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In copertina: "Un banchiere e sua moglie" (1514) di Quentin Metsys (Lovanio, 1466 - Anversa, 1530), Museo del Louvre - Parigi.

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PENSION FUNDS AS PROVIDERS OF "PATIENT" CAPITAL TO SMES◊

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ZENO ROTONDI**

Abstract

SME growth is firmly on the EU political agenda and has been heavily underscored in the European Commission's Capital Markets Union (CMU) action plan. In this perspective, institutional investors and in particular pension funds have been seen as a key source of long-term capital for SMEs, as the balance sheets of banks have become increasingly stretched. Unfortunately, in too many European countries, including Italy, pension fund investments in equities remain low. The present paper reviews the related literature and discusses policy proposals aimed at fostering the role of pension funds in providing "patient" capital to the real economy. At the European level, the CMU should foster the creation of an effective European internal market for pension funds, promoting standardized rules for institutional investors to spur foreign investments and avoiding discriminatory taxation for cross border investments. At the national level, it is important to improve the governance of pension funds and promote initiatives for the aggregation of pension funds aimed at reducing market fragmentation.

◊ The opinions expressed in this paper remain, in all cases, the exclusive responsibility of the authors and do not reflect those of their respective Institutions. Zeno Rotondi wish to thank Fabrizio Sadun for supporting this research project and Bruno Mariano for helpful comments.

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I fondi pensione come fornitori di capitale "paziente" per le PMI – Sintesi

Lo sviluppo delle piccole e medie imprese (PMI) è tra gli obiettivi principali *dell'agenda di politica economica dell'UE ed è al centro del piano d'azione della Commissione europea per lo sviluppo dei mercati dei capitali (CMU). In questa prospettiva, gli investitori istituzionali e, in particolare, i fondi pensione (FP) sono stati considerati come una fonte cruciale di capitale a lungo termine per le PMI, dato il processo di riduzione della leva finanziaria nei bilanci delle banche. Sfortunatamente, in troppi paesi europei – tra i quali l'Italia – gli investimenti dei fondi pensione in titoli azionari rimangono limitati. Il presente lavoro esamina la letteratura in materia e discute le iniziative volte a promuovere il ruolo dei FP nel fornire "capitale paziente" all'economia reale. A livello europeo, sarebbe auspicabile che la CMU promuovesse la creazione di un effettivo mercato interno europeo per i FP, attraverso regole omogenee per gli investitori istituzionali, al fine di stimolare gli investimenti esteri ed evitare un'imposizione fiscale discriminatoria per gli investimenti transfrontalieri. A livello nazionale, è importante migliorare la governance dei FP e favorire una loro aggregazione per ridurre la frammentazione del mercato.*

Parole chiave: *Unione Europea dei Mercati di Capitale, Finanziamenti a Lungo Termine delle PMI, Fondi Pensione, Governo Societario, Finanza Comportamentale.*

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Keywords: European Capital Markets Union, SME Long-Term Financing, Pension Funds, Governance, Behavioral Finance.

1 Introduction

Small and medium-sized European businesses find it hard to raise capital, especially during their development phase. In 2016 the stock market capitalization to GDP ratio was equal to 65% in the Eurozone, against 100% in Japan and 147% in US. In Italy the ratio was equal only to 31%, reflecting the relatively lower capitalization of Italian SMEs. Moreover, SMEs in Europe and even more in Italy face significant difficulties in identifying and accessing sources of funding due to the presence of an inconsistent trio (Rossi, 2015): an economic structure mostly requesting bank finance, regulators concerned with the risks posed by banks' activity, and banks consequently stepping back from ample parts of the credit markets. Therefore SME growth is firmly on the EU political agenda and has been heavily underscored in the European Commission's Capital Markets Union (CMU) action plan.[1] In this perspective, institutional investors and in particular pension funds have been seen as a key source of "patient" capital, i.e. of long-term financing, for SMEs as the balance sheets of banks have become increasingly stretched.[2] Unfortunately, despite generally positive findings linking pension system development and economic growth, in too many European countries pension fund investments in equities remain low. In 2016 pension funds' assets represent 81 per cent of US GDP and 95 per cent of UK GDP, against a mere 7 per cent of both Italy and Germany GDP (OECD, 2017a). The share of equities in investments of pension funds was 49% in US, of which 70% in domestic equities, and 47% in UK, of which 40% in domestic equities, while in Italy was 16.3%, of which 1% in domestic equities.[3] Hence pension funds contribute little to long-term funding for SMEs, as well as delivering disappointing investment returns and therefore pensions. In particular in Italy, as argued for instance recently by Botticini et al. (2017), pension funds, as well other institutional investors, represent a negligible source of long-term, domestic capital for Italian SMEs. There are many causes behind the lack of diversification in investments of pension funds and indeed of other institutional investors. These causes may include unsupportive macro conditions[4], distortions in asset management implied by regulation (Darvas and Schoenmaker, 2017), or structural fea-

