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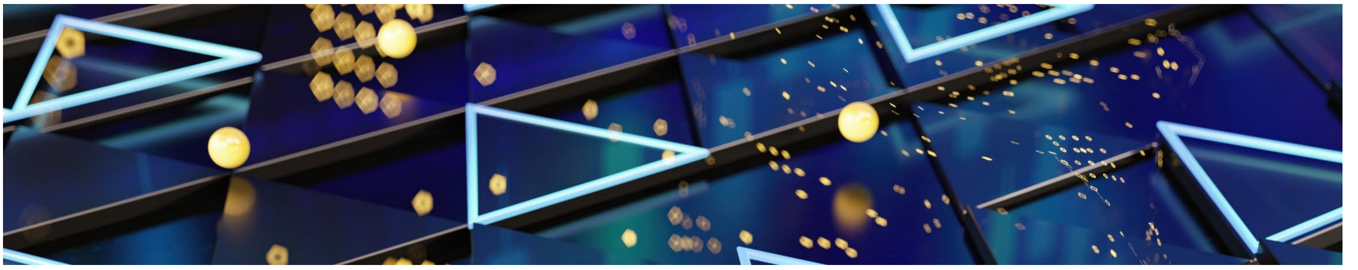

# THE FUTURE OF PENSIONS AND RETAIL INVESTMENT IN THE EU

## ANALYSIS OF RETIREMENT SAVING AND RETAIL INVESTING IN THE EU AND RECOMMENDATIONS FOR AN INTEGRATED REFORM AGENDA

June 2024

By Maximilian Bierbaum and Sheenam Singhal

In partnership with:

Vanguard

> *The lack of long-term capital is one of the biggest barriers to the development of capital markets in Europe. This report analyses the current state of play in pensions and retail investment markets in the EU; highlights the implications for household wealth and long-term investment in the European economy; and makes nine recommendations to encourage wider and better retail investment and retirement saving in the EU.*

## Europe needs to save better

Without capital, you cannot have capital markets. Without capital markets, you cannot make the European economy fit for the future. But there is not enough long-term capital in the EU, and it is too concentrated in just a few markets.

There are still reasons to feel optimistic about capital markets in the EU. Ten years after the launch of capital markets union (CMU), the renewed political focus on the EU's investment needs could provide the necessary momentum for member states and the EU to develop and implement measures that change the way in which Europeans engage with their money.

In the debate on the future of capital markets in Europe, widening retirement saving and widening retail investment are the potential missing link. But there is a danger that by dealing with the two topics in isolation, EU policymakers will miss the bigger picture. We think this needs to change. Neither pensions nor more retail investment can solve this problem on their own. To really move the dial, we need both - and there is evidence from Denmark and Sweden that at their best, retirement saving and retail investment can feed each other.

Over time reforming both could have significant, positive outcomes for millions of individuals in every corner of the EU - and for the wider European economy. For households, reforms could help increase their financial wellbeing and secure their financial futures. For the economy, reforms could unlock trillions of euros of additional long-term capital that is much needed to meet Europe's investment needs. Supporting the EU's ageing population and channelling more investment into companies, infrastructure projects, and other long-term projects can help the EU successfully achieve its green and digital transition and is directly related to Europe's competitiveness.

The first section of this report looks at the role pension systems play in building pools of long-term capital and supporting the development of capital markets. We then analyse and discuss best practice and challenges in retirement saving and retail investment markets in the EU. Finally, we outline nine proposals to encourage wider and better retail investment and retirement saving in the EU and highlight some difficult truths that are relevant in this debate.

We hope this research provides useful insights and we are always interested in your thoughts and questions. I would like to thank Sheenam Singhal for helping collect and analyse the data that underpins this report, William Wright for his support and feedback, the many experts from organisations including ICI, EFAMA, D3P, and JASPER Forum who made time to share their views with us, and Vanguard for partnering with New Financial and supporting this project.

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Rethinking capital markets

New Financial is a think tank that believes Europe needs bigger and better capital markets to help drive growth and prosperity.

We think this presents a huge opportunity for the industry and its customers to embrace change and rethink how capital markets work.

We work with market participants and policymakers to help make a more positive and constructive case for capital markets around four main themes: rebooting UK capital markets; reforming EU capital markets; driving sustainability; and driving diversity.

We are a social enterprise funded by institutional membership from different sectors of the capital markets industry.

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## Here is a short summary of the report:

1. **The 'C in CMU':** deep pools of long-term capital such as pension and insurance assets as well as retail investment are the starting point for deep and effective capital markets, but pools of capital in the EU (at 184% of GDP) are smaller than in the US, UK, Japan, or Australia. Too much money in the EU is held in unproductive investments, with negative consequences for households and the European economy.
2. **The European pensions opportunity:** the level of pension assets in the EU is particularly low, with nearly two-thirds of assets concentrated in just three member states. A (partly) funded pension system that encourages people to accumulate retirement savings is a key building block in securing the financial futures of EU citizens and providing the economy with a large potential supply of capital.
3. **Cash is king?** Households across the EU hold on average 34% of their financial savings in cash. This number increases to more than 40% in countries such as Austria and Germany, and to more than 50% in Poland, Malta, Greece. Lower fees and easier access to the EU's retail investment markets would be a good start to help people shift their money out of bank accounts.
4. **The big move:** there is a danger that by dealing with retirement saving and retail investment in isolation, EU policymakers will miss the bigger picture. Neither pensions nor more retail investment can solve this on their own. To really move the dial, we need to pair measures to widen retail investment with more structural reforms of pensions and retirement saving in the EU - and there is evidence from Denmark and Sweden that at their best, they can feed each other.
5. **Best practice:** it can be politically difficult for the EU to take inspiration from the UK or US, but there are a few examples of countries in the EU itself that have deep pools of long-term capital. Denmark's partly funded state pension, Ireland's introduction of auto-enrolment workplace retirement saving, or Sweden's investment savings tax wrapper can inform gradual or more radical reforms in other member states.
6. **European competitiveness:** more developed capital markets are not always the obvious answer to the challenges the EU is facing, but the EU will not be able to address its biggest challenges without them. Channelling more investment into companies, infrastructure projects, and other long-term projects can help the EU successfully achieve its green and digital transition ambitions and increase its competitiveness.
7. **Why now?** Over the past decade, capital markets have moved up the political agenda across the EU. The renewed political commitment over the past few years now needs to translate into concrete action. Strategic challenges, stretched government budgets, and a new European Commission and Parliament could provide the necessary momentum.
8. **An integrated reform agenda:** there are a few essential building blocks that can help encourage wider and better retirement saving and retail investment. We make nine recommendations to help people save better for the longer term, reform and design pension systems to support people and the European economy, and get the best out of the EU's retail investment markets.
9. **The growth potential:** we estimate that transitioning the EU's pension systems to (at least partly) funded models and moving savings out of bank accounts and into the capital markets could unlock around €11tn. Even if only a third of this money would be invested in European assets (in line with the average asset allocation of UCITS equity funds), this would give the European economy a significant boost.
10. **Inconvenient truths:** this is a difficult reform agenda. It will take a long time to yield results, it will be politically challenging, and while broad political support will be crucial, not everyone will be happy with every one of these reforms - but they are vitally necessary to address the challenges that Europe is facing.

## The future of pensions and retail investment in the EU

This section provides five key takeaways on retirement saving and retail investing in the EU, the role they play in the development of European capital markets, and the reform opportunity ahead.

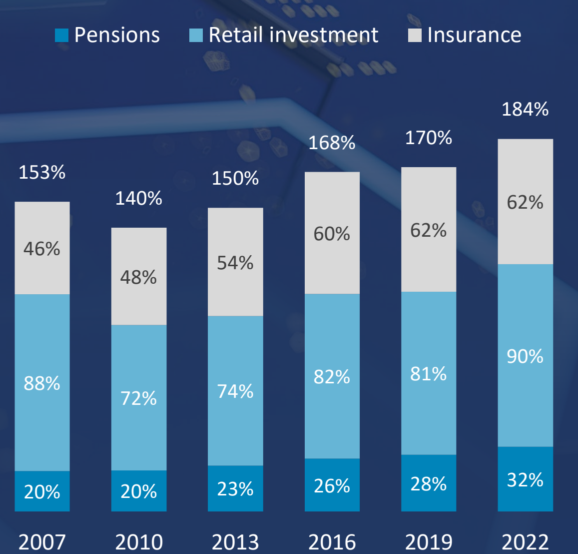
### 1. A LONG WAY TO GO

**184%** Long-term capital relative to GDP in the EU - lower than in the US, the UK, Japan, and Australia

The starting point for deep and effective capital markets is deep pools of long-term capital, but the size of pools of capital in the EU is a long way off where they could and should be. Relative to GDP, pools of long-term capital in the EU (pensions, retail investment, and insurance) have grown by 20% between 2007 and 2022 - a nominal increase of €9.7tn. But compared to the US and many other comparable economies, they are relatively low. The level of pension assets in the EU is particularly low, with the majority of assets concentrated in just three member states.

Too much money in the EU is held in cash or other unproductive investments, with households missing out on potential higher returns and the European economy missing out on trillions of euros that could support innovation, jobs, and growth.

The size of long-term capital relative to GDP in the EU between 2007 and 2022




### 2. LEADING BY EXAMPLE

**62%** The Netherlands, Denmark, and Sweden's combined share of EU pension assets

The Netherlands, Denmark, and Sweden combined account for nearly two-thirds of the EU's pension assets - €2.8tn in 2022 alone - but only 12% of EU GDP. The three economies have well designed pension systems that took decades to build.

### 3. A STUBBORN RELIANCE ON CASH

**⅓** The share of savings in the EU that is held in cash

Many European households prefer to keep their savings in a bank account. Across the EU, 34% of household financial assets are held in cash. This money - €11.4tn in total - is easily accessible but eroding in value and not being used productively.

### 4. THE GROWTH OPPORTUNITY (I)

**+€6tn** The potential increase in the value of pension assets in the EU

If EU member states with smaller levels of pension assets looked a bit more like their more developed peers - Hungary a bit more like Poland, Spain a bit more like Ireland - we estimate that pension assets in the EU would more than double to €10.6tn.

### 5. THE GROWTH OPPORTUNITY (II)

**+€5tn** The potential increase in the value of retail investment in the EU

Using the same projection, retail investment would grow by more than a third. Even if only a third of the additional €11tn in long-term capital would be invested in European assets, this would give the European economy a significant boost.

## An integrated reform agenda

Wider and better retail investment and retirement saving in the EU will not happen overnight, but there are a few essential building blocks that can help create better outcomes for households and the European economy. Here is a summary of our nine recommendations that can help drive substantial progress on this long-term agenda:

### 1) Helping people save better for the longer term

**i) Providing clear and simple savings products:** introduce tax-efficient savings and investment accounts in member states that are easy to understand, incentivise people to invest their money in the capital markets, and align with public policy objectives.

**ii) An early start:** use such tax wrappers to reinvent and turbocharge savings and investment accounts for children, seed them with an initial amount of money, and provide incentives to encourage further regular contributions on the condition that the majority of this money (or all of it!) has to be invested.

**iii) 'The year of the European saver':** design an EU-wide public information campaign to get people in Europe to talk more about their money, support the campaign with tailored communications in member states, and ideally pair the campaign with the launch of new tax wrappers to encourage better saving.

### 2) Designing pension systems to support people and the European economy

**i) (Partly) funding state pensions:** transition a small but growing share of state pensions in member states from pay-as-you-go to a funded model and, in the longer term, pool contributions from all member states in an EU-wide, sovereign wealth fund like vehicle (which would result in the world's largest pension fund).

**ii) Introducing auto-enrolment in occupational pensions:** automatically enrol people in occupational pensions, require both employers and employees to make contributions, over time increase contributions, and provide tax incentives to help make people good choices.

**iii) Encouraging additional private retirement saving:** extend the (tax) incentives offered to employees participating in occupational pensions to people in non standard forms of work who save through private pension products and use the voluntary nature of pillar III retirement saving to trial any wider reforms.

### 3) Getting the best out of the EU's retail investment markets

**i) Better access and better understanding:** use digital tools to provide people with a helicopter view of all their assets and liabilities in one place, pair this with personalised guidance and nudges, and design targeted financial literacy interventions that reach people at key inflection points and stages of their lives.

**ii) Rethinking advice and guidance:** provide full transparency on product and distribution costs when people invest in a retirement, insurance, or direct retail product, support EU member states that want to go further on inducement reform, and encourage financial advisers to expand their offering from a largely sales-driven model to advising on people's financial circumstances more widely, including retirement.

**iii) A new perspective on risk and returns:** take a more holistic approach when regulating for consumer protection that ensures savers can achieve the best outcomes possible, even if it means to take on more risk, and pair this with a push to change the deeply embedded cultural risk aversion in Europe.

# CONTENTS

**Robyn Laidlaw**
Vanguard

## Putting retail investors at the centre of Capital Markets Union

Vanguard is delighted to sponsor this report by New Financial on the personal investor aspects of Capital Markets Union (CMU), during an important period of reflection on the future of the European economy. A decade into the project, Europe's politicians clearly recognise that CMU is not only desirable but essential to the EU's economic success and its global ambitions. The EU's Member States must complement their strong political support for CMU with ambitious reforms at national level.

