

***REFORMING THE FEE STRUCTURE
OF ASSET MANAGEMET
and
Future of Asian Financial System***

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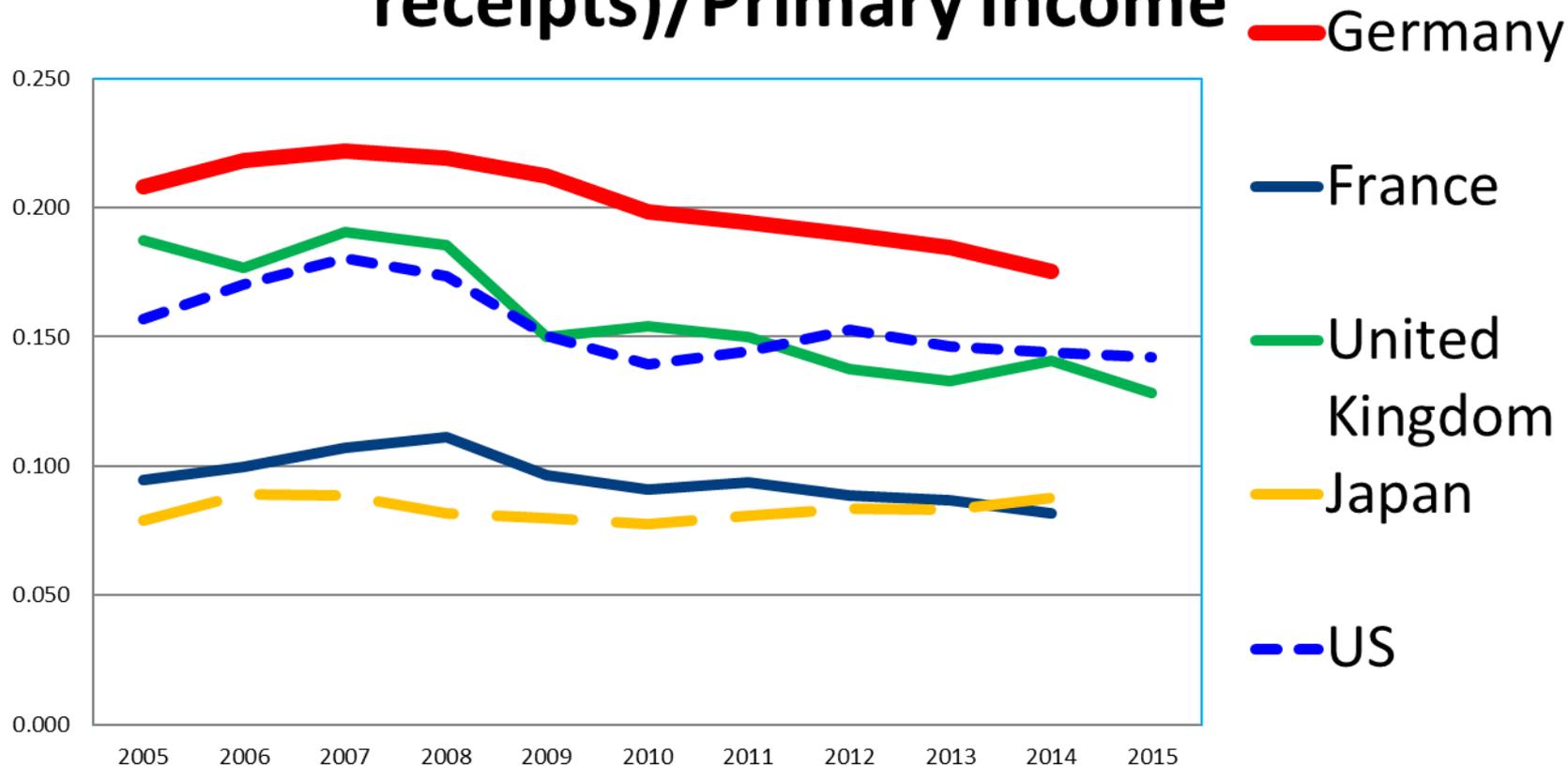
