CMU ASSESSMENT REPORT

Reconnecting EU Households to the Real Economy and the Capital Markets Union

2015-2019

BETTER FINANCE

The European Federation of Investors and Financial Services Users

Fédération Européenne des Épargnants et Usagers des Services Financiers

CMU Assessment Report 2015-2019

Reconnecting EU Households to the Real Economy and Capital Markets

November 2019

*Since "households are the principal net savers in the economy", the CMU aims to "**<u>boost retail investments into capital markets</u> and enhance individual confidence**"*

CMU Green Paper (2015)

"We need a well-functioning market for retail investment that is transparent, competitive, and cost-effective for consumers"

Valdis Dombrovskis, Vice-President of the European Commission[1]

*"As governments around the world withdraw from welfare provision and promote long-term savings by households through the financial markets, **the protection of retail investors has become critically important**"*

Niamh Moloney*

*"EU households are the main source for the long-term funding of the European economy. **This is why savers and individual investors must be placed at the heart of the CMU initiative**"*

former EU Commissioner, Lord Jonathan Hill

A BETTER FINANCE Research Report

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[1] Valdis Dombrovskis, Opening Speech at the Public Hearing on making the Capital Markets Union work for Retail Investors, Brussels, 29 June 2018.

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*The quote on the previous page from Niamh Moloney, a member of BETTER FINANCE's Scientific Council[2], is taken from Niamh Moloney, *How to Protect Investors: Lessons from the EC and UK* (2010) Cambridge University Press; emphasis added.

[2] https://betterfinance.eu/organisation/who-we-are/scientific-council/.

Executive Summary

This Briefing Paper aims to provide a targeted assessment of the progress achieved by the European Union (EU) in establishing a Capital Markets Union after four years of implementation, and just before a new EU Commission is being established. It also comes just after the "Next CMU" Report of 9 October 2019, which takes on board quite a number of BETTER FINANCE's CMU proposals of 2015.

Building on the unfortunate experience of the two financial crises (the 2008 sub-prime crisis and the 2010 sovereign debt crisis), the European Commission (EC) announced the strategy to integrate the EU capital markets, namely the "Action Plan on Building the Capital Markets Union", in September 2015.

What did BETTER FINANCE do in 2015?

In April 2015, prior to the release of the initial CMU Action Plan, BETTER FINANCE laid down an analysis and put forward 23 solutions towards creating an effective and citizens-friendly CMU through its 2015 CMU Briefing Paper.[3] Several of them have been endorsed by the EC in its September 2015 CMU Action Plan, and then in its June 2017 CMU Mid-Term Review Report. As recognised by the EC, the main source of funding and long-term value creation stems from the EU households' ability to finance the EU economy via more involvement in capital markets. Rather than just holding long-term savings in bank deposits and other "packaged" products that estrange them from capital markets and the funding of the real economy, BETTER FINANCE suggested that more <u>direct ownership of real economy assets by retail investors should be fostered</u> through effective enforcement of individual investor protection rules, transparency and disclosure of key information (past performance and fees in particular), simplicity and comparability. As mentioned by the European Commission itself, the CMU will therefore also aim for, and result in, better long-term returns of "retail" investment products.[4] BETTER FINANCE and other independent research shows that those are currently too often very poor or even negative in real terms.

What is the purpose of this report?

The EU legislature and Commission change in 2019 and, along with it, new policy priorities will follow. Also, very recently, three Member States (Germany, France and the Netherlands) sponsored a "Next CMU" report, which is significantly aligned with BETTER FINANCE's own analysis and proposals.[5] While BETTER FINANCE believes some progress has been achieved, the EU is still lagging behind in its efforts to foster retail investments back into capital markets and to revive an equity culture that would support the real economy. There is room for improvement, in particular with regard to distribution and advice on retail financial products, investor protection and redress, consumers' trust,[6] SMEs' access to financing, developing and unifying local capital markets, removing barriers to public listing and improving long-term returns for savers. Retail Finance is yet again ranked as one of the worst performing consumer markets "*where consumers suffer the highest detriment (financial loss or waste of time) in case of problems*" [7].

Individual savers - whether shareholders, pension plan participants or fund investors, among others - form the foundation of a stable and sustainable EU Capital Markets Union as the main source of long-term financing for SMEs, for growth, jobs and for the real economy. Therefore, the new legislature and policy

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[3] BETTER FINANCE CMU Briefing Paper, http://betterfinance.eu/fileadmin/user_upload/documents/Research_Reports/en/CMU_Briefing_Paper_-_For_Print.pdf
[4] CMU Action Plan, *Introduction*, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015DC0468.
[5] See part 3 of this Introduction.
[6] As confirmed by the 2018 EC study on the retail distribution of investment products, see Distribution systems of retail investment products across the European Union https://ec.europa.eu/info/sites/info/files/180425-retail-investment-products-distribution-systems_en.pdf
[7] Based on the worrying findings of the newest 2018 edition of the "EU Consumer Markets Scoreboard"; See 2018 Consumer Markets Scoreboard "Making markets work for consumers" https://ec.europa.eu/info/sites/info/files/eujus15a-1816-i02_-_the_consumer_markets_scoreboard_2018_-_accessibility_final.pdf, page 9.

makers must now redouble their focus on improving retail finance for EU citizen, SMEs and sustainable long-term growth.

This report assesses what has been achieved so far based on five key performance indicators. Building on that evaluation, the paper proposes steps and priority actions for improving the CMU strategy in order to make more significant progress in unifying and further developing capital markets in the EU in a manner that benefits both the real economy and households as long-term savers.

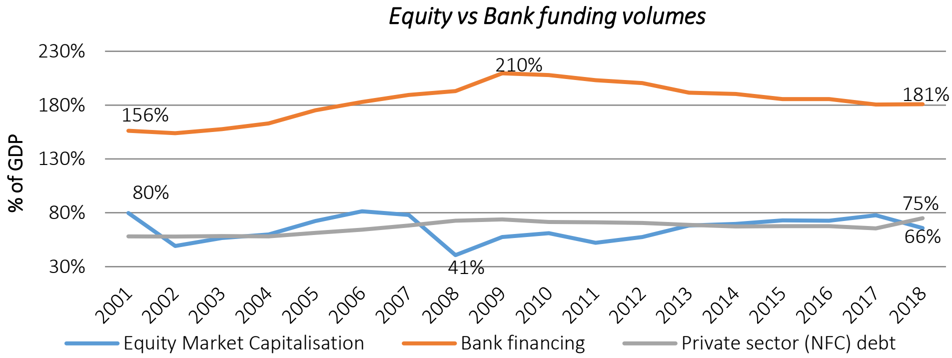
What are BETTER FINANCE's key takeaways?

The first part of this paper looks at **the CMU Key Performance Indicators (KPI) related to retail investors** and assesses the evolution of the key issues since the launch of the CMU Initiative in 2015:

KPI 1 - Equity Market Funding vs Bank Funding

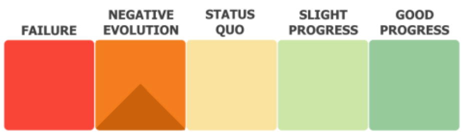
Status: Slight progress

There has been slight progress with regards to deepening the capital markets-based channels of financing within the EU. Capital markets and securities exchanges must foster IPOs and must be accessible to, and attractive for, retail investors and SMEs. With 90% of enterprises being SMEs, providing two thirds of jobs in the EU, this sector is the most important one for growth, job creation and innovation. In 2015, the total value of funding obtained via equity markets rose to 73% of GDP, compared to 186% of GDP for bank funding. In 2018, although the level of equity markets funding decreased to 66% of GDP,[8] the level of non-financial corporation (NFC) debt rose to 75% and the level of bank funding decreased to 181%. In addition, it is difficult to assess the respective roles of the CMU initiative versus the continuous rise in stock market prices during that period and the decrease of 2018, during which the equity market capitalization of EU listed companies fell below the level of 2013.[9]



Source: Table 2 under KPI 2 below

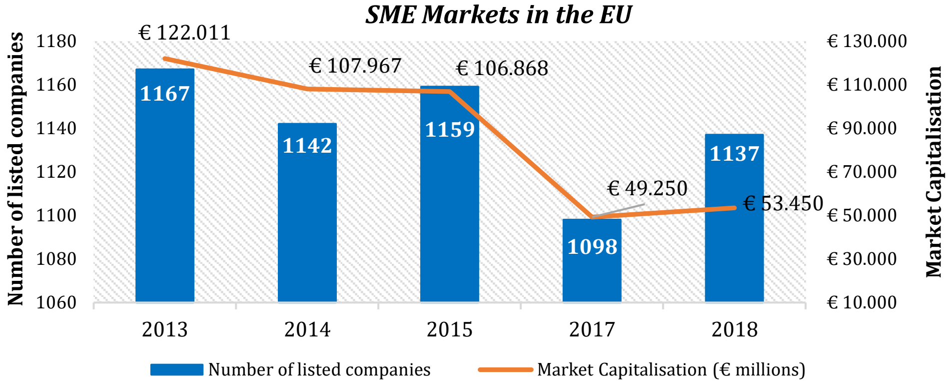
KPI 2 – SME participation in capital markets



Status: Negative evolution

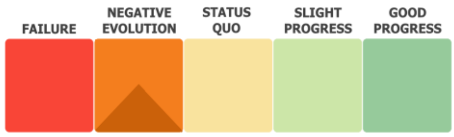
The number of SMEs and start-ups going public has decreased in the EU. The SME and IPO markets are still underdeveloped compared to those in the US and Asia. In addition, with many Eastern European markets lagging behind, equity trading in the EU is concentrated in a handful of trading venues in Western Europe.

[8] Source: Graph 2 of KPI 1 below.
[9] Source: Graph 2 of KPI 1 below.



Source: Chart 13 under KPI 3 below

KPI 3 – Retail investments in capital markets



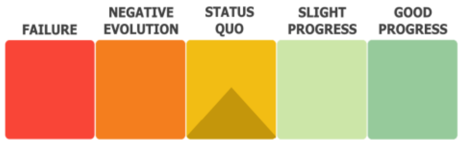
Status: Negative evolution

Unfortunately, the structure of EU citizens' financial savings has not improved as envisaged by the CMU Action Plan. EU households do save (financially) but keep most of their savings in banking products or packaged investment products, which are complex, opaque and often costly. If a part of those savings were to be invested directly into capital markets, the entire economy would benefit. However, in order to be attractive, capital markets must be more transparent, and asset managers should offer value for money, to compensate for the inherent risk of investing.

in % of total	EU28			Eurozone		
Type of account/year	2015	2018	Δ%	2015	2018	Δ%
Currency & bank deposits	30%	31%	4%	33%	34%	4%
Debt securities	3%	2%	-29%	4%	2%	-33%
Listed equity	4%	4%	-8%	4%	4%	-8%
Investment funds	7%	8%	1.3%	9%	8%	-3%
Life insurances & pensions	39%	39%	0.1%	33%	34%	3.3%

Source: BETTER FINANCE own composition based on Eurostat data; Δ%/Δ€ means change in percentage and monetary terms over the period;

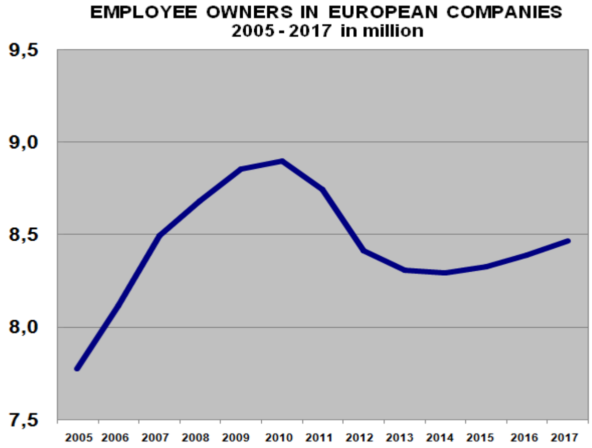
KPI 4 – The EU equity investment culture



Status: Unchanged

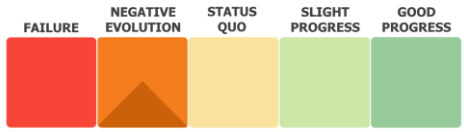
The CMU rightly aims to revive an equity culture in the EU in order to promote long-term and sustainable growth. One very powerful measure[10] to this end would be to promote employee share ownership in European businesses, in particular through promoting awareness and through regulatory incentives. Incentivising employee share ownership is one of the actions proposed by BETTER FINANCE in 2015 that has been taken on board by the European Commission's review of the CMU Action Plan. Data shows a direct correlation between regulatory incentives in EU Member States and the number of employee share owners in the past 10 years. However, the situation did not significantly change since the initial adoption of the CMU Action Plan, and EU authorities are yet to take action in this area.

[10] Guillaume Prache, 'Employee Share Ownership: The Single Most Powerful Action to Reach the CMU Goals' in Eurofi Views Magazine, *The Eurofi High Level Seminar 2019* (Bucharest, 3 April 2019), p. 176, http://www.eurofi.net/?document=bucharest-2019-views-eurofi-magazine.



Source: Graph 26 under KPI 4 below

KPI 5 – Capital market returns for retail investors



Status: Negative evolution

In order to incentivise investment and restore trust in the industry, retail investors need to be able to count on decent performances, and at least avoid negative real returns on their pension savings (i.e. destroying their purchasing power over time). This has not been the case and has been getting worse in recent years despite strong and continuous "bull" capital markets, both for bonds and for equities (with the exception of 2018 for the latter). This divergence alone shows the estrangement of "retail" investments from capital markets' and real economy assets. On aggregate, EU financial intermediaries underperform capital markets. Only 9% of Euro Area equity funds have managed to overperform their benchmark over the past 10 years.[11] With regard to long-term life insurance and pension products, the situation is worse, as research[12] shows that a majority of EU long-term and pension savings products have widely underperformed capital markets, while some of them even generated real losses for pension savers. The table below (*Table 38 of KPI 5*) shows the long-term performances of French life contracts. As for bank savings products, they have delivered on average strongly negative returns after fees and inflation for many years in a row now.

This is a very serious issue that must also be addressed from social and political perspectives, as it contributes strongly to the worsening of the pension time-bomb issue and to the impoverishment of middle classes in Europe.

Real returns of all French life contracts (*pensions*) – 2000-2018		
	19-year return	**Average yearly return**
Before tax returns		
Capital guaranteed contracts	39.30%	1.80%
Unit-linked contracts	-23.90%	-1.40%
All contracts (avg.)	28.50%	1.30%
After tax returns		
Capital guaranteed contracts	23.80%	1.10%
Unit-linked contracts	-27.70%	-1.70%
All contracts	12.80%	0.60%

Source: Table 38 under KPI 5 below

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[11] See BETTER FINANCE, Pension Savings: The Real Return (2019), page 55, https://betterfinance.eu/publication/pension-savings-the-real-return-2019-edition/.

[12] BETTER FINANCE Pension Savings: The Real Return – 2018 edition: https://betterfinance.eu/wp-content/uploads/Pensions_Report_2018_-_Final_Version_-_for_Web.pdf .

"the (financial) industry … needs to harness innovation towards creating better customer outcomes"
(Oliver Wyman, The State of the Financial Services Industry, 2018)

Many of BETTER FINANCE's proposals at the launch of the CMU project in 2015 remain valid, with little progress made in those areas. Whereas the European Commission took on board or considered a part of BETTER FINANCE's 2015 recommendations for building the CMU (5 fully taken on board, 7 partially and 11 not at all pursued) their implementation (Table in Annex I) has not always been satisfactory. It is true that it did not depend entirely on the proponent, but much more work is still needed to build a CMU centred on retail investors' and SMEs' needs. The Table below shows how many of BETTER FINANCE's 2015 proposals have been fully or partially pursued by the European Commission – with reference (*Action 1* etc.) to the numbering in the Table in Annex I.

BETTER FINANCE 2015 proposals taken on by the European Commission	
Fully taken on board	**5**
Action 5	
Action 9	
Action 11	
Action 12	
Action 15	
Partially taken on board	**7**
Action 1	
Action 2	
Action 4	
Action 13	
Action 14	
Action 16	
Action 17	
Not at all taken on board	**11**

Source: BETTER FINANCE own composition, October 2019; see Table in Annex I

Part 1. Introduction

The European Economic and Social Committee (EESC) highlighted that "[a]*n effective capital markets union is not possible without involving and attracting EU citizens as individual investors*".[13]. Individual savers and investors should be the main source of funding for new capital investments, in particular long-term ones. Retail savings should be directed at **real value creation**, which can be achieved by:

- **Increasing capital markets integration** in order to better respond to financing needs and allow for better returns at lower prices and risk;
- **Focusing on long-term strategies,** averting cyclicality and strengthening the economy's flexibility to respond to crises;
- **Supporting sustainable development**, through job creation, increased research and innovation, higher competitiveness and by reorienting capital flows to green projects; and
- **Fostering financial stability**, through better risk assessment, asset diversification, and multiplication of financing channels.

