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ICI Global[1] is pleased to submit its response to Consultation Paper on the proposed approaches and considerations for EIOPA's Technical Advice, Implementing and Regulatory Technical Standards under Regulation (EU) 2019/1238 on a Pan-European Personal Pension Product (PEPP). The core of our response is urging EIOPA to get the details of the cost cap right to ensure PEPP is viable as a product.

General comments (response to question 9)

EIOPA's work on RTS and ITS is crucial to ensuring that the newly created PEPP will develop as a successful product that helps EU citizens prepare for retirement. Getting the technical details right is critical if EU citizens are to have a chance at an adequate income after retirement. There is, indeed, urgency in helping EU citizens build their retirement savings when there are grave concerns about the continued sustainability of traditional pension systems (PAYGO and defined benefit). With the PEPP project, EIOPA is at the forefront of defining parameters in a new paradigm where individuals must become more responsible for complementing their retirement income.

As recognised in EIOPA's and the Commission's work over the years, by many national governments, and in a recent report by the European Commission's High-Level Expert Group on pensions, the role of supplemental pensions will only continue to grow, as European demographics continue to challenge adequate income generation from traditional retirement systems. See *Final Report of the High-Level Group of Experts on Pensions*, European Commission (Dec 2019) (*HLG Pension Report 2019*).[2]

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[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US$32.2 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

[2] The report is available at https://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupMeetingDoc&docid=38547.

This new long-term/retirement saving product also can help EU citizens ability to meet their other objectives, for instance their societal preference for sustainable investing. Further, developing robust retirement savings products also facilitates growth of capital markets and can help Europe meet its ambitious sustainable goals. See *HLG Pension Report 2019*; also see *Interim Report of the High-Level Forum on the Capital Markets Union*, A new vision for Europe's capital markets. (Feb 2020).[3]

EIOPA's task is not an easy one and developing standards for equity-based products is a challenge in a political environment where many do not understand how financial markets work. EIOPA must exercise its best thinking to bring forward a structure for PEPP that will facilitate individual retirement savings. If not, it will be an unfortunate missed opportunity that will take years to correct.

EIOPA can only do what the PEPP regulation requires, and the deadline for implementation is short. Moreover, the adopted Regulation reflects compromises at Level 1 that already threaten the PEPP's attractiveness to consumers or providers. We appreciate that there may be an urgent need to revisit the PEPP Level 1 text to address some of the most significant shortcomings. We therefore believe there is a great imperative for EIOPA to adopt a structure or framework for PEPP that will help its viability rather than detract from it.

One aspect that will jeopardise irreparably the launch of PEPP across Europe is the cost cap imposed on the basic PEPP. The cap is an unfortunate political compromise that will limit the types of products and providers that can enter the PEPP market, thereby reducing drastically the range of options that will be available to potential PEPP savers.

Although EIOPA cannot remedy the adoption of the cap by the co-legislators, it has the power to determine what is covered by the cap. As we urge in our response to the cost cap question (question 6), for this product to be useful to EU citizens, EIOPA must exclude certain costs from the cap. These changes are absolutely critical if we want to give the PEPP any chance of success.

We acknowledge that the consultation covers many other topics, such as minimum standards for risk-mitigation techniques and disclosures. These elements are also important to make sure the product delivers on its promise. However, the cost cap is the major issue -- the biggest impediment to the introduction of PEPP. For this reason, we have focused our response on this single topic. We would be interested in further discussing our thoughts on the other topics with EIOPA.

[3] The report is available at https://ec.europa.eu/info/sites/info/files/business_economy_euro/company_reporting_and_auditing/documents/200220-cmu-high-level-forum-interim-report_en.pdf.

We urge EIOPA to do what it can under the Regulation to launch the PEPP for EU savers. We understand that in the coming weeks EIOPA will begin a survey on the attractiveness of the PEPP, and we look forward to engaging with EIOPA.

Getting the cost cap right is crucial for the PEPP's viability (response to question 6)

We advocate that —

- The proposed approach is not "all inclusive" because it excludes the cost of the capital guarantee.

- The cost cap for the Basic PEPP should exclude mandatory advice required for opening any PEPP account.

- Portfolio transaction costs should be excluded from the cost cap.

- EIOPA should look to UCITS market to set realistic expectations for PEPP.

