



SAVING FOR RETIREMENT AND INVESTING FOR GROWTH

Report of the CEPS ECMI Task Force on long-term investing and retirement savings

**LAUNCH OF THE REPORT
BRUSSELS, 18 SEPTEMBER 2013**

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Welcome

Karel Lannoo

**CEO of CEPS, General Manager of ECMI
Senior Rapporteur to the Task Force**



Agenda

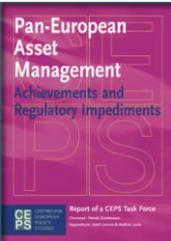
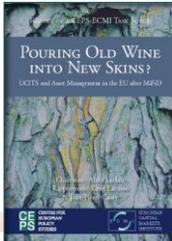
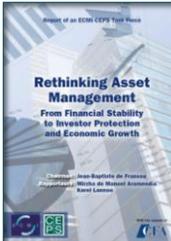
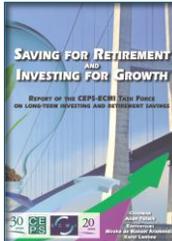


- 1. Welcome remarks** – Karel Lannoo, CEO of CEPS
- 2. Key recommendations** – Allan Polack, Task Force Chairman
- 3. Presentation of the report** – Mirzha de Manuel, CEPS-ECMI
- 4. Expert comments and reactions**
 - Nadia Calviño, Deputy Director General, DG Markt
 - Patrick Hoedjes, Director of Operations, EIOPA
 - Paul Woolley, London School of Economics
- 5. Debate and questions**



In-house expertise



▶ 2003	▶ 2008	▶ 2012	▶ 2013
			
.... an incipient single market MiFID and UCITS effects the future after the crisis long-term and pensions

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We wish to thank...

- **Carmignac Gestion**
 - Who provided seed sponsoring for this research project
- **Task Force Observers**
 - European Commission, EIOPA, EIB, OECD, French Ministry of Ecology and Energy, Danish FSA, Caisse des Dépôts, EurofinUse
 - Numerous academics and experts who contributed to the meetings
- **Task Force Members**
 - 61 individuals, 31 companies and organisations (full list in annex to the final report)
- **Task Force Chairman**
 - Allan Polack (CEO of Nordea Asset Management) on a personal capacity

DISCLAIMER: Only the policy recommendations presented at the beginning of the report reflect the general consensus reached by task force members (although not every member may agree with every aspect of each recommendation). The members were given the opportunity to comment on the draft final report, but its contents were drafted independently by CEPS ECMI and may only be attributed to the rapporteurs.





Recommendations

Allan Polack

**Chairman of the CEPS ECMI Task Force
CEO of Nordea Asset Management**

Setting the scene



- **A double challenge ... but common solutions?**
 - need for long-term investments, crucial levers for growth
 - and a growing pension gap, threatening inter-generational balance
- **A focus on beneficiaries**
 - retail investment products: solution design (geared towards long-term investing)
 - accessibility: market structure (address financial exclusion in long-term savings)
- **Against a complex background**
 - public finances: fiscal crisis, high long-term liabilities
 - prudential regulation: Solvency II and IORP II, among others
 - monetary policy: low interest rates
 - business models and product mixes: move from DB to DC
 - single market: remains largely unexploited
- **Need for industry innovation and public steering**
 - goal of delivering concrete proposals

Key recommendations (1/3)



1. Place households at heart of long-term investing (LTI) debate
2. Foster access to LTI solutions, including for retirement
3. Strengthen solution quality and deliver accessible market setting
4. Strengthen investor protection and optimise it for LTI
5. Continue to modernise regulation for provision of guarantees

And additional recommendations on...