The deepest financial crisis in the past eight decades (2008) was rooted in the endless recycling of already existing financial assets[14] (and gross misconduct). Mis-selling and mismanagement scandals, coupled with detrimental public interventions (such as bail-ins), have even further eroded the attractiveness of investing for retail savers.

The purpose of this paper is to assess the progress towards achieving the CMU based on 5 Key Performance Indicators (KPIs) identified by BETTER FINANCE in its CMU Barometer (2018):

- **KPI 1. Equity Market Funding vs. Bank Funding** – *How developed are EU capital markets?*
- **KPI 2. SME participation in capital markets** – *Does the real economy harness the advantaged provided by capital markets?*
- **KPI 3. Retail investments in capital markets** – *Are EU citizens connected to capital markets?*
- **KPI 4. EU Equity investment culture** – *How inclined are EU investors towards long-term financing?*
- **KPI 5. Investment returns for retail savers** – *Did EU citizens get value for money from capital markets*?

These KPIs will be assessed in light of the two Action Plans the European Commission developed in order to build a Capital Markets Union (**CMU**).

1. The 2015 CMU Action Plan

The European Commission's 2015 "Action Plan on Building a Capital Markets Union" (**2015 CMU Action Plan**) consisted of 33 objectives which the Capital Markets Union was designed to achieve[15] through a €315 billion investment plan and a number of legislative projects. The 2015 CMU Action Plan took over the wording and ideas outlined in the *5 Presidents Report*[16]. As such, the CMU would become the second pillar of the Financial Union, alongside the Banking Union.

Among others, the CMU's purpose was to unlock capital financing from EU (domestic) and international (foreign) investors to match holders of capital (financing offers) with new projects (financing demand) and

[13] Opinion of the European Economic and Social Committee on the 'Green Paper on Building a Capital Markets Union' (COM(2015) 63 final), point 3.7, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015AE1333.
[14] See V. Bavoso, 'Capital Markets, Debt Finance and the EU Capital Markets Union: A Law and Finance Critique' ECMI Working Paper no. 5 of November 2017, p. 3 and 5.
[15] European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: Action Plan on Building a Capital Markets Union' Brussels, 30.9.2015, COM (2015) 468 final, p. 3.
[16] Jean-Claude Junker, Donald Tusk, Jeroen Dijsselbloem, Mario Draghi, Martin Schulz, 'Completing Europe's Economic and Monetary Union' https://ec.europa.eu/commission/sites/beta-political/files/5-presidents-report_en.pdf.

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create more integrated financial systems within the European Single Market. Focusing on retail investors, the Commission envisaged three main targets:[17]

i. to restore retail investor confidence in the industry through increased transparency and disclosure of information, coupled with better investment advice;
ii. to achieve greater choice and "*access to a range of suitable and cost-effective investment products*" by increasing cross-border distribution of financial products; and
iii. to enhance retirement savings, in particular by creating "*a successful European market for simple, efficient and competitive personal pensions*".

Nevertheless, BETTER FINANCE drew attention to the fact that, in spite of retail investors being "*the main source of long-term financing for the real economy*", the 2015 CMU Action Plan was based on a Green Paper[18] that did not sufficiently focus on the direct participation of retail investors in capital markets, on the protection of their rights or on enhanced supervision and enforcement.[19]

2. The revised CMU Action Plan

In 2017, the Commission published a mid-term review[20] of its 2015 CMU Action Plan (**revised CMU Action Plan**) highlighting what was still needed in order to achieve a strong, efficient and resilient CMU. The Commission also highlighted the progress it discerned with regards the building blocks for retail investors, in particular:

(i) it announced it would "quickly move forward with three legislative proposals", among which the Regulation on the Pan-European Personal Pensions product (PEPP); and
(ii) it established "new priority initiatives to strengthen the CMU action plan", including:
    a. to enhance financial supervision;
    b. to increase investment firms' competitiveness and broaden the offer for investors;
    c. to eliminate barriers to capital markets for start-ups and SMEs and incentivize IPOs;
    d. to tap into the disruptive (and creative) force of FinTech;
    e. to "*support the development of local capital markets*"; and
    f. to facilitate cross-border investments, enhance efficient allocation across the EU.

Following the release of the Mid-term Review of the CMU Action Plan, BETTER FINANCE stressed that more should be done towards "*restoring confidence in capital markets and investment products*".[21]

The European Commission delivered on a significant number of legislative proposals to build the CMU, but a great majority of them are still blocked in the political process. The Romanian Presidency of the Council of the EU announced that one of its priorities was to push through the stalemate and deliver a part, at least, of the CMU files, which it did. Of all the proposals the Commission put forward (36), only 13 were adopted by the end of 2018[22], including the *prospectus regulation*, the *European Venture Capital Funds* (EuVECA) *regulation* and the *simple, transparent and standardized* (STS) *securitization regulation*.

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[17] European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions on the Mid-Term Review of the Capital Markets Union Action Plan' Brussels 8.6.2017, COM (2017) 292 final, 17-18.
[18] European Commission, 'Green Paper: Building A Capital Markets Union' Brussels, 18.2.2015, COM (2015) 63, final.
[19] See BETTER FINANCE, 'An EU Capital Market Union for Growth, Jobs and Citizens' (2015) Briefing Paper http://betterfinance.eu/fileadmin/user_upload/documents/Research_Reports/en/CMU_Briefing_Paper_-_For_Print.pdf
[20] European Commission, (n 15).
[21] BETTER FINANCE Press Release 'BETTER FINANCE Welcomes the Capital Markets Union Mid-Term Review and Urges the Commission to Make Progress on Fostering Retail Investment in Capital Markets' (8 June 2017) http://betterfinance.eu/fileadmin/user_upload/documents/Press_Releases/en/Other_investors/PR_-_CMU_MID-TERM_REVIEW_REPORT_-_080617.pdf
[22] In fact, during 2018 BETTER FINANCE's conference Olivier Guersent (Director-General for a Capital Markets Union at the European Commission) highlighted that *"the EC did its homework. Yet, some will say there is not much more CMU than a few years ago, and it is true. Only 3 of the 13 legislative proposals that were part of these initiatives were adopted, because they are locked in the legislative procedure. There is a true lack of ambition in the Council and since the crisis is over, complacency has settled in."* https://betterfinance.eu/wp-content/uploads/PR_-_EU_Capital_Markets_2019-2024_-_071218.pdf

3. The NEXT CMU Report

At the beginning of 2019, an ambitious effort by the Ministries of Finance of three Member States (Netherlands, France and Germany) established a High-Level Expert Group (HLEG) on the Capital Markets Union, whose purpose was to gather evidence and input from stakeholders, policy makers, think tanks and supervisors in order to assess what still needs to be done to achieve a CMU.

BETTER FINANCE was heard by the HLEG and contributed to its work by responding to the questionnaires[23] and submitting research and position papers that BETTER FINANCE elaborated on the subject of the CMU, including an early confidential version of this report.

As such, we were happy to observe that many of the research findings and policy recommendations with regards to retail investors and SME access to financing through capital markets have been taken on board by the Report.[24]

In particular, the report put forward as "*absolute priorities*" firstly the need to "*Generate more Long-Term Savings and Investment opportunities*" through measures such as:

- the consistent application of "Investor protection, fair treatment and cost transparency rules";
- encouraging "collective 'workplace savings' and 'employee shareholder plans'"; or by
- setting up "*a minimum harmonized tax incentive for general savings in simple and transparent long-term financial instruments like single shares and ETFs*";
- launching "an adequacy test for multi-pillar retirement savings"; and
- by taking "*an active role in implementing the new EU Regulation on sustainable investment disclosures and commit to public reporting on clear objectives for their investment strategies*".

Secondly, with regards to the development of capital markets and an EU equity culture, the report suggests as an absolute priority to "*Massively Develop Equity Markets*", which would be achieved by concrete actions such as:

- simplifying access to funding via capital markets for SMEs;
- distinguishing between investors ("Introduce the definition of a new category of experienced High net Worth ("HnW") investors with tailor made investor protection rules") and
- incentivizing more institutional investors to invest for the long-term and hold more equity.

For many years BETTER FINANCE has been advocating for such measures to increase the direct participation of retail investors in capital markets, e.g. by allowing experienced investors to act as semi-professionals and opt out of the highly protective mechanisms introduced for inexperienced investors, to improve access to low-cost, simple products and to enable more SMEs to acquire potential funding through regulated markets.

In particular, with view on the establishment and development of a Capital Markets Union and as shown in the progress table above, BETTER FINANCE reiterates the need to shift the focus from macroprudential regimes and financial stability to the role and protection of the retail investor.

The BETTER FINANCE Key Priorities for the Next 5 Years (2019-2024) reiterate these recommendations, in the hope that, just as the Next CMU Final Report, the EU will give "*priority to responses to citizens' needs and to the investment in the real, digital and sustainable EU economy*".

[23] See the website https://www.nextcmu.eu/send-us-a-contribution/.
[24] See BETTER FINANCE Press Release, 'Capital Markets Union Given New Breath of Life in New HLEG Report Putting Sustainable Finance at Its Core' (17/10/2019) https://betterfinance.eu/wp-content/uploads/PR-Capital-Markets-Union-given-a-New-Breath-of-Life-17102019.pdf.

Part 2. Key Performance Indicators

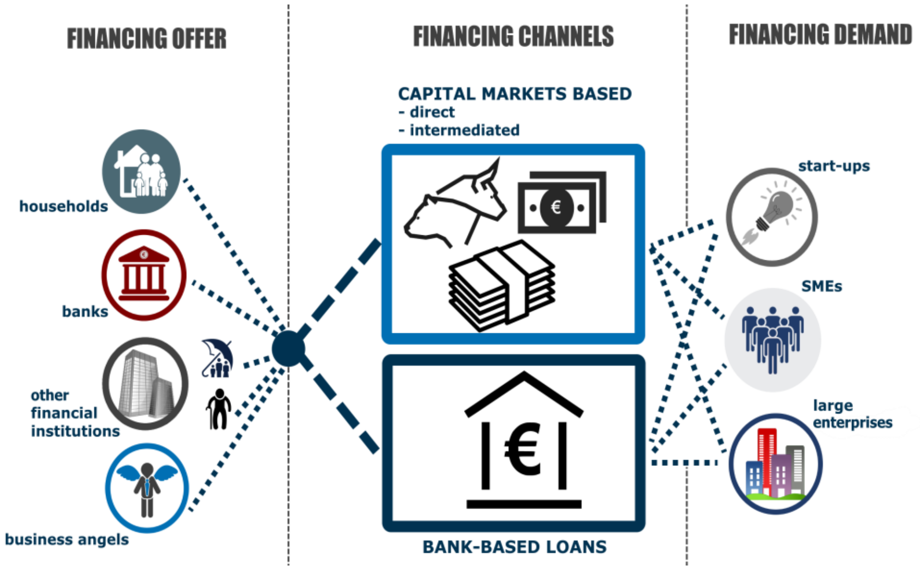
The Commission's Action Plan promised several key benefits for EU citizens and enterprises, from which we will only reiterate: "*improved access to finance, more efficient capital allocation, diversification of funding sources, improved investment opportunities, improved risk-sharing*".[25]

To assess whether the CMU project has delivered these key benefits, one needs to look at the key capital market performance indicators (KPIs). This paper will focus on KPIs that directly concern equity investing, SME growth, Initial Public Offerings (IPOs) and retail investors.

1.1 KPI 1 – Equity Markets funding vs Bank funding

How developed are EU capital markets?

Short summary: *The European Economy – ranging from SMEs to large corporations, from governments to households – is overly reliant on banks. The CMU project aims to change this situation. According to other recent studies, "most sectors in capital markets in the EU have shrunk relative to the size of the economy over the past decade".*[26]



The main funding channels in financial markets originate with households (retail savers), banks, financial corporations (such as investment funds), and venture capital investors (business angels).

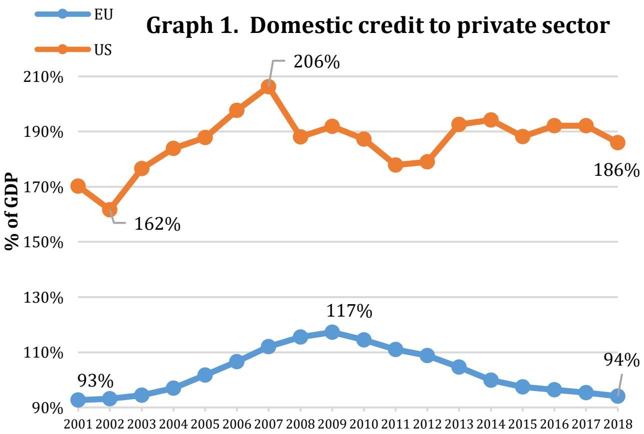
However, who has the most important role to play in financing the EU economy?

Source: BETTER FINANCE, 2019

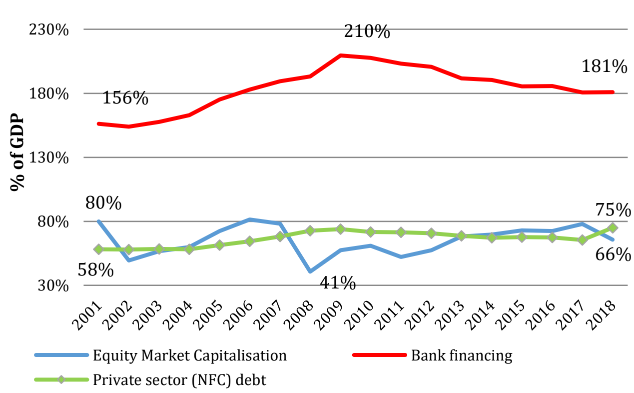
It has long been recognised that the European economy is over-reliant on bank-based sources of finance.[27] Although deregulation trends were aimed at diversifying funding channels, most EU citizens and companies go to banks to obtain funds, and financial corporations invest in one another. This is problematic as "*a very high credit relative to GDP may lower economic growth*" and financially generated market corrections affect banking-reliant economies more than capital market-reliant ones. [28]

[25] European Commission, 'Staff Working Document: Economic Analysis Accompanying the document *Communication from the Commission to the Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan on Building a Capital Markets Union*', Brussels 30.9.2015, COM (2015) 183 final, 14.
[26] William Wright, Panagiotis Asimakopoulos, 'A Decade of Change in European Capital Markets' (2018) New Financial, first page.
[27] See Vincenzo Bavoso, 'Capital Markets, Debt Finance and the EU Capital Markets Union: A Law and Finance Critique' ECMI Working Paper no. 5 of November 2017, p. 3 and 5; however, New Financial's report on the depth of the capital markets in the EU points out some encouraging signs that companies in the EU have begun to reduce their reliance on bank lending over the last 10 years. New Financial "A decade of change in European Capital Markets" (n 25) page 10.
[28] Economic Analysis 2015 CMU Action Plan (n 24) page 18.

Graph 1. Domestic credit to private sector



Graph 2. Equity vs Bank funding volumes



Source: Eurostat; AFME; World Bank database; own composition

"*The financial crisis showed us that the EU would greatly benefit from rebalancing its economic structures towards a more market-based finance*".[29]

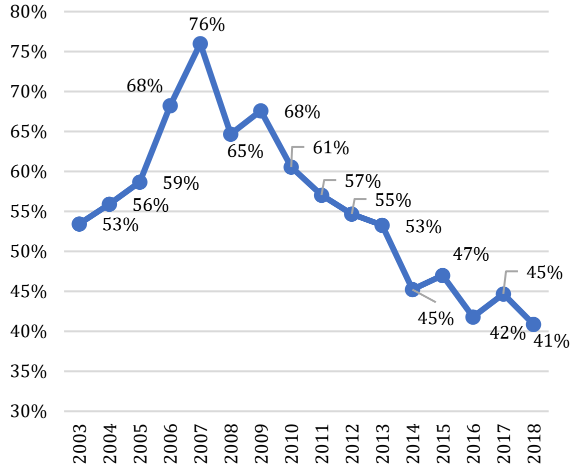
Graph 1 shows how much financial corporations lend ("*through loans, purchases of nonequity securities, and trade credits and other accounts receivable*"[30]) to the private sector relative to the GDP. Considering that the US annual output is only 13% higher than that of the EU28, there is much more potential for funding to European businesses. Graph 2 shows how much funding is raised via traditional banking channels compared to funding via stock markets. On average (18 years), the value of bank loan funding was 184% of GDP, while stock market funding has been almost equal to the level of debt (loans) held by non-financial corporations, fluctuating at around 65%-66% of the GDP.[31]

Non-financial corporations' (NFC) financial balance sheets record the highest savings rate in private equity (42% on average, 2003-2018), followed by deposits (24%, 4% increase from 2017) and other receivables (17%, such as trade credits and advances).[32] European businesses have a very small participation rate in capital markets, directly holding only 12% of their financial savings in public securities, over a 16-year average.[33] In total, Eurozone NFCs received an annual average[34] of €16.71 trillion fund flow from the economy (or 149% relative to GDP) until 2018Q2, out of which 28% are bank-based (through bank short- and long-term loans) and 37% market-based (through acquisition of listed equity and short- and long-term debt securities). The rest of their annual flows comes from loans held by households and other companies (18% on average) and other sources of funding (22%). In the EU28, the largest domestic investors in European equities are financial corporations by a large margin (49% of the total equity ownership in 2018).