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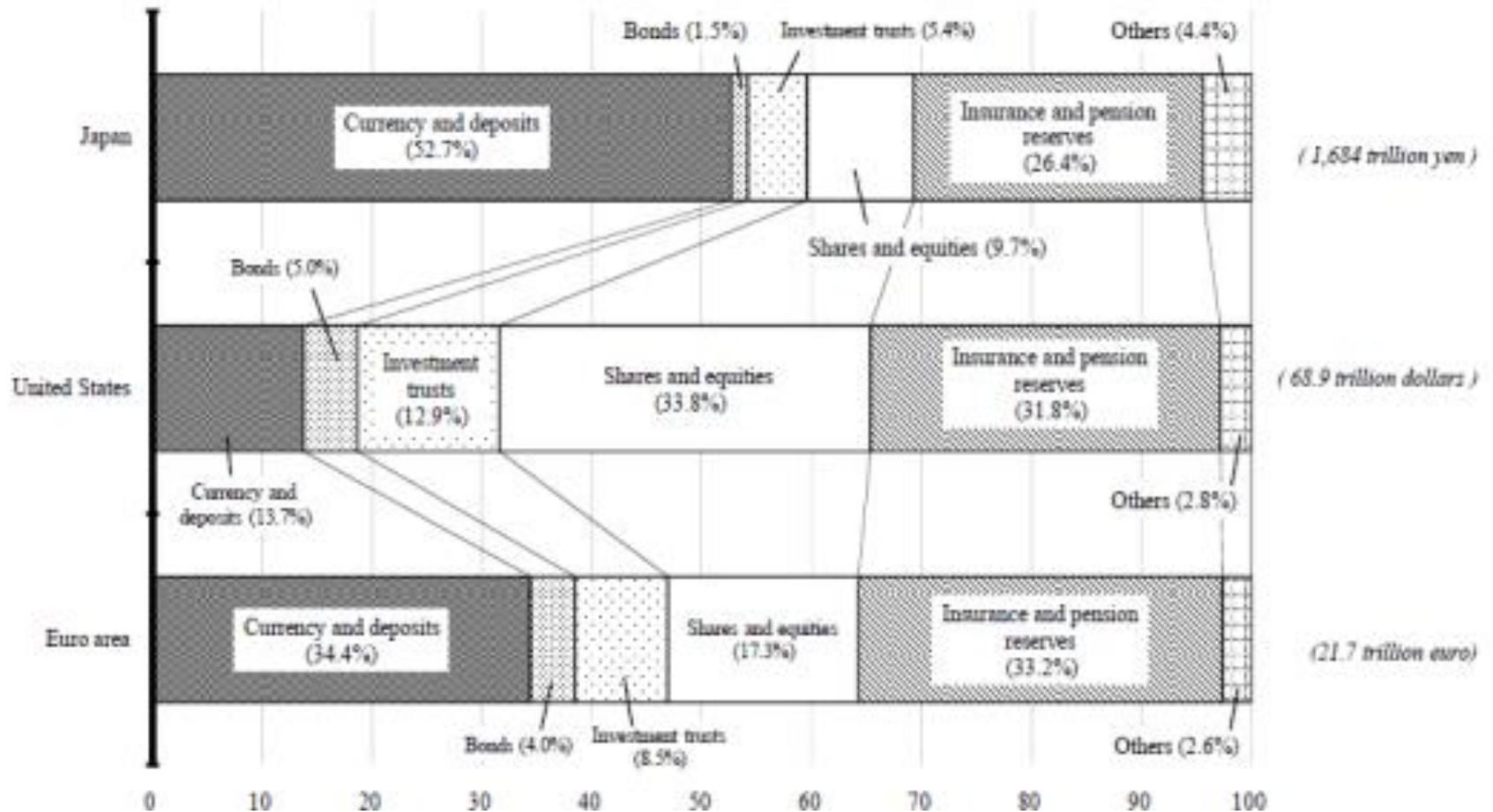
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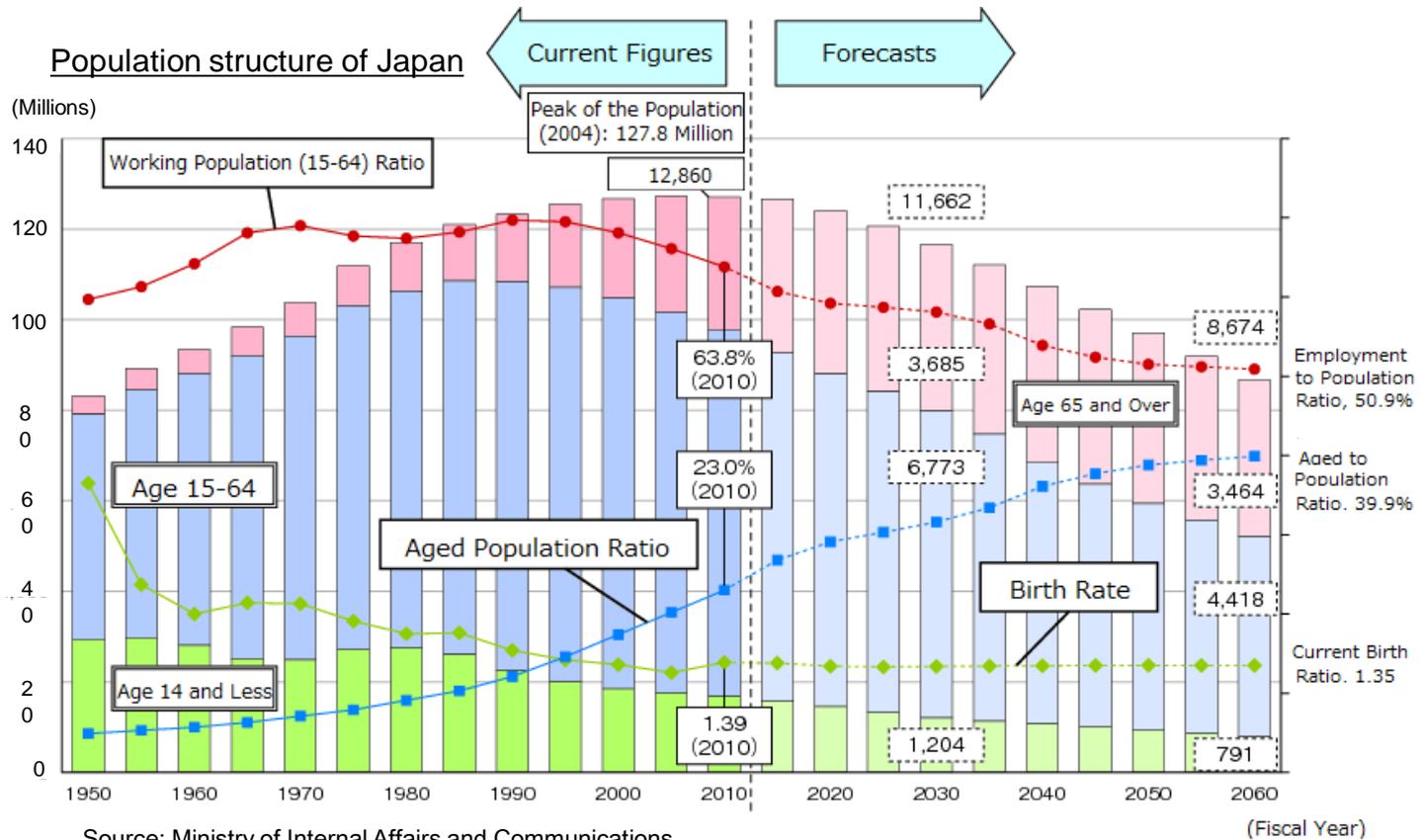
(Dividends & Interest receipts)/Primary Income



