

COVID-19: How Capital Markets Are Key to Europe's Recovery

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(As posted in [Funds Europe](#), June 8, 2020)

Before COVID-19, the region's economy already was struggling, with growth of just 0.1 percent in the fourth quarter of 2019. Now, EU policymakers are warning that, unless the pandemic eases rapidly, the European economy could contract by 8 to 12 percent or more.

How can Europe restore growth? One vital component: a bold and ambitious capital markets union (CMU). With its potential to mobilise EU citizens' investment in capital markets, the CMU is the key to helping the EU economy emerge more quickly from the pandemic, stronger and positioned to thrive in the future.

Capital Markets Are Critical to the European Union's Recovery

With capital markets experiencing significant volatility, some will say it's counterintuitive to focus on fostering robust retail investor participation in them. But restarting the EU economy will be an all-hands-on-deck job. Banks and governments alone can't finance a strong recovery—especially for the industries and small and mid-size enterprises (SMEs) most affected by the crisis—so policymakers will need to enable capital markets to play a significant role.

A crucial step toward building strong capital markets is helping citizens invest more easily in large companies and SMEs, which are the lifeblood of the EU economy. Regulated funds facilitate investment in business by channeling household savings to companies while helping investors save for their most important financial goals, including retirement, education, and buying a home.

EU households' use of regulated funds, however, lags that of households elsewhere in the developed world. As of year-end 2019, EU households held 30 percent of their financial assets in bank deposits and currency and only 8 percent in regulated funds. Contrast that with households in the United States, which held 12 percent of their financial assets in bank deposits and currency and 22 percent in regulated funds.

To foster greater participation in capital markets, policymakers need to design a CMU that makes investing in regulated funds easier for and more attractive to EU citizens.

Simplify Investing in Regulated Funds

Key to facilitating savers' use of regulated funds is making the investment process user-friendly. This will require difficult work on many fronts, particularly disclosure. Currently, fund investors can receive at least three complex and dense sets of disclosures, which are required by different sets of laws. Policymakers should look at these documents from the investor's perspective and reform requirements so that disclosures are more user-friendly and engaging.

In addition, policymakers should accommodate and encourage investors' growing use of technology. For example, making e-delivery the default method for disclosures and other communications—while still providing paper to those who request it—would make investing in regulated funds easier and strengthen investor protections. Making e-delivery the default also would better reflect a modern, sustainable, and digital European Union.

E-delivery of information, though, is only a start. Better and smarter use of technology can foster greater engagement and improve investor understanding. Features such as pop-ups or hyperlinks allow savers to easily access the information that is relevant to them. And interactive elements—such as those that enable investors to use a sliding scale to see the costs, charges, and performance scenarios for different investment amounts and holding periods—can help savers better understand the value of long-term investment.

Preserve Investor Choice

Another key step toward making investing in regulated funds more attractive is enabling investors to access a greater array of funds to meet their different goals. For example, policymakers should enable citizens to invest in target date funds, which employ a type of life-cycle strategy that has helped investors in other jurisdictions grow their retirement savings.

Variety is also crucial to helping investors meet their environmental, social, and governance (ESG) objectives. Policymakers, however, must take care to avoid stifling product innovation and limiting investor choice. EU citizens have many different ESG goals, and policymakers should ensure investors have the appropriate information they need to make informed choices about which fund best suits their objectives.

Be Bold and Ambitious

Rebuilding the EU economy in the wake of COVID-19 will take courage and commitment. Delivering a robust CMU that fosters strong retail participation in the capital markets through regulated funds will channel money into the industries and economic sectors that will be the foundation for Europe's recovery and future success on the global stage.

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