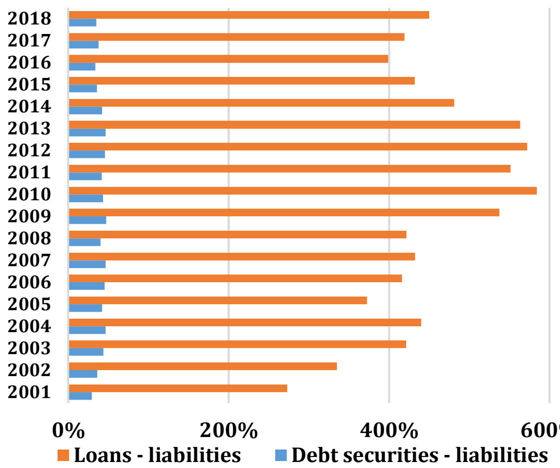
[29] Apostolos Thomadakis, 'How Close Are We to a Capital Markets Union?' 44 (17 March 2017) European Capital Markets Institute Commentary, 2.
[30] World Bank Metadata – explanation of the dataset: https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS.
[31] Own computations based on Eurostat data (nasa_10_f_bs)
[32] According to the European System of Accounts (ESA) of 2010 - https://ec.europa.eu/eurostat/documents/3859598/5925693/KS-02-13-269-EN.PDF/44cd9d01-bc64-40e5-bd40-d17df0c69334.
[33] Own computations based on Eurostat data (nasa_10_f_bs).
[34] Averages are calculated using quarterly data from Euro area statistics dating back to 2013 Q4.

RECONNECTING EU HOUSEHOLDS TO THE REAL ECONOMY AND CAPITAL MARKETS

Graph 3. Equity Market Capitalisation (€) - EU-to-US ratio



Graph 4. NFC debt - EU-to-US ratio (€)



Source: Eurostat; Federal Reserve Economic Data; own computation

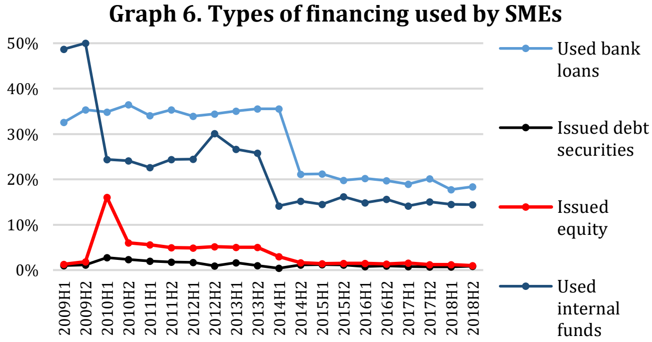
Graphs 3 and 4 show the significant differences in capital vs bank-based funding for NFCs in the EU and US. Graph 3 indicates how much of the total value of stocks traded in the CMU represents from the total value of equity traded in the US. With the exception of a peak in 2007, the average EU equity market capitalisation represented just 52% of that in the US (NYSE and NASDAQ data only) and it has been declining since 2009. Moreover, US NFCs sell on average two times (238%) more debt securities (corporate bonds, bills) compared to EU ones, showing the extent to which NFCs use capital markets to obtain short- and long-term funding. In this light, the orange bars in Graph 4 show the EU-to-US ratio of loans as liabilities on NFCs' financial balance sheet. On average, the EU private sector contracts 4.5 times (450%) more loans from banking institutions than the US economy. More details on the sources of funding for EU businesses (SMEs) will be presented under KPI 2 below. It will suffice to say that, according to Eurostat data, only 6% of EU companies sought to obtain financing through public/private equity trade, with the most important channels of financing being traditional banking products (32%), followed by other sources (25% - issuance of debt securities, internal funds, retained revenues, etc).

Table 5. Enterprises seeking finance in EU20

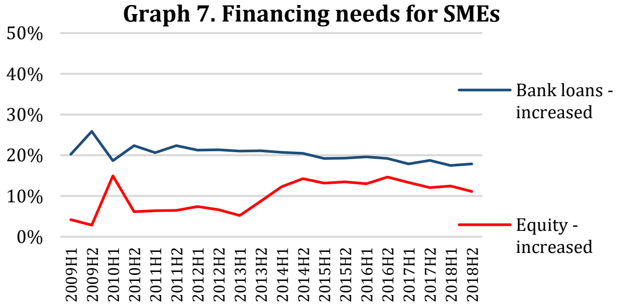
Loans	
2007	*2010*
31.56%	**32.35%**
Equity finance	
2007	*2010*
5.24%	**5.93%**
Other sources	
2007	*2010*
22.38%	**25.19%**

Source: Eurostat (LHS); ECB (RHS and Graphs 6 and 7)

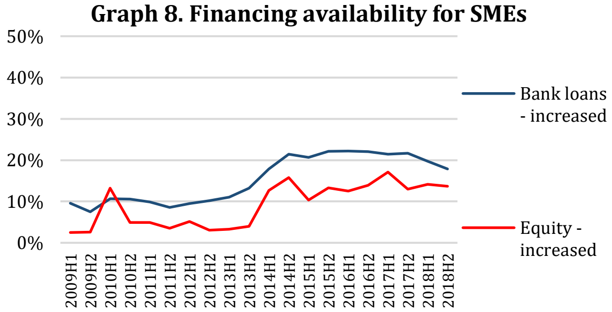
Graph 6. Types of financing used by SMEs



Graph 7. Financing needs for SMEs



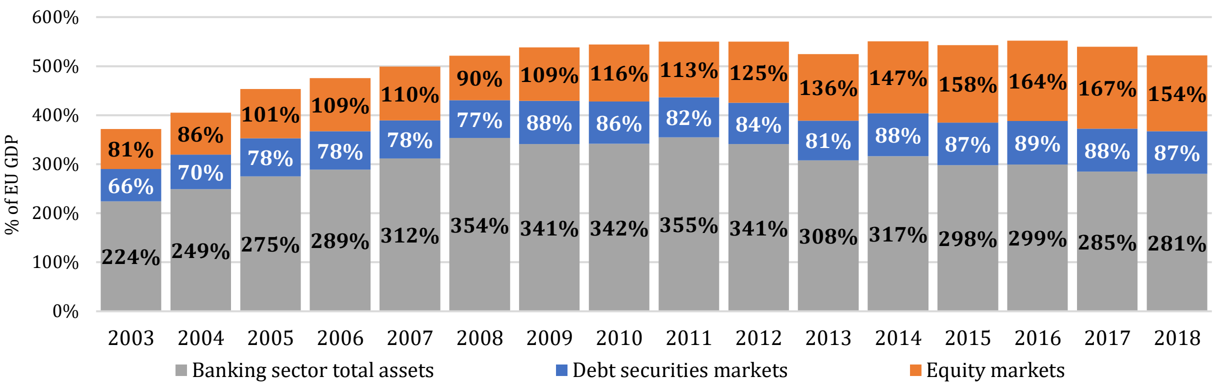
Graph 8. Financing availability for SMEs



Source for Graphs 6-8: European Central Bank SAFE Questionnaires

From another point of view, as shown in Chart 9, compared to the outstanding value of equity and debt securities markets (251% of GDP on a 13-year average), the value of the banking sector's financial assets rose to 355% of GDP in 2011 but decreased considerably to 281% in 2018.

Chart 9. Development of securities markets compared to banking sector

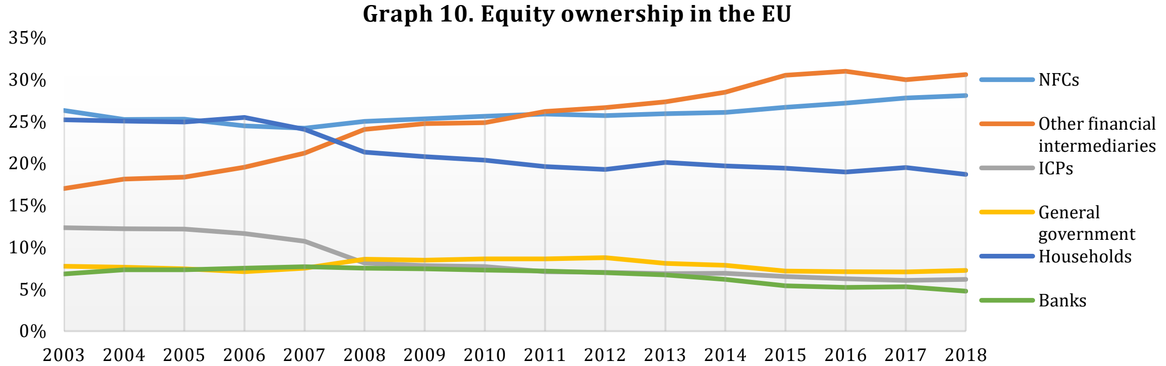


Source: Eurostat; own composition

According to a report by the European Commission[35], foreign investors hold 35% of European companies' assets, the majority of which is in non-listed companies. The report points out that "*non-EU controlled companies are generally bigger than the EU-controlled ones*", taking into consideration the total number of companies (listed and not-listed on stock exchanges) and the share of which are owned by foreign investors (by how weighting of assets from the total).

The evolution of foreign-held asset ownership between 2007-2016 was significant, increasing from around 10% in listed companies to almost half in 2016.

Graph 10. Equity ownership in the EU



Source: Eurostat, own composition; ICPs = insurance corporations and pension funds ; NFC = non-financial corporations;

Graph 10 shows the decline in equity ownership by households and the corresponding shift to intermediaries such as investment funds or other financial products manufacturers. In 2003, EU citizens and businesses were the largest holders of shares, cumulating 51% (26% and 25%) of the total value of equity. In 2018, share ownership by households represents just 19% of the total, whereas financial intermediaries have almost doubled from 17% to 31%. A potential explanation could be, as mentioned earlier, that retail investors have been increasingly diverted from capital markets (buying shares and bonds) into packaged products which now hold these securities, proxying on behalf of investors.

[35] Commission Staff Working Document on Foreign Direct Investment in the EU: Followin-up on the Commission Communication "Welcoming Foreign Direct Investment while Protecting Essential Interests" of 13 September 2017, Brussels, 13.3.2019 SWD(2019) 108 final, https://trade.ec.europa.eu/doclib/docs/2019/march/tradoc_157724.pdf, page 8.

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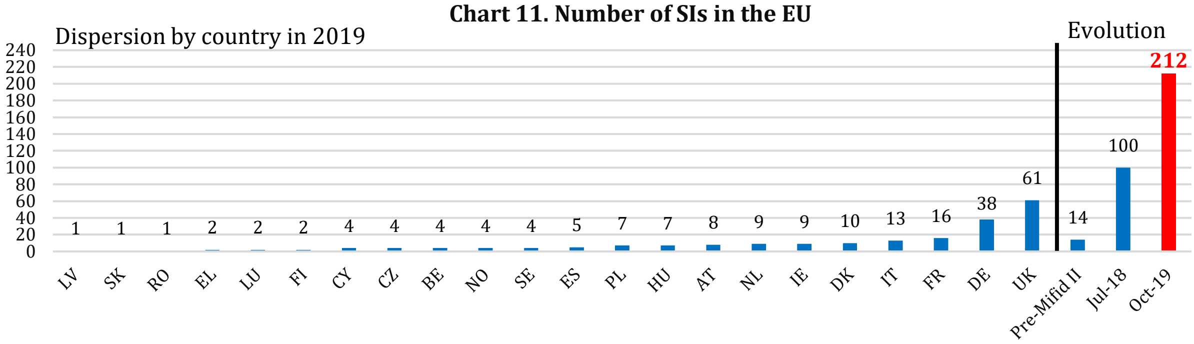
One reason for the underdevelopment of EU capital markets (compared to the US) may stem from their fragmentation, as well as their opaqueness and complexity. However, fragmentation in the EU is different from fragmentation in the US. While the US markets also have multiple competing trading venues, they do not have to cope with different legal regimes and tax rules at the same time. Significant fragmentation of markets and the persistent lack of comprehensive trade data across the EU for non-professional investors, are holding back capital market investments in Europe in general, as pointed out by a study conducted by the Association of Financial Markets in Europe (AFME) and the Boston Consulting Group (BCG).[36]

This situation is particularly unfavourable for individual investors: they have no direct access to most market "venues" other than the regulated markets, which can be said to be the only remaining, easily accessible and transparent markets for individual investors. Multilateral Trading Facilities (MTFs), systematic internalisers (SIs) and over the counter (OTC) pools are mostly unknown to them.

As any other investor, retail savers must be able to assess risk and profitability in order to directly invest in capital markets on securities exchanges. Since half of equity trading takes place in opaque or non-transparent venues (OTC or *dark pools*), investors suffer because the price formation mechanism is affected, which in turn impacts confidence and trust in financial markets. Up to 30% of stocks are traded within SIs,[37] the number of which increased considerably since the entry into force of MiFID II provisions, reaching 215 entities registered with ESMA (graph excludes Liechtenstein) by October 2019. What is more, according to a FESE study, merely 42.4% of equity trading takes place on "lit markets" in Europe.[38]

Chart 11. Number of SIs in the EU



Source: ESMA Registers; CFA Institute;[39] own composition

These results have been forecasted by academics and go against the very purpose of both the CMU Action Plan and MiFID II: to increase market transparency and decrease trading outside of regulated venues.

In addition, brokerage fees for individual investors have not been reduced significantly and remain much higher than in the US. For example, the European Commission reported[40] that "*US online brokers are cheaper than their EU counterparts for domestic trades and in most cases also cheaper for cross-border trades*" in pre-MiFID I times. According to data from OXERA, commission rates charged by retail brokers to retail investors in major financial centres were still 19bp in 2009, and 30bp in other financial centres in

[36] "*65% of the investors surveyed, who represent around €9tn of assets under management, identified market fragmentation, i.e. lack of information and understanding of differences across markets, as a factor which is holding back investments*." ('Bridging the growth gap: investor views on European and US capital markets and how they drive investment and economic growth', March 2015)

[37] The figure (30%) refers to the individual listed stocks, not to their volume, since MiFID II – and supervised by ESMA – imposed a double volume cap for equity trading outside RMs and MTFs.

[38] Federation of European Stock Exchanges (FESE), Blueprint: Capital Markets Union by 2024 – A Vision for Europe" (2019) p. 32, https://fese.eu/blog/fese-blueprint-capital-markets-union-by-2024-a-vision-for-europe/.

[39] Sviatoslav Rosov, 'MiFID II and Systematic Internalisers: If Only Someone Knew This Would Happen' (13 July 2018) – accessed 20/10/2019 - https://blogs.cfainstitute.org/marketintegrity/2018/07/13/mifid-ii-and-systematic-internalisers-if-only-someone-knew-this-would-happen/.

[40] Cost of Execution of retail equity trades in Europe in 2005 http://ec.europa.eu/internal_market/financial-markets/docs/clearing/draft/annex_3_en.pdf

2009.[41] BETTER FINANCE's member associations have not experienced any significant reduction of brokerage fees for retail investors in the EU versus the lower US ones.

Table 12. EU, US and worldwide (WW) stock markets (2018)

Region	Number	Number of listed companies				Market cap (€ trn)		Number of share trades (EOB, mil)	
		Total		Domestic					
	no.	no.	of total	no.	of total	value	of total	value	of total
EU	31	10,572	20%	9,085	19%	10	15%	105.5	6%
US	3	5,343	10%	4,397	9%	26	40%	599.8	33%
WW	81	52,207		48,631		65		1,791	

Source: World Federation of Exchanges; own computations;

Regulated markets operating in the EU count a total of 10,572 listed companies, twice the number of US ones, yet representing just a third of their market capitalisation. Trading is concentrated in a few financial centres in Europe, while some countries have underdeveloped markets. Stock exchanges in the remaining EU Member States are barely developed, with some exchanges listing only 31 companies for trading. The total market capitalisation of listed companies in the EU28 reached €10 trillion at the end of 2018, lower than three years earlier (2015Q4). As far as securities exchanges are concerned, there are 431 authorised trading facilities in the EU (RM – 128, MTF – 222, OTF – 81) with 40% of them concentrated in the UK, according to ESMA registers.