Asset Allocation (USA, JAPAN, Europe)

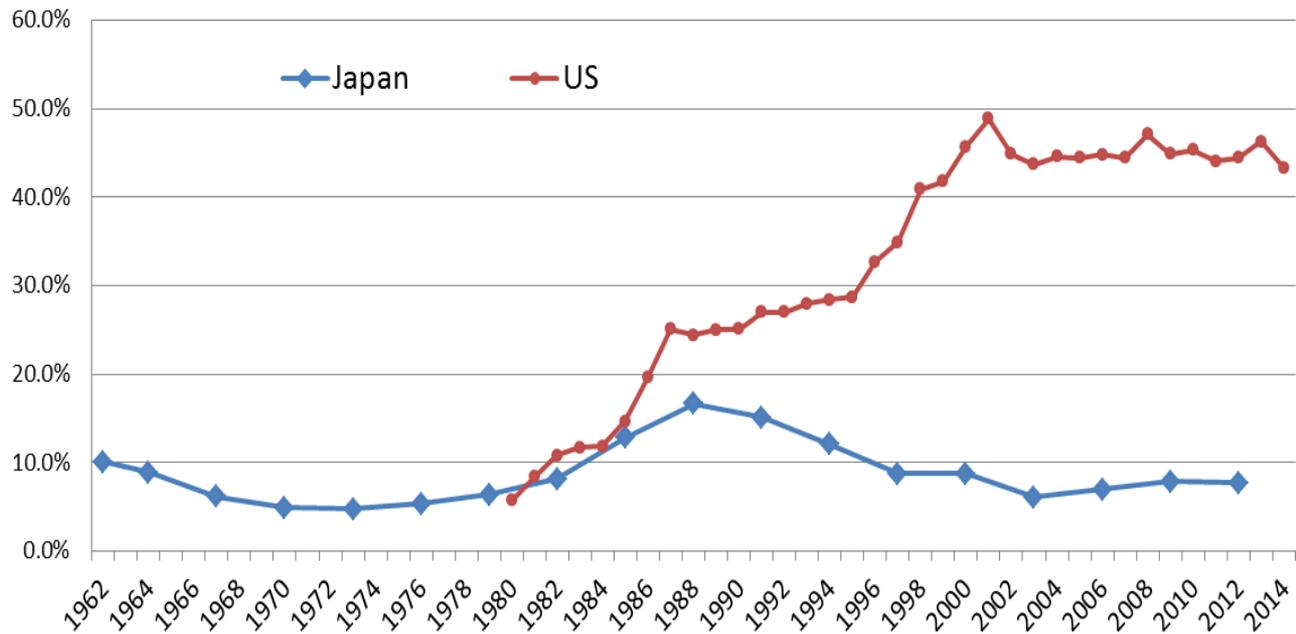


Japan's Aging Population



Various Financial Assets			Assets
Currency and deposits			17,394,359
Loans			15,253,379
Debt securities			13,471,222
	Central government sec		9,113,357
Equity and investment fund shares			12,058,549
Insurance and pension reserves			5,428,560
Trade credits and foreign trade credi			2,336,030
Outward investment in securities			5,570,573
Total			77,513,574