1 European Commission (2015a,b).

2 In the present paper the focus will be mainly on pension funds, but similar considerations can be developed for other institutional investors such as insurance companies.

3 COVIP (2017a); Willis Towers Watson (2017). If we include also undertakings for collective investment in transferable securities (UCITS) for the case of Italy, the share of equity exposure increases to 24.8%.

4 For instance in the past high government bond rates dis-incentivizing diversification, although currently we are in a low interest rates environment.

tures such as poor governance and lack of investment knowledge (Bripi and Giorgiantonio, 2010). Moreover, behavioral finance may play an important role in investment strategies of pension funds. There exists empirical evidence in the literature on herding behavior displayed by pension funds (Randle and Rudolph, 2014, and Raddatz and Schmukler, 2013, among others). In particular, after the global financial crisis, when the crisis intensified and concerns about capital loss arose, many institutional investors abandoned long-term investment strategies and tended to move with the rest of the market. This "institutional herding" is referred in the literature as procyclical investment behavior (Papaioannou et al., 2013; Broeders et al., 2016; Duijm and Steins Bisschop, 2015).

Another important cause behind the lack of diversification in investments of pension funds is the fragmentation of the EU market in personal pensions, which implies limited cross-border selling and portability (EIOPA, 2015 and 2016). Thus developing a single market in personal pensions could offer the economies of scale needed for improving the diversification of risk. In addition, a better personal pension market could also help address a lack of investment on EU capital markets supporting the CMU project. In 2017 the European Commission adopted a proposal for a regulation on a pan-European personal pension product (PEPP) (European Commission, 2017a). PEPP will be a voluntary scheme for saving for retirement. It will be offered by a broad range of financial companies across the EU and will be available to savers as a complement to public and occupational pension systems, alongside existing national private pension schemes. As part of the capital markets union action plan, the PEPP proposal will help channel savings towards capital markets and benefit investment and growth in the EU. In perspective this innovative pension product could contribute to multi-pillar diversification (in particular in countries where second pillar pensions are underdeveloped), address consumer protection issues and information asymmetry and improve cross-border activity through improved transparency and comparability of PEPPs. But there are still several issues that need to be tackled. In particular, for an adequate development of this product, a key issue that needs to be addressed is the adoption of fiscal incentives. Indeed, the European Commission's proposal was accompanied by a recommendation on the tax treatment of personal pension products, including the PEPP (European Commission, 2017b).

The present paper reviews the related literature and discusses policy proposals aimed at improving the role of pension funds in providing long-term finance for growth. The paper is organised as follows. Section 2 discusses the issue of diversification for pension funds and, more in general, for institutional investors. Section 3 analyses the governance and management of pension funds as an important precondition for diversifying their portfolios. Section 4 examines the role of regulation in allowing portfolio diversification for pension funds. Section 5 discusses the role behavioral finance in investment strategies of pension funds. Section 6 examines the implications of investment rules and behavioral policy recommendations focusing on the case of the PEEP. Finally, Section 7 concludes.

2 Diversification

Diversification with alternative domestic investment opportunities - First it is important to create domestic investment opportunities to allow pension funds to diversify their portfolios away from shorter-term (and lower yield) instruments into longer-term investments, which can have an impact on economic development and growth. Diversification is linked to the availability of investment opportunities within domestic capital markets, but also goes beyond traditional listed instruments by considering private equity, venture capital and infrastructure projects and other innovative domestic investment opportunities. In Italy the government has recently introduced PIR funds, i.e. funds with a focus on small or medium-sized enterprises.[5] In developing investment opportunities, it is important to use available funds productively, but in many economies, particularly of smaller countries, it will not be possible to absorb all savings domestically. In countries with small or no domestic capital markets, among which there are several European countries, pension funds have a high share of investments abroad, over 30% (Stewart et al., 2017). Thus the fact that Italy has a share of 57.6% of investments abroad might explain why for Italian pension funds the share of investments in domestic equities is very low, although we must take into account also their peculiarities in terms of governance.

