

# Adjusting EU frameworks to unleash long term institutional capital

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## 1. Despite public long term investors, long term finance in the EU remains under pressure

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Despite abundant private savings and the active involvement of domestic and EU public financial institutions, such as the Groupe Caisse des Dépôts (CDC), Kreditanstalt für Wiederaufbau (KfW) and the European Investment Bank (EIB), the EU continues to face difficulties in directing capital towards productive long-term investment.

### 1.1 Long term finance under pressure: geopolitical uncertainty and insurance sector shifts

An official explained that the current macroeconomic environment is unfavourable to long-term capital allocation. Geopolitical uncertainty generates a liquidity premium, prompting investors to hold capital in reserve to address unforeseen events. As a result, they are reluctant to commit funds to long-term projects. When risk is mispriced, the supply of long-term financing declines. In addition, the financial system's efforts to reduce risk have produced unintended consequences. Concerns regarding long-term guarantees in the insurance sector have led insurers to transfer risk to consumers. Since insurers must match assets with liabilities, larger players have shown diminished appetite for long-term assets, further weakening demand for long-term finance.

### 1.2 Idle savings, persistently low rates and structural weaknesses: Europe's struggle to boost long term investment

A market expert noted that prospects for long term investment in Europe appear positive given the high level of private savings, but much of this capital is not channelled into productive investment and remains unproductive, with around €10 trillion held in bank deposits.

He pointed out that weak growth and chronic underinvestment are closely linked to the prolonged period of low and negative interest rates. Demand-boosting policies, including deficit-financed redistribution, have reduced productivity, increased indebtedness, encouraged liquid savings rather than long-term investment, transferred capital to the United States, and delayed structural reforms. Geopolitical uncertainty has further reinforced savers' caution. The Inflation Reduction Act has diverted major projects to the US, while the deployment of NextGenerationEU funds has been slowed by administrative complexity, cumbersome procedures and skills shortages.

A deeper structural challenge lies in the underdevelopment of pension and sovereign wealth

funds in most EU countries. Unlike the US or Canada, Europe lacks large, stable domestic long-term investors capable of supporting equity financing and investment in strategic sectors.

### 1.3 The unique role of public long term investors in Europe's future

An industry speaker stressed that public long-term investors are essential to financing major projects, particularly when private finance is insufficient.

Firstly, the long-term horizon of large projects requires investors able to convert short-term savings into long-term capital. Institutions such as the CDC fulfil this role by transforming sight deposits and popular savings into loans with maturities of 50 to 80 years, relying on stable funding and their ability to carry risk on their balance sheets. Secondly, long-term projects are inherently perceived as risky because they involve future outcomes, and today's future is more uncertain than ever. Long-term investors address this by diversifying their portfolios and assessing risk and return over extended horizons.

Thirdly, these institutions integrate externalities into project assessments, looking beyond immediate financial returns and turning today's risks into tomorrow's opportunities. A former CEO of CDC referred to this mindset as *le goût de la brèche* or "the appetite for breakthrough".

Finally, public long-term investors play an anchoring role. Their participation can catalyse further investment by attracting additional financiers to major projects. The CDC was created in the aftermath of the Napoleonic Wars to restore trust and channel French savings into long-term investments. In today's context of uncertainty and rapid transformation, their role remains as relevant as ever.

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## 2. Europe's long term finance challenge: actors, hurdles and structural gaps

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### 2.1 Boosting long term finance: overcoming prudential hurdles and revitalising securitisation

An industry representative underlined that European commercial banks remain central to credit intermediation and long-term financing. However, risk pricing in the banking sector has undergone a profound transformation following well-intentioned prudential reforms such as Basel III. These reforms have increased the cost of longer-term financing and limited banks' capacity to mobilise deposit funding. The key challenge is to improve the velocity of financing.

Securitisation offers a way to enhance banks' capacity to extend credit, use capital more efficiently and transfer risk to non-bank entities. Since the global financial crisis (GFC), however, both the stigma attached to securitisation and regulatory constraints have led to a sharp decline in activity. In this context, the Savings and Investments Union (SIU) proposals aim to strengthen banks' ability to transfer risk to non-banks by easing capital requirements and allowing long-term investors, such as pension funds and insurers, to assume a larger share of risk. A scorecard assessment indicates that the SIU reforms could significantly accelerate the circulation of capital within banks and make securitisation investments more attractive for EU insurers. Fitch Ratings estimates that insurers' solvency charges for securitised products would fall by 60 % to 70 % under the proposed revisions.

Nevertheless, the new proposals remain 12 times less capital efficient for a "AAA" rated securitisation bond than the regime applied to US life insurers and around 1.3 times less efficient than those applicable to Korean and Japanese insurers. This clearly raises concerns regarding the level playing field. While the SIU proposals are well-intentioned and could support greater mobilisation of capital, questions remain about their practical implementation. There appears to be room for considerable disagreement between stakeholders, and as always, the details will be decisive.