EU stock markets are currently used only by the large capitalisation companies. According to a 2019 study by the European Commission, only 0.16% of European companies are listed on stock exchanges, but their assets make up for 20.5% of all assets, being on average 150 times larger than non-listed companies.[42]

1.2. KPI 2 – SME participation in capital markets

Does the real economy harness the advantages of capital markets?

Short summary: *Limited capital market financing for SMEs and a heavy reliance on bank lending has made small companies vulnerable to banking system dynamics, with constrained access to lending arising in times of financial stress. The CMU project aims to help SMEs get better access to capital markets as a source of financing. But is it easier for European Companies to raise money on public markets and has funding increased for start-ups and non-listed companies?*

There were a total of 2.3 million small- and medium-sized enterprises (SMEs) in 2016 in the EU, out of which 84% were micro-firms (up to 9 employees and an annual turnover of less than €2 million).[43] SMEs make up for more than 99% of European firms, but have only generated 37% of jobs in 2016.[44] In order to grow, provide more added value and create more jobs, EU SMEs need to have access to diversified channels of funding.

[41] *"Monitoring prices, costs and volumes of trading and post-trading services".* Report prepared for the European Commission, DG Internal Market and Services. OXERA, May 2011 http://ec.europa.eu/internal_market/financial-markets/docs/clearing/2011_oxera_study_en.pdf
[42] Commission Staff Working Document on Foreign Direct Investment in the EU: Followin-up on the Commission Communication "Welcoming Foreign Direct Investment while Protecting Essential Interests" of 13 September 2017, Brussels, 13.3.2019 SWD(2019) 108 final, https://trade.ec.europa.eu/doclib/docs/2019/march/tradoc_157724.pdf.
[43] Source: Eurostat; own computations.
[44] Mihai Ivaşcu (rapporteur), Opinion of the European Economic and Social Committee on the Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 596/2014 and (EU) 2017/1129 as regards the promotion of the use of SME growth markets, [COM(2018) 331 final – 2018/0165 (COD)], INT/856 Small listed companies, page 5.

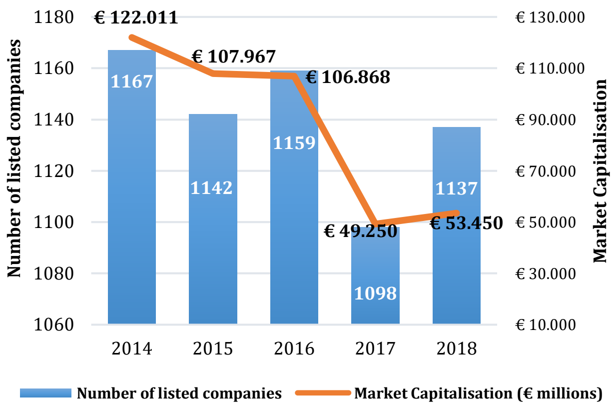
Table 14. Sources of financing for EU SMEs and Large Companies (2017)

	Micro	Small	Medium	Large
Internal funds or retained earnings	75%	67%	61%	58%
External finance - banking products	17%	21%	2%	
External finance - bonds and equity	0.03%	0.51%	0.31%	1.46%
Other	8%	12%	17%	16%

Source: EIB Investment Survey 2018

In 2015 BETTER FINANCE proposed to rehabilitate employee share ownership[45] (see more under KPI 4) as the single most powerful action to reach the CMU goals. Even if it were to just reach the level it enjoys in the US, employee share ownership (ESO) would be multiplied by 6 in the EU – adding two trillion € in equity market capitalization – and even by much more as far as SMEs are concerned.

Chart 13. SME Markets in the EU



Source: FESE Statistical Factsheet; own composition

The CMU Action Plan listed "*support SMEs seeking finance*"[46] as one of the key actions laying the foundation of the CMU. The EIB's Investment Survey of 2018 found that 99% of EU companies seek at least 61% of funding from their internal funds or related earnings, and the external sources are overwhelmingly banking products (20% on average).[47] With regard to raising funds through equity issuance, only about 0.3% of EU SMEs financing derives from share purchasing by investors. The European Central Bank's (ECB) *Study on the access to finance of enterprises* (SAFE)[48] shows grim results as well: from the second half of 2013, SME respondents indicated that they use less and less new financing (internal or financial markets based), although the need for financing through equity instruments, for example, has increased (Graphs 6 and 8). Even though the availability of funding through banks and equity issuance has significantly increased over the same period (from 4 to 14%), it is still at a very low level.

Facing difficulties to obtain finance and high compliance costs, coupled with a drop in risk equity research,[49] caused the number of publicly listed SMEs companies to fluctuate and, overall, decrease from 2014 (1180) to 2018 (1137), with the market capitalization of their shares dropping dramatically from €122.1 billion to €53.45 billion in 2018 (-56%).

The EESC opinion on the development of SME growth markets points out that the choice of SMEs for the costlier bank credit is a "*cultural characteristic*" differencing the EU and US market, coupled with the regulatory compliance costs, different tax regimes, "*lack of an equity culture and fragmented insolvency regimes*".[50]

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[45] BETTER FINANCE CMU Briefing Paper, action proposal no.2, page 22 http://betterfinance.eu/fileadmin/user_upload/documents/Research_Reports/en/CMU_Briefing_Paper_-_For_Print.pdf
[46] CMU Action Plan 2015 (n 24), p. 9.
[47] European Investment Fund, Investment Survey 2018 - http://data.eib.org/eibis/index.
[48] European Central Bank, Survey on the Access to Finance of Enterprises 2018/2019, https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/index.en.html.
[49] See CFA Institute, *MiFID II – A New Paradigm for Investment Research: Investor Perspectives on Research Costs and Procurement* (2017) https://www.cfainstitute.org/-/media/documents/support/advocacy/mifid_ii_new-paradigm-for-research-report.ashx; see also Elizabeth Pfeuti, 'MiFID II Research Rules "Hitting Sector Coverage and Quality"' (18 February 2019, IPE.com), last accessed 3 November 2019, available at https://www.cfainstitute.org/-/media/documents/support/advocacy/mifid_ii_new-paradigm-for-research-report.ashx.
[50] EESC Opinion (n 43), p. 6.

With regards to the relevance of external funding sources, the SAFE survey aligns with the results of EIB's Investment Survey of 2018: the majority of respondents draw on their internal resources or retained earnings for funding, while external sources of finance are of minor significance[51] and are heavily outweighed in favour of credit lines and bank loans. Equity funding is a relevant source of capital only for 12% of respondents, while debt securities only for 13%. In terms of newly listed companies or newly issued shares, 2014 recorded a peak with a total of 331 companies listed, out of which the majority (68%) were small capitalization enterprises. In the EU, IPOs have been "*moderate and rather volatile over time and barely exist for SMEs*".[52] Public listing, for the purpose of raising capital through equity or corporate bond issuance, may prove very costly and not profitable for SMEs, considering their income volatility[53] and the fact that a high number of SMEs (cca. 200,000) go bankrupt annually.[54]

Chart 15. Number of IPOs per year

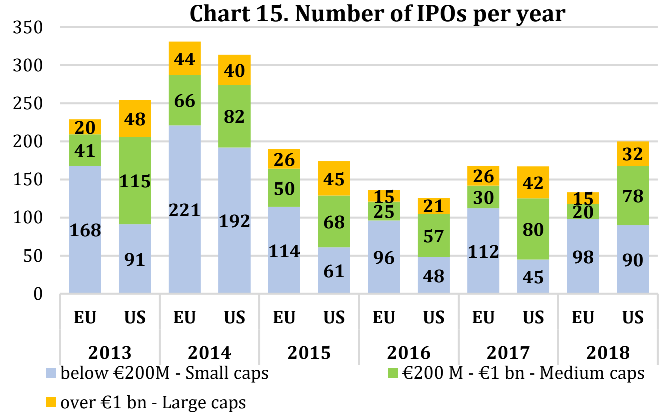
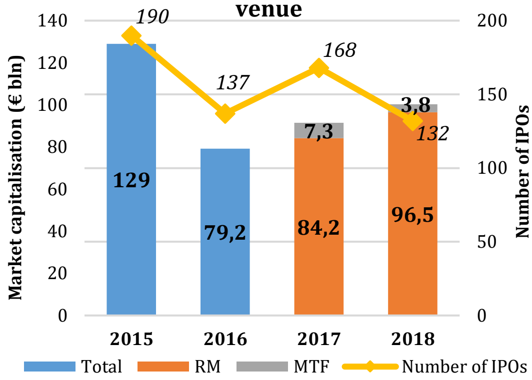


Chart 16. IPOs by type of trading venue



Source: FESE IPO database; WFE IPO database; own composition

The IPOs taking place on RMs totalled €96.5 billion (1st trading day) in 2018. The size of the EU public equity market has grown over the past 9 years but in favour of institutional financial and corporate investors (domestic and foreign). The smaller EU businesses have not profited from the pooling of capital into the EU economy.

Chart 17. Evolution of private equity market in Europe

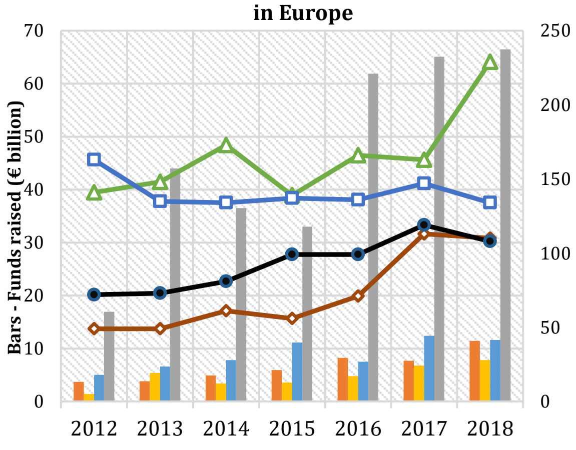


Table 18. Domicile of private equity investors in Europe

		2015	2016	2017	2018
Europe		**68%**	**55%**	**57%**	**54%**
	West	59%	49%	44%	38%
	Nordics	8%	5%	7%	5%
	CEE	0%	0%	0%	1%
	Unclassified	5%	10%	6%	9%
World	**Wide**	**32%**	**45%**	**43%**	**46%**
	North America	20%	30%	26%	26%
	Asia Pacific	12%	14%	15%	15%
	Rest of world	1%	1%	2%	6%

Source: Invest Europe Private Equity Activity 2016-2017; own composition

Source: Invest Europe – European Private Equity Activity 2016-2018; own compositions; *Legend (LHS chart): bars – buyout funds (grey), growth funds (blue); other funds (orange), venture capital funds (yellow); lines – other funds (blue); venture capital funds (green); buyout funds (black); growth funds (brown).*

[51] More than 50% respondents answered "*no, this source is not relevant to my enterprise*".
[52] Apostolos Thomadakis, 'Developing EU Capital Markets for SMEs: Mission Impossible?' 46 (4 September 2017) European Capital Markets Institute Commentary, p. 2.
[53] Ibid.
[54] EESC Opinion (n 43), p. 5.

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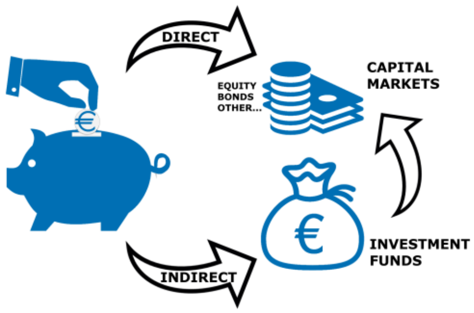
If capital markets (regulated trading facilities and MTFs) are not attractive enough for SMEs, an alternative external source of funding can be found in business angels – private equity investments – where risk capital is provided. According to the annual reports of Invest Europe,[55] the value of funds raised in European private equity trading (from governments, sovereign wealth funds, private investors, individuals, pension funds and insurers) increased to €97.3 billion in 2018, compared to the total €27 billion of 2012. However, these figures are insignificant compared to UCITS funds invested in listed equity, amounting to €3,455 billion at the end of 2018.[56] In addition, scholars noted that the venture capital market (which is just a part of the private equity market) faces a "lack of private-sector investors": between 2007 and 2015, the private-public shares of funds raised shifted, with Government agencies accounting for 31% of venture funding and pension funds, insurers and banks falling to just 14%.

Moreover, with regards to the geographic source of funding, the share of foreign investors almost balances that of domestic ones in the EU: apparent from the table above, 43% of funds raised in risk capital originates from North America, Asia-Pacific and the rest of the world, while 57% comes from European investors, where 77% (or 44.1% of the total) is from Western European countries with a higher and more developed equity culture than East-European investors and Nordics.

1.3 KPI 3 – Retail investments in capital markets

Are retail investors connected to capital markets?

***Short summary**: Whereas European households indirectly invest in capital markets, there has been a decline of direct individual ownership of securities in Europe. The EC pointed to "the lack of an equity culture (…) financial advisers are no longer marketing direct investment products (e.g. company shares and bonds) to retail investors".[57] Did retail investors start to invest more in capital markets and long-term securities and has direct share ownership by households increased?*



Retail investors have two means to participate in capital markets (infographic below): either direct, through acquisition of securities (shares, bonds, ETF units) or indirect, through packaged products, such as investment funds. However, a study launched by the European Commission showed that, in 2016, only 43% of EU citizens had any savings in financial products.[58]

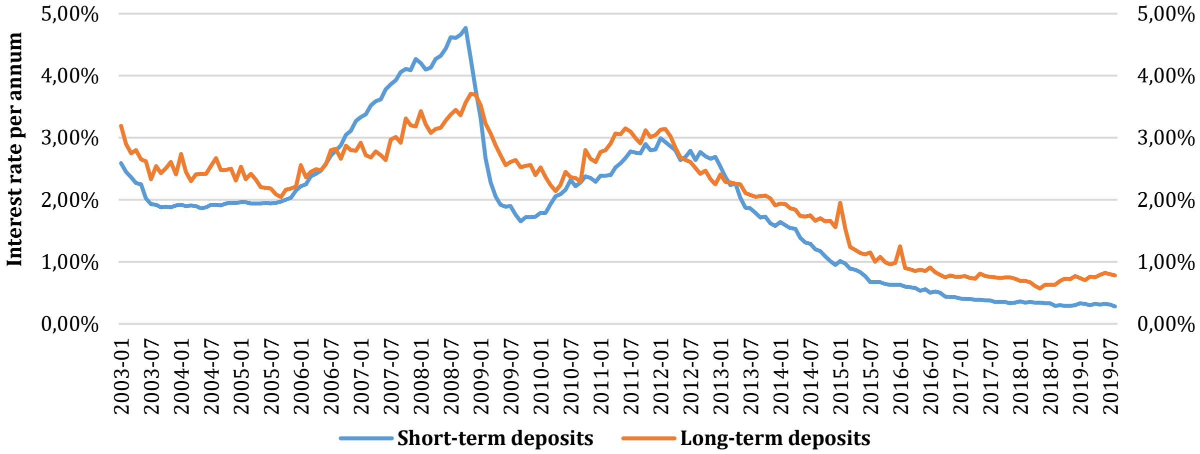
Source: BETTER FINANCE, 2019

The 2015 CMU Action Plan recognized that a significant part of EU households' savings – held in bank deposits - could be better reallocated so that the entire economy would benefit, while "*the European Commission's Capital Markets Union (CMU) Mid-term Review (EC, 2017) acknowledged that the engagement of retail investors in capital markets remains very low*".[59] If the EU27 households reduced their preference for bank deposits to the same level as in the UK, it would free up nearly €2 trillion that could be invested in the EU economy,[60] particularly in risk capital. The outlook for banking products does not look too profitable

[55] Invest Europe, European Private Equity Activity 2018: Statistics on Fundraising, Investments and Divestments; accessible here https://www.investeurope.eu/research/publications/?keyword=European%20Private%20Equity%20Activity%20Report%20and%20Data%202018#search-filter-container.
[56] Data source from the EFAMA Quarterly Statistical Release Q4 2018, https://www.efama.org/statistics/SitePages/European%20Quarterly%20Statistical%20Release.aspx.
[57] EC staff working document, CMU Green paper, 2015.
[58] European Commission, 'Distribution of retail investment products across the European Union' (2018) https://ec.europa.eu/info/sites/info/files/180425-retail-investment-products-distribution-systems_en.pdf.
[59] Apostolos Thomadakis, 'The European ETF Market: What can be Done Better?' 52 (24 April 2018) European Capital Markets Institute Commentary, 4.
[60] New Financial "A decade of change in European Capital Markets", page 11.

either for retail investors. The interest rates for Euro Area short- and long-term deposits decreased constantly since the start of 2012, reaching almost 1% p.a. for long-term and close to 0% p.a. for short-term at the end of 2018 (2018Q4).

