Developing long-term retail investment

1. Main challenges and issues to address

An official stated that Europe is facing major challenges. First is the need for significant investment in the dual green and digital transitions in the coming years, with the European Commission suggesting that between €700 billion and €800 billion per year will be required. The growth gap between Europe and the rest of the world, particularly the US, has also widened over the past 15 years, a key underlying element of which is the productivity deficit due to chronic underinvestment.

The second challenge is that European citizens have too much of their savings, which are quite substantial at EUR 35 trillion, in liquid and low-risk products. This is partly due to the overwhelming supply of such products in the EU. Around one third of savings are placed in bank deposits. This figure rises to almost 50% if low-risk life insurance investments are taken into account. As a result, they receive lower long-term returns than savers of many other developed countries, and this also results in inadequate financing of long-term, more risky investments needed for the twin transitions or to increase productivity. A significant part of European savings is also exported to other regions.

Another official noted a key takeaway from the recent report chaired by Christian Noyer on CMU[1]. The money that a majority of Europeans put into low-yielding, highly liquid products is then channelled by intermediaries into the US market, where bonds are purchased and the proceeds used to buy equity in European companies. Changing this nonsensical process will be challenging, because it would require reforming the functioning of pensions in Europe, which in most member states are pay-as-you-go Pillar 1 and fostering more pre-funded private pension products as in the US.

The objectives of channelling investments into specific areas of the European economy and providing savers with adequate long-term returns might also be contradictory, as the latter requires sufficient diversification. Effective long-term retail products must primarily satisfy investors' needs. Otherwise, the results will be counterproductive. In Austria, for example, a private pension product that aimed to channel investments into Austrian listed companies turned out to be disastrous for savers in terms of risk diversification.

A regulator stressed the importance of establishing a strong link between retail investors and capital markets. Savings must play a key role in providing long-term financing to the real economy, and capital markets must provide investors with adequate returns commensurate with the risk taken. Both roles are necessary to ensure an effective and mutually beneficial system. While more investment in the European economy is needed, European savers' investments should not be restricted to Europe however. Risk diversification is essential and investment opportunities outside Europe could also support Europe's long-term development. A strategy of global diversification should be favoured, as it will bring greater benefits to both savers and the wider economy than concentrating investment in the European market.

An industry representative highlighted that an investment product should always be designed in a way that prioritises the clients' interests. Access to well-diversified portfolios that secure clients' financial future is key, as opposed to pushing investments in a particular direction. A client-centric approach is needed to encourage individuals to invest in capital markets, instead of leaving their money in savings accounts.

An official acknowledged the importance of flexibility and diversification in portfolio management, but warned against the common misconception of global indices, which tend to allocate around 85% to US markets and only 10 to 15% to Europe. Such indices are weighted by market capitalisation rather than by factors such as GDP share or geographical distribution. Many European products that receive tax incentives, including pension products, actually invest a majority of their assets into the US. Instead, a reasonable proportion of the assets of these products - around 50% to 75% - should be invested into Europe. Otherwise, European public money is being used to finance foreign economies through tax incentives.

2. Improving the product offering and relaunching PEPP

An official suggested that improving the long-term savings products offering in Europe will contribute to the development of a larger and longer-term investor base, in turn deepening and integrating capital markets. The pan-European personal pension product (PEPP) was a first attempt at creating the equivalent of the successful US 401(k), directing funds into equities and long-term investments and providing the holder with adequate returns. However, the complexity of the PEPP, worsened by disparate tax regimes across Europe, has hampered its success. In addition, the intermediaries' remuneration cap is not realistic. Competition, rather than price controls or price regulation, is the best approach to lowering cost in the financial sector.

1. Proposals for a Savings and Investments Union – Developing European capital markets to finance the future – Report drafted by a committee of experts chaired by Christian Noyer April 2024.

For relaunching the PEPP, the first priority should be to apply common taxation principles across the EU, such as deductions from taxable income for investments in PEPP products and taxation of PEPP income after retirement at the individual's place of residence. This would enhance the functioning of PEPPs in a more consistent way across the continent. Another option, proposed in the French Ministry of Finance's April 2024 report on future steps for CMU, would be to develop common criteria at European level to identify existing domestic products that best support long-term retail investment and guide the development of new products and related tax incentives.

A regulator agreed that a focus is needed on improving the quality of product offerings and simplifying products to ensure real value for savers. Eurobarometer analysis shows that 50% of Europeans lack confidence in insurance and pension products. This hinders long-term retail investment and favours the use of liquid savings accounts. To encourage investment, products need to be simple, user-friendly and tailored to different customer needs.

