



association of the
luxembourg fund industry

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A BLUEPRINT FOR SAVINGS & INVESTMENTS



**ALFI'S VISION ON HOW THE FUND
INDUSTRY CAN HELP SHAPE
THE EUROPEAN COMMISSION'S
PROPOSED SAVINGS
AND INVESTMENT UNION.**



SAVINGS AND INVESTMENTS IN CONTEXT

Total European Union household financial assets are at only EUR 33.5tn¹ vs EUR 102tn² in the United States, whereas EU's total population is around 447m vs 334m in the US.

Household net financial wealth (=household financial assets minus financial liabilities) stands at:

- **EUR 84tn in the US** (251k EUR per US citizen)
- **EUR 24.2tn in the EU** (54k EUR per EU citizen, i.e. nearly 5x less than in the US)

This gap is even more concerning given that **private savings** in the EU represent **25% of EU GDP**, compared to **18% in the US**

It is largely due to the fact that Europeans do not invest. Indeed, savings held in cash and savings accounts are:

- EUR 10tn (**41% of household financial wealth**) in the EU
- EUR 13tn (**16% of household financial wealth**) in the US

Furthermore, Europe still largely relies on first pillar "pay-as-you-go" (PAYG) pension systems:

- Due to the evolution of demographics, PAYG systems will inevitably be unsustainable: currently there are three adults of working age for every pensioner in the EU. By 2050, there will be less than two workers for every pensioner.
- PAYG systems are expensive: Germany's public pension expenditure is already 10.4% of GDP and set to increase; in France, it is 14.5% against the OECD average of 7.7%. At the same time, replacement rates in Germany (at 55% net) and France (at 72% net) are relatively low.
- EU funded pensions are underdeveloped: together, The Netherlands, Denmark, and Sweden's represent 62% of EU funded pension assets (EUR 2.8tn in 2022 - only 12% of EU GDP).

As one of the indirect results, EU equity market capitalisation is only 81% of GDP vs 227% in the US.

1. Eurostat; data as of end-2022. This total includes households and non-profit institutions serving households (NPISH). See <https://ec.europa.eu/eurostat/statistics-explained/SEPDF/cache/57942.pdf>
2. Source Fed data as of end 2022 (excluding real estate)



It is estimated³ that transitioning the EU's pension systems to partly funded models and moving savings out of bank accounts and into the capital markets could unlock around **EUR 11tn**. Even if only a third of this money would be invested in European assets (in line with the average asset allocation of UCITS equity funds), this would give the European economy a significant boost.

The above figures should make clear that the priorities for CMU 3.0 or the rebranded "Savings and Investments Union" should be about mobilising retail savings and transition our Pay-as-You-Go pension systems into funded pensions.

The objective of this paper is to provide concrete actions that could be undertaken by governments and EU institutions to set the course.

3. *"The future of pensions and retail investment in the EU" Newfinancial.org*



KEY PROPOSALS FOR UNLOCKING HOUSEHOLD PARTICIPATION AND TRANSITIONING PENSION SYSTEMS

1. Mobilising the younger generations

FINANCIAL EDUCATION IN SCHOOLS:

Introduce compulsory lessons in schools to teach the basics of investing with an objective of laying the grounds for young people to understand the concepts of compound performance and the necessity to invest regularly and for the long term whilst demystifying market risk. This would ideally be a subject on its own taught to students or as second best integrated in other subjects.

- **EU action points:** Education is a supporting competence of the European Union. The EU can therefore only support, coordinate or complement the action of Member States. One possible way of action could be for the Commission to devise a basic financial education programme to support Member States in their school curricula. The Commission could in addition promote financial education as a best practice to Member States e.g. in the context of the European semester or in the context of the European Education Area including financial literacy as a key competence in the area of numerical, scientific and engineering skills.

INVESTMENT ACCOUNTS FOR CHILDREN:

- In a number of Member States there is a tradition for grandparents to set up a basic savings account for their grandchildren. An investment account for children would generate higher long-term returns given the typical investment horizon of at least 18 years. Additionally, an investment account would give children a first experience with investing to be built on later in their adult lives. An example of existing investment accounts for children is the [Junior ISA](#) in the UK.
- Foster a **favourable regulatory framework** for banks/investment firms to be offering investment accounts for minors which can be actively used to invest in standard investment products like equities, bonds and investment funds.
- **EU action points:** Such a framework could be inserted into MiFID, the Markets in Financial Instruments Directive.
 - Introduce **tax incentives** for parents to allocate yearly contributions to underage investment accounts on the condition that such amounts are fully invested. Such tax incentives would not be conditional on the geographic allocation of funds. Indeed, a natural home bias will ensure that a part will be invested in the investor's home Member State or the EU.

