DEVELOPING LONG TERM RETAIL INVESTMENT

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Drawing from national experiences to increase EU long-term retail investment

EU citizens' savings are abundant, but allocated to low risk instruments. In 2022, the EU had accumulated EUR 33.5 trillion in household savings, but these were quite largely composed of currency and deposits (34.1%)[1]. Increasing long-term retail investment might offer better returns for EU citizens, and finance the EU's engines of long-term growth.

Several policy avenues can contribute to it. Developing financial education is a consensual lever to empower EU citizens into making more informed investment decisions. It made its way into most recent reports on the future of the Capital Markets Union[2]. This is also a long-term effort, albeit financing needs are immediate. Where appropriate, easing regulatory requirements so that the industry may develop and recommend attractive long-term financial instruments products may be a good avenue.

We should in any case ensure that retail financial products have strong governance and transparency requirements, and provide good value for money, as introduced by the RIS. Finally, reviewing the tax treatment of long-term retail investment products can steer EU citizens' investment decisions. Successful domestic experiences from a number of Member States3 show that this may be the most promising policy avenue.

In France, the Plan d'épargne en actions (PEA) is a regulated savings product which enables retail investors to invest in, and manage a portfolio of EU company shares over the medium and long term, while benefiting from tax benefits. At the end of 2022, the number of PEA securities accounts stood at 5.2 million, amounting to total assets of EUR 101 billion[4]. Taxation being the remit of Member States, it is crucial that they closely cooperate in designing their respective long-term retail investment schemes. For this reason, the Noyer report[5] advocates for EU-wide monitoring in order to encourage national reforms while building on common principles to develop long-term savings products with similar features. Moreover, as soon as public funds are involved - for instance through capital gains tax exemptions - it seems legitimate for governments to require a certain share of investment into EU securities. Insofar as this scheme is optional, and retail investors are free to invest in non-EU securities or funds with exposures in non-EU markets, there is no basis for dismissing such policy measure. In light of this, rather than a single financial instrument, or yet another label, a package with an attractive tax treatment stands out as one of the best ways forward to develop long-term retail investment while financing the EU industry.

In parallel, a complementary approach revolves around the development of employee share ownership among EU companies. This is widely implemented in France through corporate mutual funds, but remains under-developed throughout the EU. In 2019, about 65% of EU firms did not provide any form of financial participation to their employees[6]. Developing employee share schemes at the EU level could substantially increase EU citizens' participation in capital markets, as well as favouring a culture of ownership. This policy measure enjoys strong support among European financial markets regulators[7]. At the EU level, its design could range from a voluntary framework recognized throughout Member States, to Enrico Letta's ambitious EU-wide auto-enrolment Long-Term Savings Product[8].

A package with an attractive tax treatment stands out as one of the best ways forward.

Successful national experiences in implementing tax packages and employee share schemes provide the templates to fuel long-term retail investment in the EU. In turn, this should yield higher returns for EU citizens, as well as channelling funds into the EU's most strategic sectors.

1. *Eurostat, 2023.*
2. *Recommendation 7 in ESMA Board of Supervisors' position paper "Building more effective and attractive capital markets in the EU".*
3. *PEA in France, Bertiebsrente in Germany, pension funds in the Netherlands, PIR in Italy, ISK in Sweden.*
4. *Banque de France, 2023.*
5. *In January 2024, Finance Minister Bruno Le Maire entrusted a committee of experts chaired by Christian Noyer with the task of formulating concrete proposals to relaunch the Capital Markets Union.*
6. *ECS (European Company Survey) for the European Commission "The Promotion of Employee Ownership and Participation", 2014.*
7. *Recommendation 6 in ESMA Board of Supervisors' position paper "Building more effective and attractive capital markets in the EU".*
8. *Report "Much more than a Single Market".*

CHRISTIAN NOYER
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Building a real Savings Union to finance the future

Europe is experiencing a significant financial paradox: while it holds vast savings and faces enormous long-term financing needs in the coming years, especially for the green and digital transitions, these savings are poorly allocated.