Graph 19. Euro area interest rates for household deposits



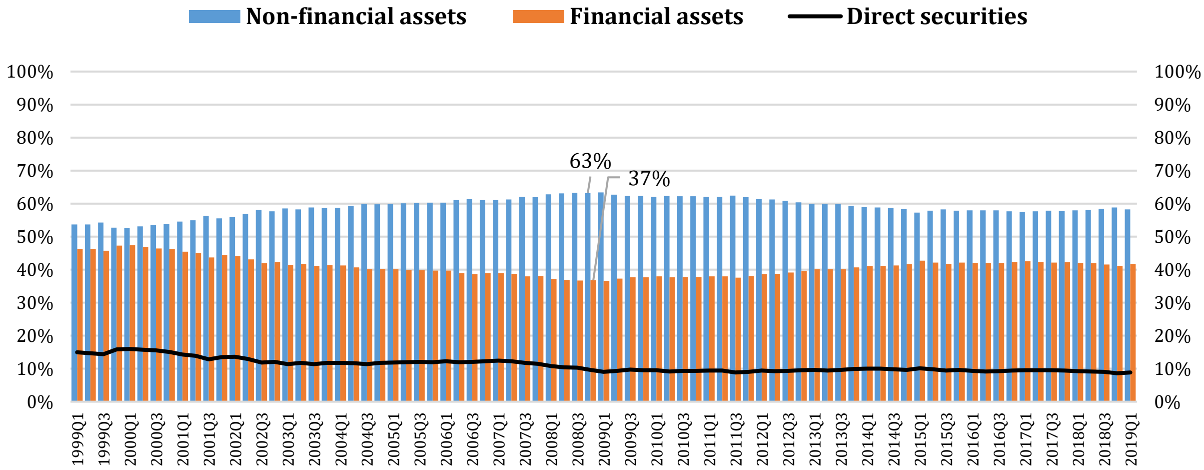
Source: Euro area statistics, own composition

Compared with the traditional peer (US), EU household investments in investment funds, shares and bonds are three times smaller relative to GDP than in the US. European citizens' deposits roughly round up to the same ratio to GDP as in the US (64% in the US and 67% in the EU27). The huge difference in financial wealth stems from investing, not saving in real estate and consumer durables as most Europeans do. On a 66-year average (1952-2018), 33% of US citizens' savings were directed to non-financial assets, the rest being invested in directly held corporate equities (17%), DB pension entitlements (20%)[61] and bank deposits (18%). Thus, two important aspects are observable from the outset: compared to the EU28 (28%) and the Eurozone (33%) average, US households hold only a minor part of their savings in bank deposits, but directly hold twice as much publicly listed equity as EU households.

EU28 households save almost the same part of their disposable income (percentage wise) as US households, but store much more in non-financial assets (real estate, commodities, other goods) than US savers. This situation has been constant since 2003. The propensity of individuals to invest in non-financial assets may stem from the uncertainty, complexity and opacity of financial products. While the institutional sector (in particular financial corporations) is better placed to assess risk and, in general, has a greater loss tolerance, retail savers are deemed to be more averse to the volatility of financial markets, which might explain the choice for illiquid assets (non-financial).

[61] Data sourced from the US Federal Reserve (https://www.federalreserve.gov/releases/z1/current/).

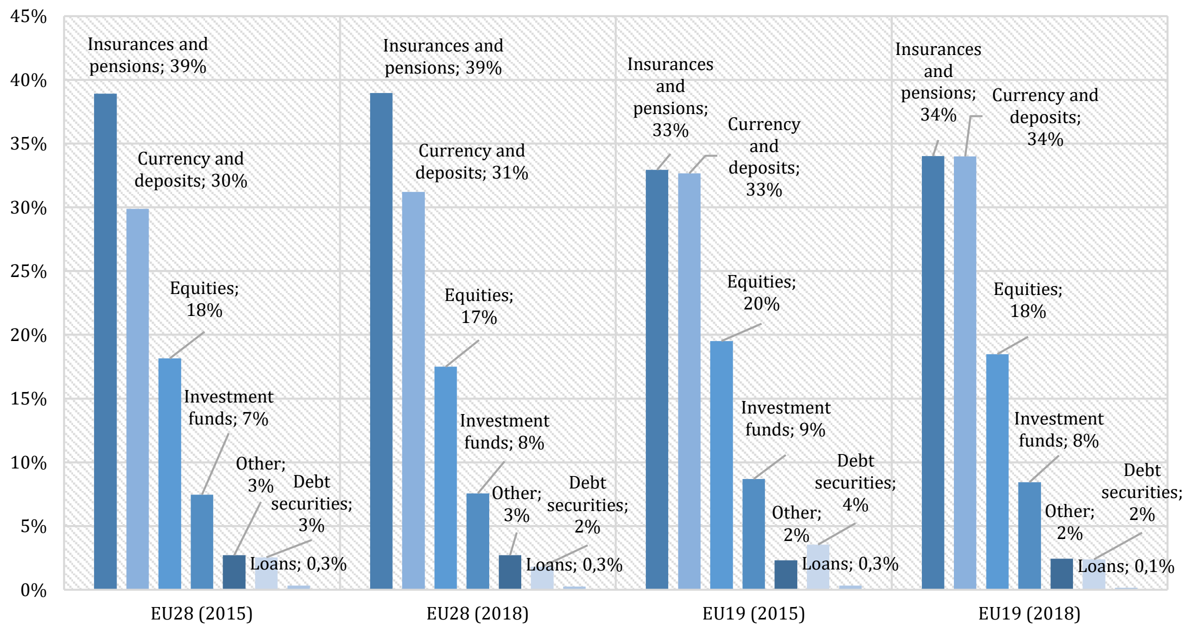
Chart 20. Eurozone household savings (quarterly)



Source: Eurostat, ECB, own composition

The blue and orange bars in Chart 20 show how much of total savings is directed to non-financial assets, which has not changed significantly since the beginning of 1999. With a very small shift between non-financial and financial savings starting with the end of 2014, the ratio between non-financial and capital-market based savings of Eurozone households has decreased in 2019 Q1 compared to 20 years ago. And the savings rate level is plummeting. In 2017, according to World Bank data, the savings level of the average Eurozone household is 26% smaller compared to that of 2000, meaning that from the small portion of savings from the net disposable income (5.2% in 2017), more than a half will go into non-financial products.

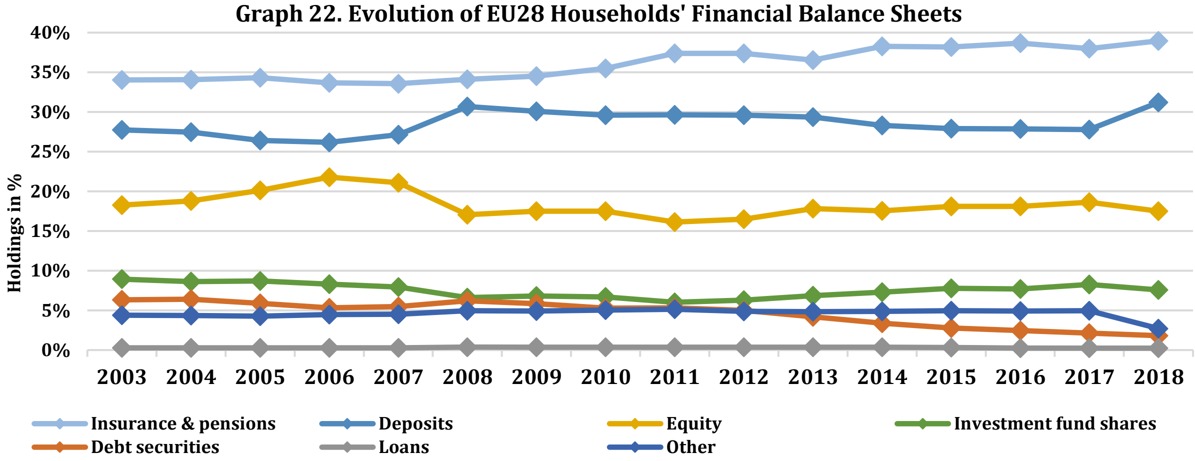
Chart 21. EU28-EU19 household financial savings



Source: Eurostat, own composition;

The financial balance sheet composition is slightly different between the Eurozone and EU28. The appetite for bank deposits in the non-euro area is much lower, turning around the balance of financial savings: the average EU citizen saves less in deposits (28% in 2017) than in insurance & pensions (39%), followed by equity (19%), investment funds' units (9%) and debt securities (2%).

Graph 22. Evolution of EU28 Households' Financial Balance Sheets

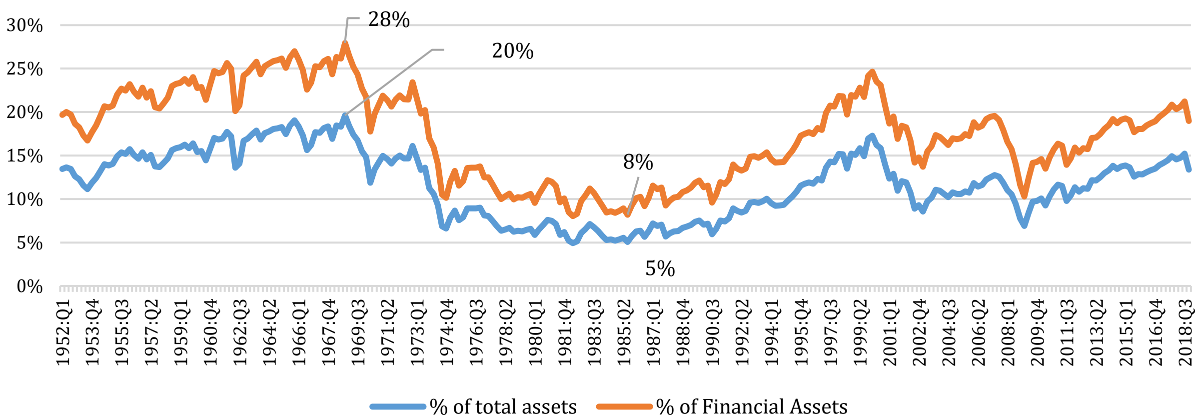


Source: Eurostat; own composition; *data for 2018 excludes MT*

The Economic Analysis accompanying the 2015 CMU Action plan correctly identified some of the reasons why households prefer *to save* rather than *to invest*: high costs for investment products; no legal protection for losses (unlike the *deposit guarantee schemes*); non-independent advice; sheer complexity of products; limited transparency of information. While reason would dictate that prospects of higher returns carry with it higher risks, "*households attribute an important role to safety and predictability*".[62] Consumer Protection Agencies (CPA) and Alternative Dispute Resolution (ADR) bodies confirm that an opaque fee structure is the subject of regular complaints filed by retail investors that feel misinformed by their advisors or the product information documents (they complain about either the costs being too high or hidden, e.g. costs of the underlying investment fund in life insurance products)[63].

The situation for US households is very different: since 1952, on average, 33% of US household savings have been directed to non-financial assets (real estate and consumer durables) and 67% to financial assets (direct and indirect corporate holdings, claims on benefits in DC/DB schemes, deposits, mutual fund shares, debt securities etc.), ranging from 61% (1982Q2) to 73% (2018Q4). Direct equity ownership is rather low in the EU19 compared to US households, where the lowest rate achieved (8% - 1985Q3 - see Graph 8) is almost as high as the total EU non-intermediated securities holdings (10%).

Graph 23. US Households' direct corporate equity ownership



Source: US Federal Reserve Statistics, own composition

[62] European Commission, Economic assessment (n 21) page 62.
[63] Distribution systems of retail investment products across the European Union https://ec.europa.eu/info/sites/info/files/180425-retail-investment-products-distribution-systems_en.pdf, page 78

When one looks specifically at equity holdings – a long-term financial asset – the average holding period by individual shareholders in the US is much longer than that for "institutional" ones, as the long-term evolution of equity markets shows. EU-wide statistics - if available – would certainly show a very similar evolution. Except for a short period between June 2011 and June 2012 when the difference between loans and deposits was smaller, for 5 consecutive years the cost of obtaining funding is becoming more and more disproportionate to the price monetary financial institutions offer non-financial corporations for the long-term agreed-maturity deposits.[64]

Table 24. Eurozone equity flows

Issuer	2013Q4	2014Q4	2015Q4	2016Q4	2017Q4	2018Q4
Corporates	67%	67%	67%	68%	66%	67%
Other financial institutions	13%	9%	9%	9%	9%	9%
Banks	9%	11%	10%	6%	9%	7%
Insurers	3%	3%	3%	3%	3%	3%

Source: Euro area statistics; own computation

The net fund inflow for funds domiciled in the Euro area remained constant between institutional sectors in the past 5 years and a half. In 2013, the highest domestic cashflow for unit-linked investments came from financial corporations (47% on average- banks, pension and investment funds, insurers, other financial corporations), followed by foreign investments (28% on average- rest of world) and only 24% on average from households and NFCs, the real economy.

Table 25. EA investment funds units' distribution by holding sector, quarterly data (2013-2018)

Holder\Time	2013-Q4	2014-Q4	2015-Q4	2016-Q4	2017-Q4	2018-Q4	AVG
Governments	2%	2%	2%	2%	2%	2%	**2%**
Banks	3%	3%	3%	3%	2%	2%	**3%**
Other financials	2%	2%	3%	3%	3%	4%	**3%**
Corporates	4%	4%	4%	3%	3%	3%	**4%**
Pension funds	11%	11%	11%	11%	11%	11%	**11%**
Investment funds	13%	14%	14%	15%	15%	15%	**14%**
Insurers	17%	16%	16%	17%	16%	16%	**16%**
Households	20%	20%	21%	20%	20%	18%	**20%**
Rest of world	29%	28%	27%	27%	27%	28%	**28%**

Source: Euro area statistics, own computation; EA = euro area;

1.4 KPI 4- The EU equity investment culture

How inclined are EU investors to long-term sustainable financing?

***Short summary**: Employee Share Ownership is one important way to promote long-term and equity investments into the real economy. Following the continuous increase since 1980, the number of employee shareowners in Europe has been in decline since 2011, partially due to the financial crisis, but to a large degree also because of a lack of policy incentives. Has Employee Share Ownership been revived in the EU Single Market?*

The assessment of this key performance indicator is based on the research and advocacy report produced by BETTER FINANCE's member active at European level in this field, the European Federation of Employee Share Ownership (EFES): "*to achieve the necessary progress, the European institutions can play a limited but significant role by providing the basic information in each EU language*". If employee share-ownership in the EU reached the level it enjoys in the US, it would multiply the SME's share-ownership by 100 times (from $13 billion to $1.3 trillion), the market capitalisation of listed companies would increase by $2 trillion and the total plans would multiply by 6 times.[65]

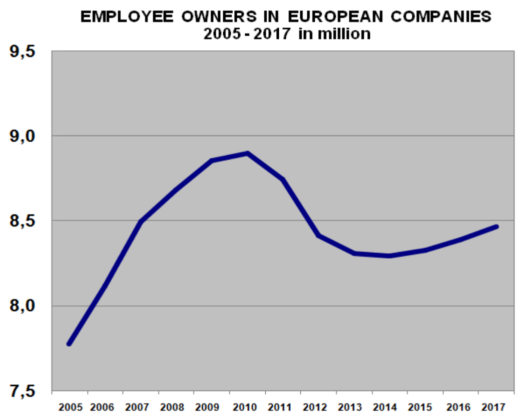
[64] Source: BETTER FINANCE own computations based on Euro-area statistics data on interest rates for long- and short-term loans for households and corporations.
[65] See European Federation of Employee Share Ownership, 'Employee Share Ownership: The European Policy' (May 2019 edition), page 10, available at http://www.efesonline.org/LIBRARY/2018/Employee%20Share%20Ownership%20--%20The%20European%20Policy.pdf.

The decline of direct ownership by EU citizens of their economy has deeper economic and political implications: Europe has transitioned to **a financial type of capitalism** where the link between owners and entrepreneurs/managers has been severed, and where the power to make decisions is increasingly in the hands of financial institutions. Direct individual ownership of securities should be encouraged rather than discouraged in order to better align the interests of capital markets participants with those of the real economy and to boost growth and jobs.

