

The Savings and Investment Union: achievements and perspectives *State of the art almost a year after its launch*

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I would like to thank ANIA for inviting me once again to take part in what has become a regular, appreciated annual event devoted to discussing European issues.

This year's theme, the savings and investment union, is a very important subject. I have given several speeches on this matter recently, in my capacity as senior deputy governor of Banca d'Italia.

And I apologise to those who have heard me making similar remarks elsewhere. But given today's theme I take this opportunity to share also with this audience a few thoughts on what I see as the key steps needed for achieving this goal, with a focus on issues concerning the insurance sector.

Why is this subject so important? Every economic textbook tells you that, generally speaking, integrated markets result in a more efficient allocation of resources. This principle has been in fact one key economic motivation for the European process since 1957. However, the pursuit of closer integration of markets, and specifically of the capital and financial markets, has a special relevance for the Europe of today. These are times of accelerating innovation, and the perception is now widespread that Europe risks being left behind. To realise the full potential of technological development for growth and prosperity, a better environment for innovation and innovative investment in Europe is a key requirement. There are many areas where improvements in policies and regulations need to be considered. A more efficient market for capital, though by no means the only relevant issue, is certainly one of them.

The raw material for investments is savings. There is no shortage of savings in Europe. The euro area's average savings rate has consistently been higher than 13 per cent since 2010, compared with just under 7 per cent in the US. Last year, European households' savings exceeded €1.4 trillion, 15.3 per cent of gross disposable income.

A significant share of European savings finances investments abroad. This is the counterpart of the area's structural current account surplus and of its sizeable positive international investment position. A strong IIP is a good thing to have; however, you can have too much of a good thing. A significant and protracted excess of savings over investment may signal the insufficient ability of the area to attract funds from both domestic and foreign savers.

As a destination for investment, Europe has two major strengths: excellent human capital and a very large market. The interaction between these two factors can be extremely powerful. To exploit this potential in full, however, effective market integration is a necessary condition. Despite much progress made over the years and decades, Europe cannot yet be said to be a fully integrated market. Specifically for capital, internal barriers remain in various segments of the financial system: banks, market finance, insurance. Let me consider each in turn.

First, banks. Banks that are strong and competitive are vital for channelling savings towards productive investment. They do this both directly, as providers of credit to businesses, and indirectly, by supporting capital markets through the supply of liquidity and investment services.

The banking union is at a much more advanced stage than that of other financial sectors. Since 2014, the supervision of euro area banks has been carried out jointly by the ECB and national authorities. Harmonised standards and practices, daily work side by side within joint supervisory teams, full information sharing and a common methodology have resulted in a largely unified supervisory structure.

As I recently reminisced, those like your speaker who found themselves in supervisors' metaphorical trenches, fifteen or more years ago, fighting the fire of the global financial crisis, cannot fail to see the difference. At that time, in a situation of acute tension, each national supervisor only had a mandate to look after its own banks; there were no established common practices; despite the communication channels that were promptly activated, the exchange of information encountered legal and technical limitations; there was a lack of institutional instruments for managing systemic risk with a European perspective.

Those days are gone; however, the journey is not finished. Several elements are missing. There is still no common deposit insurance scheme. The resolution framework needs reviewing, based on experience. As a matter of fact, many indicators of banking integration have ceased to improve. The remaining effective barriers to cross-border banking should be taken down. I therefore welcome the Commission's intention to set ambitious goals for the Banking Union.

Second, the capital market. Improved policies for the capital market are the cornerstone of the Commission's savings and investment union strategy that we are discussing today. This strategy has four main dimensions: fostering the participation of households; stimulating equity investment by institutional investors; reducing cross-border barriers; and achieving a higher degree of centralisation in markets supervision at the European level.

To date, the Commission has presented a legislative proposal aimed at revitalising the European securitisation market, a recommendation on the establishment of 'savings and investment accounts' and plans to enhance financial literacy. Before the end of the year, it is expected to put forward additional proposals concerning the consolidation of trading and post-trading infrastructures, the transfer of certain supervisory responsibilities to ESMA, the development of supplementary pension schemes, and the promotion of long-term capital investment by institutional investors.

I am not discussing the details here. In general, these are useful steps, for which the Commission deserves due recognition. However, there is a growing awareness that overcoming market fragmentation and achieving a genuine savings and investment union requires the political will to make substantial progress along all dimensions of the strategy. Looking ahead, in fact, this process needs to include at some point a willingness to tackle certain fundamental legal aspects. You can hardly have a truly integrated market without further harmonisation of company law, insolvency regimes, and taxation frameworks, or without further integration of market supervision, including the convergence of supervisory practices, a single rulebook and a more unified supervisory system. The road ahead remains long.

A more fluid and cohesive capital market would also facilitate the development of specialised operators focused on financing the birth and growth of innovative enterprises.

European savings are strongly oriented toward low-risk, low-return assets, with a high incidence of bank deposits and government securities. The segment of investment funds operating in the medium term is particularly underdeveloped. The assets managed by private equity funds in Europe are about half of those in the United States. The gap is even greater in venture capital, a form of investment useful for financing innovative projects – inherently risky but potentially promising – and companies in their early stages of life. During the period 2020-24, average annual venture capital investments in the main EU countries were, relative to GDP, slightly less than half of those in the United Kingdom and less than one-tenth of those in the United States.

The causes of these gaps are manifold. They may partly reflect a different pattern of savers' preferences. It is not for the authorities to dictate preferences. But it is their responsibility to ensure that there are no undue obstacles to the supply of products suited to financing innovation and growth. Market integration is once again a key element. The low incidence of specialised funds reflects both the limited size of European funds and the limited presence of foreign intermediaries. Operators struggle to achieve the scale that, in theory, the overall size of the European market would allow. Investing in multiple EU countries is costly due to the fragmentation of national financial markets, which in turn stems largely from legal fragmentation. This condition limits operators' growth prospects and reduces exit opportunities.

