• We have been experiencing a situation of unprecedented very low – if not negative – long-term nominal interest rates and a persistent flat yield curve.

• This new financial and market environment has longer term implications for both savers and insurers in terms of capacity to deliver guarantees, return and liquidity.

• While the topic has received little attention so far, the ‘Future of Savings’ Conference’ brought together researchers, practitioners and regulators, in order to discuss the key challenges of the new environment regarding in particular the retirement gap and the emergence of incomplete insurance markets.

• Among the various policy options that emerged from the debates, extending further workplace savings schemes – whose scope, tax and regulatory parameters are still to be clarified – provides one avenue for further study to create credible and operational solutions to fund the long-term savings needs of people.

Opening speech by François Villeroy de Galhau, Governor, Banque de France

- Key factor of low growth in the Euro area: investment deficit (or 'investment dearth').
- Evidence of the 'investment dearth': (i) gap between savings and investment (EUR 350 billion on a yearly basis); (ii) drop in the investment to GDP ratio following the crisis (and slower recovery than in the US); (iii) contraction in productive investment; (iv) and change in business behavior (from net borrowers to net lenders).
- Contributing factors: (i) low expected demand; (ii) uncertainty; (iii) lack of equity financing (only 52% of GDP in the EA vs 121% in the US) linked with high cost of equity (CoE) - the nominal CoE is still more than 9% for large listed companies in the EA, compared with a risk-free rate of around 0%;
- Potential solutions: (i) in addition to monetary policy that is “active and efficient”, structural reforms where needed and greater fiscal support where room for manoeuvre exists; (ii) steer abundant savings into productive investment.
- Two avenues: (i) savings should be reoriented towards the long-term through “new, complementary forms of savings products, that are less liquid (…), but that include some form of long-term capital guarantee” and would allow for more equity investment; (iii) savings should better circulate across Europe thanks to a “Financing and Investment Union” (FIU) that would foster, inter alia, a pan-European venture capital ecosystem with larger funds and more harmonized standards for European corporates.

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First Round Table: What is the economic and financial situation we are living in?

• Benoit Mojon, Banque de France

- An ‘overlapping generation model’ to help explain why real rates on “risk free” assets have dropped by 4% in 20 years, while return on capital has remained stable at a high level - above 10% (from National Accounts);
- Key findings: the main factors are: (i) the productivity slowdown (1pt); (ii) demography (working age population, longevity): 1pt; (iii) risk-aversion/perception of an increase in risk (2pts).

• Hélène Rey, LBS

- Historical data show that US short term real interest rates were negative in the 1920s (-14% in 1923);
- The evolution of the consumption wealth ratio (CWR) is a good indicator of the future real risk free rate, on the basis of a model where CWR = risk free rate + excess return-future consumption growth;
- Key findings: the main explanatory factor is the global credit boom/bust cycle – not the productivity slowdown; an illustration: in the 20s, the CWR went down because wealth went up;
- Key inference: in today’s context, the CWR is going down because consumption is going down (credit bust); the 2011-2021 forecast for the 10-year average future short risk-free rate is - 2%;
- Policy recommendations: greater fiscal support; more equity financing; balance sheet improvement through deleveraging and the removal of NPL in the banking sector.
• **John Muellbauer, Oxford**
  - Effectiveness of QE is very institution- and context-dependent:
    (i) very effective in the US where the home equity channel of monetary policy transmission is powerful, i.e. consumption has increased a lot thanks to easy credit;
    (ii) less effective in Europe, where home equity withdrawal is expensive or indeed impossible: owners cannot get cash from their property even if they are better off during price increases, while renters feel more constrained - Moreover, savers’ liquid assets greatly outweigh household debts especially in Germany or Japan;
  - Policy recommendations: (i) greater fiscal stimulus: infrastructure spending should crowd-in private investment, raise growth, the demand for capital and real rates; (ii) Lisbon Treaty could be amended to make Art. 123 on the prohibition of overt monetary finance of government ‘state dependent’, i.e. to allow temporary suspension, hence enabling the ECB to operate a money finance policy that does not interfere with each government’s fiscal plans; (iii) restructuring debt is a way to accelerate deleveraging

*Second Round Table: What are the practical challenges this environment raises for long-term savings and insurance?*

• **Christian Thimann, AXA**
  - The ‘Triangle of (Impossible) Desires: long-term savers have three desires: (i) guarantee; (ii) return; (iii) liquidity; in the new environment, providing even two is challenging;
  - If return is zero, inflation is not, especially in health and housing – two key savings motives for the long run – where prices greatly differ from average CPI inflation;
  - Policy recommendations: (i) segment the pockets of savings: the degree of guarantee and liquidity should vary with people’s needs; (ii) focus on investment horizons and adapt regulatory / supervisory treatment;
  - Recommendations for corporations: (i) scan the full investment universe in favour of more equity, alternative investment, and geographical diversification; (ii) exploit regulatory flexibility; (iii) also think about de-accumulation; (iv) enhance disclosure to clients; (v) increase granularity and symmetry in the approach to saving and advice