International diversification – Some international diversification of assets will be required to fulfill the primary objective of the pension system, which is to deliver a secure income in retirement. Standard portfolio selection theory provides a fundamental justification for international diversification: by widening the pool of potential assets, investors can potentially increase returns

5 Piani Individuali di Risparmio, available in Italy since January 2017. By end December this instrument has reached a volume of investments of around €10 billion.

while possibly even reducing risks through the selection of complementary assets with low correlations. Though foreign investment means that pension funds' will not be able to directly contribute to domestic economic development, we must also take into account the share of non-resident holdings of total domestic equity: non-residents have dominant roles in Luxembourg, Ireland, Switzerland and the UK, while the share is very low in Italy (Darvas and Schoenmaker, 2017).

Home bias and euro-area bias - Institutional investors, as professional parties, by holding geographically diversified portfolios of marketable securities contribute to financial integration and risk sharing across Europe's Capital Markets Union and beyond. According to Darvas and Schoenmaker (2017) a possible lack of a euro effect on home bias in equities is worrisome as equities are more important in cross-country risk sharing than bonds, and in the euro area the exchange rate is not available to compensate idiosyncratic shocks. They show that in some euro members the equity euro-area bias has increased throughout the period of 2001-14 (Austria, Greece, Italy), while in others this bias was already high at the beginning of the period examined (Belgium, Germany, Portugal) and changes little. Yet in Finland and the Netherlands equity euro-area bias has remained relatively low. Therefore, according to their findings there was no uniform development within the euro area in terms of portfolio equity euro-area bias.

3 Governance

It should be stressed that strengthening the governance and management of pension funds is an important precondition for diversifying their portfolios. As institutional investors increase in size, they become more professional and may reduce the home bias in their investments. In Italy the managed funds of pension funds amount to €117 billion (2016, COVIP).[6] The market is very fragmented: 64% of pension funds have assets under management lower than €100 million; 53% of pension funds have a number of enrolled pensioners lower than 1,000 (2016, COVIP). The market share of assets managed by the first 3 pension funds is 22% (2015, EIOPA). In addition, they are characterized by very high administrative costs. In the long run Italian pension funds should increase their size in order to reach dimensions sufficient to guarantee

6 Managed funds of social-security institutions (casse previdenziali) amount to €80 billion (2016, COVIP) of which 9.6% are investments in equities and 3.7% in domestic equities.

economy of scale and adequate diversification. An adequate governance structure can play a significant role in this process.

With this purpose important measures were adopted in the last years. In order to improve their organizational structure, the Covip resolution of 16 March 2012 obliged pension funds to build a financial department responsible for financial management control[7]. The Ministerial decree 166 of 2 September 2014 enhanced mechanisms for handling conflicts of interests based on organizational procedures, *inter alia* providing for a written policy to manage conflicts in compliance with the businesses size and complexity, in accordance with the MiFID’s (Markets in Financial Instruments Directive – Directive 2004/39/EC) principles[8]. Moreover the training programmes for pension fund employees and board members promoted by Covip, Mefop SpA[9] and the Ministry for the Economy and Finance became more structured and advanced.

Despite these reforms and training initiatives, the governance of pension funds still shows significant weaknesses (Bripi and Giorgiantonio, 2010). In view of this, the Law 124 of 4 August 2017 provides for establishing a consultation table promoted by the Ministry of Labour, in agreement with the Ministries of Economy and Economic Development, *inter alia* in order to *i*) improve the governance of closed pension funds[10], those with more members and assets in Italy (2017b, COVIP)[11], and *ii*) promote initiatives for the aggregation of pension funds aimed at rationalising the sector.

