The Consumer Voice in Europe

PUBLIC CONSULTATION ON FRAMEWORK TO ADDRESS VALUE FOR MONEY RISK IN THE UNIT-LINKED MARKET

BEUC CONSULTATION RESPONSE

Contact: Jasper De Meyer – financialservices@beuc.eu

BUREAU EUROPÉEN DES UNIONS DE CONSOMMATEURS AISBL | DER EUROPÄISCHE VERBRAUCHERVERBAND
Rue d'Arlon 80, B-1040 Brussels • Tel. +32 (0)2 743 15 90 • www.twitter.com/beuc • www.beuc.eu
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Why it matters to consumers

A unit-linked life insurance policy is an insurance product that integrates both life insurance (covering against the risk of death) and an investment component (offering the opportunity for consumers to generate capital). Studies by our members show that unit-linked life insurance contracts can be very complex, and the fees associated with these products are often very high, impacting returns for consumers. We welcome the proposed framework by the European insurance supervisor to ensure that unit-linked product offer value for money to consumers. Insurance firms should integrate these proposed principles in the heart of their business models.

Summary

Firms should ensure that the products and services that they offer to consumers are fit for purpose and offer fair value for money. There is widespread evidence in the unit-linked market of insurance consumers being sold products that are not fit for purpose or that do not offer fair value for money. Unit-linked insurance products are often very complex products, making it difficult for many consumers to understand the costs and benefits associated with these products, and to assess the value of the insurance products that are sold to them.

Insurance firms should actively put consumers at the heart of their business, including by assessing the price of the products and services that they are offering through product design and through ongoing monitoring. We support several of the principles proposed by EIOPA to assess value for money in the unit-linked market, and believe that:

- Firms should be required to demonstrate (through their POG processes) that the benefits of their products and services are reasonable relative to their price.
- Firms should be able to document that they have carried out such assessments and be required to demonstrate to supervisors that the benefits associated with their products were reasonable relative to their price.
- When carrying out such assessment, firms should be required to assess their offerings in comparison to other comparable products available on the market.
- Where there is evidence that the prices and charges or underlying investment funds do not offer fair value for consumers, then these should be reviewed by insurance firms.

Product oversight and governance rules are designed to ensure that the interests of consumers are taken on board during the product design stage and throughout the lifecycle of the product, and to ensure that products are only distributed within the right target market. If properly supervised and enforced by EIOPA and national competent authorities, POG rules could help to improve consumer outcomes in the unit-linked market. Beyond putting more emphasis on value for money considerations as part of the POG process, banning the payment of inducements to insurance undertakings could also significantly help to improve the value proposition in the unit-linked market (for our full recommendations, please see our campaign on The Price of Bad Advice).

1. Do you agree with definition of value for money presentation in paragraph 1.7?

Yes.

2. Do you share EIOPA's concenrs about value for money risk in certain areas of the UL-market?

Yes, we share EIOPA's concerns about the value for money in certain segments of the unit-linked market. There is widespread evidence, including from EIOPA[1], Better Finance[2] and our members about the high costs associated with the unit-linked life insurance products. High costs can significantly diminish the returns of these products, and our members generally caution consumers to pay very close attention to fees when taking out a unit-linked life insurance policy:

In Belgium, our member **Test Aankoop** has warned consumers about the high costs associated with Tak-23 unit-linked life insurance products (entry fees for certain products can be as high as 8%).[3] Test Aankoop has also warned[4] consumers against taking out hybrid Tak-44 insurance products (mixing capital guarantees and a unit-linked component) due to the very high costs associated with these products.

A study[5] by our member **Stiftung Warentest** evaluated 33 unit-linked life insurance contracts sold in Germany. Stiftung Warentest found that the costs associated with unit-linked life insurance contracts are generally very high, significantly reducing potential returns for investors. On the basis of their study, Stiftung Warentest could only recommend 3 of the 33 unit-linked products to potential consumers. A further study[6] by Stiftung Warentest evaluated the performance of life insurance contracts sold to German consumers and found a large gap between the services that insurers had promised their consumers when the contract was signed, and the actual service that was delivered when the contract expired.

