INDEFI

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PERSPECTIVES

THE 10 EURO TRILLION QUESTION: DEFINED CONTRIBUTIONS IN EUROPE

Assets in European defined contribution ("DC") plans are expected to soar to over €10 trillion (US$11.8 trillion) by 2030 from €4 trillion at the beginning of 2020. The market is poised to become the top growth opportunity in Europe for fund managers by assets under management (AUM) as market-linked DC products overtake traditional defined benefit (DB) schemes. As DC remains a complex ecosystem to navigate, successful investment managers must articulate a clear vision for the future and define where they want to play.

DC in Europe: A Large and Growing Investment Management Market

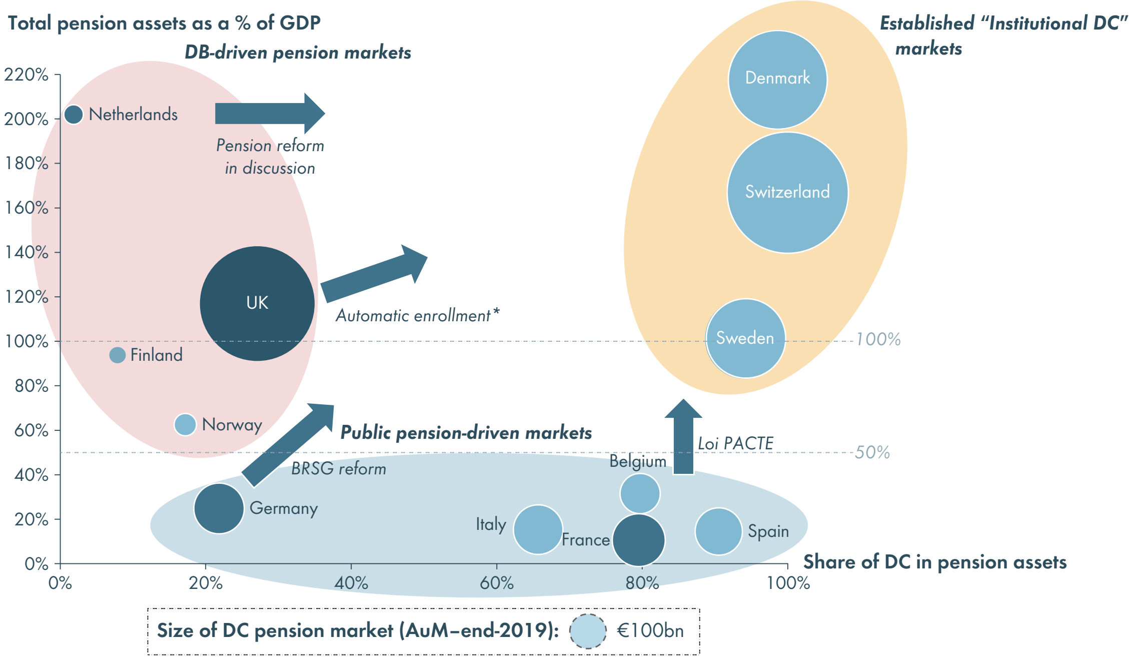
As of year-end 2019, DC pensions were a €4 trillion market by AUM. Assets have increased by 7% annually between 2014 and 2019, spurred by the following entrenched growth drivers:

- The steady switch from DB to DC in pension-driven countries (UK, Netherlands);
- The need to shore up private pension coverage rates to complement a declining social safety net in insurance-driven countries (France, Germany, Southern Europe).

In this respect, large investment management markets where DC reforms have recently been passed should become the focal point of attention: France (2019 Loi PACTE), Germany (2018 BRSG[1]) and, soon, the Netherlands (anticipated in January 2023). They are the immediate next stops for asset managers seeking to ride the European DC conversion wave, after the UK, where the process is well under way and established DC institutional markets (Switzerland, Denmark, Sweden).

[1] *Betriebsrentenstärkungsgesetz.*

Figure 1. The European pension "lay of the land"



Note: (*) Automatic enrollment was phased in from 2012, starting with the largest UK employers. All eligible workers should have been automatically enrolled by February 2018.
Sources: ABA, ABV, AFG, Assuralia, ATP, BaFin, BNB, CAA, Centre for Finnish pensions, COVIP, CSSF, Deutsche Rentenversicherung, DFSA, DGSFP, DNB, DREES, EPSV, ETK, FSMA, GDV, INVERCO, OFAS, OFS, ONS, Pensionsmyndigheten, StatBank, Statistics Finland, INDEFI Market Research, interviews, INDEFI analyses.

Mystery Revealed: What is DC in Europe?

DC straddles the pension-insurance divide typical of the European investment management market. When looking at opportunities for asset managers, two macro segments emerge:

- The "institutional DC" segment, where the client is a pension institution or insurance company, is essentially an extension of institutional "business as usual" for asset managers. It amounts to €2.7 trillion, of which 37% (€1 trillion) is currently outsourced to third-party asset managers. The balance is managed directly by institutions or entrusted to affiliated managers.
- The "platform DC" segment, where the client is a corporate sponsor or distributor, serving small-and medium-sized enterprises or individual clients, is a hybrid market mixing traditional institutional and fund distribution features. Although it is smaller than the "institutional DC" segment, at €1.3 trillion, 62% of AUM are outsourced to third-party asset managers (€800 billion), underlining the attractiveness of this segment.

When assessing opportunities through the lens of associated accessible revenue pools for third-party asset managers, the platform DC segment is more than 1.5x bigger than the institutional DC segment and where growth will come over the next 10 years. "Platform DC" is where the game will be played.

Key Success Factors For Investment Managers

While fragmentation persists because of individual country regulatory and tax regimes, selected capabilities offer growth potential and scalability to investment managers looking to expand their footprints in this promising market:

- **ESG/sustainable** pension solutions are in high demand, as new regulations (EU SFDR[2]) are creating a higher baseline for pension and asset management products across Europe;
- **Private market assets** are finding their way into DC pension schemes, especially unit-linked insurance, spurred by a more lenient regulatory environment;
- **Passive** is the go-to solution for plan sponsors looking to comply with the regulatory pressure to deliver pension solutions at lower costs.

In addition, differentiation levers for asset managers include:

- **Financial engineering skills** to support sponsors in the design of retirement plans, risk profiles and investment solutions, both in the accumulation and drawdown phases;
- **Digital tools** to support plan sponsors in enhancing the level of services (e.g. financial education) provided to their members, and help clients with segmentation, onboarding, portfolio monitoring and reporting. Such tools will also provide investment managers with the ultimate DC value chain disruption opportunity: going direct to retail investors.

INDEFI, with headquarters in Paris and New York, is a leading strategy advisor for the global investment management business. Established in 2007, Indefi helps asset managers shape their business strategies and build a sustainable competitive advantage. The firm's expertise spans public and private markets, including infrastructure, private credit and equity, and real estate. A pioneer in advising asset managers on ESG development and integration strategies, Indefi is a PRI signatory. For more information, please visit www.indefi.com.

[2]Sustainable Finance Disclosure Regulation. See INDEFI, "The SFDR reality check" (March 2021) and "SFDR: two months in" (May 2021).