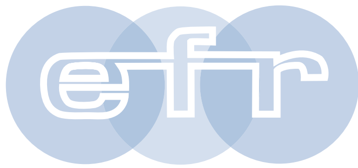

European Financial Services
Round Table

July 2024

EFR PAPER ON EUROPEAN SAVINGS PROPOSED ACTIONS CONCERNING LONG-TERM INVESTMENTS

Executive Summary

Amid the backdrop of Europe's increasing funding challenges, the EFR calls on EU policymakers to focus on actions that:

- ➢ mobilise the large reserves of current private savings towards the European economy;
- ➢ focus on initiatives that could generate more savings to foster long-term investment;
- ➢ focus on initiatives for retirement / pensions plans.

EFR strongly believes that policymakers need to step up efforts to address the current annual trend of a diversion of around €300 billion of European families' savings from EU markets to other countries, primarily to the American economy, due to the fragmentation of the European financial markets[1].

Increasing European investment capacity via new savings/pension products & approaches needs to go hand-in-hand with the development of European opportunities to invest in. Increasing availability and choice of European assets/investments combined with increasing European investment capacity would lead to a virtuous circle for European growth and prosperity.

The focus of this Paper is in line with recommendations in recent reports, such as *"Much more than a market"* by Enrico Letta (17 April 2024), proposals by former Banque de France Governor Christian Noyer to revitalise CMU (25 April 2024) and proposed measure 11 by the Eurogroup *"Support sufficient complementary income streams for an ageing population through wider use of longer-term savings and investment products, including through occupational and personal pension schemes[2].*

In today's dynamic economic landscape, it will be important to ensure that the right incentives are in place to refocus European savings on market-based investment by individuals. On the demand side, these should include the right incentive structure, with auto enrolment in workplace pensions. On the supply side, there needs to be a supportive policy environment to incentivise more investment opportunities with better returns, including to encourage more companies to list in Europe and promote the Venture Capital market. Failure to address these aspects can impede the growth and effectiveness of even the most promising investment vehicles.

Lastly, financial education has a vital role to play in equipping European citizens with the knowledge to take charge of their own financial future.

[1] Report Enrico Letta: Much more than a market, 17 April 2024
[2] Statement by the Eurogroup on 11 March 2024 on the importance of advancing the CMU, which was followed on 13 May 2024 by endorsement of a High-level roadmap for follow-up.

Introduction

It is essential to extend the EU's financing capacity by deepening and further integrating its capital markets, as well as deliver the higher investment needed for the EU's competitiveness, fund the digital and green transitions, reinforce European defence infrastructure and address the substantial pension gap. While the EU has made some progress on its Capital Markets Union (CMU) agenda, a number of issues still need to be addressed, including recalibrating the prudential and liquidity treatment of securitisation exposures to better reflect the high quality of EU securitisations. While all European policymakers agree that securitisation could play an important role, insufficient action has been taken: it will be key to take this forward in the next political cycle in order to mobilise savings and assets under management by institutional investors to fund the EU economy.

It is also paramount to ensure that European savings contribute more effectively to the financing of the EU economy. This requires a focus on unlocking growth opportunities through policies that incentivise more long term savings, alongside more efficient allocation of current and future savings and pensions towards long-term investment in Europe.

Currently, the willingness and capacity of the financial sector to finance sustainable projects significantly exceeds the availability of suitable/bankable/investible assets. When addressing the issue of how to allocate European savings to finance the European economy and transitions, it is therefore also necessary to focus on ensuring a pipeline of sustainable/bankable investments.

With the EU lacking a risk-taking culture, a fundamental step towards the success of the CMU is to increase retail investors' trust in investment products by enabling them to make informed decisions based on adequate information, advice and financial knowledge. This can be achieved through financial education. Digitalisation also has the potential to make financial services more inclusive. Regulators must also ensure that the impact of their policies and existing regulations have a positive effect on citizens' long-term investment returns.

Better direct savings

The European Union has a **high level of savings:** private savings represent 25% of EU GDP, compared to 18% in the US, and financial assets held by EU households amount to a staggering EUR 33 trillion. This wealth, however, is not being fully leveraged to meet the EU's strategic needs: a significant proportion is held in current accounts and sight or short-term deposits[3] and is used for traditional bank lending. The challenge is, however, to mobilise risk bearing equity and long-term investments in order to fund the twin transition. A concerning trend is the annual diversion of around €300 billion of European families' savings from EU markets to other countries, primarily the American economy, due to the fragmentation of our financial markets[4].

Three important factors need to be highlighted:

1. **Financial literacy:** Although there are significant differences across the EU, in the majority of countries' households' choices for allocating their savings (i) are partly fuelled by domestic tax incentives and regulated savings schemes and (ii) would be more oriented towards long-term investment products that allow better risk diversification if levels of financial literacy were higher. Financial education for all ages of the population has a vital role to play in equipping European citizens with the knowledge to take charge of their own financial future. Pension tracking systems play an important role in this regard, allowing citizens to track how much their income will be when they retire. These systems would also allow citizens to be fully conscious of what their income will be on retirement and better understand the benefits of an annuity compared to a lump sum payment. While such education efforts may take time to bear fruit, we welcome efforts at both national and EU level to promote financial education.

