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## **'Value for Money': Meaning, Function, Role in Unit-Linked Product Regulation and Beyond**

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### **1 Introduction**

*Prices for products that 'are not worth the money'*. Supervisory authorities charged with the protection of the economic interests of the public often scrutinize the price-value relation when supervising product prices. Some authorities exercise a broad mandate protecting 'consumers' on the basis of consumer protection law, while other authorities have a narrower mandate, focusing on 'investors' or 'policy holders' on the basis of sectorial regulation. Ultimately, they have in common that they police prices charged by companies for products using standards that compare the costs to retail customers against the benefits enjoyed by them, or more broadly, the distribution of economic surplus between companies and their customers<sup>2</sup>. The notion of **value for money (VFM)**, recently revamped by the European Insurance and Occupational Pensions Authority (**EIOPA**), is a standard designed with a similar purpose in mind. VFM has become even more topical since it seems that the European Commission (**EC**) may incorporate the notion in its Retail Investment Strategy, to appear in Q1 2023. Therefore, the purpose of this note is to provide a brief overview of the notion's meaning (par 2), function (par 3) and role in the regulatory system (par 4).

### **2 Meaning**

In common parlance, 'value for money' refers to the relation between the value of a good or service and the price paid for it. 'Good value for money' means that a lot is offered for the amount of money paid (the product is worth the money), whereas 'poor value for money' means that the value of the product is (much) higher than the price (the product is not worth the money)<sup>3</sup>. Assessing the value of a good or service is not straightforward. For complex services where the benefits are subject to external market events, dependent on third parties and only received in the future (e.g. investment services), the assessment is more difficult than for commodity-like goods that are received immediately after payment (e.g. oats sold on a street market). As a result, in practice the valuation of investment products requires modelling, estimation under uncertainty and benchmarking, making it hard to put a single value on those products. EIOPA has introduced the notion of VFM in the context of unit-linked products, under the product oversight and governance requirements of the Insurance Distribution Directive (**IDD**)<sup>4</sup>. As a refresher, unit-linked products are insurance-based investment products that offer both insurance coverage and investment exposure. Premium payments by policyholders are split between insurance coverage (e.g. life, critical illness, disability) and contributions to pooled investment vehicles (with other policy holders)<sup>5</sup>. The unit-linked component of the product thus allows policyholders to invest in unit-linked assets, such as

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equity or bonds, that generate a return to be paid out to the policyholder in accordance with the product's policy<sup>6</sup>. In the view of EIOPA, VFM means that the 'costs and charges of [unit-linked] products are proportionate to the benefits (i.e. investment performance, guarantees, coverage and services) to the identified target market as well as reasonable, taking into account the expenses born by the providers'.<sup>7</sup> Thus, EIOPA uses two familiar normative concepts to compose the standard with which costs are measured: proportionality and reasonableness<sup>8</sup>. The costs and charges for consumers essentially constitute prices charged by the product providers (e.g. fees) and prices charged by third parties (which are expenses of the providers). A quick comparative note: EIOPA's notion of VFM shares similarities with VFM as used by the Financial Conduct Authority (FCA). FCA uses VFM in its rules governing pensions, in which it provides that the charges and costs are 'likely to represent value for money when the combination of the charges and costs, and the investment performance and services are appropriate, (i) for the relevant policyholders or pathway investors, and (ii) when compared to other reasonably comparable options on the market'<sup>9</sup>. Just like EIOPA, FCA considers that VFM requires that the price paid is reasonable compared to the benefits received<sup>10</sup>.

### 3 Function

The notion of VFM is intended to function as a standard that national competent authorities (NCAs) can use to supervise the costs of unit-linked products to consumers, hence, essentially for the purposes of price regulation<sup>11</sup>.

#### 3.1 Standard for price regulation

The notion of VFM is central to the enforcement by EIOPA of the product oversight and governance rules in the IDD. To be clear, there is no express requirement to provide VFM in the Level 1 and Level 2 POG provisions of the IDD. Rather, the use of VFM is based on EIOPA's interpretation of the obligation of manufacturers to design products that are 'aligned with the target market's needs, objectives and characteristics'<sup>12</sup>. In its supervisory statement, EIOPA clarifies that VFM is not a bright-line price restriction<sup>13</sup>. The rule and its implementing guidance are not aimed at 'interfering with business decisions (including pricing levels)', but to assess whether the process followed is customer-centric and tests the value of the product to the target market, 'balancing profitability aspects with fairness and with the services and benefits offered, whilst taking into account that products need to be sustainable also from a pricing perspective'<sup>14</sup>. Thus, VFM is in fact an open norm that requires the balancing of competing interests of manufacturers and customers, to identify products that risk providing insufficient VFM (VFM risk). In order to show that they have assessed VFM risks in their products, manufacturers should be able to present a structured pricing process<sup>15</sup>. EIOPA suggests that NCAs scrutinizing the market for unit-linked products use three layers of supervision. *Layer I* requires a market-wide assessment to identify outliers (undertakings or their products) that merit higher scrutiny because of the costs-returns trade-off<sup>16</sup>. *Layer II* involves an enhanced product analysis to identify instances where products do not offer value in general or to their specific target market, by testing product profitability or analysing PRIIPs KID documents<sup>17</sup>. If (1) the product does not offer value at all, (2) the costs are too high for any consumer or (3) the target market does not get any benefit from the product under any reasonable scenario, the product provides poor value and should not be marketed<sup>18</sup>. *Layer III* entails a final assessment of the products that may offer VFM. This assessment focuses on whether (1) the costs are due (i.e. a balancing of the interests between the value of the products and the target market was duly made in the pricing process), and (2) the