ELTIFS

SOLVENCY II

IORP II

PERSONAL PENSIONS

Key recommendations (2/3)

- 1. Place households at heart of long-term investing (LTI) debate**
 - Households are owners or beneficiaries of 60% of financial assets in Europe
 - And they face growing need to save more and more efficiently
- 2. Foster access to LTI solutions, including for retirement**
 - Households need easily accessible, high-quality and cost-efficient long-term solutions
 - More standardisation to raise visibility, mitigate complexity and burden of choice
- 3. Strengthen solution quality and deliver accessible market setting**
 - Not only volatile market returns, poor solution design and poorly organised markets
 - Single market potential should be fully exploited (processing, taxation)
- 4. Strengthen investor protection and optimise it for LTI**
 - Advice can be too onerous, need for simple standardised "defaults" (under execution-only)
 - Suitability should consider costs for long-term solutions, given effect of compounding
- 5. Continue to modernise regulation for provision of guarantees**
 - But reconcile with long-term investing and economic reality (illiquid assets, sovereign bonds)
 - Cautious approximation of capital requirements for IORPs, full account taken of diversity

Key recommendations (3/3)

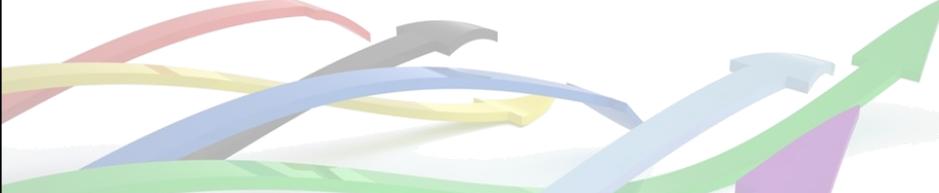
<div style="background-color: #0056b3; color: white; padding: 5px; text-align: center; font-weight: bold;">ELTIFS</div> <ul style="list-style-type: none"> ➤ Commission ELTIF proposal valuable ➤ But will it work for retail investors? ➤ Need to cope with financial exclusion ➤ Proposal on long-term balanced funds 	<div style="background-color: #0056b3; color: white; padding: 5px; text-align: center; font-weight: bold;">SOLVENCY II</div> <ul style="list-style-type: none"> ➤ Matching adjustment essential ➤ Could comprise expected cash flows? ➤ Could be reflected on capital charges? ➤ Issue of zero charges for sovereigns
<div style="background-color: #0056b3; color: white; padding: 5px; text-align: center; font-weight: bold;">IORP II</div> <ul style="list-style-type: none"> ➤ Great diversity in Europe ➤ Security and steering mechanisms ➤ Support qualitative approximation ➤ Cautious quantitative approximation 	<div style="background-color: #0056b3; color: white; padding: 5px; text-align: center; font-weight: bold;">PERSONAL PENSIONS</div> <ul style="list-style-type: none"> ➤ Blueprint for pan-European solutions ➤ Regulated "defaults" ➤ Principles for solution design ➤ Attention to processing and taxation

Presentation

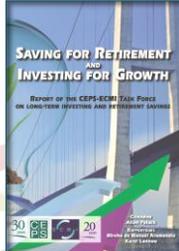


Mirzha de Manuel

Research Fellow , CEPS ECMI
Rapporteur to the Task Force



SAVING FOR RETIREMENT AND INVESTING FOR GROWTH



PRESENTATION OF THE REPORT
Brussels, 18 September 2013

Mirzha de Manuel Aramendía
CEPS ECMI Research Fellow
Rapporteur to the Task Force
Author of the Report

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Index

- 1. The issues... as we see them**
 - At macro level: need for long-term financing
 - At micro-level: need for long-term investing solutions
 - Ultimately, money from beneficiaries towards pensions
- 2. Mobilising household savings... in solutions that deliver**
- 3. Guarantees play a role... but are challenged**
- 4. DC offers opportunities... but are not immediate**
 - Need for industry drive and regulatory intervention
- 5. Opportunities maximised within a single market**
 - For investors to benefit from best practices and lower costs
 - For efficient allocation of resources and macro-economic convergence

DISCLAIMER: The content of this presentation is only attributable to the author and not to Task Force members.