We will encourage the new team of European policymakers to view CMU through its most important lens: that of the retirement system. Evidence across Europe and globally shows that retirement systems help to determine several core characteristics of our capital markets: the depth of long-term pools of capital; the diversity of the funding ecosystem; how retail investors think and act; and where and how investment is allocated. Pensions policy is a fundamental political choice in every Member State but its consequences for national capital markets and CMU overall merit thorough analysis and clear-sighted reforms.

This report shines a spotlight on the crucial interplay between retirement saving and retail investment. Until now, these topics have been typically kept separate in EU policy discussion. That has to change. From five decades of experience, serving over 50 million investors worldwide, Vanguard can share some important lessons that we have learned on our journey. First, the keys to long-term investing success are simple: clear goals; good diversification; keeping costs down and staying the course. Second, strong retail markets are founded on strong pension systems. Third, policy and regulation must continue to evolve, keeping pace with changes in the economy, society and technology.

Surveying the European landscape, we are encouraged by the pace of change - from the rapid emergence of the neo-broker model for retail investment in Germany to the adoption in Ireland of auto-enrolment for workplace pensions. Even more exciting is the range of new ideas emerging on how to boost CMU and increase Europe's economic competitiveness. Retail investment and retirement saving are essential building blocks for success. This report does not offer all the answers but we believe it identifies important questions and we encourage all our partners - across policymakers, market participants and consumer representatives - to add their voice and their insights.

**Robyn Laidlaw**
Head of Distribution, Europe
Vanguard

## The 'C in CMU'

The starting point for deep and effective capital markets is deep pools of long-term capital, but the size of pools of capital in the EU is a long way short of its potential. Fig.1 shows the size of long-term household financial assets in the EU, selected EU member states, and comparable international economies. Relative to GDP, pools of long-term capital in the US are more than two-and-a-half times as big as those in the EU, and they are larger in the UK, Japan, and Australia too. Fig.1 also shows that this is not an even picture across the EU: relative to the economy, Denmark has more long-term capital available than the US. Sweden and the Netherlands have bigger pools of long-term capital than the UK, and there is no reason why in the long run they should not be as developed in other EU economies.

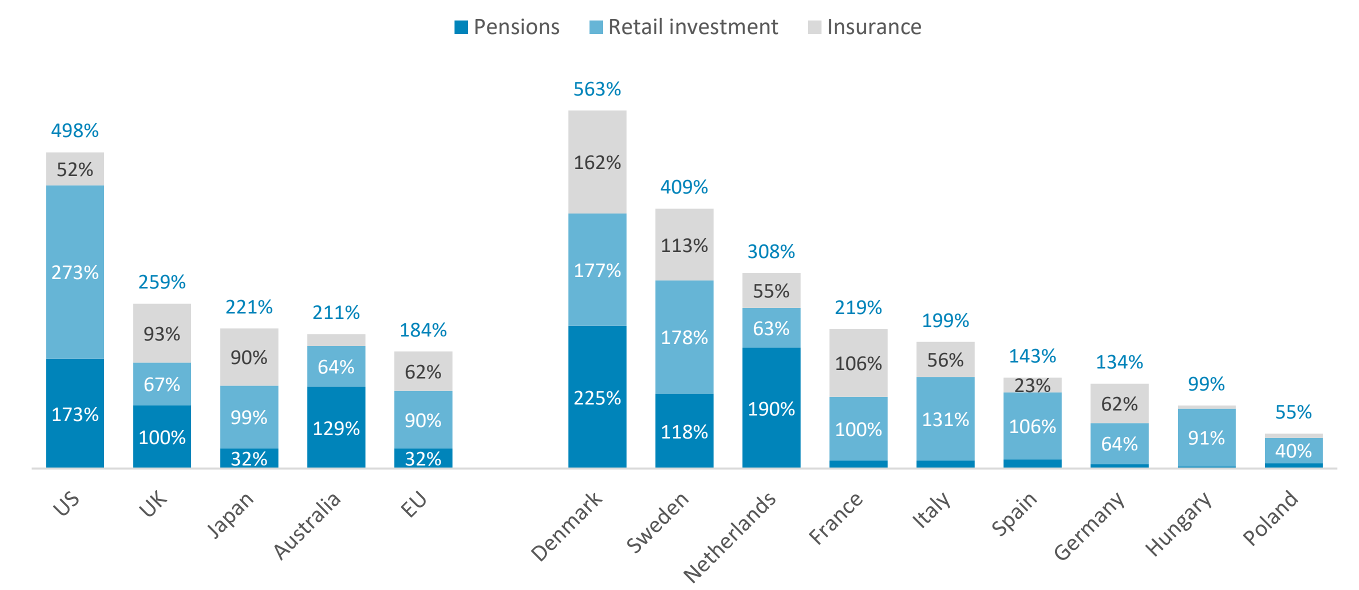
While Japan and the EU look surprisingly similar in terms of their pools of long-term capital, the most striking difference between the EU and the US, UK, and Australia is the size of pension assets. At just 32% of EU GDP in the three years to 2022, pension assets in the EU are only a fraction the size of pension assets in the US, Australia, or the UK. This repeats within the EU: the main difference between Denmark, Sweden, the Netherlands, and other EU member states is the size of pension assets. It is good to see the size of insurance assets in the EU, but prudential rules on what they can be invested in are a lot stricter under current Solvency II rules (which are being reformed).

Given the social and economic challenges the EU is facing, and the amount of money needed to address them, there is an obvious need to develop bigger pools of long-term capital in the EU. But the question of how to get there when most of the savings of Europeans are in bank accounts or property is harder to answer. The EU needs a structural, regulatory, and cultural change for Europeans to invest more - in particular through retirement saving and retail investment products. Reforms at the EU and member state level can help drive this change, and a good place to start is to look at what people do with their long-term savings that are earmarked for retirement.

### Fig.1 What is the size of pools of long-term capital in the EU and comparable economies?

The size of pools of long-term capital in % of GDP in the three years to 2022 in the EU, selected EU member states, and selected international comparator markets, with the number in blue showing total size.

*Note: retail investment includes direct household investments in funds, shares, bonds, and other financial investments*




*Source: New Financial analysis of data from EIOPA, Eurostat, FSB, IMF, OECD, and the US Treasury*

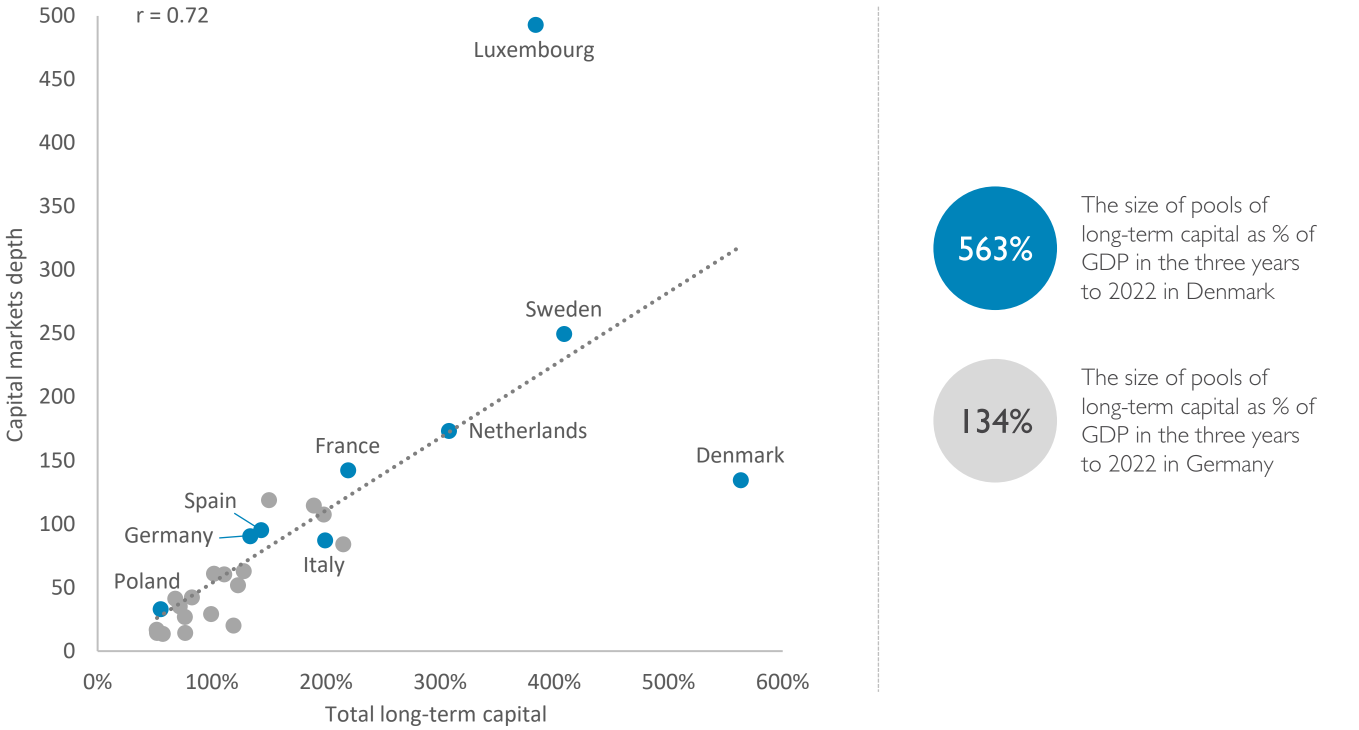
## The role of pension systems

The level of pension assets in the EU is low, but moving to a (partly) funded pension system that encourages people to accumulate retirement savings is a key building block in securing the financial futures of EU citizens, developing capital markets, and providing the economy with a large potential supply of capital.

This section analyses the relationship between long-term capital in the EU and CMU; shows the problem with European pensions and opportunity for growth; explains the main benefits and risks of the two main pension models; and argues that to really make a difference in the scale of long-term capital in the EU, you need both: deep pools of pension assets and more retail investment.

## Fig.2 What is the relationship between long-term capital and the development of capital markets?

This chart shows the correlation between the size of pools of long-term capital (pensions, insurance, and retail investment) as % of GDP (x-axis) and the depth of capital markets (y-axis) in all 27 EU member states in the three years to 2022.




*Source: New Financial analysis of data from EIOPA, Eurostat, IMF, and OECD*
*Note: the correlation coefficient (r) measures the relationship between two variables. r = 1 indicates a perfect positive relationship ('if X increases, Y increases'), r = -1 indicates a perfect negative relationship ('if X increases, Y decreases'). Correlation does not imply causation. Capital markets depth relative to EU average = 100. Depth calculations taken from New Financial's report on [EU capital markets: a new call to action](#).*

### A key ingredient

Without capital you cannot have deep and efficient capital markets, and without deep and efficient capital markets you cannot hope to have anything resembling CMU. With very different levels of long-term capital in the 27 EU member states, it is perhaps unsurprising that there is also a wide range in the depth of capital markets across the EU.

There is a strong correlation between the size of pools of long-term capital and the development of capital markets. It is not a coincidence that the five member states with the deepest capital markets in the EU - Luxembourg, Sweden, the Netherlands, France, and Denmark - are also the five economies with the largest pools of long-term capital. Combined, they account for nearly half of the EU's total long-term capital. Countries in Central and Eastern Europe had the least amount of time to build up long-term capital and have the least developed capital markets in the EU.

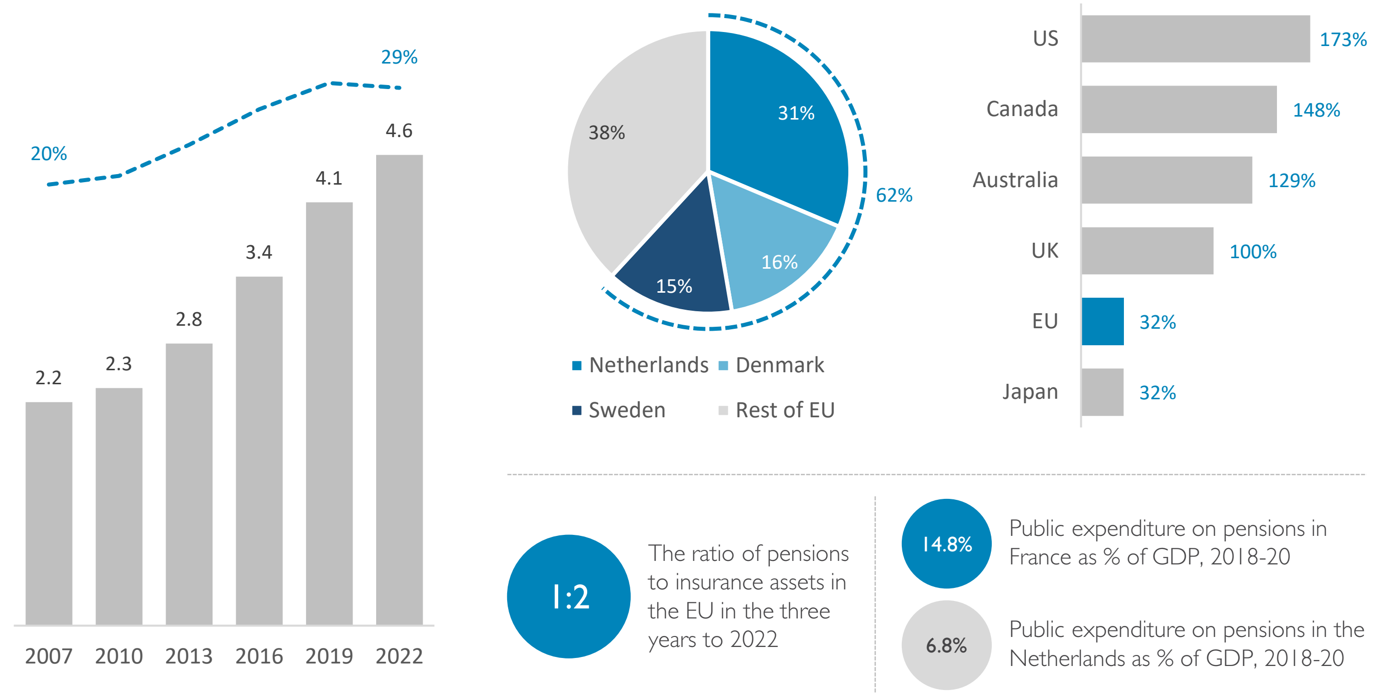
Over the past ten years, European policymakers working on CMU have focused a bit too much on the 'U' and should focus more on 'capital markets' in the coming decade. The EU needs to build capacity from the bottom up. Encouraging savers in the EU to move more of their money out of their bank accounts and into the capital markets, in particular through long-term retirement savings and investment products, will be vital for the next phase of CMU.