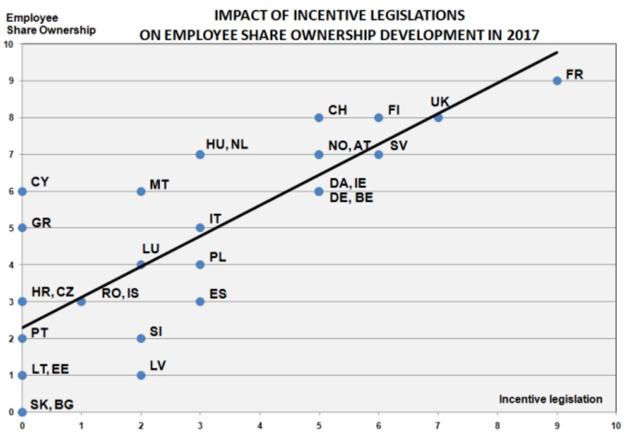
The recent evolution from direct securities ownership to packaged investment products has also had a very negative effect on **financial literacy**, in particular on the knowledge of what shares, bonds and capital markets are, and what their benefits are for the economy and for investors.[66]

Indeed, there are two main opportunities for EU adult citizens to be informed and educated about equity and bonds and capital markets: at the point of sale - when they are in contact with their financial intermediary - or at the workplace. The “retail” intermediary himself is today far less knowledgeable about capital markets, equity and bonds, since in most cases he stopped marketing and selling them a long time ago in favour of more complex and fee-laden packaged products. A level-playing field for shares and bonds is needed in retail financial distribution.

The workplace can be the other important opportunity to educate adult EU citizens, in particular via the promotion of **employee share ownership**. This now constitutes a sizeable share of individual equity portfolios on aggregate and has grown in the past although it seems to have lost some momentum lately. Employee share ownership should be encouraged while preserving diversification of employee savings.



Source: European Federation of Employee Share Ownership



Graph 27. Impact of incentive legislations on employee share ownership development in 2017 *Source*: European Federation of Employee Share Ownership

The number of employee owners in the US is almost four times higher than in the EU, and the value of the assets (equity, market capitalisation) is more than 8 times than that of Europeans.

While the number of European employee owners (in domestic companies) has decreased in the past couple of years, compared to the level of 2010, the number of companies that started to implement this kind of share-based plans has increased considerably, in particular publicly listed companies. From merely a thousand listed companies at the end 1999, the number of corporations that offer share-plans rose to 2,100 by the end of 2017. On the other hand, SMEs (and other non-listed companies) have not grown as fast (in fact, far from it), counting between 300 and 1 million employees holding title of capital participation in their workplace.

[66] For more reading on this issue: “*An Investor Viewpoint: The Fall of Financial Literacy*” by Guillaume Prache, in the EFAMA Report “Building Blocks for Industry Driven Investor Education Initiatives”, March 2014. http://www.efama.org/Shared%20Documents/EFAMA_Investor_Education_Report.pdf http://www.efama.org/Pages/EFAMA-Investor-Education-Report-Uncovers-Widespread-Financial-Illiteracy-across-Europe.aspx

The European Council highlighted as early as 1992 the necessity for EC Member States to incentivise enterprises and companies to increase capital participation of their employees by legislative policy in this direction. Graph 10 shows the high degree of correlation between the number of employee shareholders in each Member State and the number of domestic regulations supporting this type of broad-based plans (plans for all company's employees). However, the graph shows a high divergence between EU Member States. While 9 countries do not have any kind of specific legislation and 10 do not provide any incentive towards this goal, others (such as the UK or France) are way ahead. "*This gap is detrimental to all* […] *In large European companies, employees in countries without legislation suffer negative discrimination. For the same reason, the mobility objectives in the Union are thwarted*."[67] Following a 2015 proposal from BETTER FINANCE, in 2017 the EC added a new CMU action to "d*evelop best practices in employee share ownership schemes*" to boost the equity culture in Europe. Unfortunately, until now the EC has been dragging its feet on ESO instead of finally following-up on its 2014 "Pilot project".

1.5 KPI 5 - Investment returns for EU retail savers

Did EU citizens receive value for their money from capital markets?

Short summary*: The European Commission highlighted in 2013 that the "other reasons for not saving long-term are the often-poor performance of financial intermediaries to deliver reasonable returns, and costs of intermediation".*[68] *In addition, EU Authorities must improve the transparency of the actual net performance of long-term retail investment products. Did the situation for retail investors improve since the launch of the CMU Action Plan in 2015?*

Retail savers should be incentivised to allocate more of their disposable income into financial assets, in particular to securities, as well as to units in collective investment schemes. In exchange, the financial services industry must deliver more value for money, as current returns on financial savings are poor and will continue to perform as such, in spite of the double-bull market (bonds and equities) which already came to an end in 2018 (the aggregate bond index stagnated, and the aggregate equity index decreased -10%). KPI 3 of this paper shows that the asset allocation of the average EU household's portfolio mainly consists of insurances and retirement savings assets and deposits. Is the market attractive for retail investors?

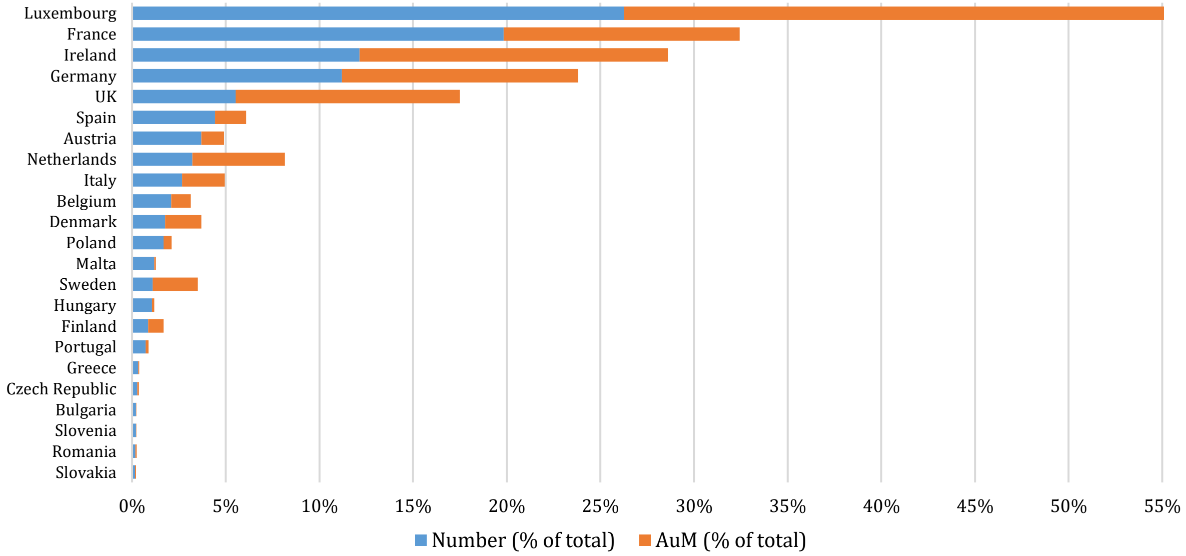
Table 28. Number and AuM of mutual investment funds – 2018					
Region	Number of funds	%	Region	Number of ETFs	%
EU	55,596	42%	EU	1,635	31%
US	15,415	12%	US	2,637	50%
WW	131,984		WW	5,277	
	AuM (€ bln)	%		AuM (€ bln)	%
EU	14,232	32%	EU	624	15%
US	20,248	46%	US	3,047	75%
WW	43,988		WW	4,081	

Source: EFAMA (2018); European Commission; own composition

Table 29[69] shows the significant fragmentation of the EU market for investment funds compared to the US and worldwide market. With approximately 4 times more funds distributed, the EU market manages 42% less assets than the US, where there are no mandatory long-term or pension savings (such as occupational pension plans), as is the case in many EU countries. Individual savers mainly invest in UCITS, which account for 75% of the retail sector, whereas AIFs account for only 15%.[70]

[67] See supra (n 54), pages 13 and 17.
[68] EC staff working document, long-term financing of the Economy, 2013.
[69] The figures for the number of funds in the EU exclude Latvia, Estonia and Lithuania, for which data was not available.
[70] European Securities and Markets Authority, 'Annual Statistical Report: Performance and Costs of Retail Investment Products in the EU' (10 January 2019) ESMA 50-165-731, p. 7.

Chart 29. Dispersion of investment funds in the EU (average 2015-2018)



Source: EFAMA Quarterly Statistical Releases 2015-2018, averages; own composition

Chart 29 shows how many funds are domiciled in each EU Member State (except for HR, CY, EE, LV, LT) and how much of the assets are managed there. As apparent from the chart, the relative number (% of total) of funds domiciled in a country mirrors the relative size of the AuM, since the average funds domiciled in a Member State is 4.4% and the average AuM is also 4.4%. Put statistically, the correlation between the number of funds and value of the AuM is almost perfect (94%), as well as the determination coefficient (88%), meaning that the size of AuM is directly proportional to the number of funds. This could mean that, when a fund reaches a certain AuM size, a new fund will be launched. However, there are several local markets that break this pattern positively (NL and SE) and some that break it negatively (HU and ES).

The low participation rate of retail savers in intermediated capital market products (investment funds) could be due to the lack of trust or understanding of products, which are complex, opaque and very costly. The number of retail unit holders has fluctuated constantly around 30% of their clients.

Table 30. Main UCITS unit-holders in EU by AuM

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Retail	35%	34%	32%	31%	25%	24%	26%	27%	n/a	29%	30%
Institutional	65%	66%	68%	69%	75%	76%	74%	73%	n/a	71%	70%

Source: EFAMA Asset Management Reports 2009-2019

The largest beneficial owners of investment funds in the EU are households (30%), followed by pension funds (28%), insurers (25%), and the last being banks and other intermediaries (17%) in 2017.[71]

With regards to portfolio composition, EU investment funds[72] are reinvested in other funds (either simply, or as Master-Feeder structures and Funds-of-Funds) up to 12% of their total assets (+0.7 p.p. compared to 2015). The largest asset share is debt securities (40% in 2018, +0.5 p.p. increase compared to 2015), followed by equities (37% in 2018, -0.9 p.p. decreased compared to 2015), and around 5% in currency and deposits (stable compared to 2015).[73]

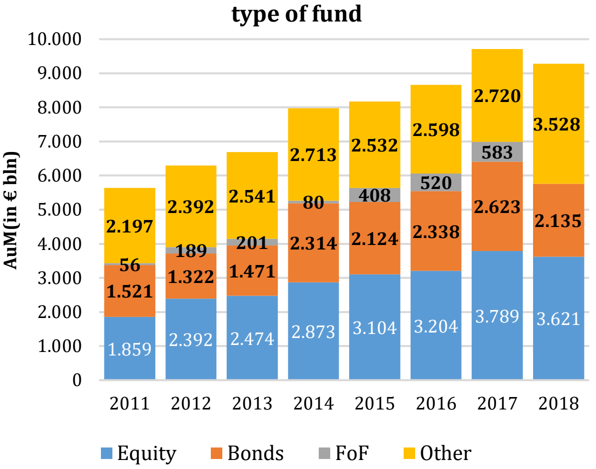
The EU market is increasingly fragmented among national lines, with an excessive number of UCITS and AIFs distributed across jurisdictions. This trend goes against the Single Market and the Commission's proposed Action Plan to harness economies of scale through the introduction of the UCITS passport.

[71] European Fund and Asset Management Association, *Ownership of Investment Funds in Europe* (February 2019), p. 18, available at https://www.efama.org/SitePages/homepublications.aspx.
[72] Non-Money Market Funds according to ESA2010; source: Eurostat – data excludes figures for the Czech Republic.
[73] At the time of writing this report, the Eurostat database did not update newer figures.

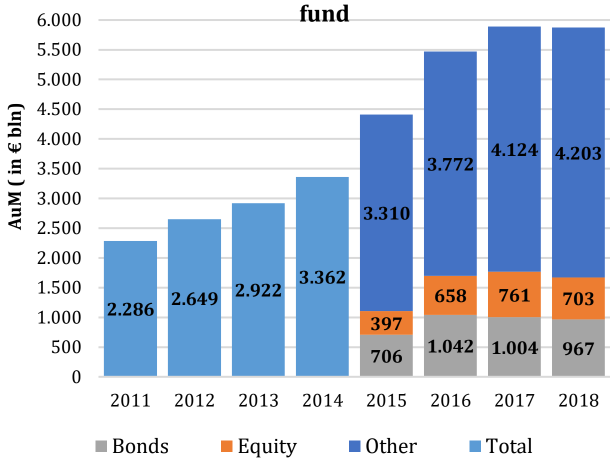
Ongoing charges can be lowered, risk sharing can be increased, and asset allocation can be optimised, with investors getting more value for money. Instead, the market for open-ended funds (UCITS and AIFs) reached a total number of 55,596 funds at the end of 2018, compared to 51,365 seven years earlier.

Looking at the type of fund by asset class, the largest share of the AuM has shifted from mixed-assets and alternative securities to equity UCITS (39%) in 2018. The situation is the other way around for AIFs, although breakdowns are not available prior to 2015.

Graph 31. UCITS Market evolution by type of fund



Graph 32. AIF Market evolution by type of fund

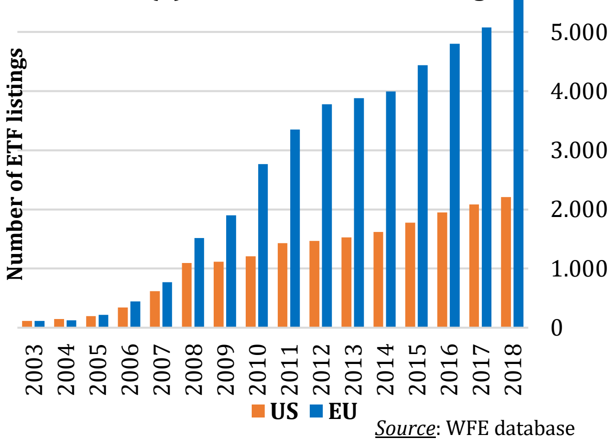


Source: EFAMA Quarterly Statistical Releases (Q4) 2011-2018, own composition

Comparing the two types of mutual funds, UCITS remain the most popular investment vehicle since the number of marketed funds is higher than for AIFs, and the AuM is virtually double. Moreover, while the AIF market was half the size of the UCITS market in 2011, the end of 2018 saw a more balanced number between UCITS and the less transparent and less regulated AIFs. Instead of fulfilling their purpose of *risk capital investment vehicles,* the majority of AIFs, especially in France, are promoted and sold to individual investors' sector. This is particularly worrying since the purpose of the AIFM Directive was to set up the regulatory framework for administrating *investment funds for* ***professional investors***, not retail.

Unfortunately, the ETF market did not take off as expected. ETFs have the advantage of considerably lower fees, allowing them to be as close as possible to market returns, in many occasions even overperforming. Since investment funds generally (close to 82%) do not overperform capital markets, it is much more attractive to invest in a simple product that costs much less and which, in general, aims to keep as close as possible to the performance of the market. Nevertheless, the "ETF boom" has been stronger in the EU than in the US: the average number of new listings in the US was 2.7 times smaller than in the EU (139 compared to 372).

Chart 33(A). Evolution of EU ETF listings



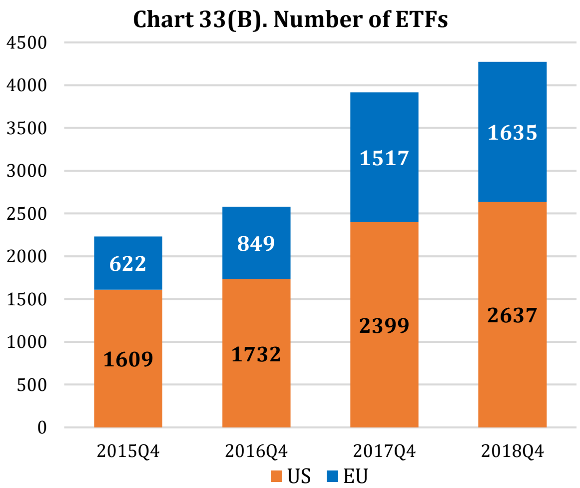
Source: WFE database

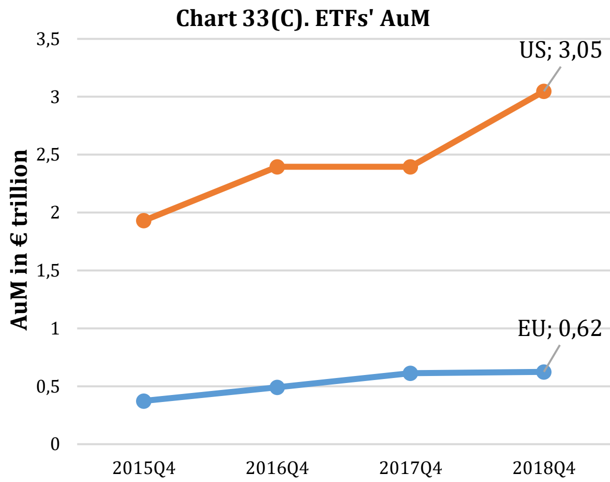
Moreover, the AuM of EU-listed ETFs has grown consecutively for almost 5 years, reaching €624 billion at the end of 2018. The ETF market is much smaller than the UCITS and AIF ones: 2018 closed with 5,693 ETFs listing on EU markets and 2,206 on US.

