The importance of institutional investors for channelling savings to investment

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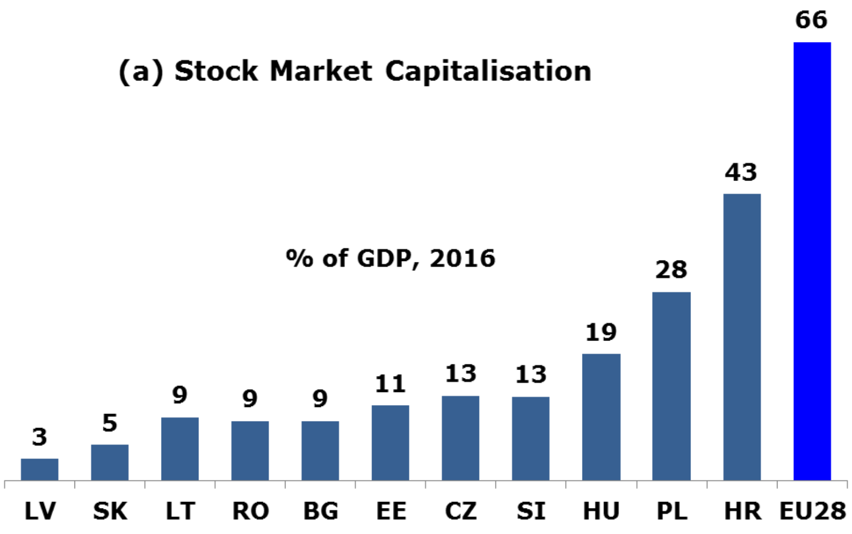
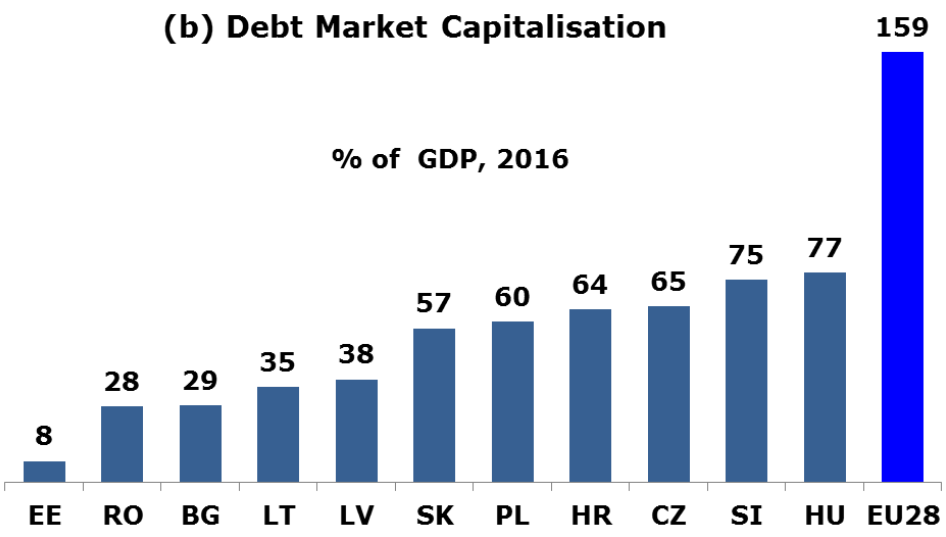
Banking and finance