1. THE ISSUES... AS WE SEE THEM (1 / 2)

Europe needs more long-term financing and wishes to mitigate bespoke short-termism in financial markets

- ✓ € 24 trillion up to 2020 – estimation of total investment needs in the EU
- ✓ € 1 trillion up to 2020 – transport, energy and telecom infrastructure, of EU relevance
- ✓ € 13.5 trillion up to 2050 – low-carbon energy, energy efficiency and infrastructure

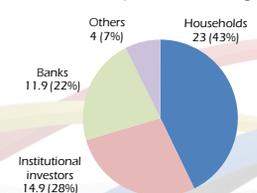


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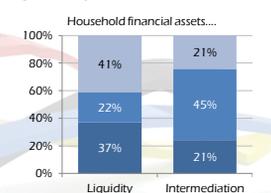
graph LR
    A[INVESTMENT UNIVERSE] --> B[LIABILITY PROFILE]
    B --> C[INVESTMENT BELIEFS]
    D[RISK APPETITE] --> E[DECISION MAKING]
    E --> F[LONG-TERM INVESTMENT]
    
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* EC * WEF

Households are the biggest holders of financial assets in Europe, mostly liquid (with virtuous exceptions)

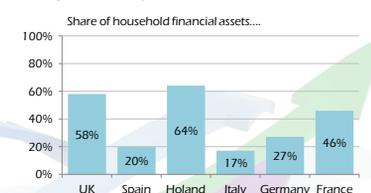


* € trn, McKinsey



Category	(+) (+)	(+) (-)	(-) (-)
Liquidity	41%	22%	37%
Intermediation	21%	45%	21%

* BCG



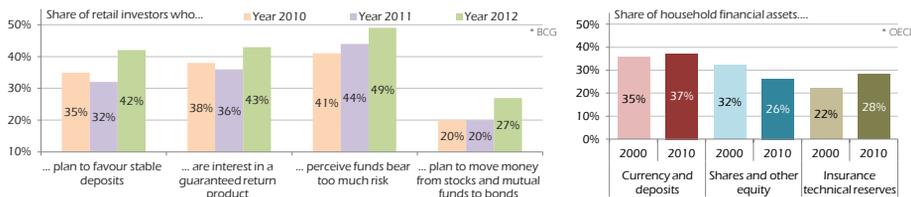
Country	Illiquid (private pensions and life insurance)
UK	58%
Spain	20%
Holland	64%
Italy	17%
Germany	27%
France	46%

* BCG

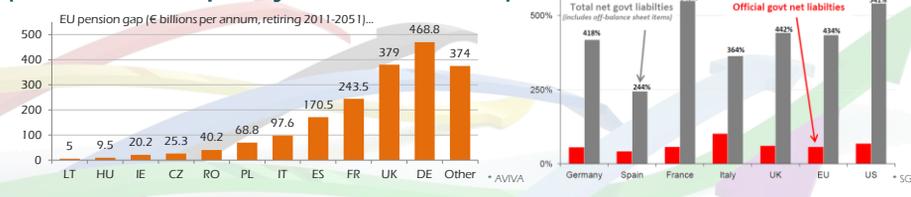
1. THE ISSUES... AS WE SEE THEM (2/2)



Risk aversion is on the rise – due only to macro fundamentals or also to inadequate intermediation?



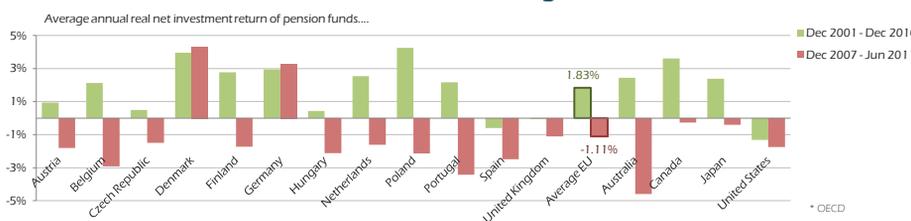
Yet, citizens need returns to fill a growing pension gap (while fiscal capacity remains limited)



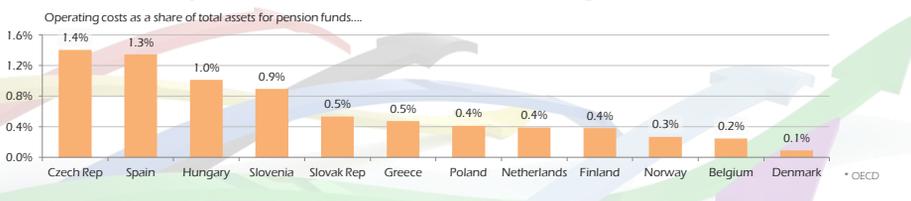
2. MOBILISING HOUSEHOLD SAVINGS... IN SOLUTIONS THAT DELIVER (1/1)