• **Ralph Koijen, NYU**
  - In response to the shift from defined-benefit to defined-contribution pension schemes, insurance companies increased the menu of variable annuities;
  - The size of the market is currently around $1.5 trillion in the US. Variable annuities are retirement savings products that come with various investment guarantees. The long-term nature of these contracts makes it challenging to compute the value and to manage the risks;
  - Key issue: Insurance companies have more exposure to aggregate risk;
  - Main implication: During the financial crisis, insurance companies in the U.S. (several of which are subsidiaries of European companies) experienced large losses on their variable annuities portfolio. In response, insurance companies raised fees, restricted the options offered in new variable annuity contracts, and moved variable annuity liabilities to captive reinsurance companies. Hence, because of this large aggregate shock, combined with limited capital backing these policies, households now face a more limited menu of retirement savings products at a higher price. This experience illustrates that capital regulation has an important impact on products offered by insurance companies. 
  - More broadly, based on the experience in various countries, it turns out that offering long-term guarantees is challenging. Offering hard guarantees in all states of the world may simply not be feasible, and insurance companies should hold sufficient capital or design the products in such a way that the risks are more limited.

• **Felix Hufeld, Bafin**
  - Long term business is desirable from social, policy, and financial stability viewpoints. The procyclicality issue is however to be further addressed. Solvency II is a major step;
  - Offering Long term saving has become more challenging given: (i) low interest rates; (ii) shift in risk; (iii) mispricing of guarantees; (iv) shifts in customer behaviour with demand for liquidity.
  - Digitalization has changed consumer preferences toward more on-demand, personalized products;
  - The flexibility given to customers to liquidate their savings products can create volatility and therefore threaten financial stability
- At stake is to adequately balance innovation with a growing need for simplicity. Current hybrid products are too complex (more than traditional life products) which is not satisfactory: we need to work on simplicity, also from a customer protection point of view.

Further remark:

**D. Duverne.** Two remarks from a practitioner’s viewpoint: (i) most VA products do not have guarantees (65%); (ii) not only are interest rates low, but have also become more volatile.


**Third Round Table: A view from the US**

- **Teresa Ghilarducci, The New School RELAB (SCEPA)**
  - US overall context compared to Europe: higher potential demand (more rapid population ageing and higher poverty rate), and yet more limited offer (health care coverage has improved, but there are significant gaps in terms of retirement);
  - US retirement system: (i) only 53% Americans are covered given the voluntary subscription, and limited availability in small and medium businesses; (ii) problems with mismatches in asset investment and subpar returns; (iii) lump sum income rather than annuities; overall, the current system works well for the 10% of people with stable economic situations
  - Huge retirement savings gap: $14,500 median accumulated savings for retirement ($80,000 average) vs $411 000 savings is needed;
  - A fully voluntary system does not work as people save too little. A well designed system offers (i) a very broad access to the scheme; (ii) a wide range of investments (liquid and illiquid); (iii) an end as annuities; (iv) a strong integration with the financial system, serving the economy (macro-economic stabilizer); (v) a guaranteed 2% return.
  - A policy proposal (jointly with Blackstone President Tony James in *Rescuing Retirement, 2016*): mandated - “universal”- Guaranteed Retirement Accounts (GRAs).

- **Phil Waldeck, Prudential Financial, Inc.**
  - Need for broader coverage as 50% of workers at small employers do not have access to a plan;
  - Obstacles for small employers to sponsor retirement plans: (i) cost; (ii) administrative burden; (iii) fiduciary concerns;
  - Legal challenge: (i) the problem is that current law prevents unrelated employers from participating in multiple employer plans (MEPs); (ii) a solution could be an open MEP legislation that would encourage unrelated employers to participate in a single plan in order to pool resources to operate efficiently like large employer plans.

**Fourth Round Table: A view from Europe**

- **Christian Gollier, TSE**
  - Historical data show that real interest rate went far below zero during some some prolonged periods (e.g. in the 20s and 30s as well as after WWII until the late 60s), and also show that return on equity has been much weaker;
  - While life insurance policyholders have a long term objective, French insurers invest a large part of their EUR1.5 trillion financial reserves in short-lived, safe and liquid assets (theory yet indicates that short term should be associated with higher risk);
  - While life products have become very attractive to customers, insurers will serve the low return of the current investment portfolio to new customers in the future (“market failure” situation);
  - Intergenerational risk-sharing organized by life insurers and pension funds should induce savers to take more risk, especially in equity that is relatively less risky for longer holding periods;
  - If most actors invest into risk-free assets, then only very few investors bear the risk of risky investments and the price of such risk is high: the cost of equity remains high
  - Policy recommendations: (i) a market for long termsavings products should be created in France, conditional with a stronger fiscal incentive; (ii) the premium associated to the guarantee (portfolio insurance) will have to be better/actuarially priced; (iii) management costs/fees should be more compressed on life insurance products since they contribute to a limited value creation;
• **Andre Masson, CNRS-PSE**
  - A model to explain the sharp decrease in direct individual stockholding in France since the 2008 crisis (6% in 2016): stock ownership was divided by two from 2009 to 2015; paradox: a need for more investment in stocks, but stock ownership has decreased continuously;
  - Key findings: until 2012 (i) demand-side: more pessimistic & ambiguous stock market expectations, esp. on expected return which is the only key driver of demand; (ii) supply-side: rise in (relative) taxation of stocks (as well as other measures such as the increase of the cap of Livret A savings deposit);
  - Other findings: while most determinants point to an increase in stocks holdings after 2012, they keep decreasing. Are French savers lacking more adapted professional advice & financial education?
  - Key issue: at stake for long term growth is to avoid over-accumulation of unproductive capital and allegedly safe savings especially in the hands of the elderly;
  - Policy recommendations: (i) introducing DC funded pensions (eg. Germany), or developing risky savings programs with quasi automatic affiliation; (ii) lowering taxation on stocks & entrepreneurship; (iii) enhance better confidence in financial markets but also in the future of social protection (background risk).