Our French member **UFC Que Choisir** warned[7] consumers about the high complexity and high costs associated with unit-linked life insurance products.[8] UFC Que Choisir has cautioned[9] consumers to beware about the high costs associated with certain life insurance contracts, with entry fees as high as 5% (UFC Que Choisir advises consumers to consider negotiating discounts with life insurance providers).

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[1] EIOPA, 'Cost and past performance report 2021', https://www.eiopa.europa.eu/content/cost-and-past-performance-report-2021_en.

[2] Better Finance, 'Long-Term and Pension Savings: The Real Return', https://betterfinance.eu/wp-content/uploads/BOOKLET-The-Real-Return-Long-Term-Pension-Savings-Report-2020-Edition.pdf.

[3] Test Aankoop, 'Beleggingsfonds en tak 23: voordelen en nadelen op een rijtje', https://www.test-aankoop.be/invest/beleggen/fondsen/analysis/2016/06/beleggingsfonds-en-tak-23-voordelen-en-nadelen-op-een-rijtje.

[4] Test Aankoop, 'Tak 44: een verzekeringsproducts dat 2 formules combineert', https://www.test-aankoop.be/invest/sparen/spaarverzekeringen/analysis/2016/10/tak-44-een-verzekeringsproduct-dat-2-formules-combineert

[5] Stiftung Warentest, '3 von 33 fonds-gebundenen Renten-versicherungen sind gut', https://www.test.de/Vergleich-Rentenversicherung-mit-Fonds-3-von-33-fondsgebundenen-Rentenversicherungen-sind-gut-1563811-0/.

[6] Stiftung Warentest, 'Wie Versicherer Rente und Kapital-auszahlung kürzen', https://www.test.de/Lebensversicherung-Wie-Versicherer-Rente-und-Kapitalauszahlung-kuerzen-4965508-0/.

[7] UFC-Que Choisir, 'Placements refuges 2021: Visez l'efficacité, rien d'autre!', https://www.quechoisir.org/enquete-placements-refuges-2021-visez-l-efficacite-rien-d-autre-n86087/.

[8] UFC-Que Choisir, 'Assurance vie: 10 bonnes raisons de vous en passer!', https://www.quechoisir.org/enquete-assurance-vie-10-bonnes-raisons-de-vous-en-passer-n64531/.

[9] UFC-Que Choisir, 'Assurance vie: Un bon contract, c'est quoi au juste?', https://www.quechoisir.org/decryptage-assurance-vie-un-bon-contrat-c-est-quoi-au-juste-n73911/.

3. **Do you believe that more emphasis on value for money considerations as part of POG, in particular through product testing, will ultimately improve the value propositions in the unit-linked market?**

More emphasis on value for money consideration as part of the POG process may help to improve value propositions for consumers in the unit-linked market. POG rules can ensure that insurance firms take a more 'consumer-centric' approach to their product approval, distribution, and monitoring and review processes, helping to ensure better outcomes for insurance consumers. However, ensuring that POG rules are actively followed by insurance firms can be more difficult to achieve in practice, depends on effective supervision and enforcement of these rules by national competent authorities and EU supervisors, which may be challenging.

As an example of the challenges involved, in the UK, the Financial Conduct Authority (FCA) introduced requirements following its Asset Management Study for asset managers to carry out value for money assessments after finding evidence of weak demand-side pressure on fund costs, resulting in uncompetitive outcomes for consumers investing into investment funds. In July 2021, the UK FCA published a review[10] to assess how these rules were implemented by investment funds, finding that many "had not implemented [the] assessments meeting the minimum consideration requirements and [that] several practices fell short of our expectations." In particular, there was clear evidence that firms were typically less active in reducing the fees paid for asset management services, which often represent the largest portion of a fund's ongoing charges.

Beyond putting more emphasis on value for money considerations as part of the POG process, banning the payment of inducements to insurance undertakings would significantly help to improve the value proposition in the unit-linked market (see also our response to Question 5 and BEUC's campaign on The Price of Bad Advice).

4. **Based on the framework presented below, do you believe there may be principles you feel are missing? Please explain.**

No. We agree with the principles set out by EIOPA.