In particular, the current design of the governance of closed pension funds may not ensure proper composition of the trade-off between representation

7 See Article 6 of Covip resolution of 16 March 2012.

8 See, in particular, article 7 of Ministerial decree 166 of 2 September 2014.

9 A company owned by the Ministry for the Economy and Finance and several pension funds and created for promoting the development of the sector.

10 Which have the legal status of association or foundation. Their boards of directors have the task of setting, according to regulatory guidelines, the strategic asset allocation and the duty to entrust the management of that property, known as tactical asset allocation, to external financial intermediaries (banks, management and insurance companies, which are selected via a competitive and regulated public procedure, and are tied to the mandate). Closed pension funds are also required to use an external custodian bank, which acts as treasurer and controller of compliance with the law, statutes and regulations.

11 Besides this type of pension funds, there are the so-called *fondi pensione preesistenti*, i.e. those that were in place on 15 November 1992, which are subject to a specific discipline. However, Law 252 of 5 December 2005 provides for their progressive adaptation – with some exceptions – to the general provisions applied to closed pension funds (see Article 20 of Law 252/2005 and the related Ministerial Decree 62 of 10 May 2007). Moreover, there are the so-called open pension funds do not have an independent legal status from financial intermediaries that set them up and have the responsibility of managing their assets directly (they may also delegate one or more lines of investment to other entities). In fact, they consist of a segregated pool of assets, governed by the financial institution that has established them: this means that the boards and audit of these funds coincide with those of the subjects who have set them up. Finally, there are the so-called *piani individuali pensionistici*, similar to social security insurance policies (see Article 13 of Law 252/2005).

and competence inherent in the composition of boards of management and control of such investors[12]. Despite the fact that some reforms (in particular, Ministerial decree 79 of 15 May 2007) have introduced more stringent competence requirements and have raised the percentage of directors of closed pension funds that need to share them[13], their possession is still required for just half of the members of the boards of directors.[14] Furthermore, the training initiatives designed to fill any skill gaps do not yet seem to have reached an effective dissemination. In line with the international best practices, it could be appropriate to raise the overall skill level of the board of directors, through the provision that a significant majority of directors gain adequate experience in the areas mentioned in Ministerial Decree 79/2007;[15] but – above all – by paying more attention to a regular self-assessment, including the continued monitoring by the supervisory authority aimed at effectively verifying the adequacy of the skill level.[16]

Moreover, the relevant legislation does not adequately explain the tasks and responsibilities of the various executive and supervision bodies. In closed pension funds the tasks of the fund supervisor (so-called *responsabile del fondo*) overlap – in some cases – with those of the person responsible for the internal audit function,[17] with powers to monitor the adequacy and fairness of the management of the fund; in other cases, they overlap with those of the board of directors, especially as regards the supervision of operations in conflict of interests. In addition, since the law provides that the status of the

12 It should be noted that Law 252/2005 provides – in general – the criterion of equal participation of representatives of workers and employers in the composition of boards of management and control of closed pension funds (see Article 5.1 of Law 252/2005).

13 See Article 2 of Ministerial Decree 79/2007, which provides that at least half of the members of the board of directors, the fund supervisor (so-called *responsabile del fondo*) and the legal representative of the pension fund should have played – for one or more periods totalling no less for three years – cover administration, monitoring of entities or companies in the bank, finance or insurance sectors, or of PFs; professional activities in matters related to social security, bank, finance or insurance sectors; activities of university education in legal or economic fields; management positions in public institutions or public authorities having to do with the social security, bank, finance or insurance sectors; administrative, control or management tasks in social security institutions or other bodies with social security purposes (paragraphs 1, letters from *a*) to *f*), and 2). The remaining members of the board of directors – if they do not share these requirements – they must however have experience of at least three years through the exercise of administrative, monitoring or management tasks in firms outside the bank, finance or insurance sectors, or the same tasks in union representations (both in the private and public sector), provided that the members in possession of those experiences have attended professional training courses on complementary pensions (certified according to the article 3 of the Ministerial decree 79/2007) at a time not earlier than three years by appointment (see article 2, paragraph 1, letter *g*)).

14 See Article 2 of Ministerial Decree 79/2007.

15 See Article 2.1 (*a*) to (*f*), of Ministerial Decree 79/2007.

16 Note the English experience, where the Pension Regulator *i*) promotes training and updating (see, in particular, the program named *trustee toolkit*); *ii*) conducted periodic audits of adequacy of the competence level shared by the Board of Directors, the results of which are also included in the assessment of pension funds (see Pension Regulator 2007).