## Fig.3 What is the problem with pensions in the EU?

i) The size and growth of EU pension assets from 2007 to 2022 in €tn and as a % of GDP

ii) The distribution of the EU's funded pension assets in % in 2022

iii) The average size of pension assets as % of GDP in the three years to 2022




*Source: New Financial analysis of data from EIOPA, IMF, and the OECD*

### Too little, too concentrated

One of the most effective ways to build up a bigger stock of long-term capital is a pension system that allows and incentivises people to accumulate a pool of capital for their retirement. Over time, this can help people to have better financial futures with more adequate retirement incomes (and, ideally, better engagement with money outside of their retirement savings along the way); make capital markets bigger and more dynamic; and provide the economy with a large potential supply of capital that can help finance innovation, jobs, and growth.

In nominal terms, pension assets in the EU more than doubled in the last 15 years. But in real terms, they increased by only a little more than a third. Relative to GDP, they are much smaller than in comparable economies and heavily concentrated in just three EU member states. The Netherlands, Denmark, and Sweden combined account for almost two-thirds of the EU's pension assets, but only 12% of EU GDP. Pension assets in the remaining 24 member states are only at 13% of the combined GDP of those countries. While some other member states such as Finland, Ireland, and Croatia have pension systems with funding levels that stand out from the rest, they are relatively small.

The EU does not have so much a long-term capital problem as a pensions problem. Transitioning the EU's prevalent pay-as-you-go (PAYG) pension system to a more funded model can bring benefits to individuals, government budgets, and the economy. But any reforms of retirement saving in the EU will take decades to materialise. That is not a reason not to do it: the best time to reform pensions in the EU was decades ago, the second-best time is now.

## Not binary

Pay-as-you-go is the standard pension model in many EU countries and provides many pensioners with a good retirement income. In simple terms, today's taxpayers and employees pay the pensions of today's pensioners. But lately, PAYG has come under pressure. Here are some of the model's challenges and upsides:

1. **Changing demographics:** PAYG pensions only work when payments by younger generations meet the pension promises made to older generations. These promises are more and more at risk. Today, there are three adults of working age for every pensioner in the EU. By 2050, there will be less than two workers for every pensioner. PAYG pension systems can be stabilised by increasing contribution rates or retirement age, or lowering retirement incomes, but these are unpopular measures.

2. **Very expensive:** another way to stabilise PAYG pensions is using public funds, but this creates an even bigger economic burden on taxpayers and government budgets. Germany's public pension expenditure is already 10.4% of GDP and set to increase; in France, it is 14.5% against the OECD average of 7.7%. At the same time, replacement rates in Germany (at 55% net) and France (at 72% net) are relatively low.

3. **Not invested:** there is a lot of notional money in PAYG systems, but it is not being used productively. Because pension 'contributions' are not invested, they do not support jobs and innovation, and pension pots are only indirectly linked to economic growth.

4. **Safety net:** on the plus side, PAYG pensions are less dependent on the financial markets or an individual's lifetime career and are ideal to provide a safety net and a basic retirement income in later life.

The alternative model to unfunded PAYG pensions is funded pensions where contributions are not immediately redistributed to current pensioners but saved and invested to build a fund that can be withdrawn in retirement. Funded pensions provide a lot of benefits, but they also come with some risks, and there can be significant transition costs that complicate moving from PAYG to funded pensions:

1. **Better retirement incomes:** the Netherlands (at 93% net) and Denmark (at 77% net) have some of the highest pension replacement rates of all OECD countries. Designed in the right way, funded pensions can provide higher retirement incomes to pensioners while reducing public pension expenditure.

2. **Productive capital:** annual pension contributions add up to billions of euros a year that can be put to work supporting the economy in much needed areas such as investment in infrastructure and innovation. Through their investments, savers and pensioners directly benefit from economic growth.

3. **Resilient:** pension savings that are invested in a diversified way and allocated across various asset classes and geographic regions are less susceptible to economic shocks that can hit a country's government budget and affect current and future PAYG pension levels.

4. **Market fluctuations:** investments in the capital markets always come with a risk. Asset values go up and down, and a global economic shock shortly before retirement can significantly reduce a person's pension pot. At the same time, things can bounce back quickly: after the 2007-2008 global financial crisis, it took Dutch pension assets only a little more than three years to recover to pre-crisis value levels.

Most pension systems combine elements of PAYG and funded pensions across pillar I (public), pillar II (occupational), and pillar III (private) as well as defined contribution (DC) and defined benefit (DB) pensions.

## Moving the dial

To really make a difference in scale of long-term capital in the EU, you need to develop deep pools of pension assets and retirement savings, and more retail investment. At the individual level, households that hold a higher share of savings in pensions (and who make regular contributions to those pensions) have less money available to invest outside of their pensions. But at the structural level, there appears to be a positive relationship between the size of pension assets, retail investment, and long-term capital relative to GDP.

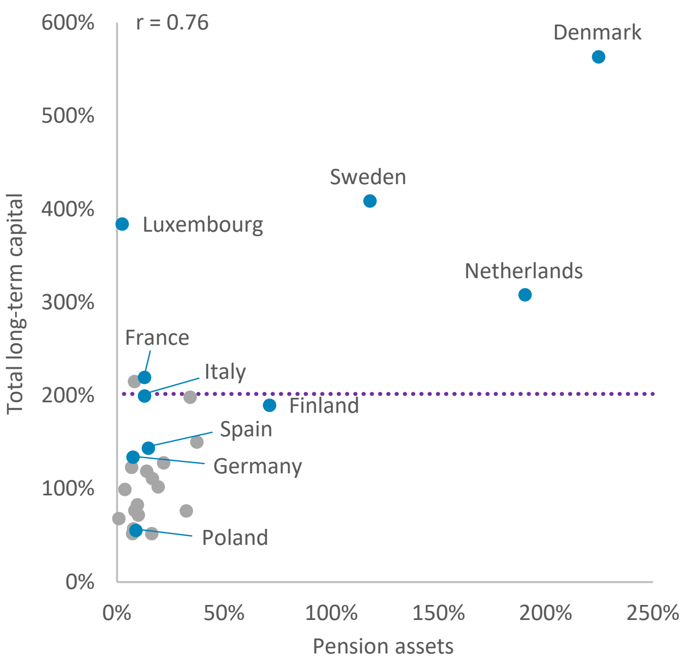
Fig.4 suggests that without bigger funded pensions, long-term capital in EU member states maxes out at about 200% of GDP. Fig.4 i) shows that three of the four biggest countries for total long-term capital are those with the largest pension assets. Most of the countries with low levels of pension assets are clustered in the bottom left of the chart. Fig.4 ii) shows that even member states with higher levels of retail investment such as France, Italy, or Belgium hover around the 200% threshold. Two of the three member states with the largest pensions also have the highest level of retail investment, suggesting that pensions can shape how people engage with their money. For reference, ICI research shows that most US households purchase their first mutual funds through employer sponsored retirement plans.

Integrated reforms of retirement saving and retail investment across structure of pension systems, financial literacy and advice, distribution, transparency and disclosure, and incentives are key to overcome inertia, to help people make better choices, and to increase the levels of long-term capital in the EU.

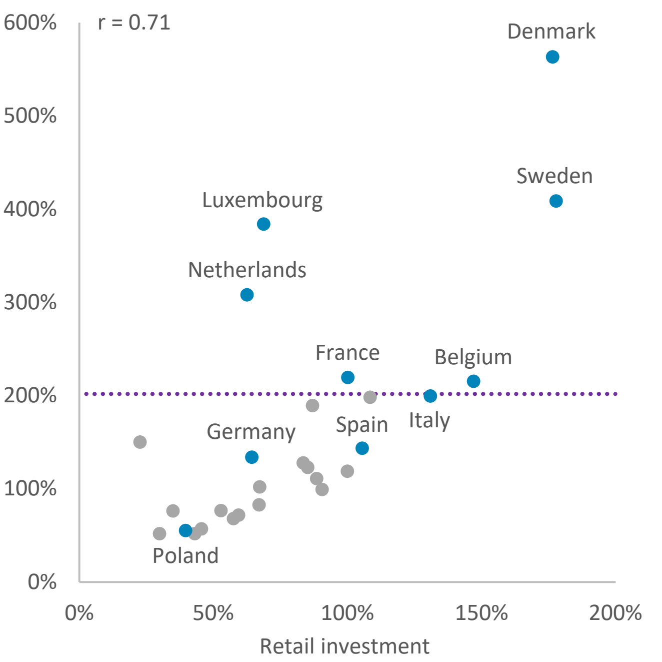
### Fig.4 What is the relationship between pension assets, retail investment, and long-term capital in the EU?

These charts show the correlation between the total size of pools of long-term capital (pensions, insurance, and retail investment) in % of GDP and the size of pension assets (i) and retail investment (ii) in % of GDP in all 27 EU member states in the three years to 2022.

i) The relationship between pension assets (x-axis) and total long-term capital (y-axis)




ii) The relationship between retail investment (x-axis) and total long-term capital (y-axis)




*Source: New Financial analysis of data from EIOPA, Eurostat, IMF, and OECD*

## Pension systems and retirement saving in the EU

While pension assets in the EU overall are quite low, there are a few member states that have deep pools of long-term capital which build on well-funded and sustainable pension systems - and there are further, promising reforms underway.

This section classifies retirement systems in industrialised economies, shows what other member states can learn from public pensions in Denmark and Sweden and occupational pensions in the Netherlands, and discusses the current pension reforms that are underway in Germany with a focus on its 'Generationenkapital'.

Any reform on pensions touches on the very social fabric that underpins the European community. They are not easy, take years to implement, should not be rushed, and should be based on broad political agreement. While the EU and member states could benefit from more radical reforms, gradual changes to optimise the three pillars in existing systems are more likely to result in buy-in from citizens, social partners, and other key stakeholders.

## Three pillars and four models

This page provides a classification of the four main models of retirement systems in industrialised economies. The list is neither exhaustive nor exclusive (many of the building blocks of the 'collective' model also apply to the 'Nordic' model), and the retirement system in any given country is unique and has evolved around different economic, cultural, philosophical, and political needs, but there are still aspects of some models that other economies can learn from:

*Note: the letters in brackets indicate each economy's rating in Mercer's CFA Institute Global Pension Index 2023*

### The 'classic' model

Predominant pay-as-you-go unfunded pillar I state pension. Private retirement savings through occupational (pillar II) and private (pillar III) pensions exist but are underdeveloped.

**Examples include:** France (C+), Germany (B), Poland (C), Italy (C), Spain (C+)

**Key building blocks for this model's success:** healthy demographics with a positive ratio between people currently in employment and people in retirement; or balanced government budgets that can finance the pension promises made to people throughout their career.

### The 'Nordic' model

Partly funded pillar I state pension that supplements mandatory or quasi mandatory pillar II occupational pensions that are individually or collectively invested.

**Examples include:** Canada (B), Denmark (A), Norway (B), Sweden (B)

**Key building blocks for this model's success:** size, scale, and professional management of the fund's assets; a gradual introduction of the fund; management of transition costs; and a mechanism that ensures people who could not contribute (enough) throughout their lifetimes still receive a basic pension.

### The 'collective' model

Basic, unfunded state pension. The majority of retirement income comes from mandatory or quasi mandatory occupational pensions that are collectively invested.

**Examples include:** Finland (B+), Iceland (A), Netherlands (A), Switzerland (B), Croatia (C+)

**Key building blocks for this model's success:** size, scale, and professional management of occupational pension funds; adequate contribution rates; low management fees (for example achieved through mandating pension plans to operate not-for-profit); consumer trust; well-managed transition from PAYG.

### The 'individual' model

Basic, unfunded state pension. The majority of retirement income comes from individually invested pension pots to which employees and, usually, employers contribute.

