Society of Actuaries in Ireland

EIOPA consultation on framework to address value for money risk in the European unit-linked market

Response to EIOPA

July 2021

Preface

The Society of Actuaries in Ireland ("Society") is the professional body representing the actuarial profession in Ireland.

The Society is a member of the Actuarial Association of Europe ("AAE") and has contributed to the response made by AAE to this consultation. In addition, the Society has made a submission to the online survey which includes comments specific to the Irish unit-linked market. The answers submitted by the Society to the online survey are set out below.

We would be happy to respond to any questions on this response. Please contact Philip Shier, Head of Actuarial Practice, at philip.shier@actuaries.ie.

Q1: Do you agree with the definition of value for money presented in paragraph 1.7?

We are in broad agreement with the definition as a high-level concept but it is difficult to apply the principles in an objective manner. The definition does not remove subjectivity from the concept of "value for money". For example, even with an agreed definition, two individuals may form a different view as to whether "the costs and charges are proportionate to the benefits".

Q2: Do you share EIOPA's concerns about value for money in certain areas of the UL-market?

In general, we believe a market with strong regulations on transparency of charges and commissions, range of distribution channels, availability of well-trained independent advisors, obligations to justify advice on product selection to be given to customers ("reasons why letter") along with a range of providers competing for business all combine to help deliver value for money to consumers. In addition, non-insurance investment products being available to consumers assists the competitive landscape and can give further baselines to advisors on value for money.

Q3: 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?

Primarily the responsibility to ensure a consumer receives value for money and purchases an appropriate product to their needs, lies with the advisor. It is not clear that a 'top down' framework will be successful and could even be counter-productive in setting an 'acceptable price' across the market which could discourage competition.

Q4: Based on the framework presented below, do you believe there may be principles you feel are missing? Please explain.

There is a general principle of disclosure: transparency of charges, Reduction in Yield, commission disclosure and alignment and further development of existing PRIIPS and IDD measures to help encourage greater competition in any markets where there is a value for money concern.

Q5: What additional measures could EIOPA facilitate to advance value for money in unit-linked and hybrid products?

1) Examine best-practice local regulations across the EU and see opportunities to implement measures that have been proven to be effective

2) A significant part of the costs associated with an insurance policy related to distribution costs and commission. Measures to ensure transparency in these costs and charges are in place in some jurisdictions. It would be beneficial to examine these more carefully.

Q6: Do you agree that costs and charges need to be due?

At an overall level, the principle has merit.

However, there may be reasons why charges and costs would not align exactly – for example an insurance company may not wish to fully recoup higher initial costs and commissions so subsidising policyholders who exit early but balancing this with higher longer term charges to ensure the overall sustainability of the portfolio. This is not dissimilar in principle to non-linked level term assurance products where the premium in early years is in excess of the mortality cost but the position reverses in later years.

So it is a complex area and there may be areas such as size of policy, duration, age at entry etc where there may not be a fixed ratio between costs and charges.

Q7: Do you agree that for evaluation purposes, costs and charges should be assigned to specific benefits and services?

The attribution of costs and charges to specific benefits may be somewhat arbitrary. Advisors should be focused on the particular needs of their target customers and compare (complex) unit-linked products with other ways of satisfying their needs through a simpler range of alternate products to help determine whether the combination of features gives value for money in the context of a particular client's needs.

Q8: 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?

We do not necessarily agree that costs without a direct link to a specific product component should be arbitrarily assigned to a dominant component. The response to Q7 gives some analysis of the difficulties. The combination of components may give rise to a value that is greater than the sum of the parts in the context of an individual's needs.

Q9: Do you agree that active investment management involves additional costs and benefits?

Whether active management involves additional costs and benefits depends on the fund manager and the time period you consider. Depending on the needs and risk appetite of the customer, an active or passive approach could suit them better. We believe the key thing is that the customer understands the charges they are paying and the service they are getting in exchange.

Q10: Do you agree that each product feature should deliver Value for Money as well as for the product as a whole?