CREATE AN INVESTMENT CULTURE:

Organise a yearly event for scholars and students to educate them regarding saving and investment. Pair these events with a yearly "investment" competition based on a "mock portfolio" to be managed for 12 months. The most successful investors winning a prize in the form of a contribution to their *underage investment account*.



- **EU action points:** Such an event could be supported or coordinated by the Commission together with EFAMA, the EBF and Insurance Europe and potentially expand on the longstanding EBF annual [European Money Week](#).

INITIATE LARGE-SCALE EU INVESTOR EDUCATION CAMPAIGN:

In order to mobilise household savings and to increase acceptance of pension reforms and the transition to funded pensions (see items below), it is key that Europe addresses the financial literacy knowledge gap of EU adult citizens. Doing so will require funding and decisive actions to educate and empower citizens. This will also imply a “mindset shift” away from the over-protection and infantilization approach EU regulators and policy makers have pursued over the past two decades.

- **EU action points:** ESMA with the support the National Competent authorities (NCAs) and the asset management industry could initiate large scale investor education programs for European citizens. Such programs could be financed through a small levy on funds and/or net interest income from European banks and budget could be allocated between the public and private sector for implementing the campaigns⁴.

2. Create visibility regarding future pension pay-outs

START WITH FIRST PILLAR TRACKING:

In a first step, EU member states should be required to provide their citizens with an online portal on which they would be able to consult their provisional first pillar pension monthly pay-outs. Unlike some of the existing national pension tracking systems, such reporting would need to be based on clear and transparent calculation rules (defined at EU level) incorporating the evolution of demography and the provisional workers/pensioners ratios, retirement age, etc. and should be a realistic picture of what citizens can reasonably expect at the time of their retirement. This reporting would provide transparency to citizens as to what they can expect to receive from the first pillar and would create a strong incentive for them to revert to second and third pillar solutions to save for their retirement. It is important to start with the first pillar as this effort should be limited for member states. Integrating second and third pillars in such tracking systems is much more complex and thus should not be a short-term priority.

- **EU action points:** The role of the EU in first pillar pensions is very limited. A provision on first pillar pension tracking systems could nevertheless be envisaged under Regulation (EC) 883/2004 on the coordination of social security systems.
- The EU can also strongly recommend actions to be taken by Member States in relation to their pension systems in its European Semester annual reviews.

4. In India SEBI has successfully implemented such an approach with the help of the asset management industry and industry association (AMFI).



EXTEND TRACKING SYSTEMS TO SECOND AND THIRD PILLARS:

Longer term, member states should be able to provide integrated reporting for all three pillars to their citizens. This however will take time and should be seen as a longer-term target although some European countries already provide this (e.g. Sweden).

3. Developing second pillar pensions (occupational funded pensions)

When implemented with the right architecture, second pillar, occupational pensions can be an extremely powerful lever for ensuring that citizens have adequate financial resources at retirement and for fostering investor education, increasing household participation and as a consequence creating a long-term source of capital in Europe. Illustrations of this can be found in various countries around the globe, including in Europe (e.g. Sweden, Denmark, Australia).

Surprisingly, the EU does not have an efficient pan-European framework for second pillar pensions and a large number of the national second pillar regimes are sub-optimal and under-utilized. A number of such schemes even lack the basic principles of cost transparency and protecting investor's interests.

IMPOSE EFFICIENT AND TRANSPARENT SECOND PILLAR SCHEMES:

- **Foster competition:** in order to ensure competitive cost structures of second pillar solutions these should be able to be provided by several actors. Therefore local regulations should ensure that such schemes can be provided under equal terms by banks, insurance companies and funds/asset managers.
- **Limit use of capital guaranteed products:** Capital guaranteed products by constructions only provide low yields and should only be seen as short-term investment options. Thus, the use of these should be limited and only be possible for individuals nearing retirement age.
- **Allocation and product choices made by the beneficiary:** second pillar scheme architectures where allocation and product choices are performed by the individual beneficiaries have proved to be the best option for ensuring high adoption of second pillar schemes and have also contributed significantly to developing the financial literacy of the working population and has increased household participation in financial markets. In Sweden, for example this has led to a high household participation in financial markets of 180% of GDP (vs a European average of 90% or household participation in the Netherlands of only 65% as second pillar investments are pooled).
- **Advice to be included by default:** Scheme providers (insurers/asset managers) should be required to provide a long-term investment product selection in the best interest of the employees and would need to provide **guidance/advice** for asset allocation and specific fund allocation choices. This could be done via guidance tools or providing sample model portfolios based on 3 or 4 risk categories but the choice would be left to the employees.