Percentage of US and Japanese household **Investment trusts and Mutual Funds**

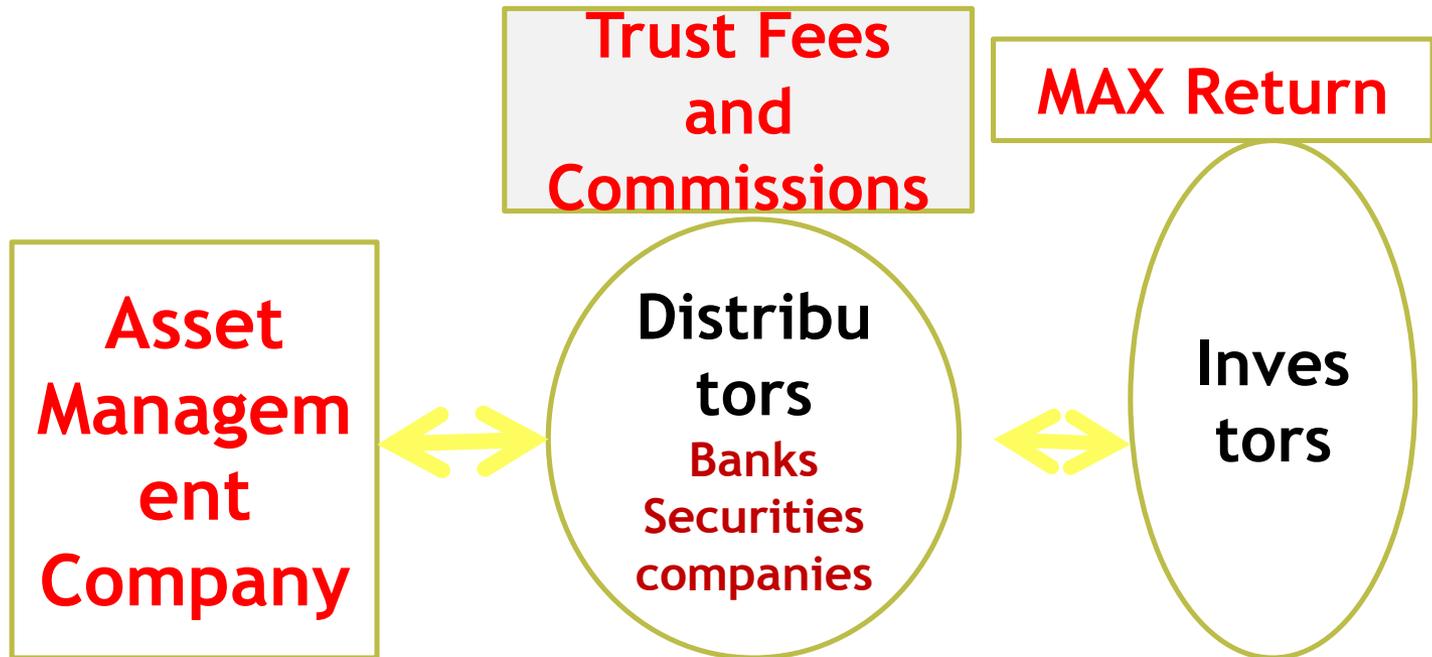


Fees and Commissions of Distributors

Maximize Fee and Commissions (**Distributors**)