While the European Commission estimates that the EU will need to invest over €800 billion annually by 2030, European households held €35.533 trillion in savings in 2022, nearly double the EU's GDP, and savings represented an average of 13.3% of gross disposable income for European households, compared to just 7.9% in the United States. Therefore, this substantial pool of savings should greatly support Europe's strategic priorities.

However, despite this abundance, European household savings are not effectively directed towards financing the European economy over the long run. Most of these savings are tied up in liquid and guaranteed products, limiting the amount available for higher-risk equity investments, such as listed stocks. These products alone are insufficient to meet the long-term investment needs necessary for Europe's green and digital transitions.

The inefficiency in the allocation of European savings largely stems from the nature of savings products and their tax frameworks, which often discourage long-term investments. Banks and insurance companies predominantly offer liquid and guaranteed products, making it challenging to channel savings into riskier assets like equities, which are crucial for fostering innovation and growth.

Therefore, it is more important than ever to foster the development of long-term savings products at the European level to address the significant financing needs ahead. This calls for a new Savings and Investments Union, focusing on a limited set of transformative reforms.

Given the failure of the PEPP, the variety of existing products, and the complexity of national frameworks, a decentralized approach based on shared principles and implemented domestically by willing Member States seems more relevant. Specifically, introducing a new category of European savings products with a common label could be effective, with Member States potentially modifying existing products or creating new ones to fit this framework.

To channel European savings effectively towards long-term financing, several core principles should be included in the label criteria.

First, these products should emphasize a long-term investment horizon. Restricting liquidity is essential to meet long-term investment needs, especially for riskier equity investments that are crucial for innovation, competitiveness, and growth. However, some degree of flexibility should be built in to address savers' concerns about accessing their funds.

Second, risk exposure needs to be carefully managed. Labelled products should not offer a permanent capital guarantee but could provide a form of guarantee at maturity. Offering a full, non-time-bound capital guarantee would severely limit the ability to invest in high-risk assets, such as equities.

Third, investment allocations should be managed according to investment horizons. While savers should be able to manage their savings themselves, labelled products should offer the default option of being actively managed according to the investment horizon. This approach would ensure that assets are allocated based on savers' risk profiles, with a gradual shift towards lower-risk investments as the maturity date approaches.

Fourth, involving employers could be beneficial. Labelled products should be available through collective, company-provided schemes, featuring automatic enrolment and possible regular contributions. This would help employees build up their savings more easily and provide a larger pool of funds for long-term investments.

Therefore, it is more important than ever to foster the development of long-term savings products at the European level to address the significant financing needs ahead. This calls for a new Savings and Investments Union, focusing on a limited set of transformative reforms.

Fifth, an attractive tax regime is crucial. Labelled European savings products should benefit from favourable tax treatment compared to other national savings products. This would make them more appealing to a broader range of savers and help generate the resources needed for long-term investments.

Lastly, a significant focus on European assets in the investment allocation is recommended. Investment criteria should be straightforward to facilitate product development, with a primary requirement being a minimum investment threshold in European assets, such as 80%. Generally, any product offering advantageous tax benefits should be subject to investing in European assets.

Recent calls from the Eurogroup to develop attractive, cost-effective, and simple cross-border investment and savings products for retail investors, combined with ongoing discussions among Member States, highlight the urgency of this initiative. A new European savings label could unlock significant long-term investment flows and help address Europe's pressing financing needs.

FAUSTO PARENTE

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Simpler and better value products to enhance trust, increase retail investment

Although Europeans save more than their American peers, they remain worried about their financial situation at retirement. In 2022, the EU saving rate was at 12.7%, compared to 3.7% in the US.[1] Despite this relatively high savings rate, only 42% of Europeans feel financially confident in their retirement, with confidence levels varying significantly by gender – 37% of women and 47% of men, according to EIOPA's 2023 Eurobarometer Survey.

The high EU saving rate shows potential for increased direct retail participation in capital markets. Nevertheless, more efforts are needed to ensure that Europeans have access to a broad range of long-term saving products which offer value for money. This includes insurance-based investment products, life insurance and personal pension products. The Survey also shows that European consumers who save through these products tend to feel more secure about their retirement.[2]

Increasing retail investment in capital markets requires a higher level of consumer trust in product providers (currently, consumer trust in insurance manufacturers is 45%, while trust in pension providers is 38%).