A new product category is not necessary, the regulator felt. The fundamentals of the PEPP remain valid, although its first version was unsuccessful. The product should be simplified and refined to be focused more on consumer needs. There is room for improvement and development of PEPP, as shown in the recent recommendations published by EIOPA. For example, the requirement to have sub-accounts in different jurisdictions could be made voluntary, to facilitate cross-border distribution and reduce administrative burden. Tax incentives should be easier to implement also with clearer rules.

A further issue is the cap on costs at 1% of accumulated capital, which, in the view of the industry, is a barrier to the launch of PEPPs. The cap should be replaced by the value for money concept proposed in the retail investment strategy (RIS). EIOPA has been working on this concept for several years, following the realisation that many long-term insurance and pension products offer insufficient value to investors, creating mistrust in the sector.

Another official considered that PEPP's lack of success stems primarily from the lack of harmonised tax treatment across member states. Instead of introducing new products that could lead to further market fragmentation, efforts should focus on enhancing existing European products like PEPP and European long-term investment funds (ELTIFs). Market fragmentation is an issue to be considered at both the European and member state level. PEPP was not adopted in Austria for example, because several domestic, subsidised retirement products and insurance-based investment products (IBIPs) benefitting from tax breaks, were already available. The fact that the PEPP cannot benefit from a European-level tax break puts the product at a disadvantage. However, while domestic products can support capital accumulation at the national level, that is suboptimal compared to a European solution.

An industry speaker concurred that the introduction of new products could confuse consumers, who already have multiple investment options, and could increase the regulatory burden for market participants. The focus should be on scaling up existing European products such as UCITS, a well-established brand, or the recently enhanced ELTIFs. These products can be fully utilised to drive EU investment and economic growth. Tax incentives could further encourage the adoption of ELTIFs, as recommended in the Letta report.

A convergent labelling approach at the EU level, with common criteria, could also be beneficial, but any new regime must be introduced cautiously to ensure it adds value without causing confusion. National labels should be avoided, as they can add complexity and may promote a form of protectionism, creating challenges for both end users and pan-European players. An industry representative also cautioned against the use of national-level investment labels, which could cause market fragmentation due to their inconsistent requirements. The focus should be on a unified European approach and initiatives that help citizens take their first steps into investment.

A regulator advised that the market should not be driven to create new products. Ultimately, it is the industry's prerogative to introduce new products that meet investors' needs and respect the existing regulatory framework. A focus on reducing complexity for investors and market participants and facilitating investor access to investment solutions would be more beneficial.

3. Additional measures for fostering more long-term retail investment

3.1 Simplifying and facilitating access to investment solutions

An industry representative noted that the results of investor surveys show that while European consumers recognise the importance of saving, they often find the investment process too complex. There is therefore a need to improve access to investment solutions and simplify the investment process. This would increase the confidence of European investors and help to create a stronger investment culture over time. One way of doing this would be to develop flexible and simple investment accounts that can be progressively invested in to meet both medium-term and long-term goals, thus complementing existing pension schemes. Fractional share dealing is another practical solution likely to reduce barriers to investment, allowing individuals to invest smaller amounts and diversify their portfolios. This would make investment in European companies more accessible to a wider audience.

Such accessible investment solutions are already available at scale in Europe. For example, German fintechs have successfully rolled out ETF savings plans that attract younger investors through ease of use and transparency, resulting in 7.5 million trades each month. France's plan d'épargne retraite (PER) has gathered over €100 billion in assets across 10 million accounts due to straightforward life-cycle investment strategies and flexibility across both individual and workplace schemes. Sweden's Investeringssparkonto (ISK) is another illustrative example. Europe moreover has a comprehensive range of funds such as UCITS and ELTIFs, that can be used to build long-term investment portfolios.

These successful examples, along with EIOPA's recent insights, offer valuable guidance for scaling up the PEPP. Users' investment journey regarding PEPP must be streamlined, with minimal steps required to open an account. Time-consuming individual suitability questions should be removed, particularly for small, regular investments, and replaced with life-cycle strategies, which protect investors through key suitability factors like time horizon, risk allocation and portfolio diversification that automatically adjust over the individual's lifetime. Embedding suitability into product design in such a way reduces cost, benefits investors and providers and also makes it easier for employers to offer such plans in the workplace. The PER example illustrates that the approach can boost participation rates. Offering an improved PEPP as a default scheme with auto-enrolment across the EU could have significant impact.

