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Keep capital markets union simple

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A few additional initiatives will need to be taken before a European capital markets union is able to unleash its full potential. The main problem is fragmentation, arising from the deep differences existing from one country to another in the structure of markets, user preferences and the availability of well-organised, long-term saving schemes. Several attempts have been made to address these barriers, but with limited or uneven success so far.

The announcement of the creation of a capital markets union has led to a flurry of possible harmonisation proposals that could lead to new Action Plans to keep legislators busy for years to come. Yet, any new legislative plan should set a clear objective, based on a thorough analysis of the reasons for the persistent differences in markets and a prioritisation of initiatives aimed at reaching more integration. Amongst these, an initiative for an EU-wide, long-term savings product stands out.

The majority of European households today have limited savings for retirement, most of which are held in low-performing deposits. European-wide investment vehicles have existed for some time in the form of UCITS (Undertakings for the collective investment in transferable securities), but their asset allocation is not easy to understand for non-professional investors. They can be sold as a simple product, but many are complex, and can be risky and costly. They have been used as a marketing tool by banks, which has led to an enormous fragmentation of mutual fund markets in the EU, where there are about 32,750 products, each with an average size €222 million (compared to about 7,886 in the US, with an average size of €1.6 billion). This fragmentation naturally increases the costs and reduces the average returns. The recent agreement on ELTIF (European long-term investment funds) – a new EU-wide product for illiquid investments, such as infrastructure – will lead to further fragmentation, which is just the opposite of the conditions needed for such investments.

The existing pension system in the EU undeniably needs a reform that accommodates the majority of European households, in which citizens are protected from mis-selling and those close to retirement against extremely negative outcomes. Citizens should also be protected from inefficient investments, such as deposits whose investment returns are too low compared to the investment horizon. Here pan-European default options could play an important role.

European households need a simple long-term savings product that is easy to understand and offers an appropriate default investment option. The majority of retail investors are incapable or unwilling to make such investment decisions. Governments should focus on making that option as safe and inexpensive as possible.

A 'simple' European investment product should have a long-term perspective in asset allocation and be highly diversified, following an allocation range governed by a regulator and reflecting the

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long-term investment horizon of pension savings, including investments in illiquid products. It should be portable at the EU level and have the same product characteristics across countries. It would not be redeemable on a daily basis and early withdrawals would be discouraged.

The product should be licensed by a European supervisor, such as EIOPA, which would give it a unique product label. The licensing criteria would focus on size and simplicity, and would discourage the issuance of a multitude of funds by individual financial institutions, as is the case with UCITS today. EIOPA would manage a website with all the information about the concept of the product, the providers, the returns and expense ratios, making it very easy for users to compare competing offers.

Wealthy European households, wielding extensive purchasing power that provides access to financial advice and specialized investment products, are not likely to be attracted to the idea of a simple pension investment product. But the vast majority of Europeans – i.e. those with little financial resources and literacy – would benefit immensely from the idea.

With the right thinking applied early on in the design phase of the regulation for a pan-European pension product, a Single Market could emerge right away, contributing both to competition and to citizens' welfare.