Importance of institutional investors

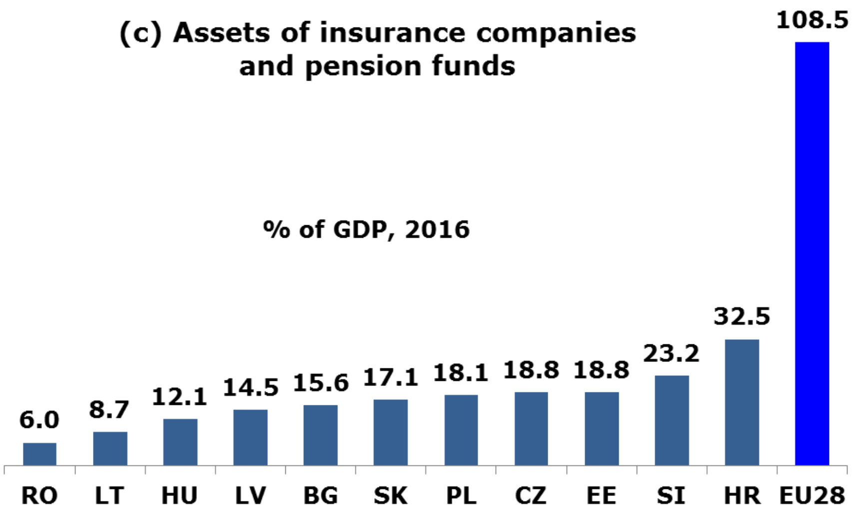
- Who: Insurance companies, pension funds, investment funds
- Role: Stable long-term provider of finance as their liabilities are also of a long-term nature, contrary to banks, which engage in maturity transformation
- Advantage for the economy: widening the investor base, distribution of risks, mobilisation of savings

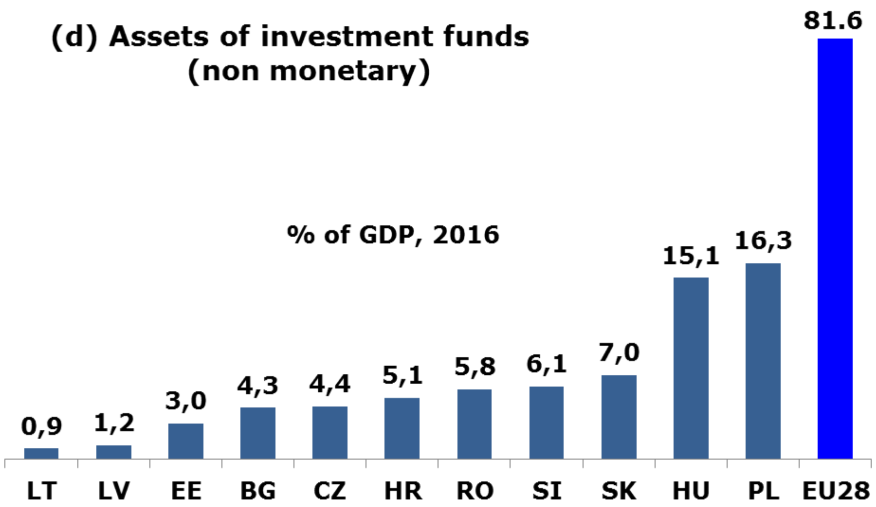
Capital markets and institutional investors (1)





Capital markets and institutional investors (2)





Pension funds in Central and East European countries

- Pension funds are important institutional investors.
- In the new Member States, the move from the PAYG system to a multi-pillar system led to the setting up of mandatory and funded second pension pillars in 1990s or even later (as for instance, in Romania)
- The introduction of a second pillar also responds to economic goals: by creating a mandatory pension that is invested in capital markets, a country's growth path is potentially increased due to more efficient capital allocation, but also, higher savings and investment.
- In recent years, though, in several countries in the region and in particular in Poland, Hungary and Slovakia, the introduced Pillar 2 schemes have been changed into voluntary schemes under Pillar 3, thus reducing the assets available for pension funds.