Therefore, it is important that consumers are offered choices that are simple, transparent and easy to understand, including regarding key trade-offs such as safety versus potential for higher returns, liquidity versus better long-term returns.

Products must align with consumers' needs and objectives and offer value for money. Products with low returns and high costs (about 15% of the products within EIOPA's Costs and Past Performance sample) can significantly impact consumer trust.

The digital transformation of the insurance and pensions sectors is creating new opportunities by lowering costs and enabling the development of increasingly tailored and personalised offers that better meet individual needs. Providing Europeans with insurance-based investment and pension products that deliver adequate and sustainable returns can also contribute positively to capital markets more broadly.

Beyond the core objectives of delivering adequate, safe and sustainable returns, increased insurance and pension savings can supply the capital needed to finance the long-term growth of the real economy and its green and digital transitions, while ensuring diversification of investments across the continent.

To improve returns and close pension gaps, consumers would benefit from more diversified savings.

The increased choice and availability of products and the range of product features can sometimes feel overwhelming for consumers, making it crucial to simplify and clarify options to avoid confusion. Hence, it is important to promote the development of simpler products informed by behavioural insights, focusing on how consumers perceive and understand product features.

Enhancing the governance of conduct risks by assigning clearer responsibilities on the boards of insurance undertakings and pension providers would help ensure that, throughout their lifetime, long-term products offer consumers value in line with their needs and objectives.

We must also streamline the distribution process. Incorporating new technologies such as AI, machine learning, and open finance can facilitate this. These tools allow insurance distributors to obtain information about customer needs indirectly, reducing the number of touchpoints during the pre-contractual phase and delivering a more effective purchasing process which fully considers the needs of consumers.

To facilitate innovation while protecting consumers, robust and impactful conduct of business supervision is a must, avoiding "one-size fits-all" blanket measures. It is important to swiftly and decisively identify and address cases of misconduct, using appropriate enforcement measures, including those that cover cross-border business activities.

Increased cross-border activities by insurers and pension providers can deepen the Single Market by providing consumers with a wider range of investment opportunities for their savings and pensions. Citizens must trust that rules are enforced consistently throughout Europe. When national supervisors are unable or unwilling to act, the supervisory framework needs to allow for swift remedial actions at European level to address consumer detriment.

1. *Eurostat, Household statistics; Bureau of Economic Analysis*
2. *Amongst respondents with an occupational pension scheme and/ or a private/ personal pension product, 53% report feeling confident in their retirement. In comparison, only 38% of those who rely on a State pension report being confident in their retirement.*

LUÍS LAGINHA DE SOUSA

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Capital markets and retail investors, a vital attraction!

The PEPP hesitant evolution clearly shows that the success of a new product in financial markets depends on a variety of complex factors. This does not mean that financial innovation should not be pursued, especially considering that investing in the capital markets can provide solutions to challenges faced by European citizens, such as achieving an adequate level of income after active working life. Indeed, the context of an ageing population, alongside contributory and pay-as-you-go social security systems, creates a critical setup where savings products must be an area of focus in deepening capital markets, for the benefit of people.

The proposal for a decentralized approach for pan European savings products based on national products that meet common criteria, allowing Member States to adapt or create new savings products as needed, deserves consideration and may point the way to developing a product that truly attracts retail investors across Europe.

The relevance of introducing new long-term investment products is also related to the need to channel savings into investments that can boost the European economy. The proposal in the Letta Report to create a "Union of Savings and Investments" to unlock the potential of the single market underscores this second aspect. This union aims to promote long-term savings products predominantly invested in European assets, aligning with the EU's green and digital strategic transition goals.

However, if Europe aspires (and it should) to use its example to play a more relevant and influential role in the world, the goal shouldn't be to trap European's investment in Europe, but rather to win over investors to Europe based on the attractiveness of the risk-reward-cost balance products on offer.

We know that Europe has increasingly exported savings to other geographies. And the fact that investors seek diversified investment solutions may, indeed, be positive from an individual standpoint, including from the perspective of risk diversification. It may even be advantageous from a collective standpoint, since Europe's sustainable development also depends on the development of other geographies to which European investors channel their savings.

