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COMMENT LETTER

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ICI Global Response to EIOPA Consultation Paper on the Creation of a Standardised Pan-European Personal Pension Product (pdf)

1 ICI Global Response to EIOPA Consultation Paper On The Creation of a Standardised Pan-European Personal Pension Product (PEPP) (submitted via online questionnaire, on 5 October 2015) General Comment: ICI Global welcomes the opportunity to comment standardised Pan-European Personal Pension product (PEPP). ICI Global, the international arm of the Investment Company Institute, serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US $19.0 trillion. ICI Global has been studying retirement systems around the globe and facilitating the exchange of information on key challenges and innovative solutions, including through high-level conferences in Hong Kong (2013), Geneva (2014), Tokyo (2015), and, most recently, in Paris (2015) an event co- hosted with the Organisation for Economic Cooperation and Development (OECD) and the International Organisation of Pension Supervisors (IOPS). ICI Global publishes post-conference reports on its discussions surrounding retirement security are widely and publicly available. See https://www.iciglobal.org/iciglobal/pubs/retirement. As the European population is ageing and public budgets become strained by the pension obligations, the European Union citizens should have additional opportunities to save for retirement. For this reason, we believe that the European Union should facilitate savings for retirement through third-pillar type arrangements, such as a personal pension product (PPP), regardless of whether a Member State already has a robust public (first pillar) and occupational (second pillar) system. 2 Further, we believe that a well-designed pan-European PPP (or PEPP) that can attract funds from across Europe may offer benefits to European citizens that national PPPs may not be able to offer. For example, by pooling assets on a cross-border basis, certain efficiencies in cost, management and administration can be achieved. In addition and importantly, a pan-European retirement savings product is likely to better accommodate an increasingly more mobile EU workforce. Also, the Commission recognized in connection with the Capital Markets Union significant positive relationship between the size of [occupational or personal pension plans] and capital market depth (as measured by the ratio of the market capitalisation of outstanding domestic stocks and See page 32 of Initial Reflections on the Obstacles to the Development of Deep and Integrated EU Capital Markets, Commission Staff Working Document Accompanying Green Paper, Building a Capital Markets Union (dated 2 February 2015). Lastly, we understand that a PEPP, unlike many pillar 1 and pillar 2 systems in Europe, will be a voluntary product. A consumer will

have to make a deliberate choice to purchase it. Therefore, by design, this consumer will be engaged in a decision to save through a PEPP. Accordingly, the Commission and EIOPA must keep in mind the need for the PEPP to be an attractive product that a consumer will choose to purchase. Providers will need flexibility to design products that meet the diverse needs of consumers from different Member States and with different personal circumstances. Question 2: Do stakeholders agree that a highly prescriptive 2nd regime will achieve the policy objectives of ensuring a high minimum standard of consumer protection and encouraging more EU citizens to save for an adequate retirement income? This consultation is an ambitious step towards creation of an attractive PEPP; yet, EIOPA should proceed cautiously in creating too many prescriptions. Because a PEPP, by design, is a voluntary investment, it must be designed in a way to attract an EU citizen to make a deliberate choice to purchase a PEPP. For this reason, we disagree with the recommendations that a PEPP should have a specified number of investment options, and any requirement that the non-default alternatives must have guarantee features or life-cycle strategies. We also oppose the imposition of fee caps. We raise these objections because they s objective to become an attractive 3rd pillar savings vehicle, which role is to supplement savings in pillars 1 and 2. As pillars 1 and 2 vary from Member State to Member State, the attractiveness of a PEPP will depend on what a particular EU citizen seeks to accomplish with a 3rd pillar product. They may wish to use a PEPP that is very similar to their current savings portfolio, or they may wish to put together a more aggressive savings vehicle; or the opposite, they may prefer a PEPP with a more conservative approach. Also see answer to Question 8. As discussed below, we do not object to requiring that each PEPP have a default option, and we believe that a life-cycling strategy with de-risking (LCS) would be an appropriate default. We also strongly LCS should be left to PEPP providers, including whether to add a guarantee. 