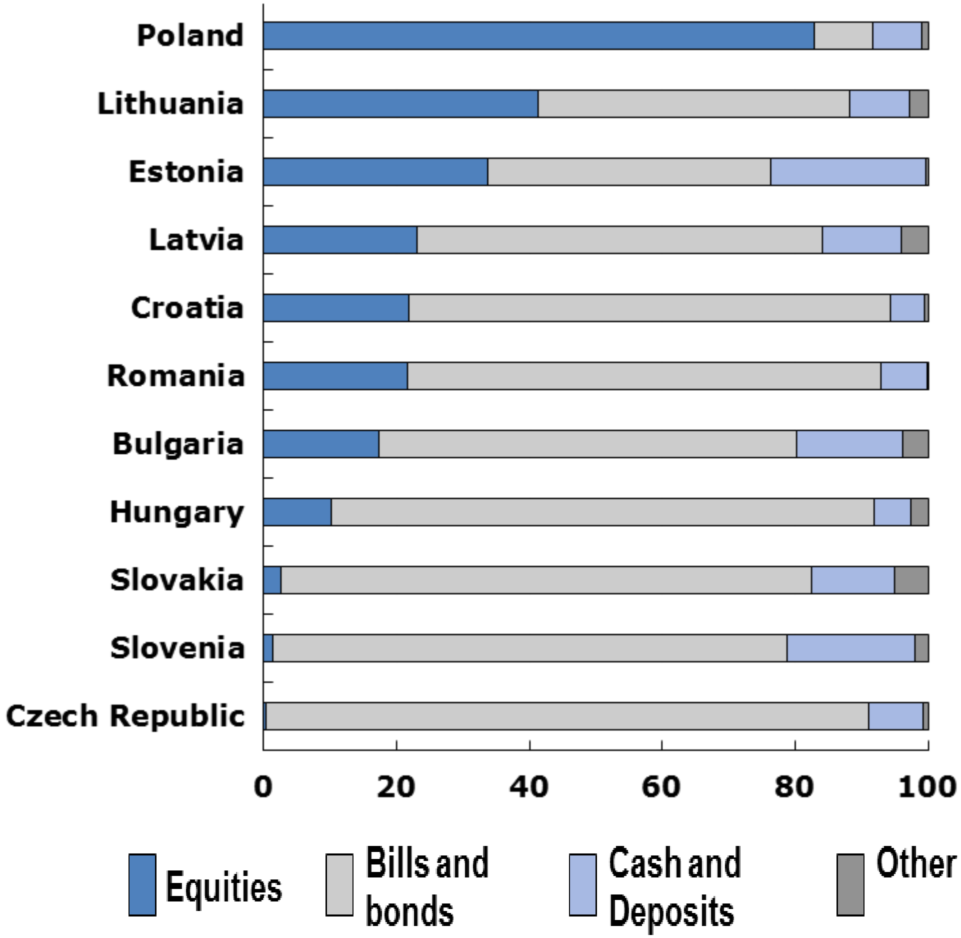
Investment of pension funds and all retirement vehicles in the CEE

2016, preliminary data	Pension funds			All retirement vehicles
	% of GDP	% change compared to 2015	% of all retirement vehicles	% of GDP
EU-28	22,1			
Bulgaria	11,7	15,2	100,0	11,7
Czech Republic	8,5	7,8	100,0	8,5
Croatia	26,0	12,9	100,0	26,0
Estonia	14,8	18,5	89,3	16,6
Hungary	4,3	8,6	73,8	5,8
Latvia	1,5	15,4	12,1	12,7
Lithuania	6,6	17,6	100,0	6,6
Poland	8,3	7,8	91,1	9,1
Romania	4,3	27,2	100,0	4,3
Slovak Republic	11,2	12,4	100,0	11,2
Slovenia	5,8	4,0	82,2	7,1

- Pension fund assets increased in all new Member States in 2016 as compared to 2015 (i.e. between 4% and 27%)
- Romania had the highest increase of pension fund investments in 2016; however, total pension fund investment (% of GDP) in Romania is the second lowest among the new Member States and well below the EU-28 average of 22%.

