PENSION AND LONG TERM SAVINGS GAP

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Building on past initiatives to address growing pension gaps

Europe is facing substantial pension gaps. These are expanding due to an ageing population and evolving labour markets characterized by more fragmented and dynamic career paths. The shift from defined benefit (DB) to defined contribution (DC) places greater risk and choice on individuals.

According to Eurobarometer data from July 2023, only 45 per cent of Europeans are financially confident in their retirement—37 per cent of women and 47 per cent of men—making the gender gap evident. Most EU citizens fully depend on statutory pensions for their future retirement income. Only 23 per cent participate in an occupational pension scheme and 19 per cent own a personal pension product. Citizens with a supplementary pension feel more financially confident in retirement than those without one (53 compared to 37 per cent).

The development of capital-funded pensions can contribute to reducing pension gaps, while increased pension savings support the Capital Markets Union. They are a source of capital to finance the long-term growth of the real economy and its green and digital transition.

The European Commission has taken steps to increase coverage of occupational and personal pensions. These include commissioning a study on best practices and performance of auto-enrolment systems, and requesting technical advice from EIOPA on pension tracking systems (PTS) and pension dashboards as well as on the review of the IORP II Directive. Additionally, the PEPP Regulation started to apply in March 2022, paving the way for the new voluntary EU-wide personal pension scheme for people to save for their retirement.

There is scope for these initiatives to be further developed during the next political cycle.

Firstly, transparent information on retirement income generated by national pension systems is essential. Requiring Member States to establish a PTS covering all three pension pillars would enhance citizens' awareness of their future retirement income. In addition, a pension dashboard at the European and Member State level is esstantial to support policymakers in monitoring the adequacy and sustainability of pension systems and in closing pension gaps. EIOPA is ready to support the Commission in its development.

Secondly, to increase coverage of supplementary pensions, the EU could consider requiring Member States to introduce a system of auto-enrolment, where occupational pension saving is not yet mandatory, as citizens do not save enough by themselves.

Thirdly, improving the effectiveness of existing EU pension regulation is important. This includes assessing whether the conditions for providing PEPPs (Pan-European Penion Products) are viable in this developing market. Broadening the scope of the PEPP regulation to include occupational pensions would constitute another improvement, as there may be a greater demand for occupational than personal pension solutions at a pan-European level. EIOPA's advice on the review of the IORP II Directive should be implemented as to better protect members and beneficiaries of IORPs.

Last year the Commission launched its Retail Investment Strategy (RIS), proposing to impose additional requirements on financial institutions to better protect retail investors. However, personal pension products tend to be excluded from the scope of retail investment products in EU regulation, such as the IDD and PRIIPs Regulation. While the RIS may strengthen existing requirements in the IDD for certain long-term savings products in the field of life insurance, in most Member States it does not ensure that personal pension products offer value for money. In addition, some types of private pension providers fall outside the scope of EU regulation. In some Member States the same financial institutions provide privately managed pensions across all pillars, including those in scope of the IORP II Directive.

More transparency and greater trust in supplementary pension saving is key to closing pension gaps.

A more balanced approach would increase trust in supplementary pensions. A first step would be to enhance EIOPA's remit beyond IORPs and PEPP, thus allowing it to make a supervisory assessment of all financial institutions that provide private pensions and of the value for money offered by all supplementary pension plans and products.

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Effective public policy and consumer focused products can close the pension gap

The Dutch second pillar pension is consistently ranked as one of the best in the world. Dutch retirees have among the highest living standards of retirees globally and old-age poverty is relatively rare. In this article, I will outline factors of our second pillar's success and possible solutions for the pension gap, looking at both the supply and demand side.

The first reason for this success is that pension saving is in many cases mandatory for salaried employees. While this takes away individual choice for pension savers (such as monthly premiums, how it is invested, which pension fund), it does solve inadequate pension saving resulting from inertia, 'presentism' and ordinary people's general lack of interest in pension affairs.

The second reason is our state-of-the-art pension tracking service. With a few mouse clicks, people can look up simple, instantaneous, and clear information about their accrued pension rights, and what they can expect in retirement - aggregated from all pension sources in the first and second pillar.

While Dutch occupational pensions are currently undergoing fundamental reforms, the large-scale, collective, and mandatory nature, high levels of protection and information provision will remain cornerstones.