Therefore, establishing a "Fortress Europe" in financial markets, however appealing it may seem (particularly in an increasingly complex and belligerent world), is not a path that best serves Europe's long-term interests. Developed capital markets are certainly open, interconnected, and global. By encouraging investments both within and outside Europe, the European Union can strengthen its global position, positively influence the global economic landscape, and promote a more balanced geopolitical scenario.

The goal shouldn't be to trap European's investment in Europe.

Nevertheless, it is also clear that the deficit of European retail investment in European companies can represent a missed opportunity for better returns and also limit the financing available for these companies, not only for the large ones, but also for those starting up or on their way to becoming large.

Thus, alongside adequate retail products, it is necessary to promote the reduction of friction costs in the investment of European savings in financial instruments, as those costs usually translate into a significant loss of profitability and therefore negatively influence the investment decision.

Among these costs, taxation costs are clearly not negligible and require adequate calibration. However, instead of focusing solely on incentives - which admittedly are, most times, gamechangers, but also face political resistance -, it may be more effective to adopt an approach of "neutralizing" tax distortions between different forms of financing. These distortions result in an inefficient allocation of resources, where debt investments are often favoured over equity investments.

It is also crucial to promote a culture where large investments and high returns are not seen as a threat or as something negative, but as an opportunity for society. Creating an environment that celebrates financial success can encourage more individuals to invest. This can also be incentivised through financial education campaigns that highlight the benefits of long-term investments, of a more balanced financing and savings structure, not as reliant on bank deposits, and of a resilient and innovative business fabric for economic growth and shared prosperity.

A balanced approach that includes cost reduction, robust financial infrastructure, attractive retail targeted products and financial education is certainly needed to facilitate Europe attracting significant investments and offering competitive long-term returns for its retail investors, as well as a more balanced allocation of its citizens' financial assets.

SILVANA PACITTI
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A client-first philosophy to EU long term investing

The Capital Markets Union (CMU), a visionary project by the European Union, aims to sculpt a healthier financial ecosystem by unifying capital markets across Member States. This is not just about connectivity; it's about democratizing the flow of capital, creating a gateway for (at least part of) the EUR 33 trillion in savings held by EU households to actively fuel businesses and nurture citizen's wealth across Europe.

To propel this vision forward, clever product design is an essential first step. Yet, the CMU initiative also calls for a shift in the EU mindset, championing a culture where investing is as natural as saving, and where the long-term benefits of growing wealth are widely understood and pursued. A cumulative combination of financial education, tax incentives, intuitive digital access and balanced product labelling can effectively support this shift.

Something old, something new

The investment landscape today presents a plethora of products designed to cater to the diverse needs of European investors. These range from mutual funds to pension savings vehicles, each with its own set of features, underlying investment strategies and benefits. Yet, product design on its own does not seem to sufficiently attract retail clients. This prompts the question: what more can be done?

Looking ahead, the focus should be on enabling product innovation, particularly to meet new retail client's investment preferences, but also on elevating existing investment solutions. Issues such as portability of investments across borders and the need for harmonized, more attractive tax treatments for long-term investments are obstacles that need to be addressed. These challenges require not only a solid and constructive commitment from Member States, but also a collaborative effort between European policymakers, regulatory bodies, and industry stakeholders to create a more coherent, accessible environment for present and future retail investors.

Recent regulatory advancements, such as ELTIF 2.0, are milestones explicitly aimed at nurturing a culture of long-term investment. Patience is key as we allow for this promising vehicle to take root, allowing asset managers to continue to innovate within the new regime. With these enhancements in place, the necessity for additional pan-European products catering to a similar need diminishes. On the other hand, introducing appropriate labelling could effectively serve as a navigational aid, helping investors to identify – and more easily access – products that align with their investment goals and risk appetite.

Product optimisation, balanced labelling, tax incentives and literacy bring us closer to our goal.

While product labelling can serve as a signpost for quality and trust, it can also carry unintended consequences. Labels can inadvertently create misconceptions about unlabelled products or add to the complexity that investors face when making financial decisions. It is, therefore, essential to approach labelling with care.