Source: OECD

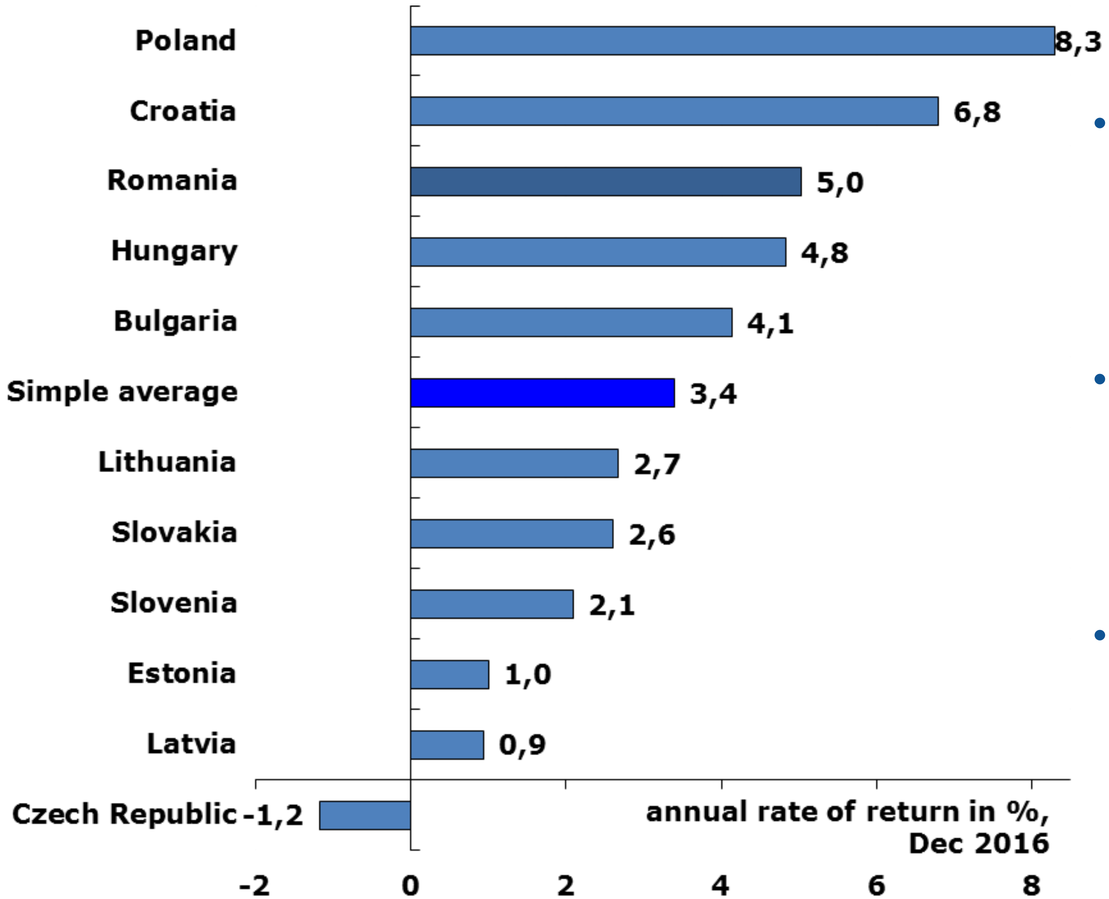
Asset allocation of pension funds (2016)



Source: OECD

- Pension funds in the new Member States continued to invest mainly in equities, bills and bonds in 2016
- Notwithstanding the low interest rate environment, pension funds in Hungary, Slovakia, Slovenia and the Czech Republic invested over 75% of their assets in bills and bonds, mostly government securities
- Polish pension funds invest most of their assets in equities following the 2014 reform, which prevents them to invest in treasury bonds and state-backed securities

Real net investment rate of return of pension funds in CEE



- Pension funds had positive real investment rates of return (i.e. net of investment expenses) in 10 out of the 11 New Member States in 2016
- Only 3 new Member States had rates of return below 2% in 2016, with the worst performing being the Czech pension funds
- Together with the Polish and Croatian pension funds, the Romanian pension funds are the best performing in the new Member States