**Examples include:** Australia (B+), Israel (A), United Kingdom (B), Ireland (B), United States (C+)

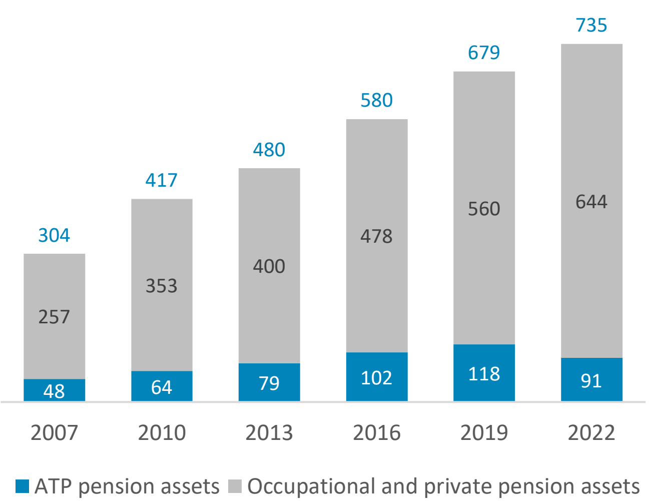
**Key building blocks for this model's success:** high levels of financial literacy, confidence, and consumer trust; a regulatory framework that ensures pension plans deliver value for money; adequately high minimum employee and employer contribution rates; incentives to encourage saving.

## An 'A'-rated pension system

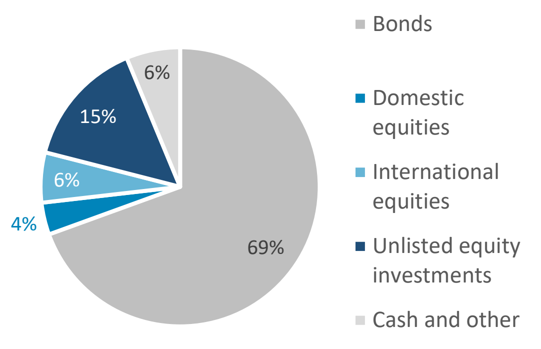
Denmark is one of only four 'A'-rated pension systems in Mercer's CFA Institute Global Pension Index (alongside the Netherlands, Iceland, and Israel). Danish pensions are larger relative to GDP than in any other EU country. The system is over 100 years old and was overhauled in the late 1980s. Denmark's net pension replacement rate is around 77% of pre-retirement earnings. More than 80% of the workforce are covered by quasi mandatory occupational DC pensions, but a key feature of the Danish pension system is a fully funded supplementary fund that supports Denmark's pillar 1 and the basic state pension. The ATP fund covers almost all wage earners who pay in fixed contributions. In 2022, the fund adopted a more growth-focused investment approach: savers with more than 15 years to retirement now have a 60:40 split between safe and growth assets. ATP is one of the largest investors in Denmark and in the Nordics.

### Fig.5 The size, development, and asset allocation of pension assets in Denmark

i) The size and growth of pension assets in Denmark from 2007 to 2022 in €bn, with the number in blue showing total size



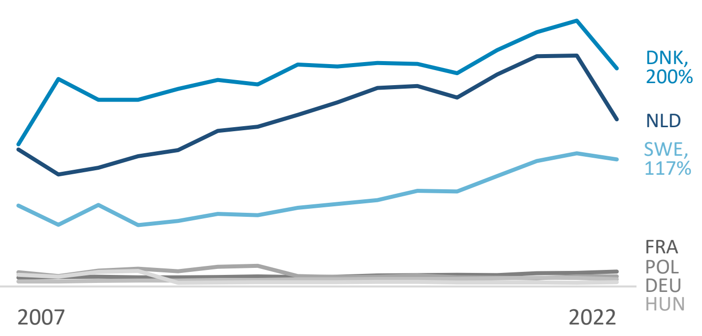

ii) The average asset allocation of Denmark's ATP pension fund in the three years to 2023




*Source: New Financial analysis of data from ATP annual reports, IMF, and the OECD*

### Fig.6 The size of pension assets relative to the economy

The size of pension assets in % of GDP from 2007 to 2022 in selected EU member states



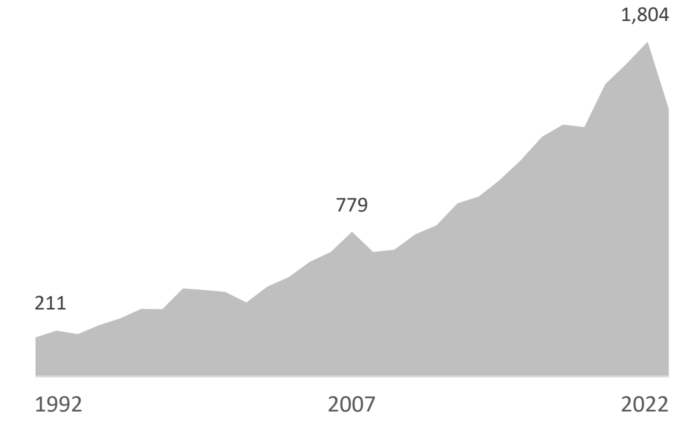

*Source: IMF, OECD, New Financial*

## Nordic neighbours

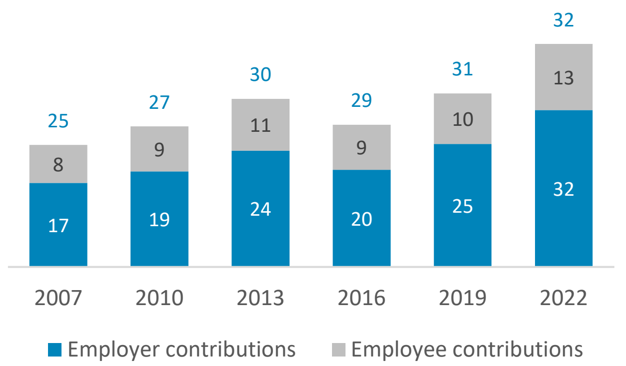
Sweden's pension system is another good example of a partly funded pillar 1: since 1998, 2.5% of each worker's pensionable income is allocated towards the 'premium pension' and paid into individual investment accounts to build up a funded pension pot. At retirement age, funds can be withdrawn or converted into a traditional insurance plan. Savers can choose between 400 privately managed funds or invest in the default, state-run AP7 fund. Nearly 90% of the AP7 fund are invested in global equities. Of that, 16% is invested in Europe. New rules introduced in 2023 allow AP7 to invest up to 20% of the fund's capital in alternative asset classes.

## Fig.7 The size and development of Dutch pension assets

i) The development of pension assets in the Netherlands from 1992 to 2022 in €bn



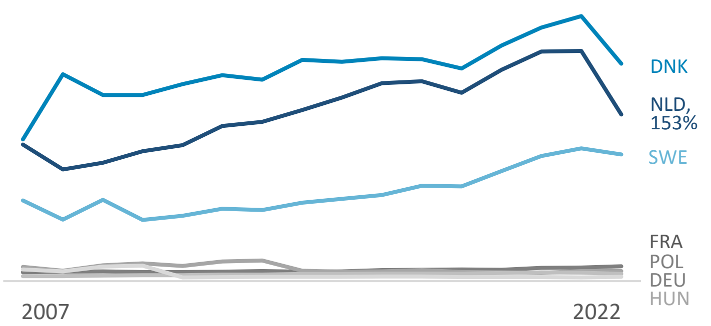

ii) Annual contributions to pension funds in the Netherlands from 2007 to 2022 in €bn, with the number in blue showing total contributions




*Source: De Nederlandsche Bank, OECD, New Financial*

## Fig.8 The size of pension assets relative to the economy

The size of pension assets in % of GDP from 2007 to 2022 in selected EU member states




*Source: IMF, OECD, New Financial*

## In transition

The Netherlands is probably the poster child in Europe - if not worldwide - for a well-designed occupational pension system.

The Dutch pillar II is based on strong occupational pensions that provide a large, funded pension pot to supplement state and private pensions. The government can make participation in a scheme mandatory for entire sectors or professions, and almost 90% of workers in the Netherlands are covered by occupational pension schemes. Dutch pension plans were set up in the 1950s and the general structure of pillar II remains the same today. This has given them around 70 years to invest and accumulate savings and allowed Dutch pensions to benefit from wider economic growth.

The combination of a basic PAYG state pension with fully-funded occupational pensions makes the pension system in the Netherlands sustainable and resilient. Key features of the Dutch second pillar are collectivity and risk-sharing, the quasi-mandatory nature of the system, and that pension funds in the Netherlands operate on a not-for-profit basis which keeps costs under control.

Employer contributions make up the majority of pension contributions. Contribution rates average around 30% of gross salaries and add up to a lot of money that gets invested and is put to work supporting the economy in much needed areas such as infrastructure and innovation. The net pension replacement rate in the Netherland is 93%, one of the highest replacement rates in the OECD. At the same time, this leaves people with little money (and need) to invest outside of their pensions.

But the system is not perfect and is being reformed. Over the past 20 years it has switched from a DB final salary to a career average model, and most recently to collective DC and more individualised investment strategies. Reforms also aim to open the Dutch pillar II schemes to the increasing number of people in other non standard forms of work, and generous tax reliefs introduced in 2023 are making additional private pension saving more attractive.

## Tough choices ahead

Germany effectively invented pensions in the late 19th century, but its modern-day pension system that still heavily relies on its pay-as-you-go public pension in pillar I is increasingly coming under pressure.

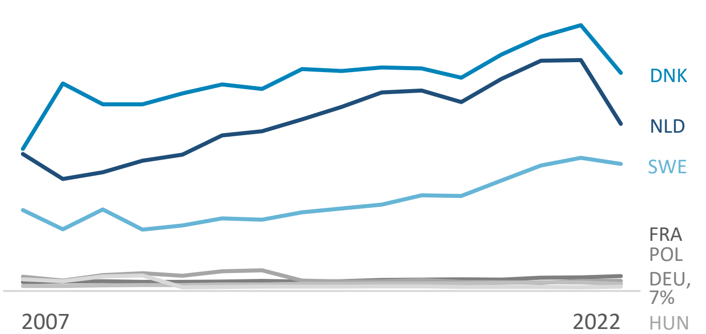
Reforms in the last two decades tried to encourage people in Germany to save more through occupational and private pensions but fell flat. The 'Riester' private pension product in particular has design flaws (for example that pots must come with a guarantee) that make the scheme costly to run and annual management charges are often higher than the bonus payments people receive from government.

The ongoing 'Generationenkapital' reform is a small step in the right direction and will introduce a pension fund that will invest in global equities and use returns to supplement and support Germany's pillar I state pension. It is not funded via contributions, however, and its target size of €200bn in the 2030s (Fig.11) will likely not make a huge difference. German finance minister Christian Lindner often referred to the Swedish premium pension as best practice, but the plan to fund the 'Generationenkapital' through contributions faced a lot of political opposition from trade unions and even from within Germany's coalition government.

Measures to reform pillar II and pillar III pensions in Germany will be announced later in the year and are expected to signal a shift away from guarantees, but there is a long way to go for Germany in creating a system and culture that allows more engagement with the capital markets.

### Fig.9 The size of pension assets relative to the economy

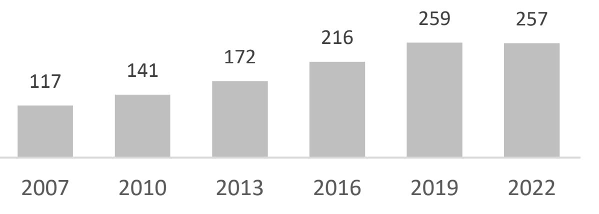
The size of pension assets in % of GDP from 2007 to 2022 in selected EU member states




*Source: IMF, OECD, New Financial*

### Fig.10 The value of German pension assets

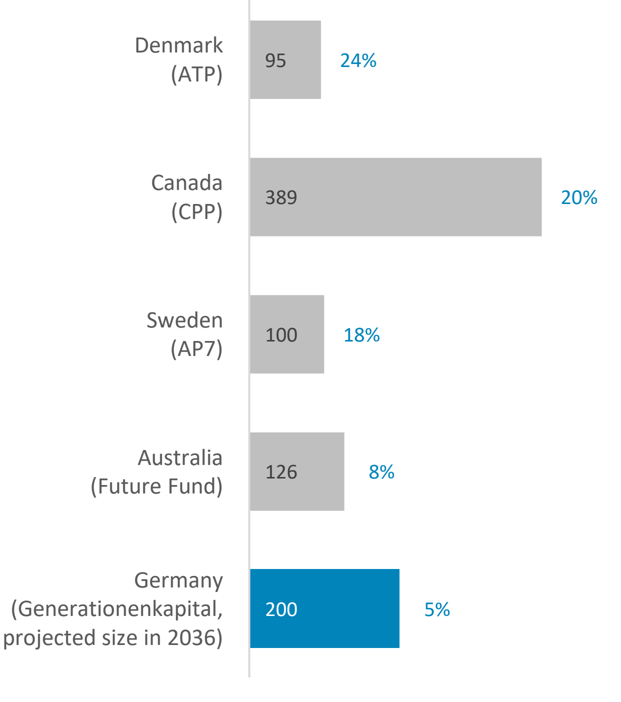
The size and growth of pension assets from 2007 to 2022 in Germany in €bn




*Source: New Financial analysis of data from the OECD*

### Fig.11 The size of the 'Generationenkapital' fund

The target size of Germany's 'Generationenkapital' fund in the mid 2030s and the size of comparable funds in 2023 in €bn and as a % of 2023 GDP in blue




*Source: New Financial analysis of data from the Bundesfinanzministerium, IMF, and the funds' annual reports*

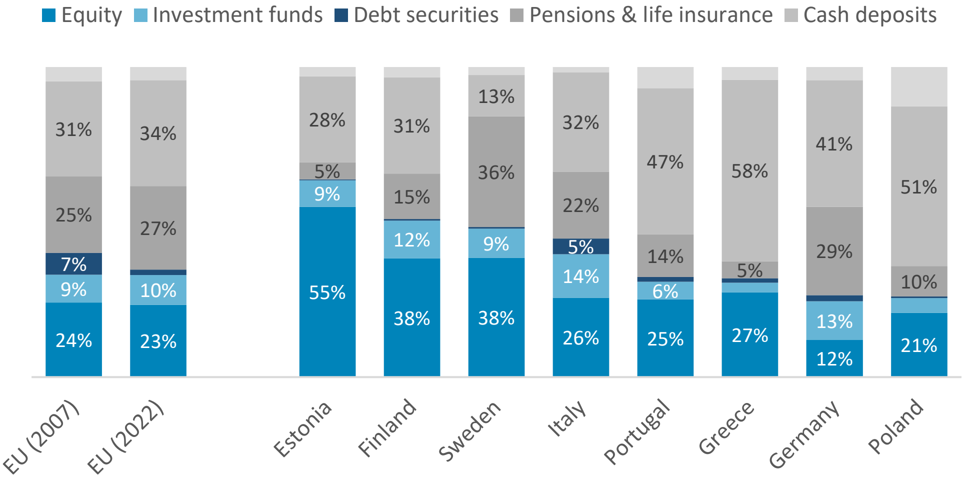
## Retail investment markets in the EU

Europeans are good savers, but too many savings in the EU are held in cash, with negative consequences for households and the European economy. While direct retail investment is not for everyone, it is a useful indicator for the level of confidence that people in the EU have when they engage with their money.