17 Covip Ruling of 4 December 2003. See Marè and Pellegrini (2006).

fund supervisor may be covered by the general manager or a member of the board of directors, a serious conflict of interest may arise: in fact, the controller may be delegated to control himself.[18] To overcome these problems and remove – at least in part – the duplication of functions and possible conflicts of interest, a first step would be to allocate tasks of the fund supervisor to the person responsible for the internal audit function, for whom the possibility of conducting activities that are themselves subject to supervision is explicitly excluded.[19]

Finally, unlike the experience of other countries (particularly the United Kingdom, the Netherlands and the United States), self–regulation in Italy is not widely used for the regulation of PF governance; indeed, there is no self-regulatory code dedicated to the definition of the governance of pension funds and the regulation of pension fund conduct as institutional investors (Bripi and Giorgiantonio, 2010). It would help to regulate profiles that the law doesn't provide for and to organize the sector, given its need to grow and consolidate. These objectives may be more easily achieved in the presence of shared rules to define relationships within the sector.

Unfortunately, the implementation of these measures can also take a long time. However in the short run, in order to counterbalance the negative effects associated with their small size, closed pension funds may participate together to an investment consortium (*consorzio di investimento*) to collect and invest their funds according to the investment policies defined by the administrators of each pension fund, strictly linked to the life-cycle needs of their pensioners. Investment consortia would allow Italian pension funds to invest in alternative illiquid asset in compliance with the Ministerial Decree (DM) 166/2014 that foresees the possibility to invest in illiquid assets only if some conditions are met: adequate diversification policy, robust organizational framework, strict risk monitoring.

4 Impact of regulation

An important factor in investment behavior is whether prudential regulations allow institutional investors to diversify across borders. Some countries still have investment limits, while others apply the prudent person principle (appropriate diversification). Darvas and Schoenmaker (2017) have devel-

18 Article 5.2 of Law 252/2005. See Messori (2007).

19 Covip Ruling of 4 December 2003.

oped a new pension fund foreign investment restrictions index to control for the impact of prudential regulations on the ability of institutional investors to diversify geographically across borders. Their index suggests that most EU countries currently apply very limited, if any, restrictions on foreign investment. Some EU countries imposed substantial limits in 2001 and have gradually relaxed these barriers in recent years (Denmark, Finland, Germany, Hungary, Romania and Sweden). In the EU, persistent barriers to cross-border investment are still present in Austria, Greece and Poland.

On the other hand, there are also floors on investments of pension funds in certain asset classes in some countries. In Poland, since 2014 open pension funds have to invest at least a minimum share of their portfolios in equity and investments in treasury bonds and state-backed bonds are no longer allowed. In Italy, the government has introduced (Budget Law, 2017) fiscal incentives for pension funds, which up to 5% of total assets exempt returns of investments for more than five years in equity of enterprises or in share of investment funds, resident in Italy or in other EU member states. Moreover, the government has extended (DL 50 2017) also to pension funds the possibility to invest in PIR, for financing SMEs and at the same time exploiting available fiscal incentives.

5 Role of behavioral finance

There exists empirical evidence on herding behavior displayed by pension funds. For instance, Blake et al. (2016) show that in UK pension funds tend to herd in subgroups, moving in and out of different asset classes following funds of similar size and sponsor type. Moreover, they systemically switch from equities to bonds as their liabilities mature, and mechanically rebalance their portfolios in the short-term.

It has been argued that relative performance benchmarks encourage herding by fund managers as they are usually based on short-term measures. In the case of funds with pension schemes with minimum relative return guarantees, pension fund management companies are required to guarantee that the returns on their pension funds (over a certain period of time) do not deviate by more than a certain percentage from the average return of the industry. As pointed out by Randle and Rudolph (2014), while most of the literature highlights the herding effects of minimum guarantees, the problem is not one of herding but in the portfolio allocation resulting from the interactions in the market. Herding is in the nature of the fund management industry and having common portfolio benchmarks helps to ensure comparability among portfolios. The minimum relative return guarantees tend to drive investments into suboptimal portfolio allocations. Instead of optimizing the expected value of the pension fund at retirement age, pension funds focus their attention in maximizing short-term returns. Raddatz and Schmukler (2013) examine herding across asset classes and industry levels by focusing on pension funds investment behavior. They study what incentives managers at various layers of the financial industry face when investing. Their results show that pension funds herd more in assets that have more risk and for which pension funds have less market information. Furthermore, their results show that herding is more prevalent for funds that narrowly compete with each other, namely, when comparing funds of the same type across pension fund administrators. There is much less herding across pension fund administrators as a whole and in individual pension funds within pension fund administrators. These herding patterns are consistent with incentives for managers to be close to industry benchmarks, and might be also driven by market forces and partly by regulation.

