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**INTERNATIONAL SEMINAR ON AWARENESS AND EDUCATION
RELATIVE TO RISKS AND INSURANCE ISSUES**

**Swissôtel, Istanbul
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Importance of Risk Transfer to Individuals

Mr Nicolas Blancher, International Monetary Fund

(PowerPoint presentation)

Importance of Risk Transfer to Individuals

*International Seminar on Awareness
and Education Relative to Risks and
Insurance Issues*

Istanbul—April 13, 2007

*Nicolas Blancher
International Monetary Fund*

The IMF's Perspective

- Macroeconomic and financial stability
- Surveillance: multilateral and bilateral; policy recommendations
- Monetary and Capital Markets Department's *Global Financial Stability Report* (risk transfer series)

Households' Changing Risk Profile

- Risk flow: banks, insurance companies, pension funds, households
- Changing risk profile—more *direct* risk exposures
- Prospective changes in healthcare benefits
- Bottom line:
 - Household sector more of a “shock absorber of last resort”?
 - Household risk management capacity part of financial stability

Households' Capacity to Manage New Risks

- Need for basic education about risks and alternatives. Households:
 - Often do not take a comprehensive approach
 - Are slow to adjust their asset allocation as needed
 - Underestimate required level of savings and risks
- Experience of previous generations not a good guide
- Some population segments most at risk? (data/identification issue)

Some Survey Results...

Surveys frequently show a substantial lack of knowledge of households' own arrangements for retirement savings:

- Netherlands: 65% of households are unable to provide an estimate of their pension income upon retirement
- U.K.: 44% of the population reported a basic knowledge of pensions in 2004, down from 53% in 2000
- U.S.: 47% of workers who have not saved at all are confident that they will have enough for retirement. Many count on employer-provided benefits that are increasingly unavailable
- France: most households consider themselves ill-equipped to choose an investment strategy, and do not compare investment products

Government Communication on Priorities and Challenges

- Important for public awareness and success of pension (and health care) reforms
- Public debate and awareness often still nascent—need for further initiatives
- Develop broad and forward-looking measures of the impact of changes in pension and welfare systems on households' wealth (including distribution of risks across subgroups)

Raising Awareness—Examples

- U. K.: Pensions Commission Report
" Pensioners will become poorer relative to the rest of society" unless taxes or social security contributions devoted to pensions rise, individuals save more, or employees accept longer working lives
- Sweden—new public pension system
Following a broad information campaign, surveys have shown that the share of participants who say they do not understand the system has fallen from about 30% in 1998 to 13% in 2003