Another industry representative agreed that simplification and ease of access are the key factors in fostering more long-term retail investment. The younger generation favour digital means of accessing investment solutions. Traditional financial institutions should further develop digital channels to get investors more actively involved in capital markets, particularly younger customers. Digitalisation can also streamline often lengthy onboarding processes, enabling advisors to spend more time providing financial advice and less on administrative tasks.

A regulator referred to Adam Smith's definition of the cost of a product as the 'toil and trouble' involved in acquiring it. Although the price of a product is the most visible part for consumers, the 'trouble' of acquiring it plays a critical role in their decision to buy it. In order to increase the attractiveness of regulated, supervised and value-generating financial products, it is essential to improve accessibility for investors and to make products easier to manage for financial intermediaries. Regulators and supervisors must contribute to this objective by adapting existing rules where necessary. Technology also has a fundamental role to play.

An official agreed with the potential of digital tools and online brokerage accounts to attract younger investors. However, their interest should be directed towards equity investments rather than investments in bitcoin.

3.2 Developing private pensions

An official suggested that further developing pre-funded private pensions in Europe could be a game-changer in encouraging retail savers to invest more in the capital markets. However, this is a challenging political task, requiring broader reforms of pension provision and social welfare systems. These are areas in which the EU has no direct competency. Pensions are also beyond the remit of financial services regulation. Increased political momentum and broader commitment beyond the financial sphere will be needed to address these issues.

Incremental progress can nevertheless be made without fundamentally changing existing pension systems in the EU. Pillar 3 private pension products can be promoted effectively at the national level with tax incentives, but attention must also be paid to product design and objectives in terms of portfolio diversification and capital guarantees. For example, in Austria, some private pension products offering a capital guarantee against losses resulted in low yields, with the tax breaks absorbed to pay for expensive guarantees.

A regulator concurred that pensions have an important role to play in the development of long-term retail investment in the EU. Social and labour laws also have an impact. There is a wider audience to be addressed beyond the financial services authorities, including pension authorities, which may have a different type of mandate. Progress is possible however if there is a convincing narrative and common benefits for European citizens.

One aspect on which progress is being made at the European level and that should be given priority, is the implementation of pension tracking systems. Such systems leverage digital technology and aim to provide citizens with a clear view of their potential revenues at retirement, increasing awareness of the need to invest for the long term. At present, these systems are available only in some member states and their use must be expanded across the EU, with a coverage of all three pension pillars. An official added that employee savings schemes can also play an important role, encouraging individuals to save early in their career.

3.3 Enhancing financial literacy and investor experience

A regulator highlighted the importance of enhancing financial literacy among the European population for fostering long-term retail investment. Financial literacy refers not only to financial education and consumer knowledge of capital markets, but also to practical investment experience. Hands-on investment experience can boost consumers' understanding of products, their confidence and their motivation to invest.

An industry representative agreed that financial literacy is a way to overcome the ingrained cultural aversion to risk, which leads many Europeans to favour low-yield bank savings. Visualisation and simulation tools, allowing a comparison of the long-term impacts of investing in capital market instruments as opposed to keeping money in deposit accounts, also have an important role to play in educating savers about the importance of long-term investment and enhancing their confidence. Such tools are already in use in the wealth management sector. Digitalisation is essential in the development of effective simulation tools. They should be leveraged by both the public and private sector to educate European citizens.

Another industry representative observed that any approach to consumer financial literacy must vary by generation and gender. Investor surveys demonstrate that female and male investors, for example, have different requirements and approaches. Addressing the shortfall in retirement savings for women across Europe should be a priority.

Public-private cooperation to roll out financial health checks would also be valuable. More emphasis should be placed on developing guided advice under MiFID rules, which could serve as a bridge between execution-only services and full portfolio advice. Combining this with a framework supporting the provision of financial planning tools could provide retail investors with more accessible options, through which they can make their initial steps into investment.

4. Conclusion

The Chair summarised that there is more to do to develop long-term retail investment across the EU. It is also clear that action beyond financial services regulation is required. Many aspects need to be considered including savings for pensions, regulation, tax, product design, digitalisation and financial literacy. One of the key themes is the need to increase European consumers' trust in long-term retail investment and facilitate access to effective investment solutions. The new political cycle and discussions on the CMU will likely have a significant impact in this area.