Challenges, however, are on the horizon across Europe and, indeed, much of the world. Aging populations, low interest rates and decreasing expected returns across Europe are creating a gap between pension income that will be required and that is available. State social security systems become strained and occupational and private pensions are not always sufficient. EIOPA estimates that one in five EU citizens runs the risk of old-age poverty.

At EU level, various initiatives have been taken. EIOPA has provided excellent advice on pension dashboards and tracking services, which increase the information position of policy makers and citizens about pension adequacy. The European Commission has published a study about best practices in auto-enrolment in pension schemes. The Retail Investment Package aims to increase accessibility and attractiveness of Europe's capital markets for ordinary investors. The PEPP regulation has been passed several years ago.

By themselves, these initiatives are unlikely to solve the problem. Better information does not necessarily lead to better behaviour. Good products do not always attract customers: the take-up of the PEPP has been very limited so far.

More must be done, but the problem is as difficult to tackle as it is urgent.
There are two directions from which the pension gap can be addressed. One is from the supply side: are retirement products accessible? Do they offer value for money and do they meet citizens' needs? The other is from the demand side: people dislike thinking about pensions altogether and put saving off until it is too late. They may simply not earn enough to put money aside.

On the supply side, supervisors and policy makers need to keep working at solutions for pressing problems: the financial industry has successfully lobbied against the European Commission's efforts to tackle the harmful effects of inducements. That has not made them any less harmful. Many products that are being used for retirement purposes are too expensive, hollowing out long-term returns for ordinary people and failing to fulfil one of the capital markets' core tasks vis-à-vis citizens. Providing a secure and adequate retirement income for ordinary citizens is a key function of financial markets. Too often, financial products and services are not up to the task.

On the demand side, we need to minimise the effects of negative behavioural tendencies (such as inertia, present bias, loss aversion) while boosting financial literacy and interest in financial markets. It would be a good idea if consumers would do a 'financial health' check every couple years or at major life events. Financial advisors, supervisors and financial literacy initiatives all can play a role here. In the Netherlands, the AFM is working together with the sector and government to develop ideas for a 'periodic financial overview'. This can help become people more aware of inadequate pension savings and other personal financial risks.

Another positive development that builds on behavioural finance insights is EIOPA's recommendation to the European Commission to introduce requirements in relation to IORPs choice environments.

Providing a secure and adequate retirement for citizens is a key function of financial markets.

The truth, however, is that the real solution to the pension gap is closely intertwined with tax, social and labour policies, which are mostly decided nationally. Member states may find it difficult to give up autonomy in these domains in favour of a European solution. Making it mandatory for every citizen to save for old age (which is not the case in the Netherlands, contrary to popular belief), either at the national or European level, would be the most effective policy option as a back-stop to close the pension gap but carries trade-offs between interests that are inherently political.

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The long-term savings gap in Europe and the priorities to address it

The scenario that we will face

In the next 30 years, EU countries will be challenged to sustain the standard of living of their retired population. Currently, replacement rates (calculated as a percentage of pension income in comparison to pre-retirement salary income) in most EU countries are between 60% - 80%. But those ratios are based on having a dependency ratio of 3, meaning that there are 3 workers under 65 contributing to provide the pension of every above-65 retiree.

Eurostat projections show that dependency ratios in Europe will decrease from 3 to 2 (by 2050) due to low birth rates and the retirement of a large part of the workforce. As a result, replacement rates will decrease further and current public pension models will not be sufficient to keep adequate levels of pre-retirement standard of living. This will be further exacerbated by a very probable increase of personal contributions to health systems, due to the same effects.

We will need to turn to private savings for retirement. But surveys indicate that almost 40% of Europeans are not saving for retirement beyond public contributions, mainly due to a lack of interest and knowledge. Additionally, the investment of savings in financial instruments by Europeans is for example less than half than in the US. Those two data points show a lack of financial literacy and awareness of the future challenges among vast majority of the EU population.

Priorities to change the trend

The long term solution to that problem will require a combination of several actions in the EU countries, involving both public and private sectors. The most relevant measure will be to drive an increased level of private savings - to be built individually during working tenure - and a more efficient leverage of those savings by investing them in financial instruments that generate adequate returns.

IBIPs product variety and insurance distribution models are key to address the long-term savings gap.

The proposed Retail Investment Strategy (RIS) aims to address the long term savings gap problem, evolving current insurance and asset management regulatory frameworks (inter alia IDD and MiFID) to motivate a higher participation of retail investors in the financial markets. That could be achieved through providing higher transparency to customers, strengthening products' competitiveness, ensuring a fair advice model, and leveraging on digital transformation in retail investment distribution. At the same time, beyond customer protection regulation, an increase in the financial literacy of the population is also a priority for the EU Commission.