The insurance field needs even more progress. It is important to recall that insurance plays a central role in the allocation of savings; in Italy, for example, insurance companies' total assets amount to more than €1 trillion, close to 50 per cent of GDP; in the European Union, they account for almost 60 per cent. Despite a common European primary

legislation, and despite EIOPA's efforts to foster convergence, differences across member states in secondary legislation and supervisory practices remain. To create a genuinely single insurance market and ensure a level playing field, a more cohesive supervisory framework, independent and prudent, appears necessary, particularly with reference to the major European insurers.

This is felt especially in consumer protection system. Without a full harmonisation of practices, there is some tension between the freedom to provide services across different member states and the principle that supervisory responsibility rests solely with the home country. In Italy we have seen several cases over the past few years where the cross-border activity of insurers has harmed consumers, without the host supervisor having adequate tools for intervention. Let me be clear: even if it were possible, I would not advocate a renationalisation of powers. That would be a step backwards. On the contrary, I would welcome progress towards more integration of the European supervisory framework.

The reform of Solvency II and the savings and investment union initiative share a similar goal: making Europe's financial system more resilient, efficient, and capable of channelling resources towards productive investment. The two projects are connected in many ways. Let me therefore take this opportunity to say a few words on how the process of Solvency II reform is developing.

First, one key feature of the system, the volatility adjustment, had been found to work in a very unsatisfactory way and needed to be revised. We appreciate that the reformed Solvency II improves its functioning in certain respects. At the same time, we cannot but observe that this improvement comes at the price of a further increase in complexity in a mechanism that was already quite complex and opaque. The need for adjustments stems from the rule of fair value accounting, which insurance regulation applies to a far larger extent than banking regulation does. While perhaps admirable in theory, in practice this principle often gives rise to undesired or counterproductive effects, which need to be corrected in ad-hoc, non-transparent ways that may be difficult for stakeholders to understand. Looking ahead, some reflection on the appropriate role and the limitations of full fair-value accounting would be warranted, bearing in mind the structure of risks in insurance companies. It is something to consider for a future Solvency III.

Second, the reform is likely to allow a significant release of capital. Our analyses show that, if risks and capital remain unchanged, the solvency ratio of Italian insurance companies could increase on average by 14 percentage points. The precise impact cannot in fact be computed until the Level 2 rules are finalised; the consultation on the Delegated regulation that will set them has just ended. I would urge the Commission to consider the implications of a massive prudential capital release carefully when fine-tuning requirements. The argument is often made that capital freed from insurance companies' requirements will be put to more productive use in the markets, and that this is a way to foster innovative investment in the real economy. I do not know what use any released capital will be put to. I can only state, once again, the opinion that the best possible contribution that financial regulation can offer to foster long-term growth is safeguarding the sound and prudent management of financial institutions (through

reasonable requirements, consistent with the nature, type and degree of liquidity of their commitments) and the overall stability of the system.

A final few words on insurance resolution, another area of legislation that has connections with the savings and investment union project. The new Insurance Recovery and Resolution Directive introduces minimum harmonisation rules; notably, it improves the tools available for managing cross-border cases. This is surely welcome. In a longer-term perspective, a greater level of harmonisation would be needed to establish a truly barrier-free European insurance market, in the spirit of what I said about the need to overcome legal fragmentation in key areas, including bankruptcy. One important element would be the definition of a common framework for insurance guarantee schemes. Reflections on the experience of the application of the Banking Recovery and Resolution Directive would also be useful.

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Europe, we often hear, is at a crossroads. A difficult international landscape, with wars and tensions, is challenging many old certainties about matters of security and peace. The acceleration of technological innovation is likely to bring with itself both opportunities and risks, as it often does. The quality of today's collective choices can make a great difference to our future security and prosperity.

The broad strategic choices are in the hands of elected governments. As financial regulators, we have the responsibility to be aware of the risks for the financial system, and to prepare as best we can.

Accelerating innovation, while likely to be beneficial in the long run, may well cause financial turbulence along the way; the more so, as its effects could be compounded by global political uncertainties. Financial instability cannot be completely avoided, but we can make the system more robust through wise, adaptable regulation. It is, I think, a fact that the financial system has shown remarkable resilience through the multiple exogenous crises of the early 2020s. I surmise that regulatory reforms, especially of the banking system and, in Europe, of the insurance system, have contributed in no small way to this achievement.

Success, however, is always temporary and should not bring complacency. Risks abound and can take new forms. As memories of the great financial crisis fade, one sees signs of a temptation to relax the rules. That would not be wise, nor would it be in the long-run interest of the industry itself. Streamlining, by all means; weakening, no.

At the same time, Europe also runs a different risk: that of lagging behind in our ability to reap the benefits of new advances in human ingenuity. We cannot foretell to what extent the 'fourth industrial revolution' that we are living through will fulfil its promise of bringing greater prosperity; but it would be ironic if the same corner of the world that started the first one, more than 200 years ago, were not able to enjoy in full the benefits of the most recent one.

Regulation and policies need to adapt, balancing Europeans' deep-rooted desire for security with the need to allow for enough risk-taking in the economy to foster long-run economic progress. Capital markets, and the financial system more generally, play a key role in ensuring an economy's ability to convert savings into investment and ideas into useful innovation. Making the European financial system work as one, smoothly and efficiently, is a goal that is worth all our efforts.

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