I. The proposed approach is not "all inclusive" because it excludes the cost of the capital guarantee.

Despite labeling its proposal as "all-inclusive," EIOPA's approach is not "all inclusive" because it recommends excluding the cost of capital guarantees. Also, EIOPA's approach must be consistent with the Regulation's language that requires EIOPA to "ensure a fair and equal treatment of the different PEPP providers and their products." (Regulation (EU) 2019/1238 Recitals (55)). Excluding the cost of the capital guarantee is inconsistent with this language.

The PEPP Regulation already reflects compromises that challenge seriously the PEPP's viability, particularly the cost cap for the Basic PEPP. We acknowledge that EIOPA has a difficult task of drafting the RTS for the cost cap provision. We urge EIOPA, however, not to further jeopardise PEPP's viability by steering a particular type of PEPP provider into the PEPP market at the expense of other types of providers.

The consultation appears to embrace a view that products that offer "guarantees" are superior to products that do not offer guarantees, and therefore products with guarantees should receive special treatment. Whether guaranteed products are the best option for all savers is a subjective judgment. Guarantees do not cover the major risk to which EU citizens are exposed i.e., insufficient income for a decent and autonomous life after retirement. We disagree that all PEPP savers will want to forego return on their investment to bolster their account growth (and incur significant costs) in favor of an account that never loses principal and has zero return (actually negative return after costs) despite years of investment.

Instead, PEPP savers should be entitled to select products that work for them and their retirement objectives. A guarantee is a product feature in the same way that a risk-mitigation technique is a product feature. Promoting one type of product over others will distort the PEPP market and limit the availability of choices, which will harm European savers who would benefit from a diverse PEPP market. EIOPA has a great responsibility toward EU citizens in this domain and should not limit preemptively PEPP savers' access to a diversity of products that may be best for them by tipping the scale in favor of guarantee products.

II. The cost cap for the Basic PEPP should exclude mandatory advice required for opening <u>any</u> PEPP account.

The receipt of mandatory advice to open <u>any</u> PEPP account, including the Basic PEPP, is a required feature of the PEPP Regulation. (Article 34(2) of Regulation (EU) 2019/1238). The proposal includes the cost of mandatory advice within distribution costs and subjects such costs to the 1 percent cost cap that applies only to the Basic PEPP.

EIOPA's rationale is that distribution costs, including advice, are too high and that including them in the cost cap would drive down such costs. We are concerned that including advice in the cost cap will not result in lower cost but in savers not receiving the advice that they need. In forcing advice in the cost cap, EIOPA may either limit the type of advice for PEPP savers or reduce the pool of PEPP providers. Specifically, if the cost of advice is more than the fee cap, PEPP providers will have to limit the advice they can provide to fit within the fee cap. Alternatively, if PEPP providers cannot provide the advice required under the Regulation within the fee cap, they will not enter the market. So rather than reducing the cost of advice, EIOPA's proposal will likely cause PEPP savers either to receive less advice or have less choice from whom they can receive advice.

This consequence is even more likely in the context of accounts with small amount of assets as would be the case for PEPP accounts at the start of the program. Based on data referenced in the EIOPA consultation, the average hourly rate for providing financial advice in the United Kingdom was between €87 and €406. Using the lower, hourly UK rate, for example, an investor needs an account balance of at least €8,700 for the cost of *one hour* of advice to fall within the 1 percent fee cap. And this does not even allow for any ongoing fund charges. By limiting the fees for advice, EIOPA may further exacerbate the problem of access to advice for smaller savers. Until PEPP accounts grow in assets over time, the fee cap may prevent providers from entering the market.

EIOPA places substantial emphasis on the fact that advice may be automated, fully or partially, and that automation will allow advice to be provided at lower cost. With time, we will see more automation. However, the anticipation of future automation that may arrive in the advice space should not deprive today's savers of access to advice they wish to purchase.

Finally, some PEPP providers will need to rely on third-party distributors and advisers. In the asset management world, the common paradigm is that fund providers manufacture products and third-party firms distribute them – so the manufacturer has no control over distribution costs (including advice) nor any potential economies of scale in the delivery chain. For those providing only the investment options, the advice costs included in the cost cap may result in providers not being able to offer products because they have no ability to influence the advice costs. As a result, these providers may not even consider entering the PEPP market because they have no way of ensuring that the combined costs of their products and advice provided by others will be within the cap.