Funded pensions and other solutions do not always deliver – low market returns but also high costs



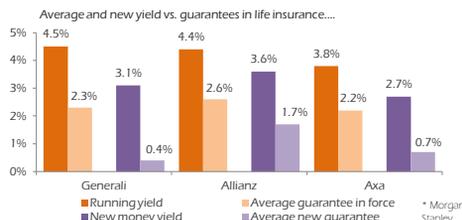
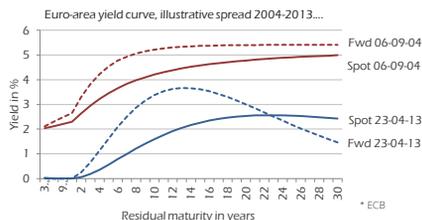
Great diversity in Europe... unexploited single market potential



3. GUARANTEES PLAY A ROLE... BUT ARE CHALLENGED (1/2)

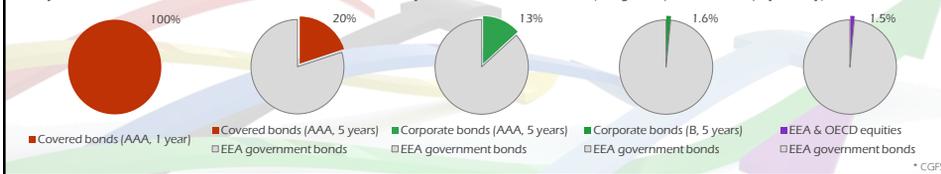


The provision of guarantees necessitates long-term investing (ALM) but is challenged by low rates...



...and the uncertain impact of revised prudential standards

Stylised illustration of trade-offs between asset classes, based on Solvency II standard formula under QIS 5 (charges for spread risk and equity risk only)...



3. GUARANTEES PLAY A ROLE... BUT ARE CHALLENGED (2/2)



Contentious issues, operational constraints and potential solutions within Solvency II

CONTENTIOUS ISSUES

- ▶ **Assets held to maturity versus available for trading...**
 → adjustment on the liability side of the balance sheet
 → discount rate for liabilities: matching adjustment (MA)
- ▶ **Calibration of capital charges...**
 → steepness: duration & rating
 → arguably inaccurate reflection of risks in less liquid assets
- ▶ **Zero risk-weights for EEA sovereign debt...**
 → distortion to asset allocation

OPERATIONAL CONSTRAINTS

- ▶ **In applying the MA...**
 → separate default & spread risk
 → eligible liabilities and assets
 → reinvestment & other risks
 → rebalancing of portfolios
 → best reporting format
- ▶ **Calculating standard charges...**
 → availability & quality of data
 → limitations embedded in methodologies & risk metrics
- ▶ **Political and economic risks...**
 → calculation of charges
 → euro-area crisis & institutions

POTENTIAL SOLUTIONS

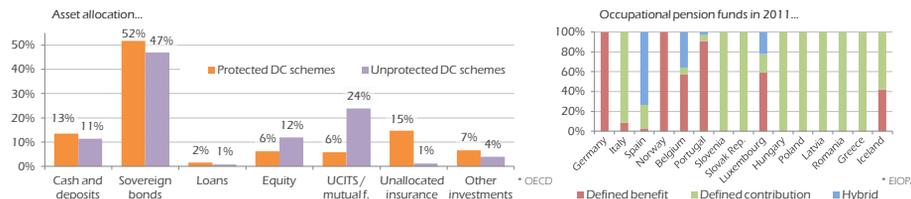
- ▶ **Broader and more flexible application of MA could...**
 → foster long-term investment (LTI) in assets different to bonds
 → but is difficult to supervise, given discretion left to insurers
- ▶ **To avoid discouraging LTI...**
 → extended MA
 → interim arrangements pending new calculations?
- ▶ **Introduce macro-economic & institutional aspects...**
 → in the debate on LTI

In conclusion: standard capital charges and solvency ratios are needed but emphasis should be on supervision