• **Mark Rebuck, Aviva**
  - Europeans need to save €2,010 trillion/year into their pensions to achieve adequate retirement income;
  - Key problem: a gap between what consumers need and what they want; a solution: improving advisory for a better investment horizon management: (i) accumulation (young age): more risk, less guarantee on the short term (eg. Unit Linked); (ii) de-accumulation (over 60): more safety, higher guarantee over LT horizon;
  - The UK government banned commissions for independent distributors on savings products in 2013, which limited advice for small savers (not willing to pay for advice), hence deepening the ‘advice gap’.

**Fifth Round Table: Practitioner and policymaking perspective, moderated by Edouard Fernandez-Bollo (ACPR)**

Corso Bavagnoli (DG Trésor), Denis Duverne (AXA), Levin Holle (Bundesfinanzministerium), Alf Neumann (Allianz), Romain Paserot (IAIS)

• **Corso Bavagnoli, DG Trésor**
  - Supply-side issues: (i) finding solutions to short termism and volatility issues may require further change in the prudential framework (SII) consistently with change in tax incentives; (ii) LT guarantees and accounting standards also pose growing problems to be addressed in terms of insurers’ resilience;
  - Three main steps toward confidence: (i) to strengthen the consistency between public and private pension systems in terms of sustainability and predictability while in particular increasing transparency of public pension schemes; (ii) to improve overall stability through long term oriented incentives; (iii) to consolidate mutual confidence among providers through activity-based prudential regulation.

• **Denis Duverne, AXA**
  - Low interest rate has resulted in a shift from defined benefit to defined contribution, more risk on the asset side (e.g., equity), and more difficulty in providing long term guarantees;
  - A Practitioner’s Recommendations: (i) insurers need to become more capital light; (ii) a change in IFRS rules is needed for the long term target of SII to be reached as marked-to-market rules have resulted in less equity investment; (iii) Unit Linked savings should be more oriented towards equity for consumers with long term time horizon, hence implying further advice despite potential risk in conflict of interest; in particular, for low and middle income households, regulation should allow only a limited number of options and make it compulsory.

• **Romain Paserot, IAIS**
  - The IAIS Insurance Core principles (ICP) framework provides a comprehensive approach from capital (ICS) to governance;
  - In order to further contribute to ensuring financial stability, the GSII designation will progressively be completed by an activity based approach;
  - Further work is to be carried out in favour of consumer protection (market conduct);
• **Levin Holle, Bundesfinanz- Ministerium**
  - Important reforms have been carried out in Germany (life insurance in 2014), and in the EU (SII) - for a full assessment it would be wise to allow some time for the new framework to settle in;
  - Consumer preferences are a key parameter (eg: Germany: 30% in cash/deposit vs 10% in stocks);
  - Digitalisation introduces significant change in the insurance industry (eg: robo advisor);

• **Alf Neumann, Allianz**
  - Consumers want safety. Formal guarantees and lifelong annuities currently key for acceptance
  - Solvency II regulation needs to provide stable and reliable framework for providers in order to maintain a meaningful market for long term savings. Stable UFR and better reflection of long-term nature of investments in credit spread risk needed.
  - In order to adapt to digitalization while increasing trust, further simplifying of products will be pivotal for the success of offerings in the marketplace;
  - Quality and consumer orientation in PRIIPs implementation should go first, therefore more time for implementation desirable;

**Concluding remarks and next steps by Robert Ophèle, Banque de France**

- Nominal and real interest rates are expected to remain low for an extended period of time;
- Low rates are not stimulating (productive) investment, but savings remain a core need of households;
- New savings products can be welcome in France, with lower liquidity and higher return expectation;
- Solution could be to transfer risk to individuals, but this would pose major risks over the long run as individuals are not equipped to bear that risk alone;
- Incremental solutions: (i) micro: new framework for more autonomous pension funds; (ii) macro: improved market discipline and macro-prudential regulation to address liquidity risk;
- SII has not yet been fully digested by market actors; there is thus no rush to revisit it; a limited reduction in the Ultimate Forward Rate is welcome but it will not solve all the problems of the optimal structure of savings products.

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