We recognize that EIOPA is aiming for the laudable goal of making advice more affordable, but the fee cap would simply reduce the availability of advice to EU savers. To allow PEPP savers an opportunity to access advice and for a diverse group of market participants to provide services to PEPP savers, we urge EIOPA to exclude the cost of advice from the cost cap applicable to the Basic PEPP.

III. Portfolio transaction costs should be excluded from the cost cap.

EIOPA's proposal includes portfolio transaction costs in the list of investment costs subject to the cost cap (see Consultation Paper, at 19, 29). EIOPA defines transaction costs as "actual payments by the PEPP provider to third parties to meet costs incurred in connection with the acquisition or disposal of any asset in the PEPP account," and lists brokerage and currency exchange fees as examples of these fees (see Consultation Paper at 19). EIOPA states that these costs "are passed on to PEPP savers as a reduction of return or assets value or in a fee." (see Consultation Paper at 19-20).

We appreciate the importance of fees and costs to PEPP savers and believe they should be provided with information to understand the fees and costs they incur including transaction costs. Transaction costs should not be part of the 1% cost cap because of the practical difficulties in quantifying these costs, and the cap will unnecessarily constrain the ability of PEPP providers and their asset managers to manage portfolio investments. We recommend that portfolio transaction costs should be disclosed to investors—as is the case in the UCITS KIID and PRIIPs KID.

Transaction costs may be incurred when assets are bought and sold. Examples of costs include explicit costs, such as exchange fees and transactions taxes, and implicit costs incurred through market impact (e.g. when trading at volume).

As a practical matter, experience with PRIIPs KIDs has shown that quantifying transaction costs is a difficult and challenging endeavour that at times can produce results that are difficult to understand (e.g. negative transaction costs). Furthermore, transaction costs by their nature vary over time, particularly in volatile markets and because of variances in a PEPP's portfolio of assets (e.g. turnover, net sales or purchases of assets if transaction costs are not symmetrical). These characteristics present significant challenges for advanced forecasting of transaction costs for the purpose of a fixed cost cap.

In addition, including transaction costs in the cost cap could hinder the ability of asset managers to manage the portfolio by discouraging trading. Managers of lifecycle funds, a permissible investment structure, will need to rebalance their asset allocations periodically incurring transaction costs. Including this fee in the cost cap could hamper the ability of the asset manager to execute on its objective.

IV. EIOPA should look to UCITS market to set realistic expectations for PEPP.

UCITS is a globally-recognised successful product for retail investors with "well-established and trusted legal framework" as recently described in the Interim Report of the High-Level Forum on the Capital Markets Union.[4] UCITS provide many important advantages to European investors, including professional management services, access to global markets, diversification of risks, benefit of regulation and supervisory oversight, and access to a wide array of investment options via "passporting."

The UCITS market is mature and competitive, and the existing UCITS market is a good point of reference as EIOPA crafts a realistic and sensible framework for the PEPP, particularly with respect to the costs and charges.

Life-cycle funds, which are explicitly identified in the Regulation as a viable Basic PEPP option, primarily invest through a fund of funds structures similar to UCITS funds of funds. We explore the unbundled costs for these types of funds to determine whether EIOPA's proposed "all-inclusive" approach to the cost cap is a realistic one in the current marketplace.

Unbundled means that the ongoing charges do not include any fees intended to pay for distribution (including advice). In addition, ongoing charges, using EIOPA nomenclature, include the cost of administration, the cost of safekeeping of assets, and other costs. Ongoing charges, unlike EIOPA's proposed definition, do not include costs related to portfolio transactions and one-off costs such as entry, exit, and switching costs.

The ongoing charges for UCITS funds of funds are commonly referred to as "synthetic" ongoing charges—made up of the ongoing charge of the fund of fund itself plus the ongoing charges of the underlying funds (proportional to the assets invested in those funds). The simple average ongoing charge of unbundled UCITS funds of funds themselves was 0.79 percent in 2018. This cost is before ongoing charges for the underlying funds are included to obtain the synthetic ongoing charge. In Table 1, we provide information on current ongoing

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[4] The interim report is available at https://ec.europa.eu/info/sites/info/files/business_economy_euro/company_reporting_and_auditing/documents/200220-cmu-high-level-forum-interim-report_en.pdf.

charges for unbundled retail cross-border equity, mixed, and bond UCITS funds that could serve as underlying funds.