## **2.2 The role of insurers in long term investment: opportunities and challenges**

### ***2.2.1 Insurers can provide risk-bearing capacity and partner with public financial institutions***

An industry speaker noted that insurers are naturally inclined to invest over the long term given the structure of their business model. The key question is whether their contribution should take the form of funding or risk capital. Their balance sheet has two sides: the asset side, which deploys liquidity, and the liability side, which usually absorbs most of their capital. Assets are typically managed for asset–liability matching. Because of the volatility of claims, non-life insurers and in particular reinsurers must maintain high levels of liquidity on the asset side. On the liability side, they can offer risk-bearing capacity through 'unfunded' credit insurance.

Insurance companies often operate in close partnership with other institutions. Munich Re, for instance, has longstanding relationships with major public financial institutions, based on a shared understanding of investment horizons and long-term risk management. In this ecosystem, banks and public institutions are the clients, while insurers act as risk-sharing partners. By leveraging their balance sheets, insurers can help attract additional private capital to large projects.

### ***2.2.2 Regulatory impediments to participation in equity, private and securitised markets***

An industry speaker stressed that capital requirements are typically assessed against short-term risk. This leads insurers to avoid securitisation as some AAA-rated tranche charges can exceed those for long-term

equity, leading insurers to rather invest in highly rated government or corporate bonds. Also, regulatory equity risk capital is largely determined by short-term fluctuations, but over a 40-year horizon, a diversified equity portfolio is inherently not so risky. Analysing the worst performance of such portfolios over any 40-year period in the past 150 years would illustrate this.

Securitisation also presents limited risk for long-term investors. European securitised products did not generate losses for institutions that were not forced to sell during the global financial crisis. From an asset–liability matching perspective, capital requirements should therefore reflect more the duration of the investment horizon.

A market expert added that investing in non-listed companies remains challenging for insurers. Higher claims volatility requires them to hold substantial liquidity, while the cost of evaluating individual non-listed investments is prohibitive. In the United States, 17 % of life insurers' assets are invested in securitised products, compared with only 0.3 % in Europe. Current EU rules discourage insurers from participating in this market, as the risk is borne by the buyer rather than the issuing bank. If instruments such as covered bonds were integrated into securitised structures, the underlying risk would remain with the issuer. This adjustment could incentivise European insurers to participate more actively and reduce the gap with their US counterparts.

## **2.3 Regulation, risk and Europe's struggle to foster equity investment**

An official observed that prudential regulation has had the unintended effect of diverting European savings towards the United States. These funds increasingly flow into lightly regulated hedge funds and business development companies, while European banks provide loans to these entities. Risk has not disappeared; instead, banks have lost the opportunity to channel these funds into equity financing within Europe.

Close monitoring is essential, as new players are rapidly emerging and scaling innovative business models. Europe's regulatory framework appears to be pushing banks towards alternative strategies, with risk reappearing in new forms. Equity investment is inherently long term and requires a framework that rewards risk-taking within a stable economic and regulatory environment. During and after the pandemic, when companies or sectors generated high profits, political debate often turned to windfall taxation. This undermines investor confidence, as investors cannot be sure their returns will be preserved. While policymakers frequently emphasise the importance of fostering an equity investment culture, they underestimate the extent to which such measures damage that very culture.

## **2.4 Financing growth: the challenge of SME reluctance towards capital markets**

An official highlighted that small and medium-sized enterprises (SMEs) in the EU are generally reluctant to use capital markets. Owners often prefer to maintain control rather than raise additional capital. This issue

must be addressed if capital markets financing is to expand. An official (Sebastian Thomasius) added that all EU member states need to make capital markets more attractive to SMEs.

### 3. Fostering long term investment

#### 3.1 Bridging the pension gap: insurers, equity, securitisation and fund structures

##### 3.1.1 Strengthening the EU's pension systems

An industry speaker observed that most national pension systems in EU countries are 'pay-as-you-go' Pillar 1 schemes, which do not generate investable funds. Significant savings can only be channelled into long-term equity through Pillar 2 or Pillar 3 arrangements, which need to be strengthened but are generally determined at national level. These systems will also only allocate significant shares to long-term equity if they give-up formal guarantees and conversely require a minimum allocation to riskier assets linked to the investment horizon and diversification requirements.

An industry representative (Monsur Hussain) explained that defined benefit (DB) pension schemes tend to have long investment horizons, enabling them to assume more risk and support long-term financing solutions. Their risk-bearing capacity is therefore substantially higher. By contrast, defined contribution (DC) funds usually operate over shorter horizons, with empirical evidence demonstrating that policyholders tend to adopt conservative investment strategies, leading DC schemes to make more cautious allocations. Consequently, lifting investment limits for alternative assets in DC funds might not trigger a significant change in practice.