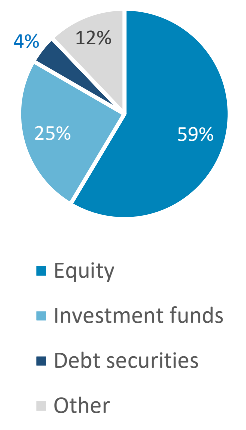
This section analyses the current state of play and developments in the European retail investment markets, shows three typical distribution models of investment products in the EU (including each model's advantages and disadvantages), and discusses how distribution has an impact on the way Europeans invest.

## Fig.12 How do people in the EU and in individual member states invest and engage with their money?

i) The distribution of household financial assets in the EU from 2007 to 2022, and the average distribution in selected member states in the three years to 2022




ii) The average asset allocation of EU savers' retail investment in the three years to 2022




**26%** Share of households that directly owned stocks and shares in Sweden in 2023

**7%** Share of households that directly owned stocks and shares in Germany in 2023

**2.35%** The average annual total cost of investing in Germany in 2022

**1.64%** The average annual total cost of investing in the UK in 2022

*Source: Deutsches Aktieninstitut, Euroclear, Eurostat, Vanguard (Total Cost of Investing 2024)*

### Standing still

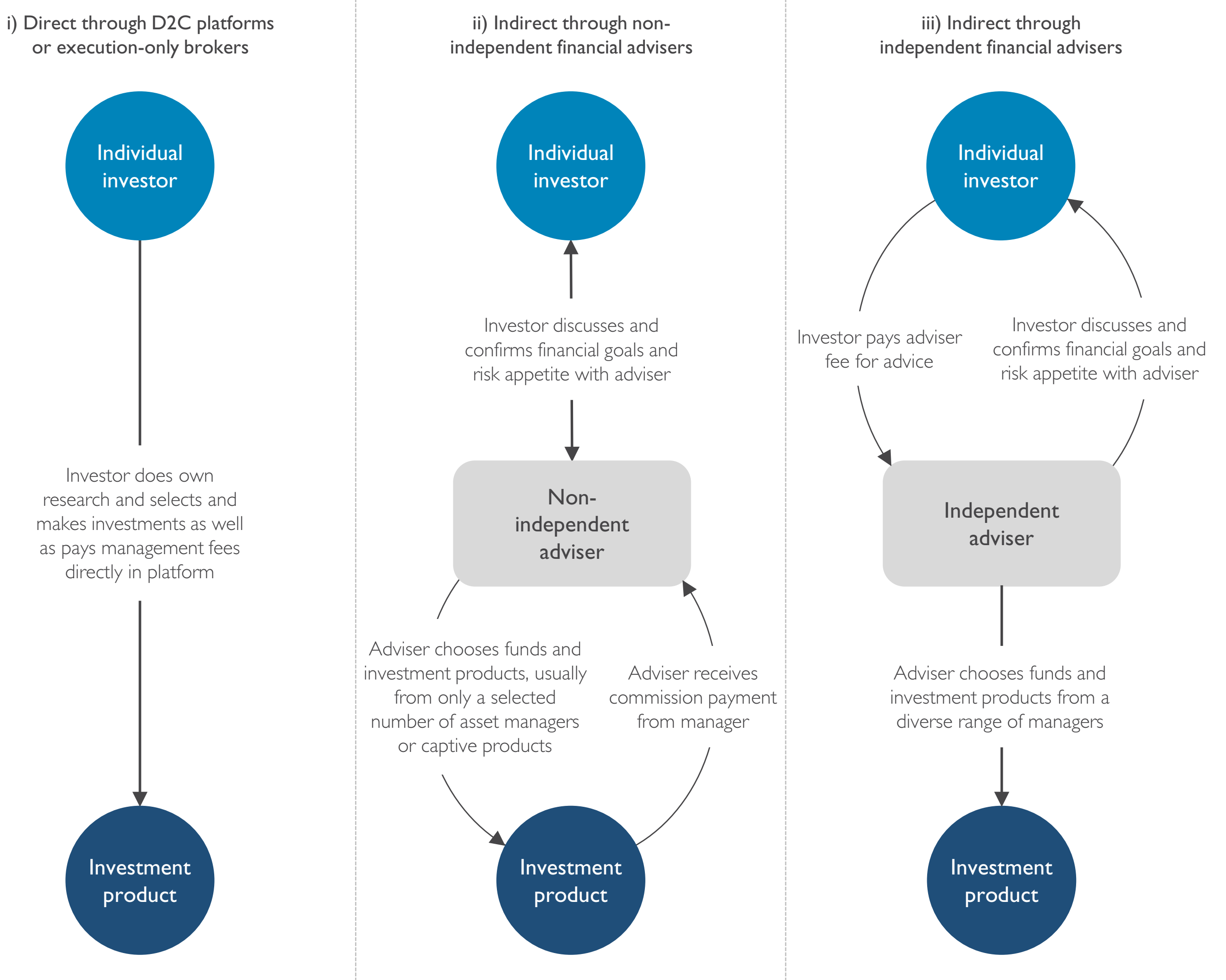
Europe in large parts is not a continent of investors. Cultural attitudes that shape risk and loss aversion in many member states, a regulatory framework that too often tries to protect individual investors by excluding them from accessing products and markets (such as IPOs), the fragmentation of markets and unnecessary complexity of cross-border investing, and the relatively high fees that savers in the EU are paying to access investment products (which are not widely understood, in particular the long-term impact of those costs on returns) all lead to an environment in which people prefer to keep a large share of savings in cash.

There have been some positive developments for retail investors in the EU in recent years: its flagship Retail Investment Strategy aims to make the EU a better place for individual investors, and a few other reforms like the EU Listing Act will make it easier for individual investors to access products and markets, but it is unlikely that these measures will inspire far-reaching cultural change and get savers in the EU to actively move money en masse out of bank accounts.

Another challenge that complicates effective policymaking is the varying levels of financial literacy and sophistication of individual investors across the EU. Investors in the Nordics prefer equity and funds, whereas Italy stands out with its retail demand for fixed income products. People in Estonia or Finland seem to be more comfortable with engaging with the capital markets than people in Portugal or Greece who face different barriers that require different and tailored measures. The mixed messaging that people in the EU receive does not exactly help either: while the European Commission tries to give CMU a boost by unlocking retail investment, German Chancellor Olaf Scholz famously said in 2021 that all of his savings are in his German 'Sparbuch' savings account earning no interest…

## Fig.13 How do people in the EU buy investment products?

One of the problems that individual investors in the EU have is that retail investing is more complicated and expensive than it should be. The European retail investment landscape is still dominated by non-independent financial advice and captive products that are not always in the best interest of retail investors. At the same time, they make investment products more accessible for people who are not confident enough to self-invest through direct to consumer (D2C) platforms. This simplified infographic shows three typical distribution models of investment products in the EU and highlights each channel's advantages and disadvantages.




**i) Direct through D2C platforms or execution-only brokers**

Accounts for 9% of EU fund assets owned by EU retail investors, according to EFAMA

**Advantage:** offers direct and low-cost access to investment products

**Disadvantage:** self-investing requires higher levels of confidence; some platforms offer access to speculative products such as CFDs that are only suited to highly sophisticated retail investors

**Case study:** following its ban on inducements, retail investors in the Netherlands are systematically directed to D2C websites and platforms

**ii) Indirect through non-independent financial advisers**

Accounts for at least 66% of EU fund assets owned by EU retail investors

**Advantage:** people can tap into existing relationships with their local bank and easily access financial advice and products

**Disadvantage:** potential conflicts of interest when advisers only advise on products their firm is offering or choose those they receive higher commission payments for

**Case study:** more than half of mutual fund assets are channelled via in house distributors in Spain, France, Germany, and Italy, according to Cerulli Associates

**iii) Indirect through independent financial advisers**

Accounts for no more than 15% of EU fund assets owned by EU retail investors

**Advantage:** offers independent, whole of market advice and access to investment products tailored to people's needs

**Disadvantage:** independent advice often comes with high upfront fees that people are unwilling to pay and might deter them from taking advice in the first place

**Case study:** in the UK, banks and insurers usually redirect retail investors looking for advice to panels of independent financial advisers

## Distribution drives product choice

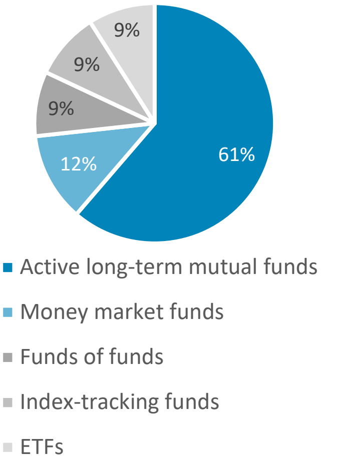
With non-independent advice and captive products being the main way in which individual investors in the EU access investment products and index-tracking funds or ETFs still relatively new, it is perhaps not a surprise that actively managed funds (who are usually managed by the institutions that advisers work for) account for the large majority of all assets under management by European investors. Active management aims to outperform the market and can more quickly respond to a sudden change in market conditions, but fees are higher than for index-tracking funds or ETFs.

There are signs that the behaviour by European investors is changing. Research by Deutsches Aktieninstitut shows that of the people in Germany that engage with the capital markets, 35% of 14 to 39 year olds invest in ETFs compared to just 17% of those older than 40. Advisers seem to be ready to adapt to such a changing world. In a survey conducted by Vanguard, 58% of advisers in Italy and 47% of advisers in Germany stated that under a hypothetical fee-based model (as it already exists in the UK and the Netherlands), ETFs would be a good way to keep costs down.

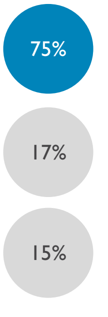
This does not mean that the traditional way of investing in Europe does not have a future. Savers who are more risk averse might still want to access the capital markets through more insurance-based products that have a guarantee component. But those who do want direct exposure to equities and funds (in particular younger investors) might steer more towards self-managed, low-cost index funds or ETFs that they can access directly through digital platforms.

### Fig.14 How does Europe invest?

The average share of European investment funds by assets under management in the three years to 2022




*Source: New Financial analysis of data from Cerulli Associates (European Distribution Dynamics 2023: Navigating Uncertainty)*




Three quarters of UK advisers surveyed by Vanguard said that retirement advice is a key part of their service, compared to…

…17% of advisers in Italy and…

…15% of advisers in Germany

*Source: Vanguard (Total Cost of Investing 2024)*
*Note: Vanguard surveyed 400 advisers in each country.*

## Why does retail investment matter?

Widening retail participation in the European capital markets presents a significant opportunity. For individuals and households, it plays an important role between short-term, risk-free savings in bank accounts and long-term investments that are locked away until retirement. The savings pot that is earmarked for a child's university education, for example, will very likely grow bigger if it is invested over 20 years than if kept in a savings account. And at a more structural level, more people choosing to invest more of their money makes more capital available for the economy, closes existing funding gaps, and directly supports companies, jobs, and growth in Europe and worldwide.

At the same time, this is easier said than done. The cost of living crisis is still having an impact on people, households have competing savings objectives (and a deposit on a house is still more attractive and more tangible for many people than stocks and shares), and trust in the banking and finance industry remains low. Lower fees and easier access to the markets will probably not move the dial on its own but would be a good start. The big move would be to pair these measures with more structural reforms of pensions and retirement saving.

