ERFF
European Retail Financial Forum

ERFF Working Paper December 2020

Issues & Solutions for Retirement Savings & Investments

Working together to create long-term financial security for European households

The European Retail Financial Forum (ERFF) is a consumer-focused, pan-European industry platform. Launched in the European Parliament in 2015, ERFF was set up in response to the European Commission's stated ambition to expand the dialogue on opening up retail financial markets in Europe and to engage with 'all stakeholders around one table'. We particularly welcome collaboration with consumer groups. Our main activities are business/consumer dialogues, technical workshops with EU policymakers and our annual 'Consumers at the heart of finance in Europe' conference. www.erff.eu

Introduction

The purpose of this paper is to help the ERFF explore issues in 2021 that go to the heart of the ageing population challenge and the role that retirement income savings can play in the financing the Covid recovery and Green Deal policies. This work complements the work of the ERFF in examining solutions to the more immediate issues facing retail consumers from Covid economic impacts.

1) Increase household retirement savings and raise citizens' awareness and level of financial literacy

Opportunity

There is a need to improve the long-term financial security of many European households, with an eye on retirement income savings. Public pension systems risk becoming unsustainable. The ability of second pillar pension schemes to deliver expected retirement incomes is increasingly at risk in the face of an ageing population and very low returns due to numerous aspects such as risk aversion, regulation and low interest rates.

In many countries, governments now seem determined to act and promote the increase of retirement income savings. At the EU level this has been addressed through concrete initiatives such as the Pan European Personal Pension product (PEPP). However, no matter how many products and incentives are available, if people don't care or simply lack the awareness for their retirement savings all efforts are in vain. For this reason, we consider the European households' awareness for their long-term financial security one of the key elements to make sure that measures such as the PEPPs or any other pension related incentives truly impact behaviour.

Obstacles

There are two principal obstacles why the level of retirement savings is too low:

- The level of retirement savings is low because people either do not enrol in a retirement savings schemes or they do not contribute enough.
- Where savings exist, they are often invested in products not designed for retirement purposes.

Potential Solutions

Overall, it will be key to ensure that pension policy related suggestions as laid out in the *Commission's Capital Markets Union Action* plan are swiftly implemented and not delayed. It is also important that there is a recognition of all the forms of savings and assets in helping citizens understand how to plan for the retirement income they want. All policy measures must be cognisant of changing employment patterns such as increased cross-border mobility, wider spread of freelance work or work beyond statutory retirement age and deliver flexible solutions that can be applied across this range of employment practices.

Developing and making publicly available a range of tools to engage households and to assess the risk that they are willing to take for the retirement income they want. The emergence of pension tracking systems, open finance and using nudge points to get citizens engaging with their retirement income savings – and seeing those savings from the wider perspective of all of their assets (e.g. property, investments and pensions) – provides an opportunity for publicly available online tools that can foster greater awareness and engagement with retirement income needs and savings in a way that we have not previously had.

Additionally, the above must be supported by the real availability of finance advice and addressing the significant need to increase EU citizens' level of financial literacy.

2) Help consumers to take informed decisions on their retirement savings based on individual risk preferences

Opportunity

We should not presume that the retirement savings landscape in the EU is homogenous and all issues facing consumers will be addressed by the measures suggested above.

A review of long-term savings and investments across Europe shows that households have substantial savings which are either held in form of financial assets or in real estate. When asked about their motivation, about half of the respondents name retirement as the key reason for saving.

The amount of financial savings earmarked for retirement across Europe has been estimated at c.€10tn, but only a very small fraction of this is invested in 'pension' products. The large majority is either held in guaranteed insurance policies or in bank accounts.

There is also an increased demand for investments at the moment, as European households have massively increased their savings during the COVID-induced lockdown.

The question we need to ask ourselves is whether these investments are delivering the returns that will meet retirement income expectations, or can we do more to realise this?

Obstacle

Too many products on offer for savers are "guaranteed products" offering in fact negative real returns.

In addition, retirement income savings are predominantly invested in low-yielding assets, which will lead to retirement income shortfalls in the long-run, should the current low interest rate environment persist for longer.

Regulation also plays a part in directing household savings towards such guaranteed products. An example of this can be found in suitability rules, such as the requirement in France that any non-guaranteed alternative to 'Fonds en Euros' be justified by formalised advice. And the debates around PEPP show that new regulation is likely to follow the same path, despite the warnings of both industry and consumer groups.

Potential Solutions

In a first step the we should review rules at the member state level to see the extent to which guaranteed investments are effectively preferred over non-guaranteed products.

Secondly, we should examine how retirement income savings products can be better structured to improve asset allocation for better returns. Part of this exercise involves reviewing capital requirements with the objective to remove any regulatory obstacles to better asset allocation (without detracting from the policy need to protect policyholders).

In addition, we have to expand our perspective on what makes up retirement income savings. Both in terms of how we evaluate what will give a retirement income and in the design of products to ensure that we meet the full range of societal needs. For instance, the creation of an EU framework for a special type of bank account that grants tax exemptions on longer term investments (cash and financial instruments) could channel savings into better yielding long-term investments, irrespective of pension insurances. Such products exist in a few EU Member States and allow the investor to switch freely between capital market related products or keep the balance in cash. A tax liability would only arise when money is withdrawn from the account before the end of a predefined timeframe.

Finally, we need to encourage the development of instruments which help to engage households and help to make reasonable risk reward decisions on an individual level. An example are 401(k) accounts in the US, where participants of second pillar pension schemes have a good range of choice over the allocation of their retirement savings. Any solution should entail both personalised advice and technology where applicable.

Regarding the latter aspect, several regulatory issues (such as in MiFID) have so far hampered the development; removing these barriers can have a considerable effect e.g. on the uptake of digital distribution channels.

3) Helping consumers identify and invest in ESG investments and supporting the recovery post-COVID

Opportunity

Consumers are more and more looking for a way to make their savings and investments work for society and the planet, not just for the medium-term financial impact. As younger generations enter into long term savings products this demand is set to increase significantly. This also create an opportunity for the significant private financing available from retirement to support the EU's major policy needs, such as COVID recovery and the Green Deal.

Recent market research has demonstrated that consumers' willingness to invest in a sustainable way was very much reinforced by the COVID crisis

Obstacle

Lack of products on offer compared to demand and a lack of clarity as to consumer wishes and understanding of the ESG impacts of funds.

Lack of clarity/shared understanding of the ESG impact of funds

Lack of visibility:
- Households fear they might need to access the money rapidly as circumstances evolve
- Liquid investment alternatives produce negative returns

Potential Solution

Ensuring the calibration of the taxonomy and the disclosure and suitability obligations on firms drive the full range of behaviour required for a green transition to be made. This requires ensuring a focus that is beyond the "bright green". Investors need to be encouraged to help finance all activities that genuinely enable a transition towards a more sustainable economy.

This requires greater engagement with investments, which for many, will include retirement income savings. The tools, such as pension tracking systems and the possibilities available through open finance type initiatives need to engage citizens with how their savings are working in the financial system – by, for example, facilitating the exercising of voting rights to change corporate behaviour. Engagement through ESG interests will help with retirement incomes savings more generally. More private savings means more private financing available for wider policy needs.

Common methodologies on ESG ratings.

Building on existing policy mechanisms to bring more ESG projects to the attention of private investment, with a particular focus on SME projects. Those mechanisms can include project pipelines and fund types.

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