- **Default options with a long-term perspective:** Default Investment Solutions should be available for employees not wanting to choose for themselves. They should include allocations to a mix of equities, bonds, and private assets. Risk levels for these default options should be depended on the time horizon. For long time horizons 100% equity exposures should be the default option. Life cycle investing (i.e. adjusting the risk profile of the portfolio according to the age of the investor and the corresponding cash flow needs) is a technique which has been tried and tested by the asset management industry in this area for a long time.
- **Investments in the real economy:** Allocations **to VC and growth capital** should be allowed to foster investment in the real economy. Specialised skills and experience will be required in this area (which may not be readily available from the scheme providers or the employer). This gap could be bridged by establishing an EU evergreen fund of funds under the expertise of the European Investment Fund (EIF) but operated by the private sector in a private-public partnership. Second pillar pension schemes should be able to include this EU fund of funds in their Default Investment Solution.
- **Cost transparency and portability:** Scheme providers would be required to provide full transparency of scheme costs (yearly full cost reporting) and ensure easy transferability of schemes between providers/employers without having to exit exposure to capital markets.
- **Freedom of investment choice:** scheme rules should not be conditional on the geographic allocation of funds as the allocation choices should be driven by capital appreciation considerations alone (but the allocation to an EU VC fund of funds as outlined above should be possible). Minimum sustainability criteria or at least investor friendly sustainability reporting for the investments made could be considered.

INTRODUCE AUTO-ENROLMENT:

- Implementing a second pillar scheme should be the norm for all employers.
- This could be achieved with an additional tax incentive for employers.
- Employees should be automatically enrolled requiring both employers and employees to make contributions (minimum contributions to be defined).
- Employees wishing to opt-out would be allowed to do so but would need to take-action if they wish to opt-out.
- **EU action points:** The EU lacks the ability to legislate in favor of auto-enrolment in second pillar pensions. Nevertheless, it can strongly recommend such a practice via a stand-alone recommendation or via the European semester annual exercise. Benchmarking EU member states in terms of proportion of employers having implemented schemes, scheme participation levels, scheme assets vs GDP, etc. would be simple measures to encourage member states to act.



REMOVE BARRIERS FOR CROSS-BORDER SECOND PILLAR SCHEMES

IORPs (Institutions for Occupational Retirement Provision) are provided for in the directive of the same name. Although the directive goes back to 2003, reviewed in 2016, there are nevertheless no or as good as no working cross-border IORPs. This is due in large part to the requirement for a cross-border IORP to get authorised and comply with the social and labour laws of each of the 27 Member States it chooses to operate in. This creates unsurmountable difficulties and costs that make the product financially uninteresting. Furthermore, as IORPs are therefore limited to one Member State, the product does not reach the size to create sufficient economies of scale.

In order to overcome these barriers, we recommend the following features for a cross-border second pillar scheme:

- A true European product which would co-exist and compete, and, be an alternative to national second pillar schemes.
- Real passport: Once approved in its home member state it does not have to be approved in each Member State in which it operates (only notification to make use of the passport).
- Allow defined contribution (DC) only.
- No additional product feature requirements based on local labour, pension or social laws (e.g. requiring that default option must be a guaranteed product).
- Allow for umbrella structure like for UCITS funds: to reach scale the scheme should be able to have one or more compartments; such compartments could be for one single employer or for multiple employers, for a single country or various countries or for additional voluntary savings from employees (ie pillar 3).
- Because of similar investment strategies, the same pension scheme vehicle could accommodate both pillar 2 and pillar 3 pension products, enhancing scale and operational efficiency. This could be achieved via the use of an umbrella structure with compartments as mentioned above.
- Ensure that cross border transfers of pension plans can operate smoothly and that requirements for cross-border transfers are not higher than for local transfers.
- Ensure that tax treatment of national schemes is not more favourable than EU second pillar schemes.
- **EU action points:**
 - Consult on barriers for cross-border second pillar schemes
 - Launch consultation on how a true European cross-border pillar 2 scheme could look like
 - Assess whether the PEPP framework could be adjusted to include pillar 2 pension schemes
 - Review the IORP or PEPP directives following consultation



HARMONISE TAX TREATMENT AND ENSURE PORTABILITY TO FOSTER THE EU SINGLE MARKET:

- Due to differing tax treatments across EU member states, second pillar pension solutions are very often only national schemes which lack scale and thus imply high operating costs ultimately borne by employees/beneficiaries.
- Portability of second pillar schemes in the case of cross border EU career tracks is an issue as taxation principles of second pillar schemes differ from country to country.
- Therefore, the Commission should advocate taxation principles of second pillar pension schemes that are aligned. Second pillar taxation should indeed be structured as follows:
 - Taxation at source at the level of the employer upon contribution to the pension scheme
 - No taxation of capital gains or income resulting from the investments to incentivise a greater portion of savings to flow into second pillar schemes
 - No taxation at exit to allow for portability of second pillar schemes across the EU and incentivise citizens and corporates to adhere to these schemes.
- Furthermore, portability of schemes both at national level across different schemes/scheme providers and cross-border within the EU should be ensured and easy to execute. In this context a framework for transferability of accumulated second pillar pension contributions from one scheme to another should be developed ensuring cost transparency, ease and speed of execution.
- **EU action points:** The Commission should bring forward a proposal for defining common taxation principles (as described above) and that taxation of a cross-border schemes is as favourable as that of national occupational pension schemes.
 - Tax incentives:

A Commission recommendation to Member States advising tax incentives for 2nd and / or 3rd pillar pensions to increase citizens additional savings to face the looming pension gap.

the Commission could also bring forward common principles for tax incentives for pillar 2 and 3 pensions or long-term savings plans as part of the solution to unsustainable first pillar pensions.



Evaluate the feasibility of a regulation on the tax treatment of 2nd and 3rd pillar pensions that would among others ensure that any pension or life insurance concluded in one Member State would continue to enjoy a tax advantage that is equivalent to the one offered to 2nd or 3rd pillar pensions in the second Member State. That would already eliminate one barrier to the freedom of movement when people can expect to continue their 2nd and 3rd pillar pensions without losing access to tax advantages when moving to another Member State

CONCLUSION

A well-developed second pillar with auto-enrolment would initiate a virtuous circle:

- Early engagement / interest for long term savings products
- Contributes to a savings discipline and exposure to capital markets
- Concretely demonstrates the benefits of compounding
- Creates an incentive to save and invest more
- Reduces the reliance on the first pillar and ensures that overall pension benefits and replacement rates are sustainable

4. Develop third pillar solutions

The development of third pillar regimes are to be considered in conjunction with measures which foster the development of second pillar schemes (see points above). Efficient and well-designed second pillar regimes will indeed develop financial literacy and long-term saving habits. A natural next step will be for households to contribute to third pillar solutions.

A FRAMEWORK FOR THIRD PILLAR PENSION SOLUTIONS:

- Echoing proposals made in the Letta and Noyer reports, there would be value for the Commission to define a framework for third pillar pension schemes. Such framework would be based around several components
 - **Product specification:** this part was already covered in the previous version of the CMU with the PEPP. However, this regime could be reviewed with a view to simplify it. A PEPP 2.0 could take the shape of:

A bank account allocating to UCITS and ELTIFs	An EU domiciled fund vehicle with investments in UCITS and ELTIFs with the possibility to create flexible allocations between public markets and private markets.
An insurance wrapper allocating to UCITS and ELTIFs	



- **EU aligned taxation principles:** for true pan-European third pillar products/solutions to emerge, EU countries would need to align their tax treatment of third pillar solutions. Such tax treatment could be structured as follows:
 - Definition of a minimum amount of deductible income p.a. and per person/household for investment into eligible third pillar solutions.
 - No taxation of capital gains and payouts to create a strong incentive and ensure portability across the EU.
- **Portability requirements:** this last component is an important aspect to foster trust and long-term commitment of households. Providers of third pillar solutions should be required to ensure transferability of accumulated third pillar savings to any other provider/scheme within the EU. Such transfers should be easy to carry out and done at reasonable costs and within a reasonable timeframe.
- **EU action points:**
 - The Commission should bring forward a proposal for a review of the PEPP Regulation identifying and amending the issues of the current PEPP failure.
 - The Commission should bring forward a proposal for a regulation defining a common taxation regime for PEPPs defining the moment of taxation and that taxation of a PEPP based in a different Member State should be as favourable as that of national personal pension schemes.

5. A European Investment and Saving Account (ISA)

The key lever for increasing retail participation in EU capital market is in our opinion through second pillar pension schemes (via auto-enrolment) as described above and reforms in this area should be prioritised. However, an investment saving account could be considered alongside as an additional entry point to savings products. An ISA could also be potentially used as entry point for a pillar 3 pension scheme.

- Successful Saving and Investment Accounts (ISAs) have been introduced in several EU and non-EU countries with a well-documented success. Examples are Sweden, the United Kingdom and Japan. Such schemes have the advantage of simplicity.
- There is no need to introduce new products that would again need to be certified individually. The EU has already a wealth of UCITS, ELTIFs, AIFs, PEPP, as well as banking and insurance products that could be used in the context of an ISA.
- There is no need for an additional label. Labels need to be granted by an agency or an authority requiring extra steps, time, administrative burden and costs. ISAs should be quickly implementable using existing products that can be kept in an investment account.