## An integrated reform agenda

One of the main messages of this report so far is that neither pensions nor retail investment can move the dial on long-term capital and the EU's investment needs on their own. We need to pair measures to widen retail investment with more structural reforms of pensions and retirement saving. This will not happen overnight, but there are a few essential building blocks that can help create better outcomes for households and the European economy.

This section discusses why there is a new sense of urgency when it comes to capital markets development in the EU, shows that different public policy objectives need different incentives to steer behaviour, and highlights why reforms need to happen at both the EU and the member state level. It then measures the growth potential of pension assets and retail investment in the EU, makes nine recommendations for an integrated reform agenda that can help make substantial progress on retirement saving and retail investment, and closes with some difficult truths that are relevant in this debate.

## A new sense of urgency

Over the past decade capital markets have moved up the political agenda across the EU and there has been a sea change in political commitment over the past few years. The work done on CMU by the Eurogroup of finance ministers and the review of the effectiveness of the single market led by former Italian Prime Minister Enrico Letta, as well as initiatives in member states such as the taskforce on CMU in France led by former Governor of the Bank of France Christian Noyer, or the statement by the Dutch central bank and the AFM all called for a renewed focus on how private savings can be unlocked to increase pools of long-term capital in the EU.

The combination of Brexit, Covid, the invasion of Ukraine, and geopolitical tensions have heightened awareness that the EU economy needs all the help it can get and that capital markets are an essential part of the solution in driving growth, investment, and competitiveness. It will be a challenge to translate this renewed commitment into concrete action, but there are three developments that might further drive the momentum on capital markets and help build a broad political coalition based on the social and economic benefits this could deliver:

1. **Strategic challenges and stretched government budgets:** the EU and member states are facing significant social and economic challenges, including demographic change, accelerating the green transition, financing innovation, increasing Europe's defence capabilities and overall security, and positioning the EU on the global stage. These challenges are complex, multi-faceted, directly linked to Europe's competitiveness, and present a once-in-a-generation opportunity to transform the lives of millions of EU citizens - but they are very expensive. Banks in Europe are hitting the limits on what they can finance, and government budgets are increasingly struggling to meet even current demands. Just recently, the European Commission reprimanded seven member states including France, Italy, and Poland for breaking the EU's budget rules. Unlocking more long-term capital and developing capital markets in the EU is the most important lever to move Europe forward, and more and more policymakers are starting to realise this.

2. **An ageing population:** many countries in the EU are facing a demographic time bomb. Today, there are three people of working age for every pensioner in the EU. By 2050, there will be fewer than two workers for every pensioner. This will put a lot of pressure on the EU's prevalent PAYG pension systems, with governments scrambling to support their pension systems (with uncertain outcomes) and households in the EU facing challenging financial futures. Some countries such as Germany have understood the problem and are starting to take small reform steps, but are reluctant to make the necessary, bigger moves. With existing pension systems coming under pressure, there will inevitably be more debate about the sort of measures that individual member states can and should take.

3. **A year of change:** in just a few months there will be a new European Parliament, a new European Commission, and a new European Commissioner for Financial Services, Financial Stability, and CMU. This is a good opportunity for policymakers to pause for breath, review the work done by the Eurogroup, Letta, Noyer, and others, and rethink and refocus capital markets policy. While there is a risk that some of this work might get lost in translation, the perspective on bigger and better capital markets in Europe has clearly shifted from a 'nice to have' to a 'must have' approach. This bodes well for a potential CMU 3.0 that is perhaps focused more on outcomes than legislative initiatives and more on what individual member states can and should do themselves rather than wait for EU-wide solutions.

   At the same time, the European elections also mean that in July this year there will be hundreds of MEPs taking their seats who do not know a lot about capital markets - and the banking and finance industry will need to work hard to build new relationships and persuade them why capital markets matter and what they can do to help them thrive.

## No one-size-fits-all approach

Fiscal incentives such as tax reductions are one of the biggest levers to change people's behaviour and encourage them to save more and better by shifting their savings out of their bank accounts and into long-term investments. But recent debates and reports have shown that the EU and national governments in EU member states have a variety of public policy goals at different levels. They do not always align and there usually is no 'one-size-fits-all' approach that can achieve all goals with a single measure or incentive. Here are three of the main public policy goals in the EU on mobilising savings and investments, and how incentives or carefully designed products can help achieve them:

### Measures to encourage people to have basic savings

**Rationale:** basic emergency funds that cover people's expenses when they face a sudden financial shock rely on risk-free access to cash.

**How to do it:** provide a cash savings product that does not tax interest payments (up to a limited amount).

**Example (I):** Cash ISAs in the UK. Allowance per financial year is currently at £20,000 (€23,500). Any interest received is tax exempt while savings are held within wrapper.

**Example (II):** Prize Bonds in Ireland. Up to €250,000 worth of Prize Bonds can be purchased. While not technically a savings account, each bond is entered into a weekly draw with a chance to win cash prizes ranging from €75 to €500,000.

**Challenges:** many people struggle to save anything as their cost of living is too high. When they can save, savings accounts are a good option for money that will be needed in the short term but the value of money usually erodes over the longer term.

**Alternative:** personal savings allowances that let people earn a set amount of interest tax-free. Interest needs to be declared and can make tax reporting more complex.

### Measures to encourage people to save better and invest for the longer term

**Rationale:** over longer time horizons, investing is a more powerful tool for individuals to improve their financial wellbeing than keeping savings in cash.

**How to do it:** grant tax incentives only when savings are invested in the capital markets.

**Example (1):** ISKs in Sweden. No upper limit on investments and a simple and low annual tax based on the estimated market value of holdings, with returns and dividends on the first 300,000kr (€26,000) completely tax free.

**Example (II):** auto-enrolment in DC pensions in Ireland. Once fully implemented, employers and employees will each contribute 6% of an employee's salary with a state top up equivalent to 25% tax relief.

**Challenges:** people might choose to invest all of their money in US equities. Higher returns for savers would not necessarily translate into more capital that is available to support the European economy.

**Alternative:** generous tax-free allowances on capital gains. These would need to be declared and can make tax reporting much more complex and complicated.

### Measures to encourage people to invest in and support the European economy

**Rationale:** the European economy needs all the help it can get, and it is not unreasonable to think that there should be some form of quid pro quo for generous tax incentives.

**How to do it:** grant tax incentives only when savings are invested in European assets.

**Example (I):** PIR in Italy. Up to €200,000 can be held in a PIR, but 70% of the capital must be invested in Italian companies or EEA companies operating in Italy (and 30% of this capital must be in small or mid caps). Any gains are tax exempt if stocks were held for at least five years.

**Example (II):** the long-term savings product proposed by the French taskforce on CMU that would require a minimum of 80% of savings to be invested in European assets.

**Challenges:** savers cannot benefit from geographic diversification and may miss out on potentially higher gains they would make if they would be able to invest in global assets.

**Alternative:** focus on creating large pension funds that have the scale and expertise to invest in public and private assets in the EU - see Denmark and Sweden.

## The limits of 'top down'

There is a growing recognition by individual EU member states that they need to take more responsibility for developing their own capital markets from the bottom up. This is partly driven by the awareness that sometimes waiting for agreement between all member states or at the EU level slows down or halts reforms, and partly driven by the reality that some reforms are not a competency of the EU and can only be done by member states.

This is reflected in the recent work done on EU capital markets and CMU. In his report on the single market, Enrico Letta called for the development of long-term savings plans at the EU level, whereas the French taskforce on CMU led by Christian Noyer argued that it would be 'simpler' and 'quicker' to allow willing member states to act rather than attempting to create a unique European savings product. The Eurogroup's statement on CMU included recommendations to both the EU and member states, whereas the Nordic Council's declaration on competitiveness and security was explicit on the need to reform the structure of national tax and financial systems, including pensions.

PEPP, the pan-European Personal Pension Product, is a perfect example of the limits of a top-down approach. It was part of the original CMU package in 2015 but only launched in 2022 after seven years of debate and so far has seen virtually no take-up with just one roboadviser in Slovakia offering PEPPs in four different markets. One lesson from PEPP is that the EU legislative process creates complexity that can cause failures in the 'real world'.

There is a long tail of measures and reforms agreed (and partly or fully delivered) in the two CMU action plans at the EU level that have an indirect but relevant impact on retirement saving and retail investment markets in the EU such as securitisation (which would generate more assets investors can invest in), the European Long-Term Investment Fund (which aims to channel capital into illiquid, long-term assets such as infrastructure projects), or the EU Listing Act (which will simplify EU listing rules and, ideally, increase the universe of stocks listed in the EU). But the big, structural levers to reform pension systems and encourage more retail investment in the EU are in the hands of member states.

Developing capital markets from the bottom up should not be seen as a 'free for all' that puts member states in conflict with EU harmonisation. Bottom-up initiatives are most effective when they are coordinated at the EU level and broadly point in the same direction. And it is not an 'either / or': bigger and better capital markets in the EU need both - reforms to encourage harmonisation at the EU level and reforms to build capacity in every member state.

**'Top down'**

Reforms that can (and need) to be done at the EU level

**Examples of 'top down' reforms and measures on retirement saving and retail investment include:**

- improvements to the cross-border transferability of pension pots and pension entitlements
- introduction of frameworks for pan-European voluntary personal pension schemes such as the PEPP
- analysis and guidance on pensions and other social protection mechanisms

**'Bottom up'**

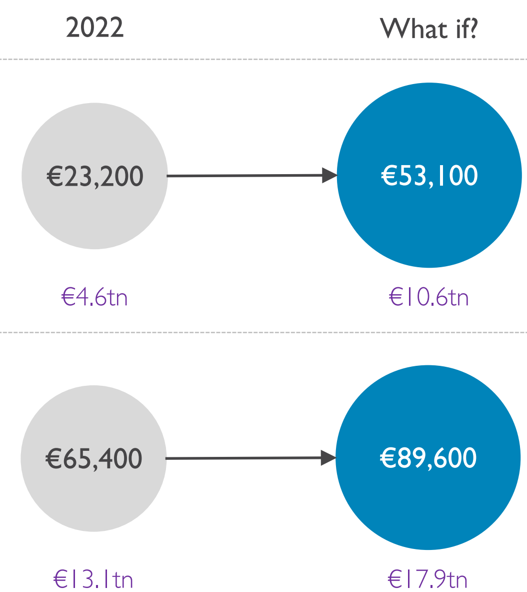
Reforms that can (and need) to be done at the member state level

**Examples of 'bottom up' reforms and measures on retirement saving and retail investment include:**

- the fundamental design of pension systems across the three pillars, including the financing of state pensions
- auto-enrolment in occupational pensions
- tax incentives to support private pension savings
- introduction of frameworks for tax efficient investment accounts to encourage retail investment

## Fig.15 What is the growth opportunity in pensions and retail investment in the EU?

i) The potential growth in the value of pension assets and retail investment per household across the EU, with the total value of pension assets and retail investment in purple




### Pension assets

+€29,900 for each household in the EU
+€6.0tn in total value across the EU
+129%

### Retail investment

+€24,200 for each household in the EU
+€4.8tn in total value
+37%

### The trillion euro question

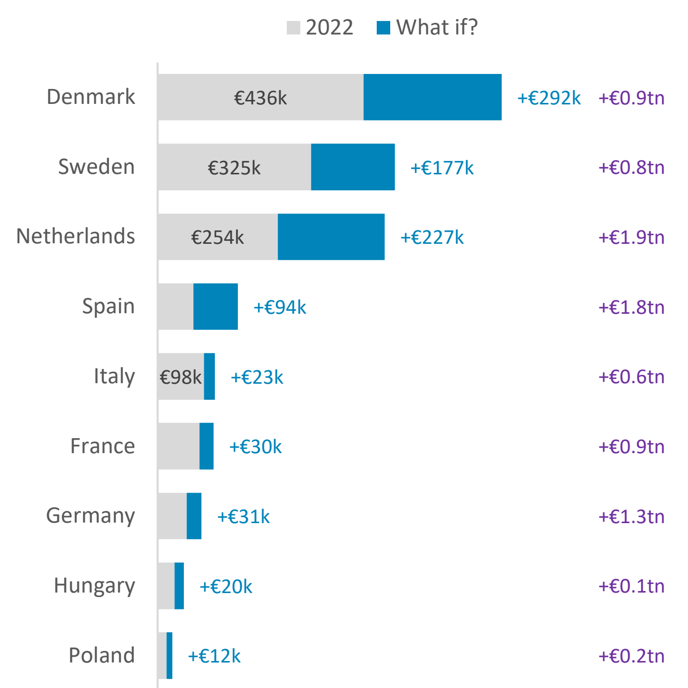
Transitioning the EU's pension systems to at least partly funded models and moving savings out of bank accounts and into the capital markets would unlock sizeable amounts of money.

Assuming that Hungary would look a bit more like Poland, or Spain a bit more like Ireland, we estimate that pension assets in the EU would more than double to €10.6tn. Retail investment would grow by more than a third. At a household level, the combined growth would increase average savings by around €54,000.

Even if only a third of the additional €11tn in pension and retail investment would be invested in European assets (in line with the average asset allocation of UCITS equity funds), this would give the European economy a significant boost. For reference, the European Commission estimates the cost of the green transition to be €700bn per year between 2023 and 2030.