Investors --- maximize Return

Trust Fees & Commissions = $\alpha(A + \text{Dividend})$

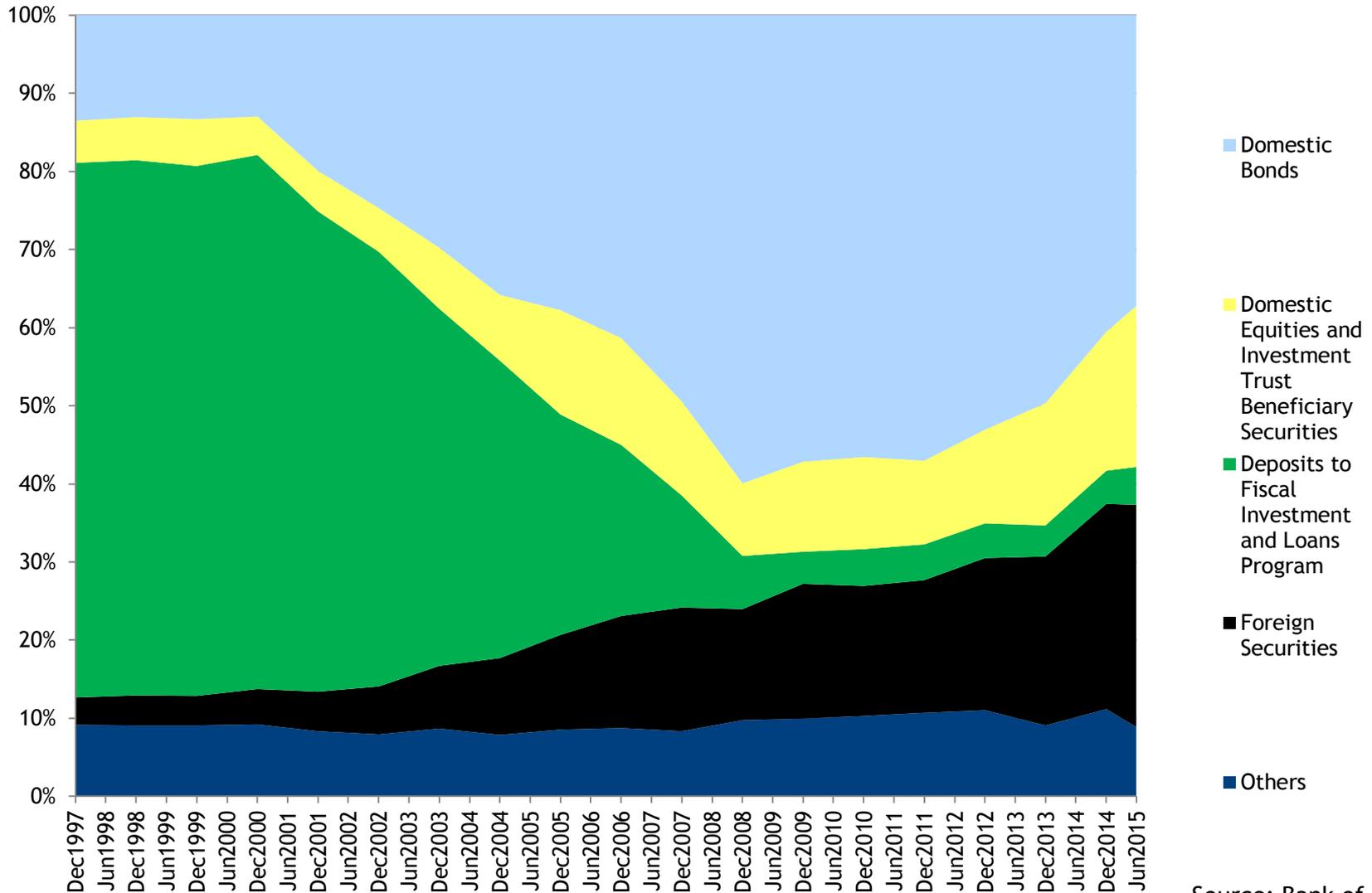


Mutual Funds - Holding Period

Fee Structure is important

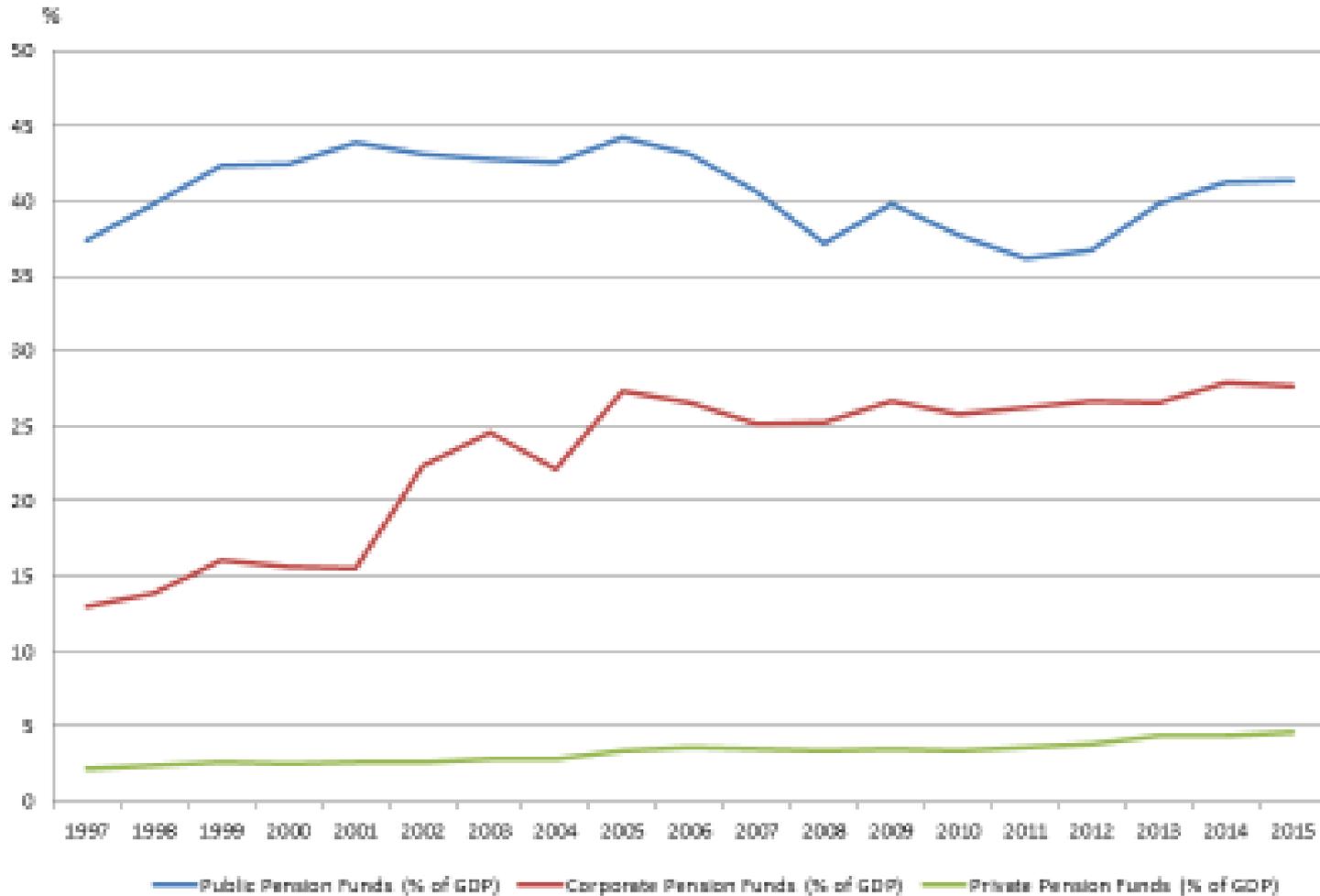
		Gross return on investment	=	Net return of individual investors	+	Sales charges	+	Trust remunerations
No switching 2000.1~2014.12	$A_0=100$	R 44.27	=	$A_T - A_0$ 24.34	+	τ 2.45	+	ϵ 17.48
Switching funds every 2.8years	$A_0=100$	R 43.31	=	$A_T - A_0$ 14.65	+	τ 12.13	+	ϵ 16.53
Switching funds every 2.0years	$A_0=100$	R 42.99	=	$A_T - A_0$ 10.47	+	τ 16.32	+	ϵ 16.20