"Client-first" philosophy

This also applies to the criteria to access such a possible label, which should be driven by a "client first" philosophy. In fact, the main goal for any asset manager when designing a product is to cater to the needs and financial objectives of our clients. The possibility to reasonably diversify investments beyond the EU is crucial to create a well-balanced and risk-weighted portfolio, capable of delivering sustained long-term returns for our clients. More intuitive digital distribution options should be also explored and supported for significantly wider distribution reach.

No participation without education

Regulatory and policy initiatives are commendable, yet they alone may not suffice in attracting retail investors to capital markets. For these individuals to truly engage in this arena, they must be given the tools to appreciate the nuances and opportunities that investing offers. This is where financial education plays a pivotal role. It is especially important for retail investors to understand the value and risk propositions of long-term investments, which may require them to lock away their savings without immediate access or flexibility. However, the benefits of long-term investments and the higher chances of financial gain that come with the long-term element should be promoted by Member States.

Conclusion

Each stone laid in the form of tax incentives, product optimisation, digital distribution and educational initiatives brings us closer to a market that caters to all. This journey is not about constantly reinventing the wheel but refining it to roll more smoothly – ensuring every step we take is imbued with attractiveness, simplicity, and a steadfast commitment to putting clients first.

MARTIN PARKES

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Strengthening retail investment and long-term savings in the EU

European retail investors are increasingly drawn to innovative solutions harnessing digital technologies and communication tools, with better transparency, and easy to set up investment accounts. EU investors are served by a diverse market of suppliers ranging from neo-brokers and neo-banks to traditional branch-based bank networks building out their digital offerings with new ways to meet the financial planning needs of European retail investors.

The product tool kit in Europe is already very broad with traditional UCITS and the fast-growing ETF sector giving access to publicly traded assets. This allows Europeans to achieve their investment goals by investing in successful global and European companies, innovative future champions, while reflecting their sustainability preferences such as transition investing. Retail investors have now a greater choice of tools to build diversified portfolios and manage risk.

Most recently, the ELTIF 2.0 opens the door to retail access to private assets – these include investment in infrastructure, innovative small and medium companies and private debt which are essential to the growth of the European economy. While an exciting development, we are still at the initial stages of ELTIF rollout with considerable focus needed on the education of both retail investors and their advisors.

Future policy action could draw on the success of national long-term savings products: France's Plan d'Epargne Retraite (PER) uses easy to understand life-cycling strategies, and has seen the opening of over 9.8 million accounts. Digital providers have witnessed similar success with ETF savings plans: These offer innovative and easy to use retail access to markets with around 7.5 million trades of €170 on average being executed on ETF savings plans every month. At the European level, the pan-European Personal Pension Product (PEPP) has still to take off. A successful relaunch of the PEPP at scale should take on board the best user features of existing investment solutions.

An essential factor in encouraging the take-up of long-term retirement saving strategies is the roll out of life-cycling strategies, as seen in the French PER or US target date funds. These have proved to be successful in reducing the complexity of making ongoing investment choices by institutionalising the suitability process within the ongoing product design. When paired with tax incentives and/or workplace auto-enrolment strategies these can be highly effective solutions for encouraging regular-term investment. Investing successfully for the long-term means allowing investors to invest across a wide range of assets – incentives to restrict diversification across asset classes, e.g. by favouring equities at the expense of broader exposure to fixed income and private assets or across geographies are likely to be counter-productive over time.

Despite many positive trends, too many European investors still consider that investment is too complicated or simply not for people like them. As an example, a recent OpinionWay survey for BlackRock showed that while 71% of the French population recognises the importance of savings to achieve financial security, 82% found investment products too complex. Future policy actions should tackle these behavioural and operational barriers to simplify the investor experience rather than increasing the number of product categories and labels. Likely success factors include simplicity of access by reducing the number of clicks needed to open basic investment accounts while also encouraging investors to invest regularly on a diversified basis with enhanced educational support. The roll out of fractional share dealing has made it far easier for investors to set up monthly savings plans allowing them to allocate a fixed monthly amount to ETFs and shares regardless of the underlying nominal value. As ESMA focuses on best practices we continue to see divergent positions at national level on the acceptability of fractional dealing – a common approach to this operational utility has yet to fully emerge.