We think our projection is ambitious but realistically achievable: €10.6tn would place EU pension assets at 73% relative to GDP, which is still lower than in the UK, Australia, Sweden, the Netherlands, and Denmark.

ii) The potential combined growth in the value of pension assets and retail investment per household in selected EU member states, with the total increase in pension assets and retail investment in purple




*Source: New Financial analysis of data from Eurostat, IMF, and the OECD*
*Note: see here for our full methodology to measure the growth potential.*

## 1) Helping people save better for the longer term

Europeans are very good savers but need to save in a better way to generate higher returns for themselves and unlock capital that is much needed to support the European economy. Simple products and attractive incentives to overcome inertia paired with softer measures on public awareness can, over time, change people's behaviour:

**i) Providing clear and simple savings products:** people who use ISAs in the UK or ISKs in Sweden to save and invest their money and then move to another European country might be surprised to learn that in almost all EU member states tax wrappers like these either do not exist, or are more complicated and more expensive to access, or restrict the assets that people can invest in.

Ideally, savers would have access to similar and transferable tax wrappers no matter where in the EU they live. But as a first step, member states should introduce tax-efficient savings and investment accounts in their own jurisdictions. This would allow them to move faster and tailor products to the needs and preferences of their own citizens. When member states design new or overhaul existing tax wrappers, they should consider three key questions in doing so: how tax incentives can be best aligned with public policy objectives; how easy it is for advisers, intermediaries, or platforms to set up and run these wrappers (subsequently reducing costs borne by savers); and how public perception and awareness of them can be improved. As an anecdotal reference, many people in Sweden think that it is illegal to invest outside of an ISK(!).

There is a range of incentives that could be offered to encourage savers to invest money through these accounts: from total (TFSAs in Canada) or annual (ISAs in the UK) tax free allowances to flat tax rates (ISKs in Sweden) or reduced capital gains tax rates (Aktiesparekonto in Denmark). Additional bonus rates could apply if people invest a defined amount in European assets, but other markets show that tax wrappers that are easy to understand and allow investments in a wide and diversified range of assets see greater uptake than those which are more complex or limit investment choices. Another option to channel more retail investment into the EU economy would be for member states to offer tax incentives for investment in European products such as European Long-Term Investment Funds (ELTIFs) as proposed by Enrico Letta.

**ii) An early start:** an effective way to help create good habits early in life would be to use such a tax wrapper to reinvent savings and investment accounts for children. Member states could commit to seeding these accounts at birth and provide incentives to encourage further regular contributions on condition that the majority of this money (or all of it!) has to be invested in the capital markets. To make this as simple as possible for new parents who are already overwhelmed, providers could offer default funds similar to those in pension plans. In the longer term, the money could be invested in a Europe-wide fund (see next page).

Such a scheme could kickstart a culture of investing. It would provide young adults with a decent pot of savings and raise billions of euros over the years. Member states could offer an additional tax incentive or bonus payment if, once 18, beneficiaries choose to use the accumulated capital (or at least parts of it) to seed their pension pots instead of withdrawing it all.

**iii) 'The year of the European saver':** one element of a renewed and refocused CMU 3.0 could be an EU-wide public information campaign that would aim to get people in Europe to talk more about their money, perhaps framed in the context of the challenges that the EU is facing and how everyone can do their bit and own their share of a growing EU economy. The approach should build on previous successful information campaigns such as the introduction of the euro. Member states would support the campaign with tailored communications that resonate with residents in their countries, and a cherry on top would be to pair the campaign with the launch of new tax wrappers or other measures to encourage better saving.

As part of this, the benefits of bigger and deeper capital markets in the EU would need to be framed less in abstract and technical language (which EU institutions tend to do) and more in concrete and accessible terms such as 'this is what your investment can mean for your financial wellbeing and wealth, and for jobs, innovation, and growth in your country and across the EU'.

Any of these reforms should not be done in a vacuum but alongside integrated reforms of pensions and retirement savings to create a world-class structure in the EU for short, mid, and long-term savings.

## 2) Designing pension systems to support people and the European economy

Pension reforms are not easy, take years to implement, should not be rushed, and are (ideally) based on broad political agreement. While the EU and member states could benefit from more radical reforms, gradual changes to optimise the three pillars in existing systems are more likely to result in buy-in from citizens, social partners, and other key stakeholders:

**i) (Partly) funding state pensions:** funding even only a small part of state pensions under pillar I can result in billions of euros that can be used to support basic state pensions for those that are not able to build up an adequate pension pot through occupational or private pensions. This can be done by seeding a fund with public money or through moving a small but perhaps growing share of contributions into a default fund. Due to the likely scale of the fund and less prudential restrictions on what it could invest in compared to insurance, this would also be one of the best ways to channel investment into the European economy and particularly support projects in areas where long-term pension money can help such as infrastructure or high-growth sectors. For reference, 39% of assets under management by KENFO - the German fund that is going to manage its 'Generationenkapital' - are invested in the European market.

In the first instance, member states could use existing funds or create new vehicles to invest the raised money. A long-term and more ambitious project could be to create an EU-wide, sovereign wealth fund like vehicle that pools contributions from all member states and professionally manages assets at scale. If the size of this fund would be in the region of just 10% of the EU's GDP (much smaller than ATP in Denmark at 24% of Danish GDP or AP7 in Sweden at 18% of Swedish GDP), it would be the largest pension fund in the world with assets of around €1.6tn.

One of the challenges would be the cost of transitioning to a (partly) funded pillar I: without increasing contribution levels, the share of contributions that is allocated to the new fund creates a funding gap in the promises made to current pensioners through PAYG. At the same time, it is not unreasonable to argue that the public money derived from tax receipts that is already being used in many member states to stabilise state pensions could just as well be used to finance the transition to a part-funded model.

**ii) Introducing auto-enrolment in occupational pensions:** the tried and tested method to relatively quickly build up pension pots is to automatically enrol people in occupational pensions and require both employers and employees to make contributions to an employee's workplace pension. The UK introduced mandatory auto-enrolment in 2012; Ireland will introduce a similar system in 2025 and is expecting total savings to amount to around €25bn after ten years - a little more than €33,000 per worker - with the figure not including investment returns. People can opt out under certain conditions, but the barrier is high because it requires an active choice, and most people remain in schemes.

Starting with small levels of contribution is key to avoid overwhelming people and businesses: a few percent each for employers and employees, increasing every few years, ideally to 12-15% combined. Auto-enrolment in Ireland will gradually be phased in over a decade, with both employer and employee contributions starting at 1.5% each, and increasing every three years by 1.5 percentage points until they eventually reach the maximum contribution rate of 12% combined by year ten.

Good incentives, such as making any pension contributions and returns exempt from income tax, are key to help people make good choices and make it easier to build up adequate pension pots. 'Free money' is a powerful reason for people not to opt out. And there is no need to reinvent the wheel: the EU published a significant report on best practice in auto-enrolment pension savings in 2021.

**iii) Encouraging additional private retirement saving:** any (tax) incentives offered to encourage participation in occupational pension schemes should also be extended to private pension products under pillar III to give those in non standard forms of work access to tax-efficient retirement savings plans. Savers should have the choice between guaranteed and non-guaranteed products, and there could be an additional tax-free allowance or bonus payment into pension pots if savers invest a certain share of their savings in European assets. Given the voluntary nature of pillar III retirement saving, these reforms could be introduced first and used as a trial balloon to assess perception and measure changing behaviour patterns of savers.

As a starting point for these reforms, the EU should ask member states to regularly review the health of their pension systems and offer support to draw up reform strategies based on best practice in other member states if reviews show that any given country's pension system is under pressure (and many will be). To secure buy-in, EU and member states should also be upfront about what some of these reforms mean in terms of changing risk levels and shifting risk from the collective to the individual level. Without widespread political support, these reforms will not be successful. Hungary disbanding its pillar II occupational pensions and effectively seizing all assets in 2010 is an excellent example for this: the right structure was in place, but it was lacking support from policymakers and the wider public.

### 3) Getting the best out of the EU's retail investment markets

It is good to see that policymakers are starting to think about how to improve retail investment markets in the EU, for example through the EU's Retail Investment Strategy, but it is important to take a step back and look at the bigger picture to really encourage change in how Europeans save and invest. Here are three key areas to consider:

**i) Better access and better understanding:** the first step for people to make better choices is to have access to a much better and easier-to-use overview of their financial situations. Digital solutions can help people to take control of their finances. Learning the lessons of pension dashboards and using the ideas of open finance, people should be provided with a simple helicopter view of all of their assets and liabilities across savings, investments, insurance, credit card debt, loans, mortgage, and pensions in one place. This could be introduced at the member state level first and later expand to include assets and liabilities people have across the EU in every member state.

Pair this with personalised guidance and nudges based on data analysis and artificial intelligence ('your bank balance has gone above a particular level, here are some investment options you might want to consider'), connect this with banks, insurers, platforms, and stockbrokers, provide full transparency on product and distribution costs for investment options in a way that people actually understand, and you would give people a great starting point to rethink how they engage with their money. On the flipside, such an overview could also help people to understand and take control of their debts if they have any.

Measures to improve financial literacy play an important role in this, but too often they are too broad and do not significantly change how people engage with their money. School curricula can lay the groundwork and focus on fundamental numerical skills (compound interest) as well as financial concepts (inflation and the erosion of the value of money). Financial literacy interventions outside of schools must be much more targeted, personalised, reach people at key inflection points and stages of their lives, and focus on resources that help make real decisions easier to understand and to make when people need to make them. Financial health checks would be one option to do this at a larger scale.

**ii) Rethinking advice and guidance:** many people in the EU cannot access the financial advice that they need to better make informed decisions around their money and investments. Well-regulated, technology and digital solutions could help make personalised advice and guidance easier and cheaper to access. Simpler products and ways to save that are easier to explain would make it easier to provide advice, too.

In the meantime, there are a few ways in which financial advice in the EU can be improved. First, there should be full transparency on the costs that people will pay when they invest in a retirement, insurance, or direct retail product. Savers should have easy access to product and distribution costs, be able to compare them with similar products, and understand the impact of those costs especially over longer time horizons. Second, while the debate on inducements is more or less settled at the EU level, the Commission could offer advice and guidance to member states who want to go further. Third, financial advisers should expand their offering from a largely sales-driven model to advising on people's financial circumstances more widely, including retirement. Finally, any EU-wide rules on financial advice need to take into account the fact that the levels of financial literacy and the maturity of savers and investors diverge a lot between member states. In many cases, specific measures tailored to each member state may be more effective than a broad-brush approach.

**iii) A new perspective on risk and returns:** the world is changing, and the reality is that people (and their representatives) need to adapt to riskier environments in all aspects of their lives, including money. For many people, investment equals risk and risk equals losing money. This loss aversion is reasonable, particularly after many burnt their fingers when they invested in shares just before the dotcom crash and then again before the global financial crisis, but the problem is that people often spend too little thought on the returns side of the equation and overestimate the likelihood of losing money from investing, especially over longer time horizons.

At the regulatory level, this could mean to take a look at consumer protection more holistically. Currently, consumer protection often means eliminating risk and protecting people from potential loss altogether. A more holistic view would be to try and ensure that savers can achieve the best outcomes possible, even if it means to take on more risk. One way to achieve this could be through expanding existing objectives of regulators in the EU to include outcomes-based mandates on facilitating capital formation (one of the SEC's mandates) or widening participation in banking and finance.

But while regulation has an important role to play in this debate, this is much more a question of culture change and behaviour than it is of regulation. Any reforms of retirement saving and retail investment at the structural level need to be paired with honest words and an information push to clearly explain why Europe needs to take more risk, what the consequences of more risk-taking are, and how more risk-taking can result in potentially higher returns.

The issue in these areas is that it will take a lot more than updating a few pieces of regulation or launching an innovative new product to achieve change. This is mostly a question of deeply embedded cultural, behavioural, and structural challenges. Even a well-designed, carefully crafted, and thought-through reform agenda will take years if not decades to tackle these. But that is not a reason not to start today.

## It is time

The main takeaway from this report is that reforms to encourage more and better long-term saving in the EU are long overdue. But getting there is not easy. EU institutions, member states, and the wider banking and finance industry will need to have an open and honest debate - and accept some difficult truths along the way:

1. **In it for the long haul:** the best time to take measures to increase the availability of long-term capital in Europe was decades ago, the second-best time is now. Pension reforms in particular can take a long time to agree, implement, and yield results. Pension plans in the Netherlands were set up in the 1950s, and the general structure of the second pillar remains the same today, while the Danish system was reformed in the 1980s. This has given Dutch and Danish pension funds more than 50 years to invest, accumulate savings, and support the economy, and allowed pensioners to benefit from wider economic growth.

   While a long-term horizon (and political acknowledgement of it) is crucial, it is not a reason not to think about reform now: the UK took 30 years to go from pension assets at 20% of GDP to more than 100%.

2. **Political hurdles at every turn:** long-term saving is a good example of what it means to build EU capital markets from the bottom up. Many of the key measures to increase the levels of long-term capital in the EU, such as pension reforms or tax incentives, are entirely a national political and social issue. This means that member states do not need to wait for the whole of the EU to act, but the challenge is that these reforms - and in particular, pension reforms - are politically very challenging. Ask France.

   National governments are dealing with a long list of domestic priorities and have limited bandwidth to focus on projects that are unpopular, difficult to explain, or too long-term to receive the political benefits. But no ambitious pension reform will be successful without widespread political, philosophical, and cultural support. Member states, with the help of the EU, must start building that support now.