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services or the product features for which the costs are made are aligned with the needs, objectives and characteristics of the target market<sup>19</sup>.

### 3.2 Due costs

The notion of (un)due costs is thus one of the pillars of VFM. This notion is not unique to VFM, however: it is also used elsewhere in financial services regulation, for similar purposes. For example, the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive<sup>20</sup> and the Alternative Investment Fund Managers Directive<sup>21</sup> (AIFMD) both refer to the standard. The UCITS Directive provides that management companies of UCITS must act in the best interests of the UCITS, a duty that has been particularized by requiring that these companies act in such a way as to prevent undue costs being charged to the UCITS and its unit-holders<sup>22</sup>. Similarly, the AIFMD prevents AIFMs from charging the AIFs they manage or the investors in these AIFs undue costs, again derived from the obligation to act in the best interests of the AIFs or the investors of the AIFs they manage<sup>23</sup>. The European Securities and Markets Authority (ESMA) has published guidance on the notion of undue costs in a supervisory briefing<sup>24</sup>. According to ESMA, whether costs are undue depends inter alia on whether (1) the costs are linked to a service provided in the investor's best interest, (2) the costs are proportionate compared to market standards and to the type of service provided, (3) the fee structure is consistent with the characteristics of the fund, (4) the costs borne by the fund are sustainable taking also into account the expected net return of the fund, and (5) costs are duplicated<sup>25</sup>. Thus, similar to EIOPA's interpretation of due costs, ESMA compares the costs against performance and assesses their relation to the service for which they are charged.

### 3.3 Regulatory diffusion

As discussed, the EC is contemplating the inclusion of VFM in its Retail Investment Strategy. This intention can also be read in a recent report on retail investments commissioned by the authority, in which the impact of current rules on VFM is considered on multiple occasions.<sup>26</sup> The EC had already expressed concern about costs in the Capital Markets Union Action plan that announced the development of the strategy, writing that an individual investor should 'benefit from [ ] open markets with a variety of competitive and *cost-efficient* financial services and products'<sup>27</sup>. The potential inclusion of VFM has been vocally supported by NCAs<sup>28</sup> and NGOs<sup>29</sup>, but not all stakeholders are pleased with the notion<sup>30</sup>. If VFM is indeed adopted by the EC in its Retail Investment Strategy, this adoption could be considered an example of 'regulatory diffusion', i.e. the adoption of a rule by supervisory authority that is substantially similar to a rule previously adopted by another supervisory authority<sup>31</sup>. Diffusions can be useful, provided that the rule really fits in the overall scheme and underlying policy objectives of the new regulation.

## 4 Role

Before I conclude, it is worthwhile to categorise the role of VFM in the vast and colourful tapestry of European Union financial and consumer protection regulations. VFM, as used by EIOPA, is essentially a form of ex post price control standard. It does not function as an ex ante price cap (a rule promulgated by a legislator or regulator setting an express maximum level for prices), but it allows NCAs to review prices after they have been set by manufacturers by balancing interests, product features and circumstances. In this sense it is substantially similar to other ex post price control standards, such as the 'unfairness standard' under the Unfair Contract Terms Directive (UCTD)<sup>32</sup>. The unfairness standard in the UCTD

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also captures both proportionality and reasonableness in the notion of ‘significant imbalance’ (as it applies to pricing)<sup>33</sup>, but applies to contract terms and has a broader scope of application (all consumer contracts). That being said, manufacturers of unit-linked products may be faced with enforcement actions based each of the standards, depending on their implementation in the national regulatory context and the circumstances.