European investors use a wide variety of sources for support before investing, ranging from finfluencers, family and friends, employers to regulated firms. In addition to financial literacy programmes, supportive policy actions may include regimes for financial health checks and for guided advice to bridge the gap between execution-only services and full portfolio advice.

Too many European investors still consider that investment is too complicated.

This goes further than proposals in the Retail Investment Strategy for simplified advice, with a regime allowing providers to roll out financial planning linked to a choice of investment goals at scale. Labels can help catalyse investor interest provided they do not become a source of complexity or reduce investor choice. With such a broad product choice available we need collectively to make it easier for European investors to choose an appropriate combination of products and reduce the administrative and operational complexity of investing.

GUILLAUME PRACHE
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Competitivity: EU economy and investors badly need a total EU stock market fund

A political consensus seems to be emerging at last that Europe badly needs a real "Savings & Investments Union" (the new name rightly proposed by Enrico Letta for the nine year old "Capital Markets union") to improve economic competitivity, as well as the net returns of long term and pension savings, i.e. to improve pension adequacy.

Simple cross-border savings products for retail investors

The Eurogroup in March 2024, the Letta and Noyer reports in April, recent proposals from France and Germany, and the elusive Draghi Report, all point to the need for "easy access to simple, transparent and low-cost retail investment products", and to "develop attractive, transparent, cost-effective and simple cross-border investment/savings products for retail investors" (Eurogroup, March 2024). The French and German public statements are more precise and practical by proposing long term equity investment plans with a tax incentive for investments into European equities.

Tax incentives are indeed needed to counterbalance the ones already benefiting less useful and less performing "retail" investment products, and to counterbalance the much higher before tax returns of US equities versus EU ones.

But a key requisite is overlooked: The content of the long term savings product(s) does matter: in the US there are very simple and very effective products for retail investors to invest massively into US equities, and not only into large caps, but also in mid, small and micro caps. This last but not least feature makes it also very effective for the US economy and innovation, as it provides massive inflows and liquidity to mid, small and even micro caps companies. It therefore also provides a major exit door for US private equity funding, by facilitating IPO.

The launch of total Europe stock market index funds should become a priority.

Not one broad EU equity index fund

These products are called total stock market index funds (whether in standard or ETF format). It enables any individual saver / investor to very simply get instant exposure to the total listed equity market with only one fund, and with maximum diversification. The long term historical returns are also excellent for individual investors and therefore for pension adequacy.

In Europe, such a simple and effective equity investment product just does not exist:

- The largest Europe-wide equity index used by any fund manager includes only 600 companies: mostly large caps (smallest market cap is €1,4 billion), very few mid caps, and no small or micro caps.
- The biggest such fund gathers 200 times less capital than the equivalent US fund.

The main reason for this highly damaging lack of an adequate retail equity funding product is that the broadest European equity index (the STOXX® All Europe Total Market) currently includes about 1 800 listed companies (versus 3 700 for the CRSP US Total Market Index) and is not used by any index fund sold in the EU[1].

Also a matter of competitivity and survival for the EU fund industry

It is at last a stated EU policy priority to channel the very large EU savings much more to the financing of the EU economy, of its energetic and environmental transition, of its digitalization and of its defense. The main way to achieve this is to thoroughly increase retail investments into European equities, in particular into mid and small cap European companies. It should therefore be a priority for EU policy makers to promote the development of broadest possible indices of European and EU listed companies, and to help find the seed money to create Total Europe and/or Total EU stock market index funds (exchange-traded - ETF - or not) benchmarked on those indices.

The technology is there to manage such index funds by using very effective sampling techniques - instead of full replication - for small and micro cap stocks.

It is also a matter of competitivity of Europe's investment and industry … and of its long-term survival. In particular, Europe should consolidate its index investment management industry asap if it wants to have a chance to survive in the future.

1. *There is one index fund benchmarked on the Stoxx All Europe total Market, but it is US-domiciled, in US $, not sold to EU individual investors, and with only $322 million assets under management.*