

FINANCIAL MARKETS, PRIVATE PENSIONS AND INSURANCE

While financial markets have recovered somewhat from the financial turmoil and corporate governance failures of recent years, the systemic weaknesses that emerged have not yet been resolved. To respond to these weaknesses, and to restore public confidence and financial integrity, remains a major challenge for financial institutions, policymakers and regulators, irrespective of the improved sentiment that has arisen from the recovery under way. Stronger governance, risk management and disclosure systems will be required to enhance financial integrity in a sustained manner.

The OECD has developed substantial policy analysis of governance by and of institutional investors. These institutions are key actors in the corporate governance of non-financial institutions to whom they provide finance. Their own governance is also at the core of financial integrity. Beyond the revision of the Principles of Corporate Governance, the OECD is developing comprehensive “Principles-compatible” guidelines on the governance of pension funds and insurers, which are the main long-term savings institutions and have a vital role in savings, investment and the sustainability of financial markets.

New challenges

More generally, the fundamentals need to be reconsidered. The emerging new financial regulatory landscape should be assessed to identify the major reforms undertaken, any significant remaining gaps and also the risks of over-regulation. This is all the more important as financial markets, and the economy as a whole, face new challenges and risks connected with population ageing, the individualisation of risk responsibility, the emergence of new catastrophic risks and the integration and globalisation of markets.

Ageing and private pensions

Ageing populations place an increasing burden on social security systems and public debt around the world and will continue to do so. Countries have reacted in a variety of ways. In recent years, pension reforms in many countries have included an increased reliance on privately managed, funded pension systems. While private pensions are expected to relieve some of the burden and their development is to be promoted, this depends on the existence of a soundly-based regulatory framework. The emergence of large corporate pension funding gaps has alerted policymakers to the need for proper funding and investment rules. Current trends toward defined contribution schemes raise the issue of adequacy of future retirement income.

Given the demographic and fiscal pressures for reform, it is increasingly necessary for policymakers to understand the complex features of different pension systems, their impact on financial markets and the best ways to regulate them. The OECD is the leading

international forum to achieve these objectives. Regular monitoring, data collection and analysis, as well as identification of regulatory principles and best practices, are already under way. The OECD Council approved in March 2004 a recommendation on core principles of occupational pension regulation, confirming the Organisation's role as a standard-setting body on pension regulation. The OECD is currently working on new guidelines on funding and investment.

The scale and pace of pension reform worldwide has also created a significant need for comprehensive, comparable pension statistics that can capture the many dimensions of pension systems and help governments assess their programmes and reforms. Indeed, there are presently only scattered bodies of data available on subjects such as retirement income adequacy and trends in coverage, funding and investment.

To fill a significant data gap in pension statistics, the OECD has recently initiated a project to set up a database of pension statistics, as a complement to the statistics it collects on insurance.

Financial education

Pension reforms are increasing the responsibility of individuals who are not always well-equipped to make proper choices and decisions, creating a need for an urgent strengthening of financial education. More generally, the importance of financial education has increased in recent years as a result both of developments in financial markets and of demographic, economic and policy changes. As capital markets become more sophisticated and new products are continuously offered, including hybrid instruments whose risk-return characteristics are not immediately discernible, it is very important that the level of financial education is adequate to provide consumers with the necessary tools to enable them to determine their financial needs, and to seek and effectively use information about financial services and products. As increasing numbers of consumers are responsible for making their own financial decisions, the consequences of poor decisions are becoming serious.

The OECD launched in 2003 a major project to respond to these policy concerns, with the aim of promoting good practices by major actors in this field. It is the only international body which has such a policy-oriented programme to promote financial education.

Private health insurance

If pension developments call for urgent policy action, the same applies to health systems. Here again the consideration of private systems is high on the agenda of policymakers, despite the fact that the overall framework is quite different among countries. The financing of health systems is of serious concern. Private health insurance can play a role in this respect, as a complement to public schemes, but needs an adequate regulatory framework to ensure that the basic social objectives of health policies are met. The OECD analysed these issues in its health project and will continue to develop work in this field, focusing on the relationship between ageing and health.

Catastrophic risks

The past few years have witnessed a number of large-scale disasters, both man-made, such as the terrorist attacks of 11 September 2001, and natural, such as tropical storm Allison in 2001 in the US, extensive flooding in large parts of Europe in 2002, the earthquake

in Algeria in May 2003 or the appearance of new infectious diseases such as SARS. The frequency of such disasters and the magnitude of the losses involved have tended to increase. Since September 11, both government and the private sector, including insurers and reinsurers, have initiated a far-reaching reflection on how to cope with the threat of future catastrophes of comparable or even greater magnitude. This threat raises an operational and financial challenge: large-scale disasters translate into innumerable claims that need to be filed, assessed and processed within a short time frame, and massive compensation payments may have to be made.

The OECD has been examining the key contribution of the insurance sector in the non-financial management of catastrophes, *i.e.* in risk assessment, claim management and risk prevention. It has also gathered information on the national mechanisms for catastrophe indemnification. Regarding terrorism, the OECD has sought to identify criteria to define terrorism for indemnification purposes, analysed the issue of terrorism insurability, and looked at the respective roles to be played by private insurance and reinsurance markets, financial markets and governments in covering terrorism risk. Lastly, it considered the issue of mega-terrorism and options to compensate for extreme losses.

Globalisation

All these new risks emerge in the framework of the globalisation and integration of financial markets. Globalisation affects financial infrastructure and the *modus operandi* of “small” financial markets, while integration has led to further market and supervisory consolidation in several countries. These structural developments also affect the regulatory coherence of national and sectoral financial systems and the related search for better international mutual understanding and co-operation which is proving indispensable in an increasingly global and integrated financial world.

The development of international co-operation in the financial services field and, above all, the liberalisation of regulations applying to the establishment, investment and cross-border operations of financial services companies are essential if individuals and businesses are to have access to the best financial services on offer. This in turn conditions sound economic development and fosters entrepreneurship.

To support the development of open and soundly-regulated trade in financial services, the insurance provisions of the OECD Code of Liberalisation of Current Invisible Operations have been reviewed and updated to reflect current market and regulatory conditions. To enhance transparency and allow gradual liberalisation, member countries will now have to assess their conformity with the new requirements of the Code and lodge reserves accordingly. Sensitive issues, such as the relevance of prudential carve-outs, will have to be reviewed. More generally, the relation between liberalisation and deregulation will remain a priority issue for regulatory and supervisory authorities, in fast-evolving and increasingly integrated insurance markets.

The financial world is now global and OECD countries are working more and more closely with other countries. The OECD is playing a key role in promoting adequate financial regulation and good practices in emerging economies with a special focus on Brazil, India, Russia and China, as well as the Asian and Latin American regions. It also encourages international co-operation through the International Network of Pensions Regulators and Supervisors or the Multilateral Network on Debt Management which was set up in 2003.