LONG TERM RETAIL INVESTMENT PRODUCTS

JOS HEUVELMAN
Member of the Executive Board – Dutch Authority for the Financial Markets (AFM)

Long-term products must be simple and cost-efficient to fill the investment gap

The urgency that is currently felt across Europe is an opportunity for member states to make serious work of stimulating citizens to improve their prosperity by investing for the long term. They can do this by organising second pillar, occupational pension systems, or by creating simple, cost efficient and diversified long-term investment products, or a combination. This will increase future prosperity of European citizens and provide our economy with the necessary capital funding.

Member States can take different routes depending on their preferred economic model and other national characteristics. Whichever option they choose, however, low costs, high trust, and a long-term nature will be key features. The European Commission and European institutions can support Member States.

For those who have been following the Retail Investment Strategy closely over the past four years, the problem diagnosis and recommended solutions in the Draghi, Letta and Noyer reports frankly feel like a déjà-vu. Political will to fix major deficiencies in the European retail landscape has been insufficient in the face of national interests. Hopefully, the new discussions on the Savings and Investments Union can ensure that products are of high quality and advisors work in the interest of their clients.

Collective pensions decrease costs for investors

The Dutch experience with large, mandatory occupational pension funds has shown how a collective approach can bring down costs, improving outcomes for consumers, and invest more directly in young and dynamic companies and small and medium enterprises. The large amount of assets owned by pension funds gives them a better bargaining position vis-à-vis asset managers. Moreover, the large number of participants leads to relatively low fixed costs. Although costs vary per fund, the large Dutch pension funds have total annual costs of about 50 basis points, which includes investment management, transaction fees and pension administration. This is much more attractive than the 2.1% average annual costs that non-ETF UCITS funds charge to investors (Source: ESMA Cost and Performance of EU Retail Investment Products 2024).

Products must be simple and offer value for money

The above route may not be desirable or feasible for each Member State. Instead, long-term products can fill the investment deficit if they are cost efficient, diversified and relatively simple. A label for simple products can help (potential) investors make sense of the sometimes overwhelming supply of different kinds of products and funds available on the market. Products that qualify for this label must primarily be in the client's interest through cost efficiency, adequate diversification and a relatively simple nature. Investing in EU assets can be a secondary goal, but not at the expense of necessary diversification and long-term returns.

Consumer behaviour and the demand-side

There is no lack of products available to European investors, ranging from personal pension products to investment funds and investment-based insurance products. Developing more types of products may offer little additional benefit. Rather, insights from consumer behaviour should be applied to entice potential investors. A recurring financial fitness check, which happens every five years or at major life events, can help raise awareness of the necessity to invest, for yourself or for your children.

Even with recurring check-ups, however, the average citizens will postpone difficult decisions, sometimes until they are too late. Auto-enrolment is a far-reaching but effective policy option to diminish the risks associated with suboptimal consumer behaviour. **When it comes to long-term investing**, either through a pension plan or a long-term product, **small steps will yield big results**. Even small percentages, e.g., in terms of gross wages, will make a big impact.

PEPP review

A lot has been said about the one percent cost cap of the basic PEPP. With sufficient scale, offering a PEPP below this cap should certainly be possible. The problem is the start-up phase, where firms need to make expenses and scale has not been achieved yet, making PEPP unprofitable. Because of the importance of low costs, however, I would argue against letting go of the cost cap. It remains to be seen whether costs will really go down in later phases of the product, once scale has been achieved. This hypothetical decrease may come too late to be of use for early investors. Instead, the PEPP could be made simpler and less burdensome to offer.

When it comes to long-term investing, small steps will yield big results.

The Commission has committed to propose (legislative) initiatives the coming years that address these issues. The ambition looks promising. Member States, supervisors and other European institutions will have to match that ambition to ensure that capital markets fulfil their promise for future prosperity.