The global financial crisis caught many financial market participants by surprise and institutional investors were no exception. As the crisis intensified and concerns about capital loss arose many investors abandoned long-term investment strategies. Exceptions certainly exist, but as a group, institutional investors tended to move with the rest of the market. This "institutional herding" is referred in the literature as procyclical investment behavior. Papaioannou et al. (2013) argue that such procyclical investment behavior is understandable and may be considered rational from an individual institution's perspective. However, behaving in a manner consistent with long-term investing would lead to better long-term, risk-adjusted returns and, importantly, could lessen the potential adverse effects of the procyclical investment behavior of institutional investors on global financial stability. Broeders et al. (2016) distinguish between weak, semi strong and strong herding behaviour. Weak herding occurs if pension funds have similar rebalancing strategies. Semi strong herding arises when pension funds react similarly to other external shocks, such as changes in regulation and exceptional monetary policy operations. Finally, strong herding means that pension funds intentionally replicate changes in the strategic asset allocation of other pension funds. While weak herding can contribute to financial stability, strong herding behaviour is a risk for financial stability. Finally, Duijm and Steins Bisschop (2015) examine Dutch insurance company and pension funds equity and sovereign bond portfolios during the global financial crisis and the European sovereign debt crisis. In their paper, a first analysis shows that while insurance companies massively sold equities during the crisis, pension funds kept buying equities as markets tumbled. The behavior of insurance companies for investments in equities cannot be characterised immediately as 'strongly procyclical', since it may have structural causes. In anticipation of the new regulatory framework Solvency II, to be implemented from 2016 onwards, Dutch insurance companies have been replacing parts of their equity portfolio by less risky assets, such as government bonds. The increased pressure on their business model could also have initiated a shift away from equities. Results from regression analysis over a longer time horizon suggest procyclical behavior by insurance companies, while for pension funds they do not find evidence for procyclical or countercyclical investment behavior.

6 Investment rules and behavioral policy recommendations: the case of PEEPs

The EU market in personal pensions is fragmented, with limited cross-border selling and portability (EIOPA, 2015 and 2016). Developing a single market in personal pensions could offer economies of scale, better diversification of risk and more innovation. This could benefit consumers who are looking to save in personal pensions to support their retirements, but have been dissatisfied with the options currently available. In addition, a better personal pension market could also help address a lack of investment on EU capital markets contributing to the completion of the CMU. To these aims, in 2017 the European Commission has proposed to introduce standardized pan-European personal pension products (PEPPs) that would be available in the accumulation phase, jointly with national personal pension plans (European Commission, 2017a). The intended standardization of the investment rules calls for the use of a limited number of default investment options and the presence of a de-risking strategy, at least for the default option. Consumer protection would be stimulated if the investment options that are offered and their labeling are comparable between different PEPPs in different countries. The choice to limit the number of investment options in PEPP products and to select one of them as the default seems to be well supported by the recent academic literature which shows that consumers have difficulties in choosing from many alternatives (see e.g. Huberman and Jiang, 2006) and tend to select default strategies selected by trusted parties. Financial literacy rates differ enormously between the major advanced and emerging economies in the world. In 2014, on average 55% of adults in the major advanced economies – Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States – are financially literate (see Klapper et al., 2016). But even across these countries, financial literacy rates range widely, from 37% in Italy to 68% in Canada. Thus given the low level of financial education in Italy the introduction of PEPP products may be helpful to avoid that consumers get overwhelmed with too many investment choices.[20] However, limiting too much the number of investment options may lead to a situation where investment options will be very similar between providers, with little choices for consumers. Moreover, it has been argued by Laibson and List (2015) among others that restricting people's choice and too heavy handed paternalism has a bad track record. For this reason in recent years behavioral policy recommendations have tilted towards "nudges", which recommend or facilitate certain behavior without removing options or the freedom to choose (Thaler and Sunstein, 2008).

