*How [cost] are calculated*" would lengthen the PRIIPs KID and make it even more challenging to include all the required information within the 3-pages mandatory limit imposed by the Level 1 PRIIPs Regulation.
- Also based on these considerations, it is preferable to retain the RIY as cost indicator, including in table 2.

	Type of costs	Total costs accumulated in the ecommended holding period or Impact on return each year during the holding period	How they are calculated	
One off costs	Entry costs	xx euros / x%	X% on the price/sum paid	(When applicable) These costs are already included in the price you pay. Or (for IBIPs) These costs are deducted from the first payment(s) due by you (or from the redemption payment if necessary) and are not invested into the asset". This includes [the full amount of the biometric risk premium] /[the costs component of the biometric risk premium] (When applicable): This includes the costs of distribution of your product. [x%] (When only the maximum distribution fee is known): This does not include the cost of distribution. The person selling you this product may charge a maximum of x%. . When applicable, describe when these costs are applied or differences depending on timing/size of the order or other factors in max xx characters
	Exit costs	xx euros / x%	X% on the exit value [redemption amount]	When applicable: These costs will be included in the price/sum you receive. When applicable, describe when these costs are applied or differences depending on timing/size of the order or other factors in max xx characters (see suggested text below)
On going costs	Management fees and other ongoing costs	xx euros /%	X % on net asset value (per year)	These are costs taken each year to manage your investment. It includes an estimation of operating costs based on last year data.
	Portfolio transaction costs	xx euros/%	X % on net asset value (per year)	This is an estimation of the costs of us buying and selling underlying investments based on historical data
Incidental costs	Performance fees	xx euros/%	X % on … (per year if the condition is met)	These costs are taken from your investment if …. (describe when they are applied in max xx characters). This is an estimation based on historical data.
	Other costs (name)	xx euros/%	X % on …	These costs apply if … (describe conditions)