As a core principle, advisors should seek products that give the best value for money to meet the holistic needs of a client. Alternative discrete products that meet the same needs should be compared against a combined product for each client.

It is not clear that a product that gives value for money as a whole for a particular client must deliver the same for each product feature. However, in such a case there may be an opportunity for an advisor to choose a more optimum product set for this client.

Noting the answer to Q1, there is inherent subjectivity in the concept of Value for Money and it becomes more difficult to measure or quantify with more granularity and disaggregation.

Q11: Do you agree that value for money is dependent on the target market's characteristics, needs, and objectives?

Value for money for a client will depend on their individual characteristics, needs and objectives. The target market should reflect a collection of individuals with similar characteristics, needs and objectives but these can be hard to define.

Q12: Do you agree that active and passive investment management have different target markets?

This is difficult to be conclusive on as the risk appetite of an individual may have a significant bearing on their choice of active versus passive investing.

Q13: 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?

Distribution costs such as initial commission and trail commission are often incurred as a percentage of the premium paid or performance of units. However, it is common practice, especially where there is full commission disclosure, that tiered commission levels are applied with lower levels of costs (and charges) on larger amounts of premiums or fund values. This is a natural consequence of transparency of commission and distribution costs. This enables the client to make an evaluation of the value of the advice relative to the costs incurred.

Q14: Do you agree on the assumptions to be made when assessing the reasonableness of the expected break-even point and of the expected returns?

The breakeven point should be one of the criteria that advisors consider when recommending a product to a client. The expected return should be reasonable and there are advantages to clear regulation on maximum projected returns such as exists in the Life Disclosure Regulations in Ireland.

Q15: Views on other criteria / ways to assess reasonableness are sought

Encouraging transparency by disclosing commission levels, projected values on prescribed bases and using prescribed methodologies and illustrating the Reduction in Yield as a metric to give to prospective clients are all good ways to communicate value for money.

Q16: Do you agree that manufacturers have a duty to review costs and charges, performance and the services offered on a regular basis?

Yes, we view a regular review of costs, charges, performance and services as an integral part of ensuring that products remain suitable for a target market.

Q17: Do you agree that policyholders should expect returns that are in line with market returns over the long run?

Yes

Q18: Do you agree that actively managed underlying funds should be reviewed in relation to their performance against that of their related benchmarks?

Yes

Q19: Do you agree that mass marketed UL products should provide a limited number of options?

The number of options should be capable of being explained clearly to individuals in the target market and for an advisor to make clear recommendations for each option to meet the needs and risk appetite of the individual.

Larger numbers of options may require a higher quality of advice.

Q20: Do you see alternative measures to mitigate risks associated with a high number of options?

A clear advice process to enable selection of optimal choices to be for the client, with clear identification of needs enabling well founded recommendations and ultimate decisions.

Q21: Do you agree that UL products require a high degree of financial literacy for consumers to understand?

There are very many varieties of UL products and a wide number of them (certainly in Ireland) are relatively straightforward and compare favourably with other investment and insurance products to meet the same needs. Therefore, we disagree with the general comment, while acknowledging that certain complex UL products do require a higher degree of financial literacy.

Q22: Do you agree that products with many different options carry additional conduct risks?

They may have a higher level of inherent risk, however good regulation on advice and monitoring of compliance can mitigate these risks leaving a low level of residual conduct risk.

Q23: Do you agree with the variables to be taken into account to determine product groupings? Or do you believe more/less variables should be taken into account?

No comment

Q24: For each of the variables identified provide views on options which EIOPA should consider

No comment

Q25: Do you think there may be other criteria to be followed when grouping products?

No comment

Q26: Considerations on the model are sought

No comment

Clanwilliam House
Clanwilliam Place
Dublin 2, D02 AV90,
Ireland
Tel: + 353 1 634 0020
Fax: +353 1 634 0039
Email: info@actuaries.ie
Web: www.actuaries.ie