Moreover, several issues need to be tackled in the process of development and implementation of PEEP products. First, they should have an attractive tax regime. By designing the PEPP with appropriate characteristics it should be possible, at least, to give the PEPP the same tax treatment of the national pension products. Second, in order to ensure that the PEPP is indeed a truly pension product and to ensure the adequate protection of savers benefitting from successful long-term investment strategies against longevity risk, the design of the default investment option is key and will, to a significant extent, determine the success of the PEPP.[21] Third, the design of the PEPP also needs to ensure conditions to allow European Union citizens to invest in a balanced portfolio including assets such as equities, infrastructure and green technologies. With the appropriate safeguards, this will provide a good chance to accumulate a pension that outperforms inflation and grows to levels that can provide a better standard of living.

In conclusion, a more developed market for personal pensions in the European Union will provide a better chance for adequate retirement for European

20 On how communication can best be structured to reach out the target audience of an educational programme see the analyses developed in Linciano and Soccorso (2017). In particular, with specific reference to retirement choices, Alemanni (2017) underlines that simplicity, reference to real and practical events, emotional connections, and proper goal framing are key to engage people in virtuous conducts. Moreover, to account for heterogeneity across individuals, communication cannot apply a one-size-fit-all approach, but needs to be attuned to the profile of the targeted audience. Once again, psychological and behavioural studies may provide important clues for the design of salient communication strategies, tailored to the characteristics of a specified target.

21 Recently, the chairman of EIOPA has suggested that the default option should include the following requirements: (i) if provided, guaranteed only at the point of decumulation; (ii) a specification of default conversion of a significant part of the accumulated amount into programmed withdrawals or annuities (see Bernardino, 2018).

citizens and at the same time will stimulate more savings and channel them into long-term investments, promoting growth and contributing to the objective of the CMU.

7 Conclusions

At the European level, the CMU should foster the creation of an effective European internal market for pension funds, promoting standardized rules for institutional investors to spur foreign investments and avoiding discriminatory taxation for cross border investments. National barriers are manifold and are related to restrictions to the investments of pension funds (for instance in different currencies), transferability of funds, social, labor and contract law, but the most important barrier is tax legislation. These barriers imply that pension funds tend to remain small and that cross-border activity remains very low with limited competition among supplier. Market fragmentation prevents pension providers from maximizing risk diversification, innovation and economies of scale. This reduces choice and attractiveness and leads to increased costs for pension savers. It also contributes to a lack of liquidity and depth in the capital markets compared with other advanced economies where pension funds play a leading role as institutional investors. For creating a deeper EU internal markets for pension products, in addition to the harmonization of national frameworks for pension products, another policy option is the creation of a parallel dedicated pan-European pension product.

At the national level, many national and international surveys have assessed that financial knowledge and competencies of Italian households are far from being satisfactory even at a basic level.[22] Moreover, it is important to improve Italian pension fund governance, which does not adequately guarantee the composition of the trade-off between competence and representation and a clear definition of tasks and responsibilities among the various organs of the pension fund. It may be appropriate to raise the overall level of competences of the board of directors, with more attention to training and regular self-assessment, and to clarify the tasks of the board of directors, the fund supervisor (so-called *responsabile del fondo*) and the person in charge of the internal audit function, eliminating the current duplication of functions and possible conflicts of interest. Some of these measures could be effectively

22 For an empirical evidence see Montanaro and Romagnoli (2016), Linciano and Soccorso (2017), Klapper et al. (2016) and OECD (2017b).

implemented through the adoption of a self-regulatory code dedicated to the definition of PF governance, in line with the experience of other countries. Unfortunately, the implementation of these measures can also take a long time. However, in the short run, encouraging and incentivizing the creation of consortia of investment among pension funds could promote investments in SME equity, ensuring the support of “patient” capital to these enterprises. Pension funds may participate together to a consortium of investment in order to counterbalance the negative effects associated with their small size by improving their portfolio diversification, organizational framework and risk monitoring.

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