However, these figures are reported by the World Federation of Exchanges, which could indicate that, since one ETF may be traded on several markets, the actual number of ETFs is much smaller. EFAMA reported at the end of 2019Q1 a total of 1,660 ETFs, cumulating €715 billion, or 7% of the market. A study of the European Commission found a total of 1,563 ETFs in 2017. In terms of AuM, the ETF market makes up 4.45% of the EU fund market.[74]

The dominant commission-based distribution model in the EU keeps fees high and does not incentivise retail distributors to promote low-cost index funds such as ETFs and direct investments in equities and bonds. BETTER FINANCE on several occasions highlighted its support for ETFs and, especially, UCITS index-ETFs, that are better performing than "actively managed" funds, and at a third of the cost.

As seen under KPI 3 above, retail investors are "sold", not advised, into, more and more packaged products, and not direct holdings of securities (such as shares and bonds), mainly due to the distribution models available in the EU. In many countries, the captive or "in-house" distribution model is dominant, meaning that financial products are advised on and sold by salaried networks, to which the MiFID II provisions on independent/non-independent advise do not apply, and which sell only in-house products, such as funds. Moreover, in France the 15-year old ban on inducements for personal pension products (PPPs) has been lifted in 2019, resulting in a stronger incentive to sell certain packaged products.





Source: EFAMA International Quarterly Statistical Releases 2015Q4-2018Q4

Of importance for the completion of the CMU is also the *cross-border distribution* of investment products. According to the study published by EFAMA,[75] funds owned by investors domiciled in other countries than that of the funds' domiciles accounted for less than a third (32%) in 2017, although slightly increasing from the level of 2008 (25%). However, at Member State level, the ownership of foreign investment fund ranges from 8% in Poland to 70% in Italy, and the European average is at 61% domestic and 39% cross-border.

Of those investment funds distributed cross-border, in some jurisdictions (such as Greece and Spain) the majority are "round-trip", meaning that the domicile is foreign, but the management company is domestic. Cross-border UCITS are distributed, on average, in 5 jurisdictions, while out of the 3% of cross-border AIFs, 75% are domiciled in France, Germany, Luxembourg, Ireland and the Netherlands.[76]

In our view, another important reason for households' preference for bank products may be the poor performances of investment funds. Two annual research studies conducted by S&P Dow Jones Indices

[74] According to Investment Europe, the EU ETF market totalled €663 billion, and the fund total market (incl. ETFs) totalled €12,716 billion; Investment Europe, 'Review of the European ETF Market – 2018', https://www.investmenteurope.net/opinion/4000866/review-european-etf-market-2018; EFAMA Quarterly Statistical Release, 2017 Q4, https://www.efama.org/statistics/SitePages/European%20Quarterly%20Statistical%20Release.aspx.
[75] EFAMA (n 60), p 18.
[76] Esther Kramer, Maria Gimeno, 'Initial Appraisal of a European Commission Impact Assessment: Cross-Border Distribution of Collective Investment Funds', European Parliamentary Research Service (July 2018) PE. 621.849, P. 2.

report on the percentage of equity funds (by region) that **underperform** their corresponding benchmarks and on the performance persistence of the "best in class". On a 10-year average, only 9% of Eurozone equity funds and 13% of European equity funds have overperformed their corresponding benchmark index.[77]

In addition, BETTER FINANCE's research report on the correlation between fees and performances in European investment funds showed that only 27% of UCITS and AIFs - domiciled in Belgium, France and Luxembourg – delivered excess return on 5-year moving averages from 2008-2017 (quarterly basis), i.e. 509 funds of the total of 1,886 analysed.[78] The strongest "weight" on fund performance are fees, whereas the size of AuM is the only positive determinant of fund returns. In other words, in general fees significantly reduce gross returns, and can only be offset by large economies of scale. Even when compared with the low-cost fund alternative (ETFs), active management returns lower net performances compared to passive (or index) management.[79] The study also revealed that 1 in 5 funds manage to overperform the benchmark only 3 years out of 10, but the percentage decreases dramatically as the number of overperformances increases. In other words, less than 1% of the funds in sample managed to overperform their market index every year during a holding period of 10 years.

Even so, when asset managers find themselves in the top quartile and overperform the benchmark, another S&P study (albeit restricted only to the US market) shows that, in most cases, overperformance should be attributed to chance rather than manager's competence. That is because the "*persistence scorecard*" of 2018 shows that only 0.45% of the funds who were the "best in class" initially, have kept their position on a **5-year analysis period**. Considering the interconnectedness of the US and EU asset management industry, one can hardly imagine that the results for Europe would be better.[80]

Table 34. Average fees in EU funds in 2017

Type of CIS	Fee	Type of CIS	Fee
Equity fund	1.89%	Equity ETF	0.31%
US equity fund	0.45%	Real estate fund	1.28%
Mixed fund	1.51%	Life insurance (G)	0.88%
Bond fund	1.01%	Pension product	1.45%
Life insurance	1.38%	Pension fund	1.15%

Table 35. ETF ongoing charges EU vs US 2017

Type	EU	US
Equity	0.31%	0.22%
Fixed-income	0.27%	0.23%
Multi-asset	0.68%	0.53%
Average	0.30%	0.23%

Source: CEPS/ECMI; own composition; data for 2018 is not publicly available;

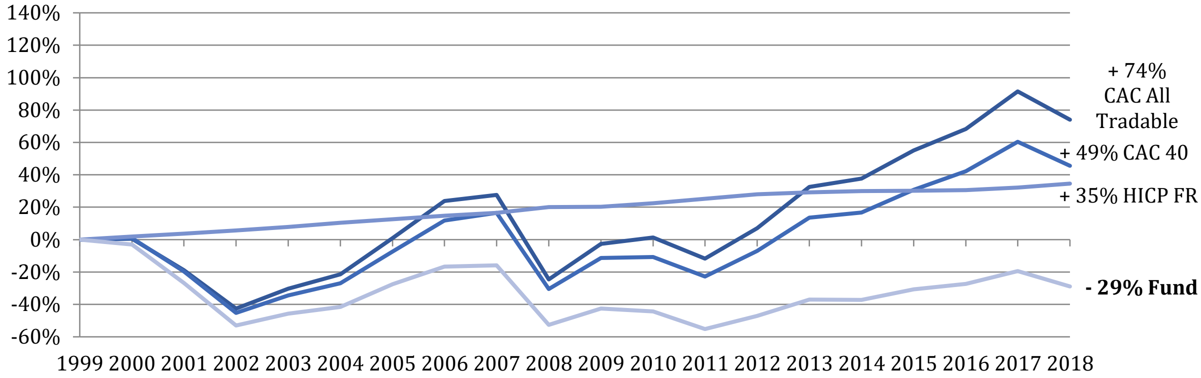
The average fees of EU equity funds were 4 times higher than in the US in 2017. The US equity ETFs were 5 times less expensive, and an explanation for this high level of fees can stem from the abovementioned market fragmentation. By not benefiting from larger numbers of investors and economies of scale, the EU fund industry may find it harder to offer such competitive prices, with the average AuM also being considerably larger in the US.

Moreover, as regards the fee differences between the US and EU, in its study on life-cycle pension funds, BETTER FINANCE found that the average fee for a US product of this type was 64 bps, less than half of the fees charged for the 28 EU funds in scope.[81] Compared to the figures in the table above, pension products are considerably costlier and almost reach the level of actively managed equity funds, even though the majority asset allocation is in debt instruments and in other collective investment schemes, not in equity.

The graph below shows an example of the decorrelation between capital markets returns (broad and narrow indexes) and an investment fund and the effects of fees, gross of inflation.

[77] S&P Dow Jones Indices LLC: SPIVA Europe Scoreboard, Year-End 2018, Report 1, p.4, https://www.finanzaoperativa.com/wp-content/uploads/sites/7/2019/04/spiva-europe-year-end-2018.pdf.
[78] BETTER FINANCE, *Study on the Correlation between Costs and Performance of EU Equity Retail Funds* (June 2019) https://betterfinance.eu/wp-content/uploads/BETTER1.pdf.
[79] ESMA, *Trends, Risks, and Vulnerabilities Report*, no. 2 of 2019, https://www.esma.europa.eu/sites/default/files/library/esma_50-165-883_report_on_trends_risks_and_vulnerabilities_no.2_2019.pdf.
[80] S&P Persistence Scorecard, Year-end 2018, https://www.spglobal.com/en/research-insights/articles/does-past-performance-matter-the-persistence-scorecard.
[81] BETTER FINANCE, *Study on the Dispersion of Risk Mitigation Techniques in Life Cycle Pensions* (4 July 2018) https://betterfinance.eu/wp-content/uploads/The_Dispersion_of_Risk_Mitigation_Techniques_in_Life_Cycle_Pensions_-_Final_Report_-_130618.pdf.

Graph 36. Real case of French retail equity fund



Source: BETTER FINANCE Pensions Report 2019

What individual investors are actually averse to are **"high risk, low return" investment offerings"**. In today's environment of very low interest rates and of financial repression, direct investments into equities, bonds and index ETFs would provide EU households with better possibilities of getting **a decent return on their long-term savings**, i.e. to at least protect their real value. Direct bond investments might be more appropriate in case transparency is guaranteed and access is granted to bond markets. Even ESMA, through its *Trends, Risks, and Vulnerabilities* bi-annual report shows that in the past years retail investor confidence was on the decline due to the poor performances of their portfolio.[82]

The outlook on European pensions is presented below. On a 19-year average (2000-2018) only two retirement vehicles overperformed aggregate broad EU capital markets, while the other 17 (according to available data) heavily underperformed, with more than half returning around 0% or negative each year.[83]

Table 37. Long-term returns of a Belgian life insurance product

Capital markets vs. Belgian individual pension insurance 2000-2018 performance	
Capital markets (benchmark index*) performance	
Nominal performance	124%
Real performance (before tax)	59%
Pension insurance performance (same benchmark*)	
Nominal performance	48%
Real performance (before tax)	1.2%

Table 38. Real returns of all French life contracts 2000-2018

	19-year return	Average yearly return
Before tax returns		
Capital guaranteed contracts	39.3%	1.8%
Unit-linked contracts	-23.9%	-1.4%
All contracts (avg.)	28.5%	1.3%
After tax returns		
Capital guaranteed contracts	23.8%	1.1%
Unit-linked contracts	-27.7%	-1.7%
All contracts (avg.)	12.8%	0.60%

Source: for both Tables (37, 38) BETTER FINANCE Pensions Report 2019

The table above is a simple example of how retirement savings are performing across the EU. Bearing in mind limitations (i.e. that this is an example, and there might well be better returns, depending on the country), pension savers lose almost half of the profit, while the real value is barely more than the initial invested sum, which is before taxes are applied. Depending on the fiscal regime, a Pillar III savings product with an investment component could very well turn into a mere inflation-protected product, since the only element that is "saved" is the current purchasing power.

Looking at the number one financial savings product in France (€1,639 billion of assets, 2018), French individual investors are often criticized for preferring capital guaranteed life insurance contracts (€1298 billion) to "unit-linked" ones (€341 billion),[84] which are more often invested in equities (indirectly) and other riskier assets (and this despite heavy promotion and advertising efforts by retail intermediaries to

[82] European Securities and Markets Authority, *Trends, Risks and Vulnerabilities Report*, No. 1/2016 (ESMA/2016/348), No. 2/2016, No. 1/2018 and No. 2/2018 (ESMA 50-165-632).
[83] See BETTER FINANCE Press Release, *Pensions Inadequacy: the high fees often charged by European Pension Providers prevent many EU Citizens from enjoying a decent retirement* (25 September 2019).
[84] BETTER FINANCE, 'Pension Savings: The Real Return – 2019 edition', Table GR11(A) on page 49.

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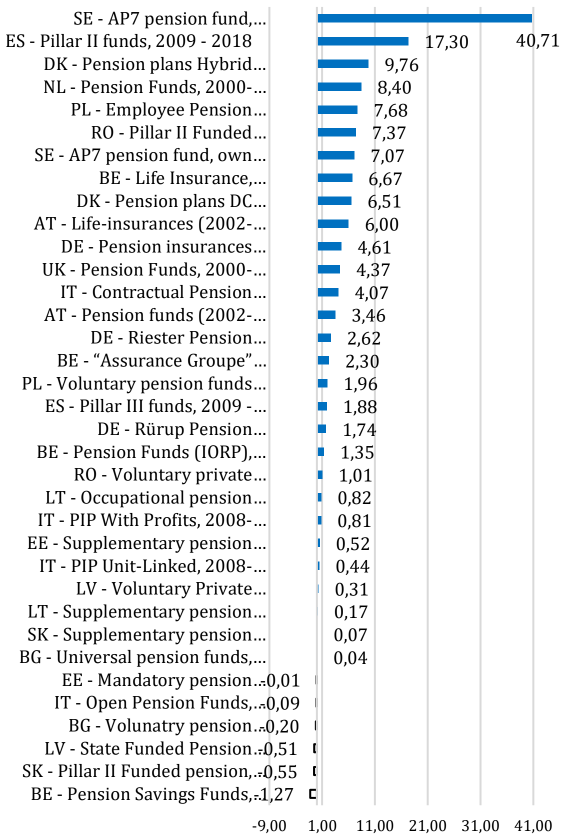
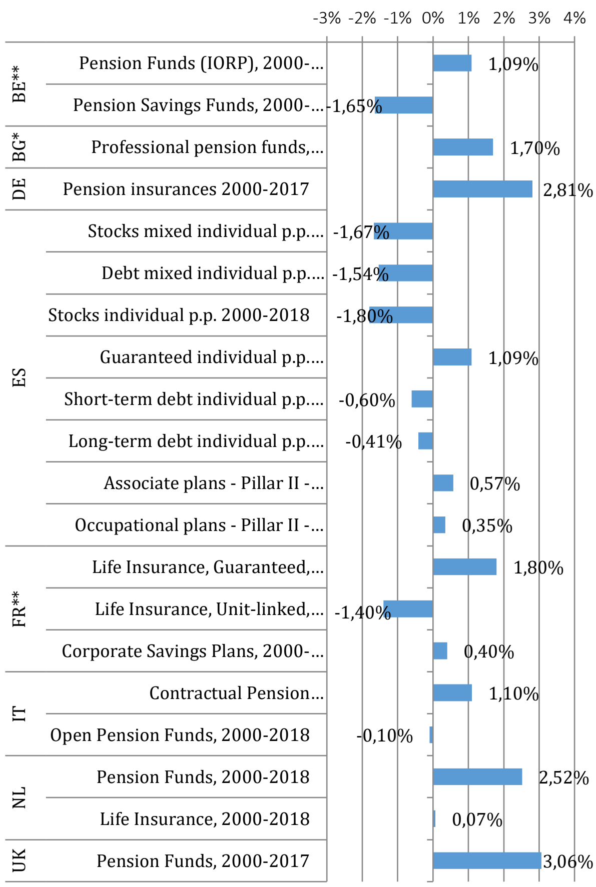
push individual investors into the far more profitable, with fees three to four times those charged on capital guaranteed contracts, unit-linked contracts). BETTER FINANCE'S research into the real net returns of private pensions shows that investors have been quite wise to keep their preference for capital guarantee contracts so since the beginning of this century. French pension savers that contributed to complementary pension plans under the form of unit-linked life insurance (that is, life insurance with an investment component tied to the performance of an investment fund) have registered cumulative negative returns of -23.9% over the past 19 years, before tax. This means that the effects of charges and inflation generated an annual loss of the contributions of -1.4%.

In 2018, pension funds across the EU were mainly invested in debt and fixed income securities (45%), followed by the equity share (31%) and alternatives (17%), which include units in collective investment schemes.[85] In addition, the level of market development for retirement savings vehicles greatly differs from one country to another: while in countries such as Spain or the UK there are more than 1,000 funds on offer only in the occupational pensions sector (pillar II), other countries are deeply concentrated in the administration of a handful of providers, such as Romania (7 funds) or Austria (10 funds). With regards to individual voluntary pension arrangements (pillar III), the affiliation rate is very low and mainly allocated in life insurance products.

Chart 39. Pension returns per unit of cost



Graph 40. Annualised real net returns - before tax, from 2000/01



Source: BETTER FINANCE 2019 Pension Savings Report; own composition based on available data;

[85] Source: EIOPA database.