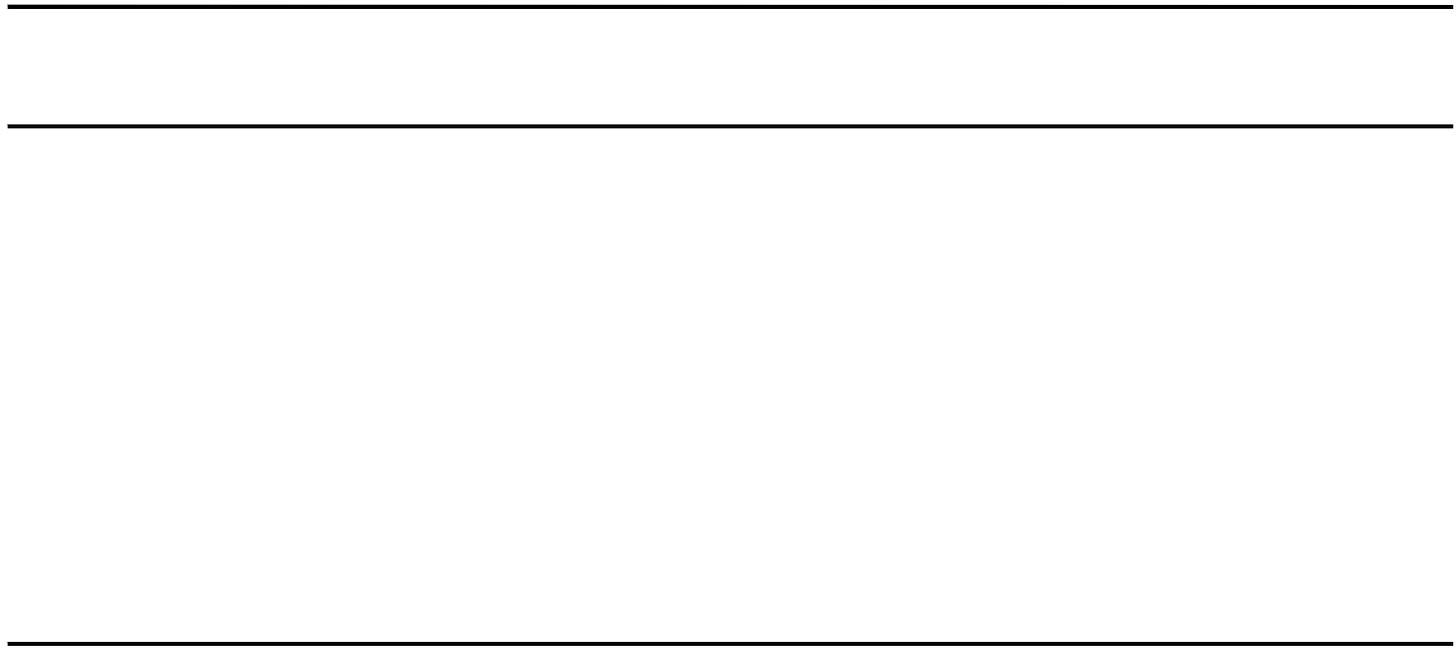
US National Retirement Risk Index

A good example of how complex risks associated with retirement saving can be presented relatively simply

- Measures share of working age households who are “at risk” of being unable to maintain their pre-retirement standard of living in retirement
- Assuming individuals retire at age 65 and annuitize all their wealth, 43% will be “at risk”
- Good news: changing retirement and savings behavior can substantially improve the outlook (e.g., retiring at 67 reduces share to 32%)

Percent of Households “At Risk”

(at Age 65, by Birth Cohort and Income Group)



Source: Munnell, Webb, and Delorme, *A New National Retirement Risk Index*, Center for Retirement Research, Boston College, June 2006

Household “Financial Margin” (Sweden)

- The Sveriges Riksbank has sought to assess households’ financial margin relative to anticipated future obligation (e.g., after interest expenditure and regular living costs)
- Distribution across income categories
- Takes into account potential benefit adjustments or economic shocks (e.g., a rise in interest costs and/or a decline in income)

(Sveriges Riksbank, Financial Stability Report, 2004:2)

Information vs. Education

Information cannot substitute for greater household financial literacy

- Financial information may be accessible, but households often make limited use of it
- U.S.: increased financial information for consumers may not result in improved financial management in areas such as mortgages and investment (behavioral economics and finance)
- Disclosure vs transparency

A Key Role for Governments in Financial Education

- Governments may come under growing public pressure to intervene in support of the household sector, for example:
 - in the form of added public expenditure pressures
 - in the form of re-regulation of certain products or services
 - in order to deal with waves of litigation
- A key objective for governments may be to strengthen basic financial education programs at school and at the workplace—indeed, such efforts are underway in some countries

Financial Education and Long-Term Saving Challenges

- Saving for retirement: uncertainty over returns and costs of systematic errors
- Uncertainty/risks affecting ageing-related liabilities (e.g., longevity risk)
- Complexity/variety of products available (greater for savings/investment products)
- Purpose of financial education (equip individuals to ask informed questions and understand potential outcomes)

Challenges in Financial Education Program Design

Define strategies to strengthen financial education programs

- Focus (e.g., home ownership; savings accumulation vs. debt reduction; etc.)
- Target audiences - need to reach different population groups and levels of sophistication:
 - Basic financial education in schools
 - Long-term planning for the middle aged
 - Consideration of payout strategies during later working life
 - Need to identify the most vulnerable population categories (requires detailed cohort data)

Challenges in Financial Education Program Design (cont'd)

- Delivery channels (e.g., public/private, different media, new technologies)
- Coordinate efforts to strengthen financial education (e.g., U.K.'s FSA, U.S.' Office of Financial Education)
- Evaluate the effectiveness of existing efforts

Government Policies and Household Savings Strategies

- Governments can help households implement the new approaches to savings and investment that they increasingly need
- Savings (e.g., taxation; opt-in/out schemes; mandatory savings?)
- Investment (e.g., lifecycle products; annuity products; equity release products)

Public/Private Complementarity

- Governments and private industry have comparative advantages in addressing household financial needs
- Employers and financial institutions are well positioned to deliver targeted financial education and advice
- Examples:
 - Japan: role of banks
 - U. S.: employer-supported seminars

Incentives for Financial Advice

There may be a need to strengthen the incentives for financial advisers to better support the needs of households

- Availability and appropriateness of advice may be an issue
- Household reluctance to pay for advice
- Policy considerations:
 - Simple and stable tax and regulatory regime
 - Educational standards for advisers
 - More transparent commission/fee structures

Wrap up

- Risk transfer through the financial system— increasingly shifted to households
- Surveys show lack of household knowledge of even basic financial issues
- Financial education shortcomings are not new, but increasingly urgent to address
- Governments have a major role in raising awareness and financial literacy of individuals
- The private sector has a key role in providing targeted, quality advice and products