- The ISA should be a simple investment account. In order to ensure the greatest possible offer and foster competition, these should not be limited to banking accounts. All forms should be eligible—a securities account at a bank, an insurance wrapper or an investment account in a fund/Investment firm/Investment Fund Manager. The use of blockchain technology should also be permitted.
- Such investment accounts should also be available for minors (see section 1 above) in order to encourage hands-on investor education from an early age.
- In order to ensure best possible take-up of such accounts, maximum flexibility should be given in terms of available products. In particular equities, bonds, funds (UCITS) and ETFs should be in scope. Investments into private assets via AIFs or ELTIFs should also be possible.
- No mandatory EU or national allocation criteria should be imposed, as natural home bias will guide EU investors. Indeed, investor performance should be the main driver. If, however EU allocations would be foreseen these should be limited to a certain percentage (e.g. below 50%) to allow for sufficient diversification and the EU allocation requirement should be the same across the EU.
- Taxation should be as simple as possible with a preference for a yearly amount that can be deducted from the taxable base and allocated to these accounts with no taxation (nor on capital gains nor on interest/dividends at pay-out) after a minimum holding period.
- Ideally no limit should be imposed on investment accounts.
- No fee caps, a better idea is to foster competition and multiplicity of solutions for such accounts.
- Minimum Holding Periods should be limited to minimal periods to avoid speculation.
- European coordination is key for fostering retail participation also in the context of free movement of people within the EU.

6. Identifying roadblocks in the Internal Market

UCITS and AIFMD have become global brands with 25% of European domiciled funds assets distributed outside of Europe (EUR 5tn) creating jobs and tax revenues within the EU. The EU has already a rich toolbox (UCITS, AIFs, ELTIFs etc) to build pan-European saving products. There is no need for new products or labels but tax incentives/national pension regulations should allow for investment into EU products.

Nevertheless, distribution of investment funds is not always a smooth process. It is regularly made more difficult by legislative or regulatory gold plating by Member States or plain discrimination. It is therefore important to get a comprehensive overview of these barriers via a dedicated report and monitor progress in dismantling them.



Examples of existing roadblocks are protectionist tax measures only applicable to domestic investment funds, ineligibility of non-domestic funds in life insurance policies, sustainability gold plating. For pension products, there are the above-mentioned protectionist domestic labour and social laws as well as tax hurdles.

- **EU action points:** The Commission should establish comprehensive overview of barriers, monitor, publish and address these through targeted actions by the EU Commission.

7. Supervisory simplification and convergence

A well-functioning capital market also requires simplicity, smooth and cost-efficient operations and scale. Therefore, supporting the growth of pan-European investment products and solutions which are fit for purpose for addressing all 27 national markets is key. However, the implementation of a single European supervisor for funds and asset managers would be counterproductive:

- As a transition to single supervision would not result in directing any additional savings to capital markets in Europe.
- Transition to single supervision would take between 8 and 10 years and take up a lot of focus and resources as we learnt from the banking union, and would divert resources from more important projects which can really make a difference as outlined in sections 1 to 6.
- All significant roadblocks for increased household engagement in capital markets and the transitioning of pension systems are related to national tax rules and other national laws and thus will not be addressed by a single EU supervisor.
- We support regulatory convergence whilst recognising the benefits of specialisation/expertise of certain NCAs. We strongly believe that under the current European supervisory framework, ESMA already has all the necessary tools and powers to ensure such convergence.
- Maintaining a decentralised supervision model for asset management ensures time to market, agility, and adaptability for national authorities. A centralised or single supervisor will add complexity and costs for a limited if at all benefit.

Over the past 35 years (since UCITS I), Europe has developed centres of excellence in fund and asset management supervision which have led to the fact that of the EUR 20tn of European domiciled investment funds, EUR 5tn are sold outside of Europe.

ALFI will issue a separate paper on simplification recommendations.



ABOUT ALFI

The Association of the Luxembourg Fund Industry (ALFI) represents the face and voice of the Luxembourg asset management and investment fund community. The Association is committed to the development of the Luxembourg fund industry by striving to create new business opportunities, and through the exchange of information and knowledge.

Created in 1988, the Association today represents over 1,400 Luxembourg domiciled investment funds, asset management companies and a wide range of business that serve the sector. Luxembourg is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg domiciled investment funds are distributed in more than 80 countries around the world.



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