1.6 Conclusion

The CMU Action Plan was set to restore savers' trust, reconnect households to capital markets and improve access to financing for SMEs, mainly. There has not been much positive change in the development and further integration of the CMU and, therefore, most of BETTER FINANCE's 23 action proposals from its 2015 Briefing Paper still remain valid. Although the value of bank funding continued to decrease up to 2018, coupled with an increase in the value of market capitalisation of EU listed equities, the Single Market is still overly reliant on the banking sector, which not only makes it more vulnerable to financial crises, but also slows down economic growth. EU businesses (SMEs and large companies) mainly use retained earnings (and internal funds) for financing, and as far as external sources of funding are concerned, bank loans are still (statistically and subjectively) far more preferred over capital market instruments.

From 2003 to 2018, secondary SME markets have lost 56% of their size, and the IPO trend (and market cap) does not compensate for this contraction. Concerning EU citizens, the financial balance sheets have remained virtually unchanged since 2003 and are significantly skewed towards banking products and "mandatory savings" (insurances and pensions). The direct participation rate of EU households in capital markets remains very low at 11% of total savings for the last quarter of 2018, and on average 59% of savings are held in non-financial assets.

Investment products remain opaque, complex and poorly performing, which makes investing in collective investment schemes unattractive for retail savers. The EU Member States have made slow progress with regards to reviving the equity culture and incentivising employee share-plans, and there is still a lot of untapped potential in this area. Last, a functional CMU that works for its citizens rests on proper enforcement mechanisms, which currently are insufficient. The current proposal for a collective redress mechanism, however, does not improve the situation as it would discriminate against direct investors in favour of indirect ones – BETTER FINANCE is actively campaigning to remedy this situation.

ANNEX I

BETTER FINANCE 2015 proposals for making capital markets more accessible and attractive to individual investors

2019 Status

Text in black represents the BETTER FINANCE 2015 Actions for Building the CMU; text in blue represents the 2019 assessment. The green arrow signifies "slow progress", the red "x" signifies "no progress" and the green check-sign shows "good progress".

It is also mentioned when BETTER FINANCE 2015 proposals are also advocated by the Next CMU October 2019 Report

1. Restore investor confidence and trust in capital markets: much stronger emphasis on EU market abuse and MiFID (best execution, conduct of business rules, misleading information, etc.) rules enforcement.
   This means improving further supervisory effectiveness and convergence,
   (*also in the Next CMU Report,*[86] *Recommendations 2 and 13: "a strong and coherent supervisory framework"*)

The ESAs Reform vote of 2019 introduces moderate but real[87] *improvements for consumer and investor protection.* ↗

setting up collective redress mechanisms for all EU private investors (private enforcement),
(*also in the Next CMU Report, Recommendation 2: "Investor protection … rules should be consistently applied and enforced"*)

The current file on Representative Actions for the Protection of the Collective Interests of Consumers does not include direct investors in capital markets. While US investors have already been indemnified in parallel class actions in the US (Volkswagen), EU consumers' redress process just started on 30 September 2019). ✗

improving tracking and sanctioning of market abuses.

The ESAs still seem under-equipped to track abuses. In particular, they do not have databases of the retail savings and investment products they are supposed to supervise. ✗

2. Rehabilitate equity investing (in particular for SMEs) – as the simplest, most effective and most liquid long-term investment product - and individual share ownership (including employee share ownership),
   (also in the Next CMU Report, Recommendations 5 to 9: "massively develop equity markets")

The EC brought amendments to the SME Growth Markets provisions under the MiFID II regime to facilitate access to public listing; in addition, the EC continues to monitor developments on employee share ownership. ✗

by ensuring a level-playing field for simple securities at the retail point of sale.

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[86] We refer to the "Savings and Sustainable Investment Union - The Next CMU High-Level Group: Report to Ministers and presented to the Finnish Presidency (October 2019)" as the "Next CMU Report". – available at https://www.nextcmu.eu/.
[87] See BETTER FINANCE Press Release, 'European Parliament takes Consumer and Investor Protection Seriously in Financial Supervision Reform' (10 January 2019) https://betterfinance.eu/wp-content/uploads/PR-EP-Vote-on-Financial-Supervision-Reform-100119.pdf.

(*also in the Next CMU Report, Recommendation 2: "establishing a minimum harmonized tax incentive for general savings in simple and transparent long-term financial instruments like single shares and ETFs"*)

Despite BETTER FINANCE demands, it will not be possible for EU citizens to invest directly in listed shares and bonds and ETFs within a PEPP, and retail distributors are now promoting/informing about listed equities, bonds and ETFs even less, using MIFID II as an additional excuse. ✕

3. For politicians, policy makers, industry and media to stop confusing "equity markets" with their large cap component only, by referring from now on to broad - "all-tradable" - indices instead of narrow - blue chip - ones, e.g. including small and mid-cap issuers, and not only the big ones.

No change despite BETTER FINANCE's published research. ✕

4. Eliminate barriers to individual shareholder engagement; in particular ensure free, simple and easy cross-border voting for individual investors, enforce actual voting rights for shareholders in nominee/omnibus accounts, and full rights of association for individual shareholders of any EU domiciled listed company.

The recently adopted Shareholders Rights directive II is currently being transposed in Member States. BETTER FINANCE will update its research on the barriers to shareholder engagement and to cross-border voting once this is done. However, SRD II failed to provide a definition of "shareholder" at EU level, enabling agency owners such as nominee accounts and big international custodians to still vote in lieu of the real beneficial owners of shares, especially those domiciled in a different Member State than the issuer. ↗

5. Improve the summary prospectus for shares and bonds by making it as user-friendly, formatted, short and comparable as the KID for funds and as the future KID for PRIIPs and possible "PBS" for pension fund participants (IORP review proposal from the EC) and KID for personal pension products (current EIOPA work for the EC). The ESMA proposal for having a centralised database for all prospectuses would then be more useful.

The new format for the EU growth prospectus and the application thresholds for publicly listed companies achieve their purpose of relieving companies of compliance and issuance costs. Concerning the Pension Benefit Statement "PBS", EIOPA did issue guiding principles for the PBS, but the IORP II Directive still allows for discretion at national level, triggering divergent applications of the law. ESMA did create a centralised database for prospectuses and base prospectuses, but it unfortunately still lacks certain technical aspects as some prospectuses are not available. ↗

6. Reduce market fragmentation, "dark" and OTC trading; impose same transparency requirements that currently apply to Regulated Markets to the new market venues (example: SIs – typically big banks - selling equity warrants without the best execution rules applying to Regulated Markets to unaware individual investors), or ban any promotion to individuals of those venues.

BETTER FINANCE research shows that the new provisions of MiFID II on trading facilities have favoured a 14-fold multiplication of the number of systematic internalisers (Sis) and, despite the double volume cap, more than half of European equity is now traded in dark venues. ✕

7. Easily accessible, free and comprehensive trade data for individual (non-professional) equity investors within a reasonable time delay not only from regulated markets (who have always been providing those), but also from the other

- post MiFID I – market venues such as "MTFs", "SIs", "dark pools" and "OTC" which together now represent more than -half of equity trades.
(*also in the Next CMU Report, Recommendation 12: "Establish a single market data Consolidated Tape"*)

❌

No progress. Data provided by regulated trading facilities still has a 15-minute lag and most of the times is difficult to access.

8. Ensure easy and free access for retail investors to all major capital markets: market transparency is correlated to retail access (see 2007/2008 fixed income markets crisis): improve fixed income markets transparency and retail access to bond trade data.

Deteriorating status: Retail investors are increasingly crowded out of corporate bond markets due to the PRIIPS Regulation implementation (issuers required to design and publish PRIIPS KIDs on top of prospectus and summary prospectus), and more generally out of capital markets as a whole following the MiFID II implementation. ❌

9. Any resumption of securitisation must be highly standardized and kept as simple as possible; banks should keep significant "skin in the game".

Securitization re-started in the EU. It is still too soon to measure the effect, but considering the thresholds for risk retaining and tranches, BETTER FINANCE believes that monetary and non-monetary financial institutions still don't keep enough "skin in the game". ❌

10. Align securities lending disclosure and profit-sharing rules for direct share ownership with those applicable to UCITS funds ownership.

No progress. ❌

Re-lending of lent securities should be banned, as well as the re-pledging of securities as collateral, following the Canadian example.

No progress. Following an ESMA peer-review of just 6 National Supervisory Authorities (NSAs) on the implementation of the guidelines on efficient portfolio management techniques (EPMT), ESMA found not only divergent national regulations, but also weaknesses in the construction and provisions of the latter. A BETTER FINANCE report on securities lending shows the lack of actual enforcement of the rule allocating 100% of the net profit of securities lending to the funds. ❌

11. Quickly harmonise crowd-lending and crowd-investing rules in the EU to create and develop a single and strong market for crowdfunding, while ensuring fair competition with other capital markets.

The European Commission's March 2018 proposal on European Crowdfunding Service Providers (ECSP) has been amended and adopted in the first reading with the European Parliament in March 2019. The proposal set out a proper framework for retail investor protection (although it fell short of a fully-fledged mechanism), and now the proposal is awaiting to be debated in trilogues. ↗

12. An EU Capital Market Union for Growth, Jobs and Citizens should contribute to boost employee share ownership as an important basis of individual share ownership in Europe, through effective tax incentives like recently adopted in the UK
(*also in the Next CMU Report, Recommendation 2: "further encourage employee shareholder plans"*)

No progress ❌

13. Greater harmonisation in the areas of financial reporting –IFRS-, insolvency law and taxation (namely ending the double taxation of dividends and other investment income for cross-border investors within the EU).
(*also in the Next CMU Report, Recommendation 4 "Develop a straightforward EU procedure for repayment of withholding" and Recommendation 15 "Reinforce the effectiveness of insolvency regimes in Europe"*)

❌

No end to the double taxation of dividends within the EU, and still very difficult to claim credits from other Member States despite the recent publication of the EC Code of Conduct on Withholding Tax.

BETTER FINANCE proposals to attract individual investors to "packaged" "retail" investment products that are more invested in capital markets:

14. Further improve and harmonize disclosures for all long term and retirement savings products:

PRIIPs' KID principles extended to all retail long-term and pension investment products, including shares and bonds (for which it could favourably replace the current ineffective "summary prospectus") and pension savings products

No progress – PRIIPs KID (as the name suggests) covers only certain packaged investment products, excluding most pension ones. ❌

Standardized disclosure of past performance compared to objective market benchmarks: long term historical returns after inflation; after all charges to the investor; and after tax

No progress – the UCITS KIID remains the only standardised mandatory disclosure document so far that shows the track record of a product. Following ESMA's Guidelines of April 2019, fund managers have stricter conditions for benchmark comparability. But the UCITS funds KIID requirements will be abrogated end of 2020. ❌

Disclosure of total fees and commissions charged to the end investor, both direct and indirect

No progress – the PRIIPs KID shows a derived measurement, the "Reduction-in-Yield" (based on one of the future performance scenarios, not on actual amounts invested), which is dependent on the recommended holding period and future performance scenarios: no information on the actual cost structure presented to retail investors. ❌

Disclosure of funding status

No progress. ❌

Disclosure of transfer/exit possibilities.

No progress. ❌

15. The European Supervisory Authorities (ESAs) must better comply with their legal duty to analyse and report on long term and pension investor trends, including actual net performance and fees of all retail long term and pension products;

Slow progress. On 10 January 2019, following a 2015 request by BETTER FINANCE, the European Supervisory Authorities (ESAs) finally released reports on costs and past performance of long-term and pension savings products sold or marketed in the EU. However, the reports fall short of meeting their objective and of fulfilling the European Commission's request as they *cover only a very small fraction of the €20 trillion retail market in the EU and lack both objective comparisons (against benchmarks) as well as concrete recommendations or next steps, in particular with regards to the utility of the current EU disclosure documents (the PRIIPs KID for example).* ↗

16. Simple retirement savings vehicle to protect long-term purchasing power of savings

readily accessible, without need for advice (and no related fees) ✗

supervised by public bodies ✓

a pan-European Personal Pension Plan ✓

Some progress. The European Parliament adopted the Regulation for a Pan-European Personal Pension (PEPP) on 4 April 2019.[88] *However, as highlighted several times by BETTER FINANCE, the PEPP (even the "basic" one) is not simple anymore, its "Capital Guarantee" feature in the default option remains a major issue, since it will do nothing to protect the real value of the capital subscribed. As it stands the purchasing power of the "capital guarantee" upon retirement will amount to just a small fraction of lifetime savings. Moreover, despite BETTER FINANCE's demands, it will not be possible for EU citizens to invest directly in listed shares and bonds and ETFs within a PEPP.* ↗

17. Simplify, standardize and streamline the range of product offerings:

Forbid the use of non-UCITs funds (the 20 000 or so "AIFs") in all packaged long-term and pension products promoted to individual investors. ✗

Reduce the excessive number of UCITs on offer in the EU ✗

Replace the specific and nationally incentivised long-term investment funds by the pan-European ELTIFs ✗

ESAs to make full use of their product intervention powers in order to ban any toxic investment product targeted at individual investors.

A first use of this new power from 2018: ESMA suspended the distribution of binary options to retail investors in 2018 and renewed the measure in 2019. However, the temporary restriction on the distribution or sale of CFDs to retail investor came to an end on 31 July 2019. ↗

ESAs to ensure EU individual investors have full access to low cost index ETFs ✗

18. Establish EU-wide transparent, competitive and standardised retail annuities markets; and grant more freedom to pension savers to choose between annuities and withdrawals (but after enforcing a threshold for guaranteed lifetime retirement income).

Slow progress. Due to the ongoing low interest rate environment, pension plans with limited or no guarantees have a constantly increasing share of annuity markets as well for private as for occupational pensions. Competition, transparency and cost-efficiency are not progressing. ↗

[88] The file is waiting formal adoption by the Council of the EU.

Hopefully the future implementation of the PEPP Regulation will trigger some improvements of the annuities markets.

19. Improve the governance of collective schemes: at least half of the schemes' supervisory bodies should be designated directly by the pension schemes' participants.

No progress.

✕

20. End biased advice at the point of sale and guarantee competent advice on long-term investments, including equities and bonds;
(*also in the Next CMU Report, Recommendation 2: "consumers should have access to fair advice"*)

MiFID II, implemented on 01/01/2018, distinguishes "independent advice" with no commissions and other "inducements" received by advisors from providers to sell their products, and "non independent advice" for which inducements are still possible. However, recent independent surveys of MiFID II implementation and other evidence show that "non independent advice" or – worse – closed architecture "advice" remain dominant, except in the UK and in the Netherlands where commissions were completely banned before 2018. Worse, in France, Public Authorities lifted the 15-year-old ban on commissions for the main unit-linked PPPs in 2019.

✕

more powers to supervisors to ban "retail" distribution of toxic packaged investment products;
Fortunately, in line with BETTER FINANCE's demands, the European Supervisory Authorities, responsible for supervising financial services at EU level, are to be granted enhanced powers that will finally equip them with the necessary "teeth" to ensure robust consumer protection. Now, we expect to finally see increased efforts to tackle mis-selling and the use of reinforced product intervention powers that will allow for ESAs to ban toxic financial products and activities.

✓

21. Special treatment by prudential regulation of all long term & pension products allowing for an effective asset allocation.
(*also in the Next CMU Report, Recommendation 8: "Strengthen incentives for institutional investors to hold more Equity"*)

Slow progress. BETTER FINANCE's (and others') unabated efforts to convince the EU Authorities to recalibrate the capital requirements for equity have started to bear fruit. On 8 March 2019, with the input of BETTER FINANCE and other stakeholders, the Commission tabled targeted amendments to the Solvency II delegated regulation, in particular to the equity calibration. The amendment creates a derogatory provision for "long-term strategic investments in equity", for which the capital requirement (SCR) is smaller. Such a provision would ensure that the capital requirement for a stock that qualifies for the abovementioned category would only be of 0.22€ for each stock worth €1. This is a first step to stop penalising insurers for investing in equities to cover their long-term and pension liabilities. Hopefully, the EU Parliament and Council will alleviate the multiple constraints that still severely hamper the EC proposal.

↗

22. Taxation to incentivize long-term retirement savings and investment over consumption and short-term savings; ELTIFs will not emerge significantly unless they get the most favourable tax treatment already granted to numerous other nationally sponsored long-term investment products. The FTT (financial transactions tax) should be reviewed in order to actually meet its stated goal: tax the transactions of financial institutions (the largest ones by far being the Forex ones, and then derivatives) instead of those from the real economy (end-investors in non-financial equities and corporate bonds, individual ones in particular). To this aim, a FAT (Financial Activities Tax) may be more fit for purpose.

(*also in the Next CMU Report, Recommendation 2: "establishing a minimum harmonized tax incentive for general savings in simple and transparent long-term financial instruments like single shares and ETFs"*)

No progress. ✕

23. Basic financial mathematics and capital markets (shares and bonds) basics to be part of school curricula; financial institutions to have at least a part of the use of their financial education resources supervised by independent foundations.

No progress, but this is a Member States' competency. ✕

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