Public Pension Funds: Portfolio Asset Allocation



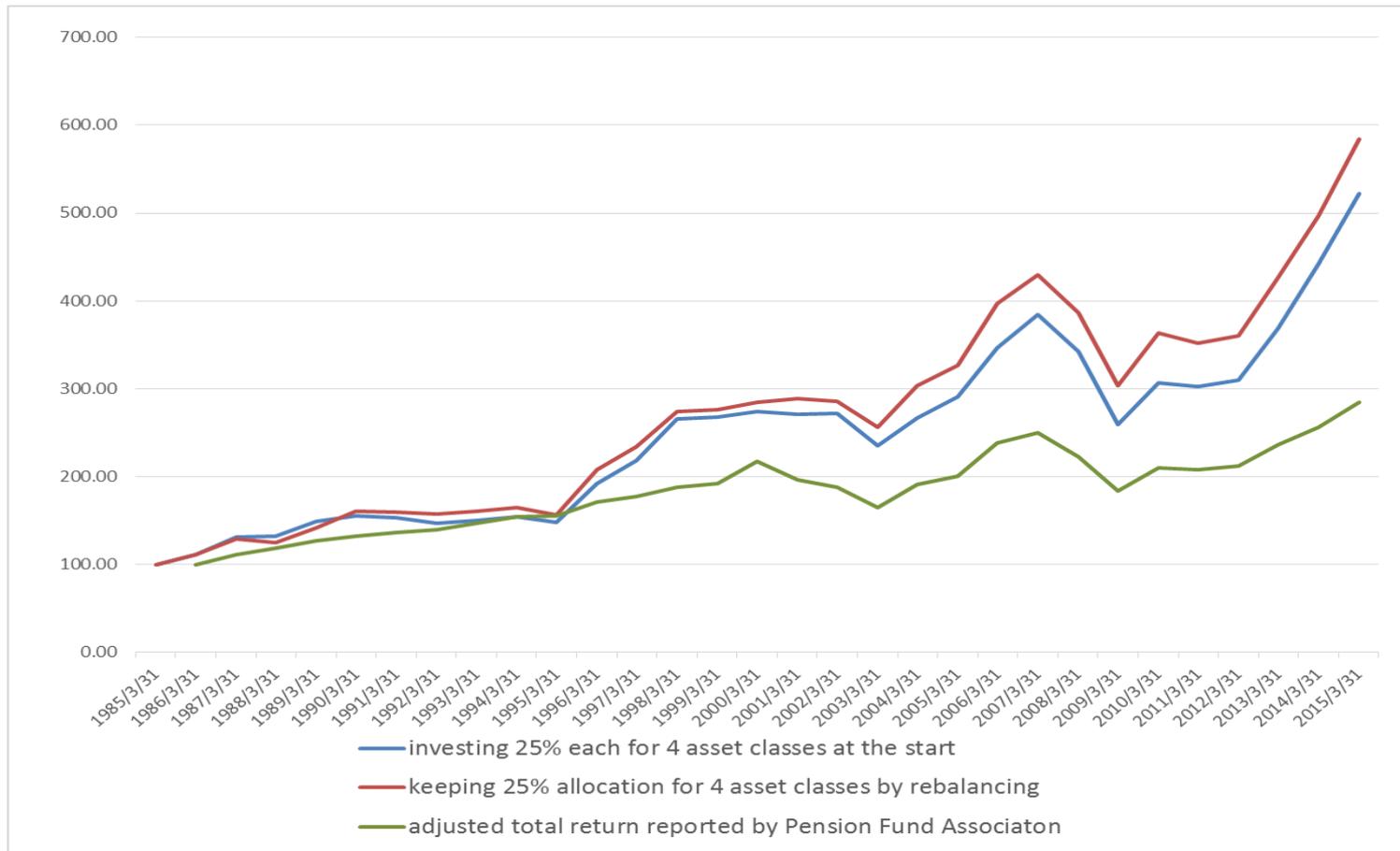
Source: Bank of Ianan

Public, Corporate and Private Pension Funds as % of GDP



Source: Bank of Japan

Rate of Return on Pension Funds



Corporate Pension

frequent rotation in Japan

© Effect of Frequent Rotation of Corporate Asset Managers

Why frequent rotation ?