5. **What additional measures could EIOPA facilitate to advance value for money in unit-linked and hybrid products?**

The monetary incentives that insurers receive from asset managers can act as a significant conflict of interest, encouraging insurance undertakings to select underlying investment vehicles that provide the highest level of remuneration for the insurer. Inducement-based advice puts a conflict of interest at the heart of client relationship, encouraging financial advisers to recommend products that generate higher commissions, instead of recommending products that may be more cost-effective or more suitable for the client.

The EU should ban the payment of commissions on all retail investment and complex investment products. Financial advisers should no longer be permitted to be remunerated by inducements, and instead charge a separate fee for advice to their clients. A ban would reduce conflicts of interests for advisers, improve advice and encourage the distribution of lower-cost investment products to consumers. An inducement ban would substantially improve value for money in the unit-linked market, encouraging insurance undertakings to select lower cost and better-performing investment vehicles for their clients. A study by the UK Financial Conduct Authority (FCA) found that while as much as 60% of British fund savings were injected into the most expensive funds prior to the UK inducement ban, this

[10] FCA, 'Authorised fund managers' assessments of their funds' value', https://www.fca.org.uk/publications/multi-firm-reviews/authorised-fund-managers-assessments-their-funds-value.

proportion had fallen to 20% almost two and half years after the ban came into place.[11] According to the Dutch Authority for Financial Markets (AFM), the inducement ban in the Netherlands has improved competition between product manufacturers, improved the quality of financial advice, and encouraged the introduction of "more cost effective, simpler financial products and fair advice" for consumers.[12]

6. Do you agree that costs and charges need to be due?

Yes.

7. Do you agree that for evaluation purposes, costs and charges should be assigned to specific benefits and services?

Yes. Unit-linked life insurance contracts offer a wide range of different benefits to consumers (including biometric risk coverage against the risk of death, an investment component and/or capital guarantees). Each of these components should be priced separately by insurance undertakings for the purpose of assessing whether these services offer value of money to the consumer.

8. Do you agree that the costs which cannot be directly linked to a specific product component, should be assigned to the dominant product feature? If not, do you have an alternative proposal?

Yes, we agree with the approach suggested by EIOPA.

9. Do you agree that active investment management involves additional costs and benefits?

Active investment management often involves additional costs for asset management firms. Active management strategies require stock selection by fund managers and active trading in order to generate potential higher returns for investors compared to a given benchmark. Such strategies also require higher knowledge and skills for investment fund managers, which are generally matched with higher compensation and in turn higher fees and costs for end-investors.

We agree that there are potential benefits with active investment strategies. For instance, active strategies offer consumers the potential to achieve higher potential returns (outperforming their benchmarks) compared to passive investment strategies. However, in practice, studies by ESMA[13] show that only 25% of actively managed investment funds (1 in 4) are actually able to beat their benchmark after costs. Moreover, there is evidence that the group of 25% actively managed funds that beat their benchmark changes over time, such that there is limited opportunity for retail investors to consistently pick the 'right' outperforming actively managed funds.

Passive investment strategies, or 'index tracking' is an investment strategy which seeks to replicate the performance of an underling index. As passive investment strategies do not require security selection or extensive research by fund managers, the fees associated with these products are significantly lower. Studies show that the level of fees of an investment fund is critical to fund return over time. For instance, in 2018, the FCA carried out a study into the asset management sector in the UK. The study found that there is "no clear relationship between price and performance – the most expensive funds do not appear to

[11] Europe Economics, 'Retail Distribution Review: Post Implementation Review', p. 73
[12] Dutch AFM, 'Next steps for the CMU', https://www.afm.nl/~/profmedia/files/publicaties/2020/afm-view-cmu-april-2020.pdf?la=nl-NL.
[13] ESMA, 'Performance and costs of EU Retail Investment Products', https://www.esma.europa.eu/sites/default/files/library/esma_50-165-1710_asr_performance_and_costs_of_eu_retail_investment_products.pdf

perform better than other funds before or after costs."[14] On the contrary, the FCA found that there is "some evidence of a negative relationship between net returns and charges."[15]

In 2019, ESMA published a study showing that the performance of investment funds is significantly impacted by fees, with charges on average reducing gross returns by 25% for investors.[16] ESMA's study also found that passive funds consistently outperformed actively managed funds, once charges were taken into account. A study by our member the Norwegian Consumer Council similarly found that actively managed investment funds offered to retail investors in the Norwegian market only rarely outperformed their cheaper passive alternatives.[17]

10. Do you agree that each product feature should deliver Value for Money as well as for the product as a whole?

Yes.