The importance of insurance based investment products and insurance distribution models

The existing diverse life insurance products landscape supports the objective of long term savings building by retail customers. There is a variety of Insurance based Investment products (IBIPs) which are designed to cover any specific customer needs. Key dimensions in this context are holding period, risk profile - expected return, and any cover providing additional protection to the customer (e.g: mortality, longevity, morbidity).

On the other hand, the current insurance distribution model is also conducive to the aforementioned goals. Insurance intermediaries play a key role in regard to awareness generation and professional advice. Distributors are a very important player to make customers aware of the need to start saving regularly from an early age, based on their personal relationship with customers and their extensive footprint (in cities but also rural areas). Those distributors are already today required to act only in the best interest of customers providing tailored advice based on their expertise and assessing the suitability of any product to customer's needs. As such both current IBIPs product variety and insurance distribution models are key enabling factors to increase participation of retail investors in the financial markets and fulfil the objective of RIS.

Private and Public sectors should join forces to enhance financial education

Future higher customer protection ensured by regulation, and the awareness of the savings gap promoted by insurers and intermediaries will not be enough to turn around the observed trend. The most recent Eurobarometer survey on the level of financial literacy in the EU shows that only about a quarter of the respondents answered at least four out of five questions on financial knowledge correctly. The results are particularly concerning as they point to the need for financial education to target in particular women, younger people, people with lower income and with lower level of general education, i.e. those segments of the population most concerned by the future long term savings gap. Hence, the development of financial knowledge for all generations should become a political priority of EU member states. Coordinated programs among members states are needed with the insurance and asset management sectors standing ready to support such initiatives and joining forces with the public sector to build the desired financial knowledge.

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Mind the pension gap! A way forward

European Governments are facing unprecedented challenges as their population is ageing rapidly and is expected to start shrinking by 2026. By 2070, over 30% of the EU's population is expected to be over 65 years old, and with it, the expenditure of age-related public services, including pensions, healthcare and long-term care, is expected to experience a significant increase. The challenge is exacerbated by the contraction in the working-age population, the reduction in saving propensity, especially among the younger generations, and the uncertain socio-economic developments.

If not properly and timely faced, the widening of the pension and long-term savings gap may hamper the social stability of the European continent, with systemic effects on the well-being of the European citizens. Notably, the persistent gender pension gap, whereby European women receive on average 30% less retirement income than men, poses an additional concern exacerbating these challenges.

Governments must focus on formulating public policy options to mitigate this gap, whilst exploring the role of insurance-based investment products as potential solutions.

The multitude of different factors affecting the widening of the pension and long-term savings gaps require a multifaceted approach, involving several stakeholders making simultaneous progress in various areas towards the same goals:

1. Promoting financial literacy: according to the 2023 OECD International Survey of Adult Financial Literacy, European countries display heterogeneous results, with some of them showing alarmingly low scores. Without the proper level of awareness and competence, European citizens cannot make informed decisions. The collaboration between public and private sectors is crucial to launch specific educational programs, also embedded in the school system, aimed at improving the understanding of the different saving options and the related risks.

2. Nudging individual ownership: the sustainability of public pension schemes is under strong pressure in several European countries; for this reason, citizens must be stimulated to take personal responsibility for their retirement planning. This implies encouraging individuals to start saving for retirement since the beginning of their professional career and make adequate and consistent contributions throughout their working life. In addition to pension dashboards, public authorities should provide clear incentives, such as tax benefits, for individuals following a virtuous behavior.

IBIPs can play a decisive role in reducing the pension and long-term savings gap.

3. Leveraging technology and innovation: pension management can be a complex task, particularly daunting for the individuals lacking adequate preparation. Advanced digital tools and platforms, such as pension planners and simulators, can be used to increase awareness, accessibility and engagement with pension information. This could be particularly effective for younger generations, more used to acquire information and take decisions leveraging innovative technologies.

In this context, insurance-based investment products (IBIPs) can play a decisive role in reducing the pension and long-term savings gap: the main characteristics of these products, the presence of multiple investment options and the financial security they might offer make them viable for all type of customers. In fact, these products are typically very flexible and therefore well suited for a wide variety of potential investors, addressing different type of needs throughout different phases of their life.