[3] See Eurostat Households - statistics on financial assets and liabilities

[4] Refer to page 28 of the report "Much more than a market" by Enrico Letta

2. **Tax incentives:** Currently, some European countries offer tax incentives which are geared at short-term and risk-free investments. However, in order to favour long-term investments, consumers should also be offered incentives with a long-term focus to further rebalance their current allocation decisions. This will allow investment choices to be better diversified and calibrated in terms of long term risks while also aligning more closely with the funding needs of the European economy, which requires risk capital to support growth and innovation. Such **tax incentives** need to be sufficiently significant, sustained over time and coordinated between Member States.

3. **European investment capacity should be directed towards European assets:** Europe needs a better pipeline of companies being brought to the public market to increase the supply of equity investments and improve their returns. Although the reforms contained in the EU Listing Act go in the right direction, a broader and more holistic focus on policies to promote competitiveness is needed, as has proved successful in Sweden. A vibrant Venture Capital (VC) sector, for example, is essential not only to drive innovation and risk-taking by entrepreneurs, but also to feed the pipeline of companies wanting to raise equity capital on European markets. The Venture Capital market in the EU is significantly smaller than that in the US, where USD 246 bn of VC was invested in 2022. As a consequence, it is more difficult for young European firms to scale up compared with their US peers. They often depend on non-European investors for larger funding rounds. This heightens the risk of European startup companies relocating abroad. Less favourable exit environment in the EU than in the US. US stock exchanges boast a market cap that is almost three times as large as that of all European stock markets combined. Hence, many exit routes lie outside the EU. Two out of three IPOs of startups backed by European VC firms took place on non-EU exchanges in 2023.
   This stream needs to be reversed if European savings are supposed to stimulate European firms and European growth.

For this reason, it is worth considering a complementary offer to existing savings products of **collective long-term savings instruments**, invested for the benefit of the European economy and supported by coordinated tax incentives (but not necessarily harmonised). To start with, this offering could be a joint approach by several Member States. In this respect, the proposals set out in Enrico Letta's report "Much more than a market" are worth considering[5]. While various options could be envisaged, this Paper focuses on two in particular, targeting the largest possible share of the population: (i) **schemes that are supported / proposed by employers** to enable savings by employees, (ii) **retirement savings and pension plans**.

Schemes supported / proposed by employers can take the form of collective savings schemes that enable employees to buy shares with the company's assistance. Employees and companies may make payments to the collective scheme, with minimal taxation on (i) the amount invested by the employees, (ii) the amount added by the employer and (iii) the capital gains when employees withdraw their funds. As proposed in several position papers, in return for this favourable tax regime, (i) investments would be directed towards certain types of assets and (ii) the sums are locked in (i.e. illiquid) for a set period of time, except in exceptional cases of early release. It is important to consider that steering EU consumers towards certain assets (as a trade-off for the tax benefits) needs to comply with existing consumer protection rules and financial intermediaries' duty of care.

Furthermore, it should be noted that current pan-European products (ELTIFS and PEPPs) have faced challenges – among others - due to differing tax rules across EU countries. To fix this, we need better aligned tax rules and better incentives to encourage people to save for retirement. The impact of other factors on their lack of success should be thoroughly evaluated.

[5] Refer to page 30 of the report "Much more than a market" by Enrico Letta

Pension/ Retirement plans

As Europe is facing substantial pension gaps, due to the ageing population and more fragmented labour markets, EFR calls on policymakers to embrace bold action on pensions. Close collaboration between public and private stakeholders is essential. Mandatory pension systems (first pillar) should be complemented by collective occupational pension schemes (second pillar) and individual pension products (third pillar). Member States are also encouraged to make full use of national pensions dashboards (all 3 pillars) to provide citizens with a holistic picture of their individual situation.

It is also important to focus on the decumulation phase, for which a lump sum payment should not be the default option. Indeed, in addition to the imperative need for EU citizens to be able to secure a minimum replacement income through the payment of annuities, the decumulation phase can be conceived as an active investment phase. The objective here is to offer the possibility of generating higher income through higher risk taking.

Also, incentives for employers are required to ensure that they can offer pension arrangements and enable part-time workers, self-employed workers, and "gig economy" workers to join retirement saving schemes. Auto-enrolment with an opt-out should also be encouraged as citizens do not save enough by themselves. Finally, the effectiveness of existing EU pension regulation needs to be improved. This includes a thorough revisitation of the fee capping and tax treatment in the PEPPs (Pan-European Pension Products). Attractive tax treatment should have three angles: taxation of the product itself, tax incentives for employer contributions and tax benefits for clients or unit holders. From a regulatory standpoint, flexibility is crucial for these products to remain viable over time.

The European Financial Services Round Table (EFR) was formed in 2001. The Members of EFR are Chairmen and Chief Executive Officers of international banks or insurers with headquarters in Europe. EFR Members believe that a fully integrated EU financial market, a Single Market with consistent rules and requirements, combined with a strong, stable and competitive European financial services industry will lead to increased choice and better value for all users of financial services across the Member States of the European Union. An open and integrated market reflecting the diversity of banking and insurance business models will support investment and growth, expanding the overall soundness and competitiveness of the European economy.

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