4. DC OFFERS OPPORTUNITIES... BUT ARE NOT IMMEDIATE (1/1)



DC offers more leeway in asset allocation but incentives need to be aligned with long-term investing



Issues identified in solution design and market structure highlight difficulties in aligning incentives

SOLUTION DESIGN:

- Unclear retirement purpose and governance
- Liquidity profile inconsistent with pension objective
- Asset allocation skewed towards short-term assets
- Inadequate or simplistic investment practices
- Unsophisticated or poor risk management
- Communications lacking behavioural purpose

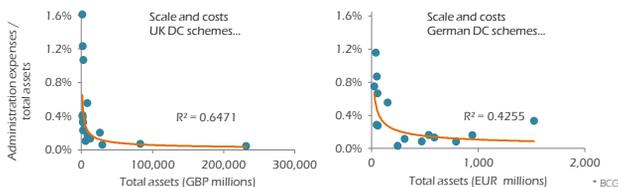
MARKET STRUCTURE:

- Product proliferation and consumer segmentation
- Difficulties for individuals to approach the market
- Widespread financial exclusion
- Potential for abuse due to consumer captivity
- Inefficient processing architecture
- Lack of standardisation

5. OPPORTUNITIES MAXIMISED WITHIN A SINGLE MARKET (1/2)



Single market holds potential for efficiencies, both for headline costs and long-term investing



- ✓ Eased access to less liquid asset classes (given high minimum investments)
- ✓ Capacity to internalise expertise
- ✓ Potential for higher business sophistication / innovation
- ✓ Lower costs for beneficiaries due to scale economies

Single market is also an opportunity to deliver greater accessibility and long-term investment focus

- **Addressing both solution design and market structure:**
 - tackling financial exclusion as regards long-term savings / investments
 - ensuring industry delivers primarily to end investors
- **Delivering easily accessible default solution (s):**
 - no perfect solution exists, instead need to balance trade-offs
 - customisation vs. cost – sophistication vs. cost – LTI vs. size – transferability vs. LTI

5. OPPORTUNITIES MAXIMISED WITHIN A SINGLE MARKET (2/2) 

A blueprint for pan-European personal pensions in six building blocks

<p>SOLUTION DESIGN</p> <ul style="list-style-type: none"> ➤ Principle-based rules for non-default solution (s) ➤ Explicit consideration of retirement purpose and long-term investment horizons and practices ➤ Long-term absolute-return objectives (replacement rates) ➤ Link to de-accumulation phase (annuities, draw-downs) 	<p>DEFAULT SOLUTION (S)</p> <ul style="list-style-type: none"> ➤ Product regulation of default solution (s) ➤ Life-cycling and life-styling features or options (limited or restricted range) ➤ Eligible assets and permissible investment practices ➤ Allocation range per asset class, including less-liquid assets
<p>SOLUTION PROVIDERS</p> <ul style="list-style-type: none"> ➤ Resources and expertise ➤ Alignment of incentives with LTI investment horizon ➤ Conflicts of interest in asset management value chain ➤ Industrial organisation and market structure policy (volume, access to less-liquid assets classes, cost) 	<p>INFRASTRUCTURE</p> <ul style="list-style-type: none"> ➤ Pan-European processing architecture ➤ Pan-European clearing house for default options ➤ Administration of contributions ➤ Unbundling of services with lower efficient scale ➤ Uniform regulation of holding rights and transfers
<p>COMMUNICATION</p> <ul style="list-style-type: none"> ➤ Full fee transparency, based on harmonised fee structures ➤ Standardised pre-contractual disclosure, supported by a single pan-European online information point ➤ Annual statements focused on replacement rates and follow-up actions by members 	<p>DISTRIBUTION</p> <ul style="list-style-type: none"> ➤ Special suitability requirements, with broad market coverage and explicit consideration of costs ➤ Professional standards for sales staff ➤ Execution-only access for default solution (s) supported by publicly-provisioned information

In sum... 