An additional benefit provided by IBIPs is the possibility to gain direct exposure to capital markets (i.e. through unit-linked funds), providing customers with a significant long-term growth potential and the opportunity to preserve their lifestyle during the retirement years.

Besides insurance companies, regulators and Governments also play a crucial role in promoting a savings culture among European citizens: all the actions targeted at increasing the level of transparency and promoting a more inclusive approach through common standards, such as the CMU, RIS and IORP II review, can help increase the level of confidence and trust of customers, and hence their propensity to save with a long-term perspective.

The Retail Investment Strategy is a prime opportunity to make the EU a safer place for citizens to invest in the long term and to encourage participation in EU capital markets. The industry is ready to contribute meaningfully to the debate to enhance consumers' trust in the capital markets. More digital solutions will better serve customers and will continuously improve advanced advisory services.

In the current challenging times, regulators should ensure a level playing field for all financial service providers, in order to safeguard an efficient competitive landscape for the benefit of all European citizens.

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Mind the gap - The importance of saving for our twilight years

In today's uncertain economic climate, saving for a rainy day – whether for a pension or long-term savings – is more important than ever.

But for consumers, knowing where to invest can be tricky. In an investment product? Or maybe a guaranteed pension plan? What about crypto? It is easy to get lost in the overwhelming amount of information which is too often unreliable or inaccurate. That is why access to reliable and independent advice is so crucial.

Ask the expert

Financial systems are complex, so getting help from an expert for important decisions is the rational thing to do. But for that, we need experts available to help consumers. In medicine, you can speak to a doctor, for legal issues you can find a lawyer. In finance, this is not the case. When you approach a financial institution or any other so-called "financial advisor" for advice in most of the EU, you are actually talking to a sales representative. This person receives commission to sell products like life insurance or funds. The higher the commission, the more attractive a product is to sell. The problem is that this translates into costs, reducing net returns for consumers. However, returns are the very purpose of an investment, especially for pension plans. This means that our market is suffering from adverse selection, the worst products are the easiest to distribute, which means the failure of the sales system negatively impacts product design.

Paying for bad advice

In our campaign "The Price of Bad Advice," BEUC showed how harmful and detrimental conflicts of interest in financial advice can be to consumers. In almost all EU countries consumers have been affected by mis-selling scandals that led to significant financial losses. And this is just the tip of the iceberg. A recent study from the University of Regensburg used OECD data to measure the harm of inducements to consumers in the EU per year: a staggering €375bn. That is how much money households are losing because of the current system. Similarly, the European Commission's Directorate General for financial services (DG FISMA) found that retail investment products are 25% more expensive for consumers than products for institutional investors. This is unacceptable.

We must establish genuine competition on product quality to create fairer private pension markets.

A question of trust

Consumer surveys show people do not trust capital markets and financial advisors and that trust is a major factor in market participation. Consumers also keep much of their money uninvested, which could be used to finance the transition towards a more sustainable economy.

This is not a problem of transparency: what would consumers who receive bad advice do? They can accept it and take the loss in opportunities. They can get bad advice from a different seller with the same result. They can try to become financial experts, but few have the time to study very complex regulations. Or, too often, consumers disengage. Any meaningful reform will have to break this market power, to allow for fair competition on product quality.

Consequences on pensions

Both underperformance of investments and disengagement contribute to the pension gap on the demand side. The extent is notoriously difficult to define, however. There are differences by gender, by age, by country, socioeconomic status and it's partially a matter of definition: how much is too little? Finally, it may not be in all authorities' interest to spell out the size of the problem which is why there is a wide body of scientific literature on the subject which agrees on one point: We have a major problem.

Time to fix a broken model

The European Commission is well aware of the problem and has taken some steps to address it in its recent Retail Investment Strategy proposal. Unfortunately, due to heavy industry lobbying, the proposal fell short of taking appropriate action, which would require banning inducements and establishing a body of truly independent advisors. However, the proposal does contain measures that may improve the consumer experience. For example, the ban on inducements in sales without advice (for example, when consumers choose their own products online and only need an intermediary to follow through on their decision) or the Value for Money approach to improve product quality via supervisory intervention.

Decision-makers must now choose whether they want competition at the product performance level or if they want to support those offering higher commissions to sell the worst products. It is not possible to have both.

Finding the right balance

Ultimately, to fix the broken retail investment market, we need to fix the imbalance between vested interests on one side and consumers on the other. Doing so will help establish genuine competition on quality and create more efficient and fairer market outcomes for both consumers and society.