PRIIPs Key Information Document — costs and premiums

Introduction

The Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation aims to ensure that retail investors are provided with accurate, fair and clear pre-contractual information to allow them to compare different investment products[1]. Should the premium for the insurance cover of insurance-based investment products be considered as a cost, the information in the Key Information Document (KID) would be distorted and a proper comparison of PRIIPs would not be possible.

In this context, Insurance Europe believes that it is of the utmost importance that the features of insurance-based investment products are properly taken into account within the PRIIPs KID. Insurance-based investment products have, per se, an insurance cover.

Unlike other PRIIPs, these products provide for:

- Additional benefits and protection, in addition to the investment opportunity, such as guarantee of a given investment performance or a given level of benefits (ensured through solvency requirements).
- Additional benefits and protection, which are not related to the investment opportunity, such as protection against biometric risks (death benefits, occupational disability income, surviving dependants' provisions etc.).

A correct definition of the "cost" term of an insurance-based PRIIP is essential for a useful KID. A sharp and clear distinction must be made between costs and premiums. Premiums — which are payments that directly finance the benefits of a PRIIP — should never be considered as costs. Premiums for protection against biometric risks are not costs, since the retail investor receives insurance benefits for these payments.

Even in theory, risk premiums are not costs.

- Costs are the charges, that do not directly finance the benefit and which cover the expenses and the profit margin of the product designer or of other members of the value chain, such as distributors.
- The risk premium provides retail investors with additional benefits, namely the insurance cover. Risk premiums are calculated according to the actuarial equivalence principle. This ensures that the retail investor receives the equivalent value in insurance benefits in exchange for the risk premium.

In this context, the insurance sector does not support one indicator that aggregates costs and risk premiums. It is believed that such an indicator would be misleading and confusing for retail investors as well as create an unlevel regulatory playing field for PRIIPs:

- In order to compare investment-opportunities, retail investors should be provided with information to be in a position to *compare what is comparable*. The original purpose of the KID was to make substitute products comparable. Insurance-based investment products and pure investment products are, however, not substitutes. Insurance-based investments products have an investment element and an insurance element whereas pure investments products only have an investment element.
- If premiums are included in costs, it would lead to the appearance of systematically higher costs of insurance-based investment products when compared to other products and would create an unlevel regulatory playing field. If premiums are considered as costs the products will appear more expensive than they really are.
- According to research in the field consumers tend to give unbalanced prominence to the costs of a product, which distracts them from other crucial elements such as the insurance cover it comprises.

[1] Recital 15 of the PRIIPs Regulation states that the "*retail investors should be provided with the information necessary for them to make an informed investment decision and compare different PRIIPs ...*".

Therefore, adding insurance premiums in the cost section would only give the consumer a distorted view of the product when compared to other products.

- In practice, the insurance premium cannot be communicated upfront in a pre-contractual phase as:
    - The premium will depend on the personal characteristics of the person that needs to be insured.
    - The premium will also depend on the individual choice of the consumer, i.e. the amount of insurance cover they seek.
    - For unit-linked products, the death cover depends on the development of the funds, which is unknown. Therefore, the actual amount of death cover is also unknown at the pre-contractual phase.

Reduction in yield

Insurance Europe wishes to highlight that the representation of annualised costs together with a "reduction in yield (RIY)" approach is the most appropriate method for the cost representation, which is also very useful and understandable for retail investors. The RIY has two key advantages when compared to the total cost ratio (TCR):

- It takes into account the timing of costs.
- It is not based on the term "average investment", which is not a meaningful term and does not provide relevant information for life insurance products with regular contributions.

Products comparison in practice

In practice, a single indicator would be non-transparent and lead to confusion. Different PRIIPs will not be comparable should both the costs and the risk premiums for insurance-based investment products be included in one indicator. For instance:

- **Example 1**
    - A EUR 10,000 single-investment.
    - On death, the benefit is the value of the investment and an additional EUR 10,000 risk benefit.
    - The retail investor is 60 and the product term is 15-years.
    - The product has a simple 1% p.a. fund management charge and a charge for the risk benefit that is the approximate monthly cost of the cover.

  With this example over 15-years, the RIY is 2.4% p.a. which splits out as 1% p.a. for the investment costs and 1.4% p.a. for the insurance premiums. In this example, only 40% of the total RIY relates to the investment costs with 60% relating to the value of the benefits payable on death. It is, therefore, clear that this product would appear materially more expensive than an equivalent UCIT (undertaking for the collective investment of transferable securities) with a 1% fee.

- **Example 2:**
    - A with-profit life insurance product.
    - The retail investor is 35 and the product term is 30 years.
    - The regular premium is 1000 €/year and the death cover is 30.400 €.
    - The acquisition cost is 4% sum of all premiums and the regular costs is 8% of the premium/year.
        - Its cost indicator is 0,91% RIY.
    - If the premiums for death cover are treated as "costs", its "cost" indicator (together with the risk premium) would be 1,17% RIY (i.e. 30% higher).
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  This example demonstrates that an integrated cost indicator does not provide retail investors with the possibility to actually compare the products adequately.

There are many products that contain important risk cover. These products are also supported by governments with tax incentives in some countries. Retail investors are informed of both the costs and the benefits of the product, so they are fully aware that only part of the product is for investment. If the cost indicator includes risk premiums, then this indicator will be relatively higher than other PRIIPs, and the retail investor will not be in a position to compare the investment part of the different products on the market.

The impact of a misleading cost indicator can be very detrimental to insurers offering insurance-based investment products. Should such a single aggregated indicator be introduced, an insurance-based investment product, which includes an investment element and insurance cover, would be presented as:

- The contribution is 100 €, with:
    - 75 € invested.
    - 25 € for costs.

What is presented to retail investors should rather be:

- The contribution is 100€, with:
    - 20 € is a premium / costs for insurance cover.
    - 80 € for the investment component, with:
        - 75 € invested.
        - 5 € for costs.

In the distorted presentation of the product, the costs for the product would suddenly be five times higher (20 € + 5 € = 25 € instead of 5 €). With such a presentation, a meaningful comparison would be possible neither with a pure investment PRIIP, nor with another insurance-based investment product.

Therefore, the inclusion of the premium of insurance benefits in the cost indicator of PRIIPs potentially disadvantages insurance products in comparison to other non-insurance PRIIPs and may also have a detrimental effect on the design of insurance products as companies may be forced to remove risk benefits in order to better compete.

For more information:

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