EIOPA Methodology on Value for Money Benchmarks

09/10/2024

BRIEFING

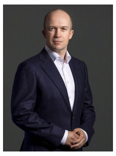
EIOPA recently published its methodology on Value for Money (VfM) benchmarks in relation to unit-linked (UL) and hybrid insurance products. For some time, EIOPA has been reporting on risks arising from the complexity and limited benefits for consumers in respect of UL and hybrid products (see in particular the EIOPA supervisory statement on VfM in 2021 and the methodology to assess value for money in the unit-linked market in 2022, and our previous article).

The objectives of the benchmarks are primarily to assist national competent authorities (NCAs) in identifying products with higher VfM risks and eventually to allow comparability so that insurance product manufacturers can determine if their products will offer value.

There are three steps to the methodology:

1. **Grouping products into clusters** – based on features addressing policyholder needs.
2. **VfM indicators for calculating benchmarks** – for each product cluster based on a list of indicators covering costs and returns.
3. **Data collection and calibration of benchmarks** – benchmarks will be established for each product cluster based on the quartiles of distribution of the indicators.

Key Contacts



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Product-led approach to ensure

comparability

As the market for insurance-based investment products in Europe consists of diverse products and features, EIOPA has developed clustering features to balance the need for comparability against limitations on data collection. The benchmarking exercise will not therefore be performed at a national or European level, rather it is based on product clusters using data from products across all the markets in which they are distributed, to ensure outcomes are consistent across the relevant markets.

What the benchmarks are not

EIOPA makes it clear that benchmarking is intended as a *complementary* activity to the product oversight and governance (POG) process, as market comparisons do not ensure that a given product offers VfM. Product testing should always verify and prove VfM regardless of comparisons with other products in the market.

In addition, benchmarks are not a safe harbour – even if VfM indicators are within the benchmarks, compliance with POG requirements is not waived or proved. Benchmarks should also not be seen or used as price regulation or cost-capping, as benchmarks cannot capture all products' specificities or consumer needs. Nor should they be used as a disclosure tool, given they would not be easy to understand for most consumers.

Clustering features

There are six clustering features, which are further broken down into categories:

Clustering feature	Categories
Product category	– *Unit-linked*– *Hybrid (Type 1)* – allocation between components follows consumer's choice– *Hybrid (Type 2)* – allocation between components follows a pre-determined strategy at inception of the contract
Premium frequency	– *Single*– *Regular*
Recommended holding period (RHP)	– *Short* – less than 10 years RHP– *Medium* – 10 to 20 years RHP– *Long* – more

	than 20 years RHP
Biometric coverage	– *Significant* – where the product provides a significant level of coverage as compared to the premium paid at RHP **–** *Other* – all other cases
Asset class	– *Equity* – complementary identification code (CIC) numbers 41 (equity funds) and 31 (common equity)– *Asset allocation funds* – CIC number 44 (funds that invest in assets that pursue a specific asset allocation objective)– *Rest* – all other asset classes
Summary risk indicator (SRI) – to differentiate between risk of the investments	– *Equity* – SRI 2-4 and 5-7– *Asset allocation funds* – SRI 2-4 and 5-7– *Rest* – SRI 1-2, 3-4 and 5-7

VfM indicators

These 8 indicators cover metrics which are highly relevant to VfM in view of product costs and benefits:

1. Ratio of entry costs to premium.
2. Ratio of entry costs to total costs.
3. Ratio of total costs to total premium.
4. Reduction in yield (RIY).
5. Ratio of surrender value to total premium.
6. Internal rate of return (IRR).
7. Insurance benefit (premium returned if the insured event occurs).
8. Break-even return (the minimum performance of the investments required to break even).

The indicators should be assessed in a comprehensive manner, meaning supervisory judgment and consideration of non-clustering features are necessary.

Setting benchmarks

Benchmarks will be established for each product cluster. Most benchmarks will be set at the third quartile. However, for surrender, IRR and insurance benefit indicators, these will be set at the first quartile (because, as opposed to the other indicators, lower values represent higher VfM risk for these indicators).

Non-clustering features

EIOPA also identifies several non-clustering features – other qualitative benefits which can justify deviation from benchmarks, such as capital guarantees and sustainability features (which might justify higher costs or lower returns).

The VfM methodology should bring some welcome clarity in terms of regulatory expectations on VfM for UL and hybrid products. However, as the benchmarking exercise is intended to be in addition to POG requirements, and the methodology allows for a degree of subjective assessment on the part of EIOPA and NCAs, there will likely be an additional compliance burden for insurers offering these products as a result.

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