3 Question 3: Do stakeholders agree that EIOPA has identified the correct challenges associated with introducing a 2nd regime? If so, how might these challenges be overcome? If not, what do stakeholders believe might be other challenges associated with introduction of a 2nd regime? A PEPP creation will likely face a number of challenges, from differences in Member State retirement laws to cultural reluctance to utilise a 3rd pillar product, especially because this pan-European product may potentially compete with national PPPs. Nevertheless, we believe EIOPA should seek to resolve some challenges. For example, EIOPA chose not to standardise certain features that vary from Member State to Member State. On taxation, EIOPA stated that treatment where these -term pensions In its advice to the Commission, we urge EIOPA to consider how it might foster a tax approach that would allow PEPPs to be competitive across the EU and facilitate the free movement of capital. We believe this to be a critical issue for a successful PEPP. Question 4: Do stakeholders believe that an investment option containing a guarantee, e.g., a 0% minimum return guarantee, does not in addition require a life-cycling strategy with de-risking? We assume this question is about a non-default investment option, and that this question does not suggest that a guarantee should be required. We believe that the decision to offer an investment option that combines a guarantee with a life-cycling strategy should be left to the investment provider; neither of these features should be required. As we discuss in Question 8, the purpose of a default life cycle investment strategy or the use of minimum return guarantees during the accumulation phase is to alleviate the impact of market risk on retirement savers. Because a PEPP would be supplemental to pillar 1 and 2 savings, and because of features to ensure maximum protection for their savings, while other citizens may prefer just a guarantee, and some may prefer a product without either. In combination with clear disclosure, we strongly believe the provider should have the flexibility to accommodate the different and varying circumstances of investors across the EU and to offer an investment option with or without a guarantee, and with or without the life-cycling element. Question 5: Do stakeholders agree to limit the number of investment options, e.g., to five? We understand that EIOPA has asked this question in light of behavioral economics studies (described in Annex 2 to the consultation), particularly those that suggest that consumers get overwhelmed with too many investment choices. We encourage EIOPA to take a more nuanced approach to addressing the challenges identified in the studies rather than limiting investment choices to a specific number. This product is voluntary and is 4 intended to supplement retirement savings in pillars 1 and 2. Therefore, a PEPP provider should have flexibility to offer a range of investment options to succeed in attracting retirement savers into a PEPP. In the US, a 2014 survey of more than 1,500 individuals whose households had defined contribution (DC) plan accounts, found that 94 percent of DC-owning households agreed that it is important to have choice in, and control of the investments in their retirement accounts, and 82 percent thought that their DC plans had a good lineup of investment options (see ICI Research Report (January 2015) available at www.ici.org/pdf/ppr_15_dc_plan_saving.pdf). At the same time, the use of target date funds the most popular default investment option in 401(k) plans is also significant. At year-end 2013, 71 percent of 401(k) plans offered target date funds, 41 percent of participants held target date funds in their accounts, and target date funds were 15 percent of 401(k) plan assets (see ICI Research Perspective 20, no. 10 (December 2014) available at www.ici.org/pdf/per20-10.pdf). In the US, it is also possible to roll over assets from employer-sponsored retirement plans into individual retirement accounts (IRAs), and again there, the US experience indicates that individuals appreciate choice. Among U.S. households with rollovers in their traditional IRAs, 64 percent indicated that one of the reasons for their most recent rollover was to gain access to more investment options (see ICI Research Perspective 21, no. 1 (January 2015) available at www.ici.org/pdf/per21-01.pdf). To consider a number of approaches, which have been used in other jurisdictions. Hong Kong recently went through a consultation about creating a standardized default fund, and they referred to it as See http://www.mpfa.org.hk/eng/information_centre/Consultations_and_Conclusions/file/Consultatio n_Conclusions_Providing_Better_Investment_Solutions_for_MPF_Members_Eng.pdf. Similarly, EIOPA could consider requiring each PEPP to have a default investment option that is clearly labeled UK NEST, which is designed with an understanding that most employees will remain in the NEST default funds, also offers additional choices to its investors. In a speech, Tim Jones, former CEO of NEST explained that the NEST offers these additional choices on the advice of behavioral economists, who recommended giving people some choices to help them feel empowered that they did make a decision (including whether to stay in a default fund). See Insights from the Global Retirement Savings Summit: Japanese and International Experiences (April 2015, Tokyo), soon to be available at https://www.iciglobal.org/iciglobal/pubs/retirement. Pre-Retirement Fund, NEST Lower Growth Fund, NEST Higher Risk Fund, NEST Sharia Fund, and NEST Ethical Fund. 5 While the US does not impose an explicit cap on a number of investments in 401(k) plans, 401(k) See 29 US Code of Federal Regulations 2550.404c-1(b)(3), available at https://www.law.cornell.edu/cfr/text/29/2550.404c-1. The US Department of Labor explained that the risk and return spectrum while at the same time minimizing the risk presented by their portfolio See preamble to the final regulation, 57 US Federal Register 46906, 46920 (Oct. 13, 1992). investment alternatives are sufficient to provide the participant with a reasonable opportunity to: (a) materially affect the potential return and the degree of risk in his individual account; and (b) choose from at least three investment alternatives. Further, each of the three alternatives must be diversified, must have materially different risk and return characteristics, and, in the aggregate, they must enable the participant by choosing among them to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant; and, each of the alternatives, when combined with other alternatives, tends to minimize through diversification the overall risk of a See 29 CFR Regulation 2550.404c-1(b)(3). 