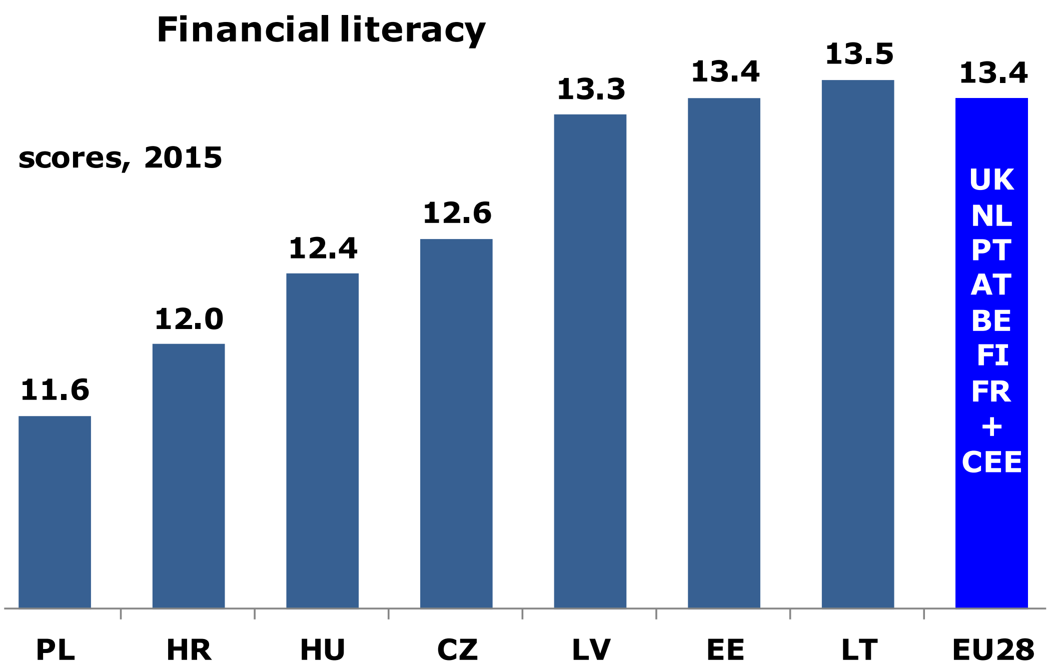
Source: OECD

Household savings are geared towards banks

% of total financial assets, 2015	Currency and deposits	Debt securities	Equity and investment fund	Insurance and pensions	Other
EU-28	30.4	3.1	24.4	39.3	2.4
Bulgaria	38.3	0.1	41.9	9.6	8.8
Czech Rep.	50.5	3.7	28.4	13.0	4.4
Estonia	30.1	0.3	51.9	14.9	2.6
Croatia	55.1	0.2	17.6	23.8	3.3
Latvia	37.7	0.9	22.7	12.0	16.8
Lithuania	36.0	1.6	40.2	9.3	12.2
Hungary	28.3	9.5	40.1	8.5	10.7
Poland	47.9	0.3	25.6	15.2	10.2
Romania	35.3	1.3	24.4	6.7	32.1
Slovenia	50.0	0.3	26.2	17.2	4.6
Slovakia	62.3	2.5	8.6	19.5	6.9

Source: Eurostat

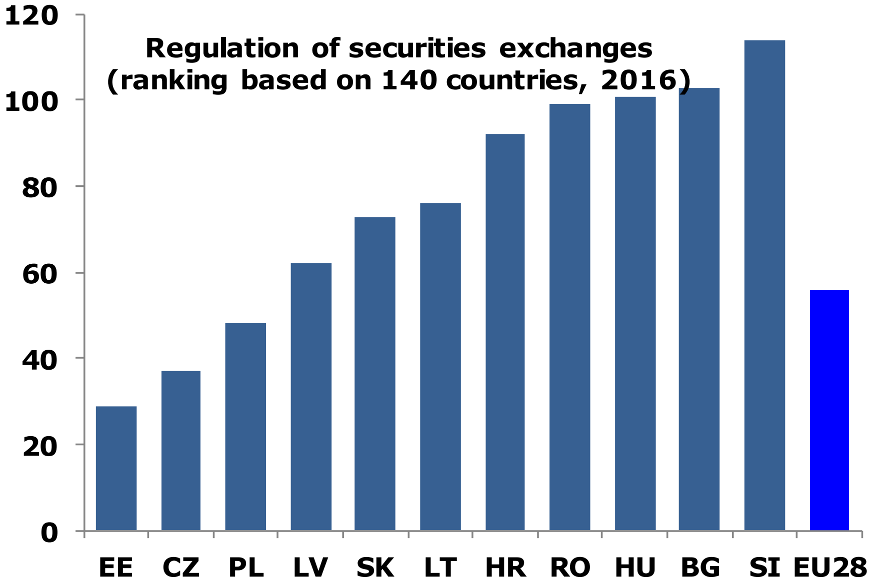
Financial literacy and savings behaviour