Based on the simple average ongoing charges for unbundled equity, mixed, and bond UCITS, it is quite clear that it would be challenging for current funds of funds to fit under the 1 percent cost cap. Even if the fund of funds were to use index-tracking funds as the underlying funds, the cost cap is still likely to be too restrictive. For example, consider a UCITS fund of funds in which the assets are a 50/50 mix of index-tracking equity UCITS with average ongoing charges of 0.34 percent and index-tracking bond UCITS with average ongoing chares of 0.24 percent.[5] The synthetic ongoing charge for this hypothetical fund of funds would be 1.08 (0.79 percent + 0.5*0.34 percent + 0.5*0.24) exceeding the 1 percent cost cap even before the cost of advice and transactions costs are included.

Figure 1
Percentage of UCITS Share Classes With Ongoing Charges Above and Below 1 Percent Cost Cap
Percent, 2018

	Percentage of share classes with an ongoing charge of:		
Investment objective	≤ 1.00 percent	> 1.00 percent	Simple average
Equity*	36%	64%	1.05
Mixed*	64%	36%	0.98
Bond*	89%	11%	0.75
Memo:			
Index trackers†	**99%**	**1%**	**0.31**
Equity	99%	1%	0.34
Bond	99%	1%	0.24

*Data only include unbundled share classes that exclude any fees intended to pay for distribution.
†Data for index-tracking UCITS include all share class types.
Note: Data include index tracking UCITS but exclude exchange-traded funds. Data exclude UCITS that invest primarily in other funds.
Source: Investment Company Institute tabulations of FITZ Partners data

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[5] Source: Investment Company Institute tabulations of FITZ Partners data

We also consider another hypothetical example. Suppose, as an illustration only, PEPP providers are able to offer a Basic PEPP with an ongoing charge equal to the simple average ongoing charge of UCITS index-trackers (0.31 percent). As discussed in Section II, assume advice costs €87 per hour and that a potential PEPP participant requires one hour of advice in opening an account (e.g. to help the participant select the appropriate PEPP, determine how much to invest initially, and fill out paperwork). If the potential participant wishes to make initial investments of €500, €1,000, €2,500, €5,000, €10,000, or €12,500, even under these very modest assumptions, the relevant charges will exceed the 1 percent fee cap in each case (Figure 2). This underscores that the 1% fee cap is highly restrictive and even low-cost funds would have difficulty meeting the fee cap after advice and other costs are included.

Figure 2:
Costs to Potential PEPP Participants of Investing Would Exceed 1% Fee Cap Even Under Very Modest Assumptions

Initial balance	Average ongoing charge for index funds	Initial cost of advice (1 hour of advice at €87 per hour) as % of initial balance	Total cost to potential PEPP participant as % of initial balance
€500	0.31%	17.4%	17.71%
€1,000	0.31%	8.70%	9.01%
€2,500	0.31%	3.48%	3.79%
€5,000	0.31%	1.74%	2.05%
€10,000	0.31%	0.87%	1.18%
€12,500	0.31%	0.696%	1.006%

Further, there are two additional factors that EIOPA should consider in their examination of the fee cap. First, the amount of net assets in a fund directly affects ongoing charges (particularly fixed costs) because of economies of scale. The problem of scale will be further exacerbated if providers need to create new life-cycle funds as the default investment option in the Basic PEPP. PEPP as a new product will have little starting capital, and it will take time to build assets and realize economies of scale. Until these funds can gather certain level of assets, they will not be able to meet the cost cap particularly if distribution costs (including advice) and transaction costs are included.

Second, cross-border products will likely be more expensive if Member States can impose certain local requirements for their savers. The UCITS presented in Figure 1 were cross-border UCITS domiciled in Luxembourg and Ireland. We looked at these funds because PEPP is intended to be a cross-border product. We note that ongoing charges in cross-border funds tend to be higher than for single country funds because average fixed costs in cross-border funds tend to be larger. Specifically, most countries in Europe impose local requirements on the marketing of cross-border funds, thereby incurring costs for funds in each country in which they are registered and available for sale. There are also additional administration costs to cover the complexity of offering different share classes in different countries, which are often in different currencies.

We hope EIOPA will consider the realities of the UCITS market and define a cost cap that enables market participants to bring products and options that can meet the needs of EU savers. Capping costs at a level that is not realistic risks EU savers having limited solutions that do not meet their retirement needs.