- **At micro-economic level, LTI depends on retail solutions**
 - focus should be on beneficiaries and end investors
- **Europe is focusing on prudential rules (and rightly so)**
 - low interest rates represent a risk to financial stability
- **And there is space to further align those with LTI**
 - but supervisors will need more resources and powers
- **But the world is moving away from DB into DC**
 - need for a pan-European framework for personal pensions
- **And pension markets are becoming quasi-markets**
 - policy-makers need to ensure they deliver value primarily to investors (not to industry)
- **Where the single market potential remains unexploited**
 - in addition to efficiencies, need for macro-economic convergence

The Report

CHAPTER 1
SETTING THE SCENE

Long-term investing and retirement savings

- What is long-term investing?
 - Investors
 - Asset classes
 - Underlying
- What is the focus of the report?
 - Beneficiaries
 - Retail investment products
- Retail long-term investing today
 - Diversity in Europe
 - Intermediation
 - Liquidity
 - Awareness / risk aversion
 - Incomplete single market

CHAPTER 2
SINGLE MARKET

Less liquid funds

- Commission ELTIF proposal
- Long-term balanced funds
- Accompanying market structure

Occupational pensions

- Challenges in IORP reform
- Potential benefits
- Recommendations

Investor protection

- Specifics for long-term investment products
- Disclosure & sale process

Direct investments

CHAPTER 3
PERSONAL PENSIONS

Private pensions today

- Diversity in Europe
- Insufficient coverage and low contributions
- High costs & low returns

Market structure

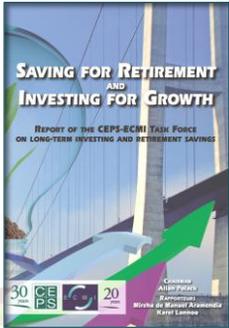
- Demand & supply dynamics
- Scale & Infrastructure
- Single market potential

Solution design

- Shortcomings identified
- Key trade-offs in design

A blueprint for pan-European pensions

Thank you!



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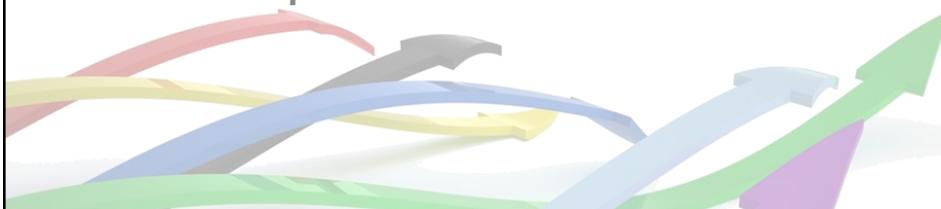
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Comments



Nadia Calviño

Deputy Director General, DG Internal Market and Services
European Commission

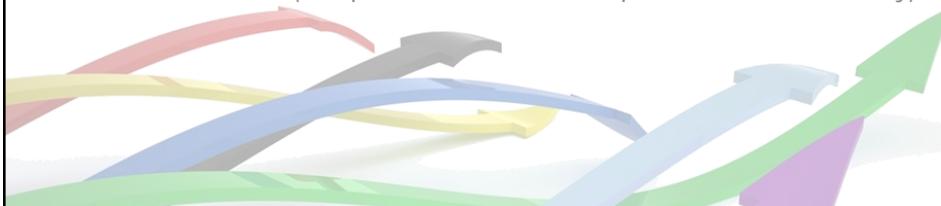


Comments



Patrick Hoedjes

Director of Operations, EIOPA
(European Insurance and Occupational Pensions Authority)





Comments

Paul Woolley

Senior Fellow and Chairman of the Advisory Board
**Centre for the Study of Capital Market
 Dysfunctionalities**, London School of Economics




Debate



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Deputy Director General
 DG Internal Market and Services
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Patrick Hoedjes
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 Centre for the Study of Capital
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Allan Polack
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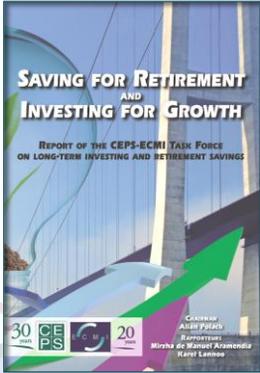
Karel Lannoo
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Mirzha de Manuel
Research Fellow
 CEPS ECMI
 Author of the Report



Good bye!



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