## 5 Conclusion

To sum up, the ‘value for money’ notion defined by EIOPA is a normative standard designed to assess and police the price-value relation of unit-linked products. It is not intended to be prescriptive or cap prices across the board, but to weed out products that are prohibitively costly. To this end, pricing by manufacturers must reflect a balancing of interests. The notion and implementing guidance rest on familiar notions, in particular reasonableness, proportionality and due costs. Value for money has the role of an ex post price control standard, similar to other standards such as the ‘unfairness standard’ in Article 3.1 of the Unfair Contract Terms Directive, even if its formal status is guidance, not legislation. Given that the notion is likely to be incorporated in the European Commission’s Retail Investment Strategy and by extension diffused to other areas of retail financial services regulation, it will be important to follow its implementation in the administrative practices of supervisory authorities across the Union.

1 Attorney, PhD candidate and regulatory counsel. This note is written on personal title.

2 For instructive reading see e.g. Niamh Dunne, ‘Regulating prices in the European Union’, 37 Yearbook of European Law, 344-394.

3 Cambridge Dictionary, ‘value’ (<https://dictionary.cambridge.org/dictionary/english/value>); Oxford Learner’s Dictionaries ([https://www.oxfordlearnersdictionaries.com/definition/english/value\\_1](https://www.oxfordlearnersdictionaries.com/definition/english/value_1)).

4 Article 25 of Directive (EU) [2016/972](#) and Articles 4, 5, 6, 7 and 8 Commission Delegated Regulation (EU) [2017/2358](#).

5 EIOPA, ‘Report on Thematic review on monetary incentives and remuneration between providers of asset management services and insurance undertakings’, ‘EIOPA-BoS-17-064, 26 April 2017, 10.

6 Ibid.

7 EIOPA, Supervisory Statement, ‘On assessment of value for money of unit-linked insurance products under product oversight and governance’, EIOPA(2021)0045739, 30 November 2021, par 3.2.

Suggestion for further reading: Katherine Young, ‘Proportionality, Reasonableness, and Economic and Social Rights’, in Vicki C. Jackson and Mark Tushnet (eds), *Proportionality: New Frontiers, New Challenges* (Cambridge University Press 2017), 248-272.

9 COBS 19.5.5A(1)(a).

10 FCA, ‘Final non-Handbook Guidance for firms on the Consumer Duty’, FG22/5, July 2022, Section 7.

EIOPA’s methodology implements its supervisory statement, which was issued on the basis of its competence to develop new practical instruments and convergence tools to promote common supervisory approaches and practices (Article 29.2 Regulation (EU) No [1094/2010](#), and EIOPA (n 7), par 2.6: ‘designed to assist competent authorities in supervising the manufacturers’ and distributors’ POG implementation’).

12 EIOPA (n 7), par 2.5.

13 EIOPA (n 7), par 2.6.

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EIOPA (n 7), par 2.6-2.7; EIOPA, 'EIOPA's approach to the supervision of product oversight and governance', 8 October 2020, par 4.2. In this respect, it is similar to FCA ('We are not seeking to cap the prices or margins of products'), see FCA (n 10).

15 EIOPA, 'Methodology to assess value for money in the unit-linked market', 31 October 2022, EIOPA-BOS-22/482, par 3.3.

16 EIOPA (n 15), section 1.

17 EIOPA (n 15), section 2.

18 EIOPA (n 15), section 3.

19 Ibid.

20 Directive 2009/65/EC.

21 Directive 2011/61/EU.

22 Article 14(1)(a) and (b) UCITS Directive and [Article 22](#)(4) Commission Directive 2010/43/EU implementing the UCITS Directive.

23 Article 12(1)(b) AIFMD and [Article 17](#)(2) Commission Delegated Regulation (EU) No 231/2013 supplementing the AIFMD.

24 ESMA, Supervisory briefing on the supervision of costs in UCITS and AIFs, 4 June 2020, ESMA34-39-1042.

25 ESMA (n 24), par 19.

26 DG FISMA, Final report 'Disclosure, inducements, and suitability rules for retail investors study', May 2022 (Kantar Public).

27 CMU Action Plan, Brussels, 24.9.2020, COM(2020) 590 final, par 1.3.

28 AMF France, 'Retail investors: Make Targeted Adjustments to the European Framework to Improve Their Access to Capital Markets', position paper, October 2021.

29 Finance Watch, Response to EC's consultation on a retail investment strategy for Europe, 30 July 2021.

30 For example, Insurance Europe, 'Response to EIOPA's consultation on a framework to address value for money risk in the European unit-linked market', COB-PRI-21-055, 16 July 2021.

31 Jennifer Nou & Julian Nyarko, 'Regulatory Diffusion', 74 Stanford Law Review 857.

32 Article 3(1) Directive [93/13/EEC](#).

33 See for example Case C 621/17 Gyula Kiss and CIB Bank Zrt. v Emil Kiss and Gyuláné Kiss [2019], par 55.

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