1992, and our research shows that, on average, 401(k) plans offer participants 25 investment options (when the suite of target date funds is counted as one investment option, 401(k) plans offer 20 options, on average). See page 15 of The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans (2014), available at www.ici.org/pdf/ppr_14_dcplan_profile_401k.pdf (the report extracts data from the annual forms filed with the government; the analysis covers more than 35,000 large (100+ participants) DC plans (primarily 401(k)s)). Question 6: Do stakeholders agree that the default investment option should either be based on a life-cycle strategy with de-risking or be assisted by a guarantee, e.g., a 0% minimum return guarantee? We assume that the dichotomy in this question arises from the understanding that the purpose of a default life cycle investment strategy or the use of minimum return guarantees during the accumulation phase is to alleviate the impact of market risk on retirement savers. See page 130 of the OECD Pensions Outlook 2012. We agree that a life-cycle strategy is an appropriate default investment option for retirement savings. We reject the recommendation that the LCS should be accompanied by a mandatory guarantee. Guarantees offer benefits, but those benefits come with increased costs. If consumers judge that the benefits outweigh the costs, PEPP providers will have sufficient incentive to offer guarantees. Given that the PEPP would be a supplement to savings in pillars 1 and 2, a mandatory guarantee is not likely to be the best choice for many consumers. 6 In this regard, we refer EIOPA to the OECD work on this issue, outlined in detail in OECD Pensions Outlook 2012. The assessment of whether to introduce investment return guarantees during the accumulation phase in DC plans needs to be done in the context of the overall pension system. If public pensions (and occupational DB plans) already provide sufficient protection, guaranteeing that retirement income will always be above a certain minimum threshold, investment return guarantees may lose some of their purpose. Furthermore, even if public and other DB pensions are low, the value of guarantees in DC plans has to be compared against the cost of providing such guarantees the fee or insurance premium to be paid for the guarantee and their impact on investment strategies (and hence on net of fees, risk-adjusted returns). See Chapter 5, The Role of Guarantees in Retirement Savings Plans, of the OECD Pensions Outlook 2012. With respect to costs, the but even its low cost would represent approximately an additional 1% of contributions compared to the case where there are no guarantees. See page 147 of the OECD Pensions Outlook 2012. In other words, even - for the average investor. Id. Importantly, the PEPP will be a voluntary third-pillar product. Thus, it means that each PEPP investor will already have some type of a 1st pillar promised payment from their Member State, and possibly a promised 2nd pillar payment. Payments from the 1st pillar and 2nd pillar, in most cases, would serve as a minimum savings floor. Thus, the purpose of PEPP is to help an EU citizen generate extra income for retirement. Requiring a guarantee in this option, at the expense of the returns, is likely to make this product much less attractive, which would compromise . However, given the range of retirement systems in the EU, a provider should have the flexibility to offer a guarantee. Question 8: Alternatively, would it be better for all investment options to contain either a life- cycling strategy with de-risking or a guarantee? As we discuss in Question 6, these are the methods to minimize market risks for retirement savers. However, because the PEPP would be a 3rd pillar product, supplementary in nature to pillars 1 and 2, these restrictions on all investment options in a PEPP may make a product less attractive for those EU citizens who would want, for example, a more aggressive investment strategy. Question 10: Considering the fact that the PEPP aims to maximise returns outweighing inflation, should retirement savers be allowed to buy a PEPP if the remaining duration of the product is e.g., only 5 years? As we discussed, this will be a voluntary product designed to supplement other savings, and, therefore, it must be able to accommodate a variety of consumer circumstances. 7 the PEPP proposed in section 4.1 and 4.2 of this paper? Is the level of standardisation sufficient bearing in mind the objective to achieve critical mass, cost-effectiveness and the delivery of value for money? Please see answer to Question 2. Question 19: What do stakeholders think of requiring a cap on the level of costs and charge of PEPPs, or a cap on individual components of costs and charges? We oppose mandatory fee caps for this voluntary product. Fee caps, in the same way as other kinds of price restrictions will distort the market, limiting the supply of investments from which investors may choose and, consequently, potentially driving product fees up rather than down. By contrast, competition (assisted by transparent disclosure) is likely to drive down the fees. By way of example, in the US, average expenses paid by mutual fund investors have fallen substantially over time. See page 92 of 2015 Investment Company Fact Book, available at www.icifactbook.org. On an asset-weighted basis, average expense ratios for equity funds fell from 99 basis points in 2000 to 70 basis points in 2014, a 29 percent decline. Mutual fund expenses have fallen, in part, because of economies of scale and competition. Also, shareholders tend to invest in funds with below-average expense ratios. See Figure 5.3 from the 2015 Fact Book, at page 95, included below. The simple average expense ratio of equity funds (the average for all equity funds offered for sale) was 133 basis points in 2014. The asset-weighted average expense ratio for equity funds (the average shareholders actually paid) was much lower 70 basis points.