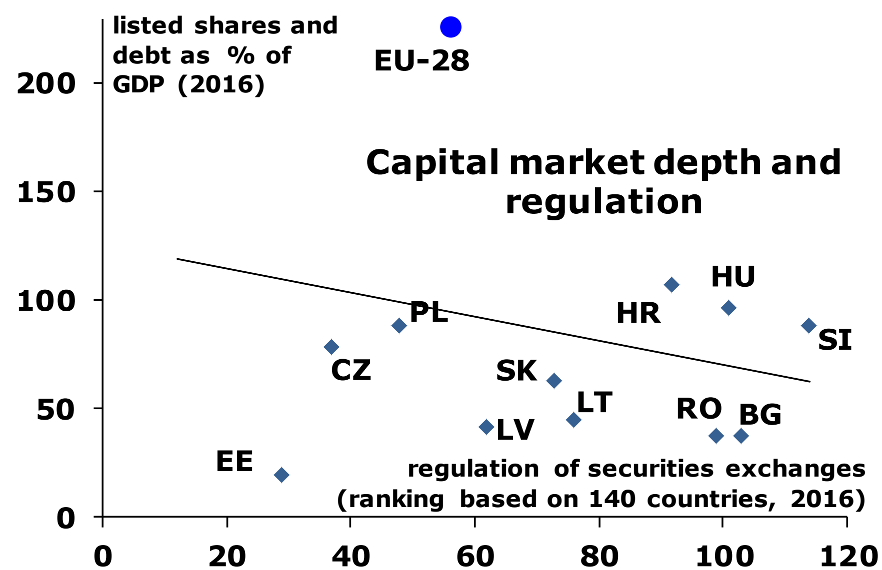


source: OECD

- **The lower the score, the more savings are directed to banks, e.g. in PL, HR, CZ**
- **In the Baltic countries, which have a higher financial literacy score, there is relatively less investment in bank deposits**

Regulation and capital market development (1)