11. Do you agree that value for money is dependent on the target market's characteristics, needs, and objectives?

Yes.

12. Do you agree that active and passive investment management have different target markets?

Yes, actively managed investments should have a different target market than passive investments. Active management strategies may suit consumers seeking to achieve returns that are above that of a market index, and therefore may prefer investing into an actively managed fund. Passive investment strategies are more suitable for consumers who seek to achieve overall stock market returns.

13. Do you agree that distribution costs which are charged to the consumer as a percentage of the premium paid or the performance of the units can create a risk of being poor value for money?

Yes. Distribution costs are often charged to consumers as a percentage of the premium paid or the value of the underlying unit-linked funds, and this can increase the risk of consumers receiving poor value for money. In the absence of a full inducement ban, BEUC supports a full alignment of the MiFID II and IDD rules on inducements, including introducing a requirement for insurance intermediaries to disclose inducements and provide a quality-enhancing service to their clients. According to the MiFID II rules, the value of these so-called quality enhancing services also need to be proportional to the level of inducements received by the firm.

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[14] FCA, 'Asset Management Market Study – Interim Report', https://www.fca.org.uk/publication/marketstudies/ms15-2-2-interim-report.pdf, p.15.

[15] FCA, 'Asset Management Market Study – Final Report, https://www.fca.org.uk/publication/marketstudies/ms15-2-3.pdf, p. 4.

[16] ESMA, 'ESMA Report finds investment product performance highly impacted by charges', https://www.esma.europa.eu/press-news/esma-news/esma-report-finds-investment-product-performancehighly-impacted-charges

[17] Finansportalen, 'Indeksfond Eller Aktive Fond – Hva er Best?', https://www.finansportalen.no/andrevalg/artikler/indeksfond-eller-aktive-fond-hva-er-best/

14. Do you agree on the assumptions to be made when assessing the reasonableness of the expected break-even point and of the expected returns?

Yes.

16. Do you agree that manufacturers have a duty to review costs and charges, performance and the services offered on a regular basis?

Yes. Manufacturers should have a duty to review the performance and the cost of charges of the services that they offer through their unit-linked products on a regular basis, including in comparison to other similar products available on the market. Insurance undertakings should regularly review the performance and costs and charges associated with investment funds offered through their unit-linked products. Where there is evidence of investment funds consistently underperforming their benchmark, then insurance undertakings should have clear processes in place to take potential corrective actions, including reducing the costs and charges associated with the unit-linked product, considering replacing asset managers or selecting other underlying funds to offer to their consumers, or passing on (in part) to clients any remuneration or inducements received from asset managers.

17. Do you agree that policyholders should expect returns that are in line with market returns over the long run?

Yes.

18. Do you agree that actively managed underlying funds should be reviewed in relation to their performance against that of their related benchmarks?

Yes.

19. Do you agree that mass marketed UL products should provide a limited number of options?

Yes.

Unit-linked life insurance policies often offer a wide range of investment strategy possibilities to consumers. This leads to information overload, often impedes comparability for consumers and complicates the decision-making process for consumers. Limiting the number of investment options for mass marketed unit linked products could simplify decision-making for consumers and help to address consumers' choice overload. For instance, under the PEPP Regulation, future PEPP providers can only offer up to six investment options to prospective PEPP savers (including the so-called default option, i.e. the Basic PEPP). By improving the comprehensibility and comparability of products and services, consumers can more readily make informed decisions, and information asymmetries can be reduced.

20. Do you see alternative measures to mitigate risks associated with a high number of options?

Limiting the number of investment options available through unit-linked products could enhance comparability for consumers. The use of 'default options' (the approach of the 'Basic PEPP' under the PEPP Regulation) could also help to simplify the decision-making process for consumers.

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