Rivisiting the landscape of European long-term savings - A call for action from the asset management industry

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A call for action from the asset management industry

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The financial crisis caused record-breaking declines in the financial assets of European individual

investors, but it has also aggravated and highlighted long-standing issues these investors face in the areas of **long-term savings** and the **distribution of retail investment products**.

- **Long-term savings**: Occupational pension funds, which represent an important part of overall long-term savings, are vital in securing many investors' living standards at retirement age. During the crisis, some pension funds came under pressure and had to make quick investment decisions that ran contrary to their long-term objectives. Given the tough financial situation many of their sponsors (i.e., employers) are in, it is questionable whether all the funds can deliver fully on their promise. This could leave investors with less money than expected at retirement. Taking this together with the state of public finances, which have long ignored the impact of demographic change on the sustainability of their pay-as-you-go (PAYG) systems (longevity risk1), it seems increasingly clear that Europe's long-term savings systems will not be sustainable without taking actions that include strengthening individual contributions;
- **Retail distribution**: Volatility in asset flows (e.g., the difference between gross and net sales, or shifts from asset management products to bank deposits) has reached a level during the crisis that is fundamentally at odds with the long-term nature of most asset management products. This has meant that many investors have withdrawn assets prematurely, thus cementing losses and missing the benefits of subsequent recoveries. This raises questions as to whether the forces at work that drive individuals' investment decisions are optimally structured and regulated

This report seeks to address the main challenges in these two areas of concern, and to derive a set of practical recommendations with the dual objective of:

- Providing individual investors with additional solutions to meet their long-term investment ygoals more closely, specifically in pensions, and
- Building a strong foundation for investor trust in the wider financial services sector, yespecially in the asset management industry.

This dual objective places the individual investor at the heart of the effort. Together with an assessment of the state of the industry and existing European regulatory frameworks, it serves as starting point for the recommendations described herein.

Of particular concern for the group of 23 interviewees is the **need to ensure a level playing field for different long-term investment products and to create sufficient transparency at the point of sale**. More concretely:

Long-term savings: All European countries face severe challenges in getting their citizens to engage in long-term savings that provide adequate returns, for example to secure their standard of living upon retirement. Today, the lack of a level playing field:

- **Leads to regulatory arbitrage** as differing regulatory standards applied to different but competing products can create incentives for some providers to develop products that are subject to the least regulation or attract the most state aid, rather than focusing on true investor needs;
- **Adds to complexity costs** as vast differences between national legislation make it hard for providers of long-term investment products to realise efficiencies of scale that could stem from unified approaches to marketing products and managing long-term assets;
- **Impedes competition for best investor solutions** as differences in transparency requirements and/or allowable risk exposures across product categories make comparing different solutions and products difficult. This makes it harder for investors to drive the quality of long-term investment products;

Retail distribution: Previous industry and regulatory efforts have focused on investment production rather than distribution. Product regulation has been particularly thorough on asset management products, while to some extent ignoring other (substitute) investment products. This has led to distorted competition between different product types at the point of sale. In addition, given the impact that the right combination of investment products has on overall returns, and given that asset allocation is typically done at the point of sale, the focus of regulation should shift from production to distribution. This is the point at which the individual investor is significantly exposed to the risk of making bad investment decisions. In this report, therefore, references to "distribution" and "point of sale" refer not just to the sale of products but also where appropriate to the provision of advice – i.e., identifying client needs and advising on the best way to meet those needs.

The recommendations of this report build on the worldwide success of UCITS and seek to embrace the objectives expressed by the European Commission in its strategic goal for 2020, i.e., to increase connectivity through the single market to the benefit of European investors. Recommendations fall into three categories: recommendations to address long-term savings challenges, recommendations to address distribution challenges, and finally actions from the asset management industry that underpin commitment to improvements in both areas (see page VI).

The challenges and recommendations discussed in this report are, of course, not the only areas in which the asset management industry should act. Others have been highlighted in the foreword of this report and also need attention.

This paper seeks to be practical rather than academic. It focuses on distilling a few quickly applicable high-impact measures alongside other more fundamental actions that will be essential to ensuring sustainable long term savings and strengthening distribution mechanisms.

The findings are not trying to reinvent the wheel. Existing regulatory frameworks – especially asset management-oriented UCITS – already enjoy a global reputation as state-of-the-art in terms of investor protection. They have also helped the asset management industry in Europe market its products and services successfully across the EU and beyond and survive the financial crisis in reasonable shape. Nevertheless, recent events, together with broader industry trends towards convergence of product categories and diversification of distribution models, challenge both the role of asset managers (and other industry participants) as well as the validity of today's regulations in a post-crisis era.

The recommendations in this report are informed by the perspective of asset management firms as opposed to other types of financial services providers. However, the 23 interviewees firmly believe that the recommendations are in the best interests of European citizens and investors.

Some of the recommendations put forward in this report could be adopted by the industry alone. Others could be initiated only in partnership with or led by European and national legislative/regulatory bodies. The interviewees recommend that EFAMA seeks to work with industry members and policymakers to help put the proposed changes into practice.

Chapter II gives an overview of some of the key challenges retail investors face today. Chapter III elaborates on the specific recommendations for long-term savings and distribution, outlining their potential impact on the identified challenges. Chapter IV adds to these specific recommendations by putting forward two proposals that underpin the industry's commitment to the recommendations. Chapter V contains some closing remarks.

Il rapporto, sponsorizzato da EFAMA, presenta otto raccomandazioni rivolte a policy maker e industria

per la valorizzazione del risparmio a lungo termine e il miglioramento della trasparenza ed efficienza della distribuzione dei prodotti di risparmio

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