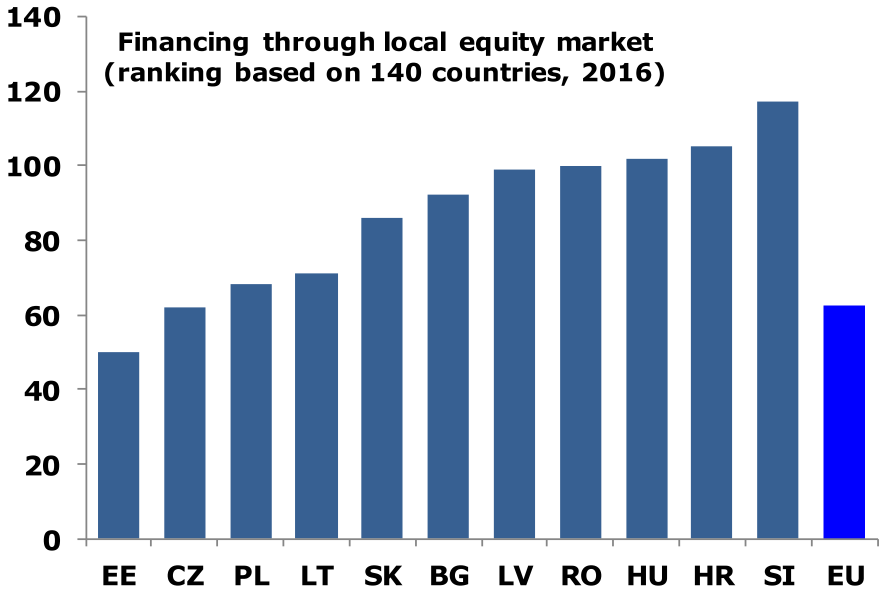


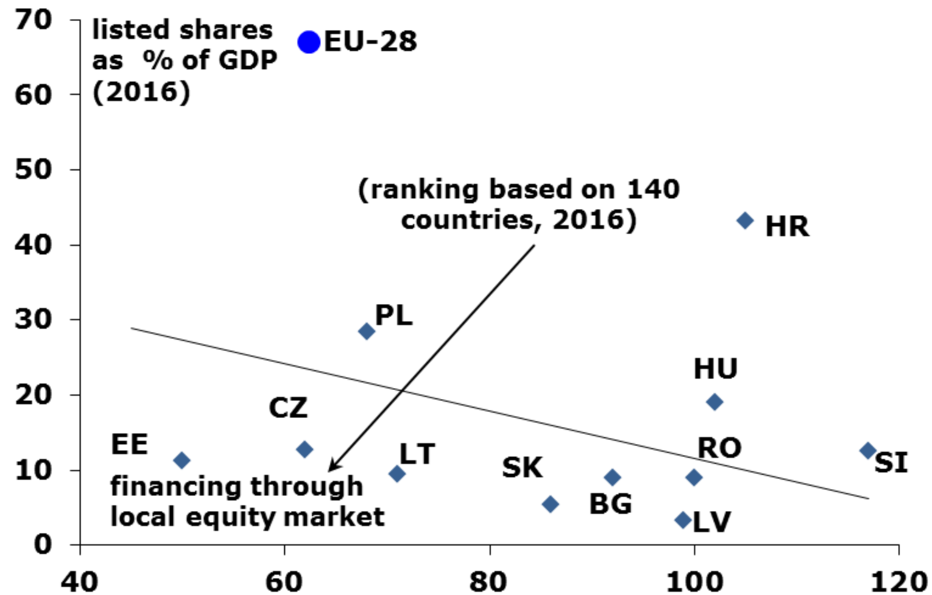


Source: World Economic Forum, ECB

- **Few countries (EE, CZ, PL) score better than the EU average; some CESEE capital markets (Si, HR, HU) are relatively deep (listed bonds and shares about 100% of GDP) driven by public debt and score relatively poor on effectiveness of regulation and supervision in private market surveys.**

Regulation and equity market development (2)





Source: World Economic Forum, ECB

- Most countries score worse than the EU average (except EE); easiness of issuance on equity markets impact on the development of local markets (HR outlier)

Capital Markets Union

- Is a "regulatory reform" leg of the Investment Plan for Europe, contributing to an investment-friendly environment; it complements the EU public investment component (European Fund for Strategic Investment)
- Aims to diversify the funding of the EU economy and reduce over-dependence on bank loans
- Combines initiatives at EU level and national level
- Has high potential benefits for countries in Central and Eastern Europe

The CMU Action Plan (1)

Communications of the Commission:

- Action Plan on Building a Capital Markets Union, 30 September 2015
- Accelerating Reforms, 14 September 2016;
- Mid-Term Review of the Capital Markets Union Action Plan, imminent;

Purpose: stimulate investment and growth through increasing market-based finance with particular attention for SMEs and infrastructure

The CMU Action Plan

Specific actions include:

- Easier financing for listed and non-listed companies, leveraging banking, facilitating cross border investment (*venture capital, prospectus, STS securitisations, covered bond, insolvency frameworks, barriers to free movement of capital, supervision, SRSS technical assistance)*
- Fostering retail investment (*European personal pensions, better choice and deal for retail investors)*
- Fostering institutional investors (*Solvency II and CRR calibrations)*
- Technical assistance is possible: provided by the Structural Reform Support Service

Conclusion

- Institutional investors are a factor of financial stability in an economy and contribute to long-term investment and growth.
- In Central and Eastern Europe, institutional investors lag behind in terms of assets under management compared to EU average.
- Nevertheless, the rate of return of pension funds appears quite satisfactory.
- Savings behaviour with a preference for banks, financial education and the regulatory environment are some elements behind the relative modest development of capital markets in Central and Eastern Europe