3. **Not everyone will be happy:** agreeing and implementing these kinds of reforms will require an honest conversation with EU member states about what they want, what they individually will need to do, and what trade-offs they will need to make. The hard truth is that for the EU to have the capital markets it needs, not all member states can have the capital markets they want. This does not mean that a successfully developed and integrated CMU would inevitably see all activity concentrated in France and Germany. With European capital markets that are a bigger overall, there would be plenty of opportunity for the banking and finance sector in smaller markets as well. But the current fragmentation of capital markets in the EU has an adverse impact on development, scale, efficiency, cost, and outcomes.

4. **'Notre Europe est mortelle':** while these reforms are challenging, they are vitally necessary. In his recent Sorbonne speech, French President Emmanuel Macron warned that Europe could die if it does not get its house in order. But addressing the challenges the EU is facing - from its green and digital transition to security, health, an ageing society, and the EU's struggle to remain a global superpower - requires a lot of money. With strict rules on budgets and deficits, public money alone cannot meet the EU's financing needs. Private capital must come in to help.

   The good news is that there is no need to do something that no-one else has ever done before to unlock much of the capital that is required. The EU and individual member states have all the tools they need to get people to save better and to use those savings more productively. They just need to stop admiring the problem and start doing something about it. And if they need a source of inspiration, a good place to start would be to ask Sweden, the Netherlands, or Denmark about how they did it.

NEW FINANCIAL
Rethinking capital markets

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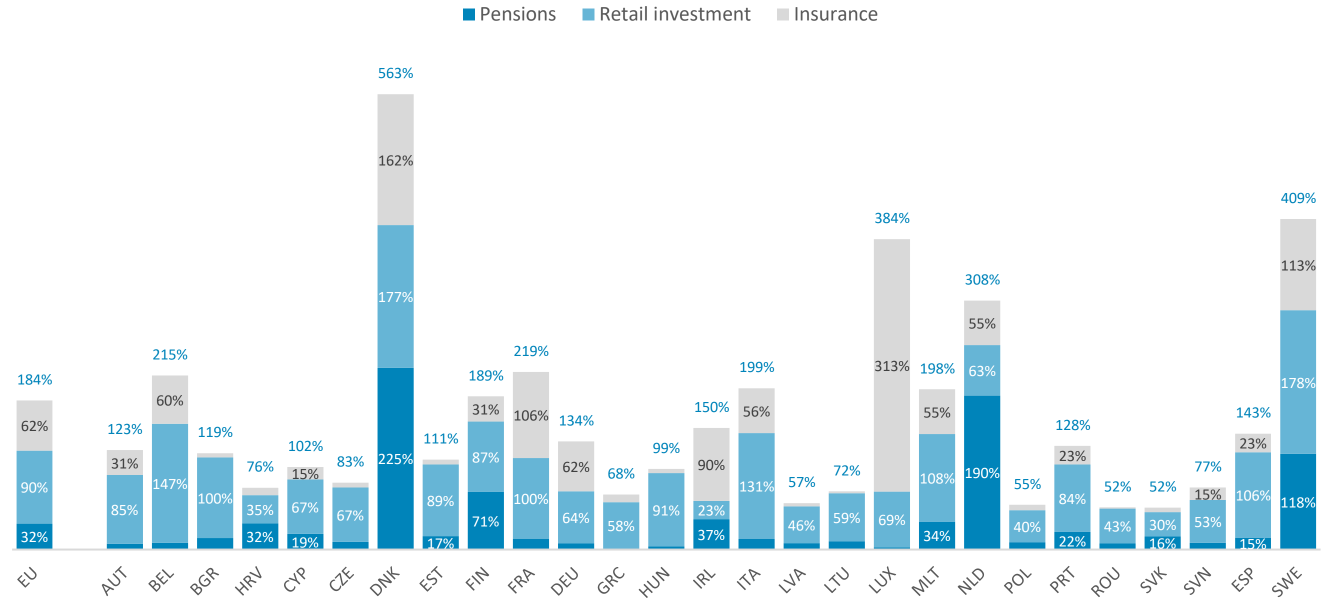
- *Building EU capital markets from the bottom up*

## Fig.16 Pools of long-term capital in the EU

This chart shows size of pools of long-term capital in % of GDP in the three years to 2022 in the EU and in individual member states, with the number in blue showing total size.

*Note: retail investment includes direct household investments in funds, shares, bonds, and other financial investments*

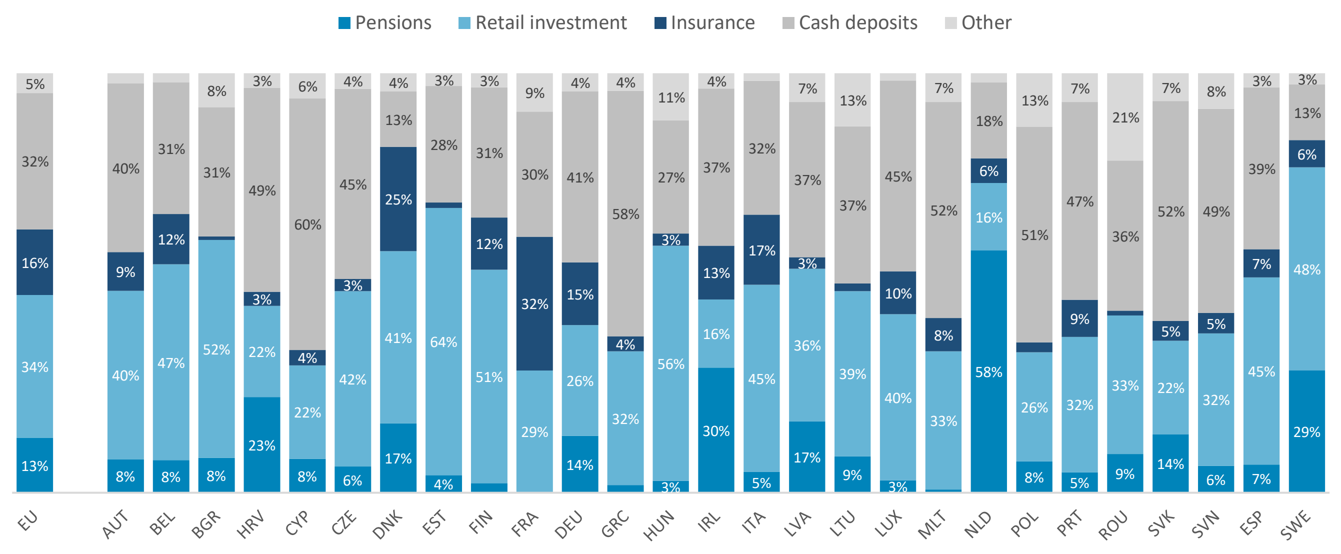



*Source: New Financial analysis of data from EIOPA, Eurostat, IMF, and the OECD*

## Fig.17 The distribution of household financial assets in the EU

This chart shows the distribution of household financial assets in the EU and in individual member states in the three years to 2022.

*Note: retail investment includes direct household investments in funds, shares, and bonds*




*Source: New Financial analysis of data from Eurostat*

## Measuring the growth potential

Our starting point to measure the growth potential for pension assets and retail investment in the EU and in individual member states is the question, 'what if countries in the EU with smaller pools of long-term capital would look a bit more like their peers with more developed pools of long-term capital?'.

For both pension assets and retail investment, we rank each member state by the value of assets as a percentage of GDP and divide them into quartiles. We then estimate the potential growth opportunity for pension assets and retail investment in each economy by assuming that the level of each increases to the average level relative to GDP of the quartile above. For countries already in the top quartile, we assume that activity has the realistic potential to grow at half the weighted average rate of less developed economies.

**Example (I):**

- With average pension assets of €41bn (8.2% of GDP) in the three years to 2022, Belgium is in the third quartile of the 27 EU economies when ranked by the depth of their pension assets.
- The average depth of pension assets relative to GDP in the second quartile is 16.3%.
- If Belgium were to increase the level of its pension assets to the average of the second quartile (and there is no reason why in the long run Belgium should not be as developed as countries in the second quartile such as Spain or Portugal), pension assets in Belgium would roughly double to €82bn - an increase of nearly €7,900 in pension assets for every household in Belgium.

**Example (II):**

- With average retail investment assets of €931bn (178% of GDP) in the three years to 2022, Sweden is in the first quartile of the 27 EU economies when ranked by the depth of their retail investment assets (and the EU economy with the highest levels of retail investment relative to GDP overall).
- Our estimated, weighted average growth rate of retail investment of all less developed markets in the second, third, and fourth quartile is 48%.
- If retail investment in Sweden would grow at half the weighted average rate of the less developed economies, it would increase by another €222bn to nearly €1.2tn - an increase of €46,600 per household in Sweden.

We repeat this exercise across EU member states and across pensions and retail investment to create an ambitious but achievable vision for capital markets in the EU.

There is no perfect way to estimate growth potential in capital markets and our approach has obvious limitations. However, we think our approach creates a simple, realistic, and achievable benchmark for potential growth. There is no reason why a country should not be able to move up into the quartile above. We think this methodology may underestimate the growth potential for countries that are towards the top of their quartile and overstate the growth potential for countries towards the bottom of each quartile. In any case, we would stress that these numbers are not a growth forecast but a directional and realistic indicator of what could be achieved.

## Fig.18 The growth potential in pension assets and retail investment

The growth potential in pension assets and retail investment, by country

| Country | Pension assets | | Retail investment | | Pension assets & retail investment combined | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2022 | What if? | 2022 | What if? | 2022 | | What if? | | | |
| | €bn | €bn | €bn | €bn | €bn | Assets per household (€) | €bn | Assets per household (€) | Growth (€bn) | Growth (%) |
| Austria | 28 | **49** | 348 | **551** | 376 | 90,689 | **600** | **144,580** | 224 | 59% |
| Belgium | 41 | **82** | 736 | **912** | 777 | 151,124 | **994** | **193,206** | 216 | 28% |
| Bulgaria | 10 | **96** | 69 | **93** | 79 | 27,518 | **189** | **66,092** | 110 | 140% |
| Croatia | 18 | **78** | 20 | **36** | 38 | 26,370 | **115** | **79,448** | 77 | 201% |
| Cyprus | 4 | **32** | 15 | **22** | 20 | 55,559 | **54** | **150,859** | 34 | 172% |
| Czech Rep. | 23 | **39** | 162 | **232** | 185 | 41,069 | **272** | **60,250** | 87 | 47% |
| Denmark | 758 | **1,523** | 595 | **737** | 1,353 | 436,179 | **2,260** | **728,611** | 907 | 67% |
| Estonia | 5 | **44** | 28 | **43** | 33 | 45,829 | **86** | **119,406** | 53 | 161% |
| Finland | 179 | **360** | 219 | **339** | 398 | 136,335 | **699** | **239,517** | 301 | 76% |
| France | 319 | **402** | 2,471 | **3,325** | 2,790 | 88,342 | **3,727** | **118,013** | 937 | 34% |
| Germany | 268 | **425** | 2,304 | **3,436** | 2,572 | 61,755 | **3,861** | **92,702** | 1,289 | 50% |
| Greece | 2 | **22** | 107 | **178** | 108 | 26,470 | **200** | **48,816** | 91 | 84% |
| Hungary | 6 | **18** | 140 | **208** | 146 | 35,715 | **227** | **55,518** | 81 | 55% |
| Ireland | 161 | **324** | 98 | **277** | 260 | 127,441 | **601** | **294,962** | 341 | 131% |
| Italy | 231 | **290** | 2,331 | **2,888** | 2,562 | 97,752 | **3,178** | **121,245** | 616 | 24% |
| Latvia | 3 | **4** | 15 | **21** | 18 | 20,230 | **25** | **28,773** | 7 | 42% |
| Lithuania | 6 | **9** | 33 | **53** | 39 | 24,728 | **62** | **39,996** | 24 | 62% |
| Luxembourg | 2 | **8** | 49 | **68** | 51 | 181,217 | **77** | **274,048** | 26 | 51% |
| Malta | 5 | **10** | 16 | **19** | 21 | 91,230 | **29** | **129,854** | 9 | 42% |
| Netherlands | 1,644 | **3,303** | 540 | **829** | 2,184 | 254,161 | **4,132** | **480,796** | 1,948 | 89% |
| Poland | 52 | **95** | 232 | **374** | 284 | 18,633 | **469** | **30,794** | 185 | 65% |
| Portugal | 48 | **305** | 183 | **296** | 231 | 54,437 | **601** | **141,535** | 370 | 160% |
| Romania | 18 | **29** | 107 | **159** | 125 | 16,584 | **188** | **24,910** | 63 | 50% |
| Slovakia | 16 | **137** | 30 | **63** | 46 | 26,552 | **201** | **116,628** | 155 | 339% |
| Slovenia | 4 | **9** | 28 | **33** | 32 | 37,537 | **42** | **49,183** | 10 | 31% |
| Spain | 178 | **1,694** | 1,287 | **1,595** | 1,466 | 75,690 | **3,289** | **169,838** | 1,823 | 124% |
| Sweden | 618 | **1,242** | 931 | **1,154** | 1,549 | 324,681 | **2,396** | **502,042** | 846 | 55% |
| EU | 4,646 | **10,630** | 13,095 | **17,942** | 17,742 | 88,646 | **28,571** | **142,758** | 10,830 | 61% |

*Source: New Financial analysis of data from Eurostat, IMF, and the OECD*