Increasing the scale of pension funds would likely, however, generate major benefits. Larger pools of capital provide much greater risk-bearing capacity in absolute terms. Australia offers an instructive example: with a population below 30 million, its pension fund sector is similar in size to that of the EU. Australian pension assets, currently just under USD 3 trillion, are expected to reach around USD 7 trillion by 2035. This greater scale has a transformative effect on investment allocation, regardless of individual savers' conservatism, with a clear tilt towards longer-term financing assets.

An official highlighted that the German government is developing a policy known as Frühstart Rente ('early start pension'), a subsidised securities account for children aged six to 18, offering a €10 monthly contribution for investment. Funds would be locked in until retirement. By familiarising young people with the opportunities and risks of equity investment, it could help cultivate a new generation of investors.

##### 3.1.2 Fixing the prudential rules on long-term equity and securitisation

An industry speaker stressed that regulatory frameworks such as Solvency II, the Institutions for Occupational Retirement Provision II Directive (IORP II) and the accounting treatment of long-term investment

should better reflect the nature of these assets within asset-liability matching when applying capital requirements. Current treatment of long-term equity and securitisation is inadequate.

For securitisation, capital requirements should be linked to fundamental credit risk rather than to spread risk. As the European Commission rightly proposes, lowering these requirements must be accompanied by measures to maintain sufficient liquidity and avoid forced sales during market stress. Regulation must remain prudent.

Non-life insurers primarily deploy capital on the liability side but can also provide risk capital. Allowing them to invest in significant risk transfer (SRT) securitisation using the simple, transparent and standardised (STS) framework should help recycle bank capital and increase the financing available to the economy. Because the insurance industry is unfunded, this capital will support long-term, low-yielding assets such as housing and infrastructure. Credit funds are unlikely to take on these assets as many such funds depend on bank leverage to achieve sufficient returns. In contrast, diversified deployment of insurance capital can stabilise the banking system and reduce the risk of systemic vulnerabilities re-emerging 'through the back door'.

An official noted that targeted regulatory adjustments can have a tangible impact. The reform of the European Long-Term Investment Funds (ELTIF) Regulation illustrates this clearly. Initially, ELTIFs struggled to gain traction. Following the reforms, however, they expanded rapidly and continued to grow. Greater flexibility and closer alignment with investor needs have significantly enhanced their appeal. Between 2023 and 2024, assets under management in ELTIFs increased by around 38%, accompanied by a marked rise in fund launches.

#### 3.2 From grants to blending: maximising the impact of EU investment

##### 3.2.1 Public institutions as catalysts for private investment

An official underlined that public institutions play a crucial role in infrastructure investment. When a public body supports a project, it signals its investment potential. However, public institutions should not fully replace private capital. Total private investment should exceed the level that would have occurred without public intervention. Financial support must be provided on market-based terms, linked to private co-investment whenever possible, and should not distort competition. Through this approach, public institutions can effectively mobilise private capital to support structural transformation and foster economic growth.

##### 3.2.2 Leveraging the Multiannual Financial Framework (MFF) to boost investment

An industry speaker explained that public institutions can play a greater role in addressing the EU's fiscal constraints. With national and European budgets under increasing pressure, grants alone are no longer sufficient to support long-term investment. Blending mechanisms, which combine grants with equity, loans or guarantees, should therefore be expanded.

The most recent MFF introduced a guaranteed mechanism under InvestEU and piloted blending through the Connecting Europe Facility (CEF). The next MFF offers an opportunity to scale up these initiatives. This approach is facilitated by a network of long-term European public investors capable of acting as implementing partners. Such instruments enable public institutions to attract private capital and generate stronger leverage effects.

### **3.2.3 Improving the Capital Requirements Regulation (CRR)**

An industry speaker stressed that the regulatory framework could also incentivise long-term investment. Equity exposures are considered particularly risky and are subject to high capital charges. There is, however, one exception: when banks invest in equity through legislative programmes, capital requirements are capped at 100 % of the exposure value. The European

Commission could clarify that this treatment also applies to the equity holdings of public promotional banks. This would ensure that banks and co-investors benefit from the 100 % ceiling and send a strong signal that long-term investment is essential to Europe's competitiveness.

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## **Wrap up**

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The Chair noted a broad consensus on the challenges facing long-term investment. While these challenges are significant, numerous potential solutions have been identified. It is essential to continue reflecting on these issues and testing different approaches. Some failures are inevitable, but persistence is crucial. Inaction is the only option that must be avoided.