In order to avoid miss conduct of huge amount of asset management.

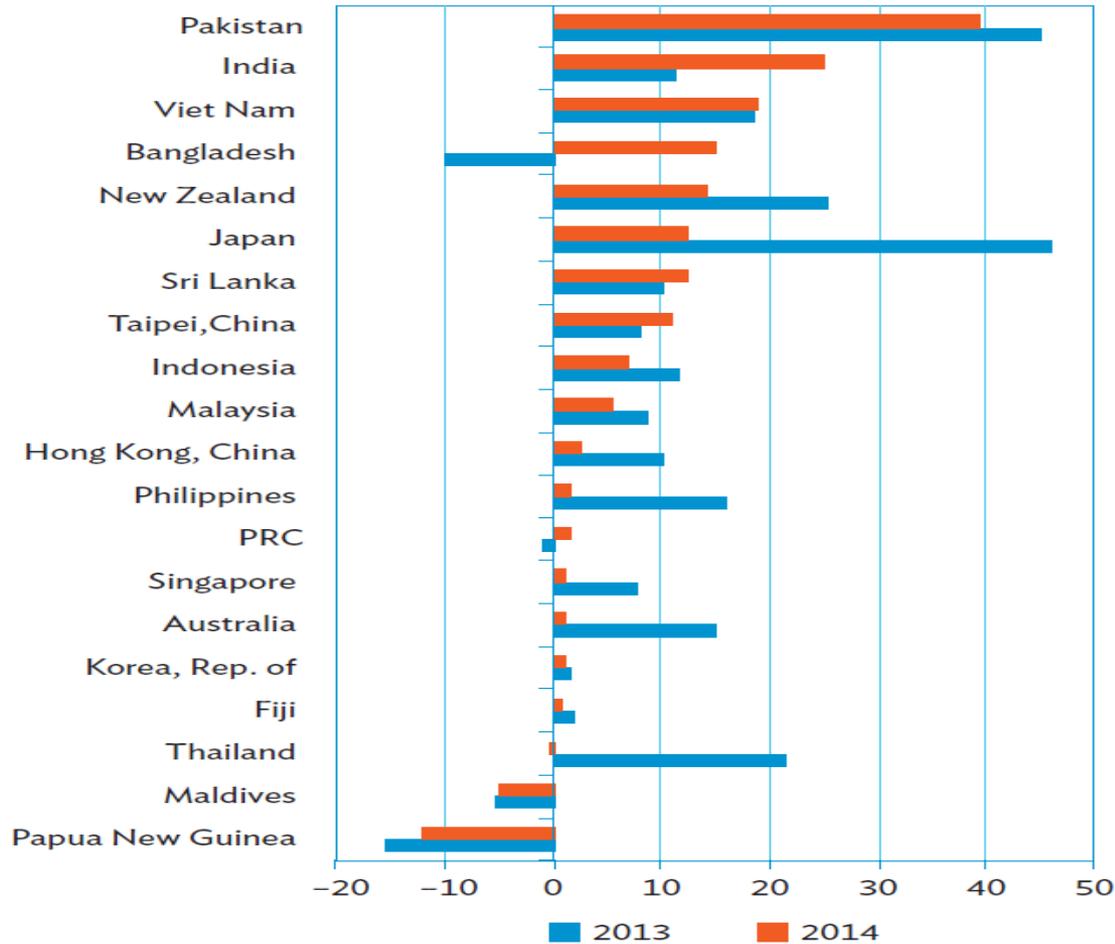
All the asset management at corporate pension funds prefers to keep non-negativity of their asset management during his term

They tend to invest into safe assets such as government bonds.

They prefer to invest into private equity where evaluation of market values are not done.

New asset managers of the corporation often changes his own strategy compared to the previous asset managers even though his predecessors aimed for long term investment.

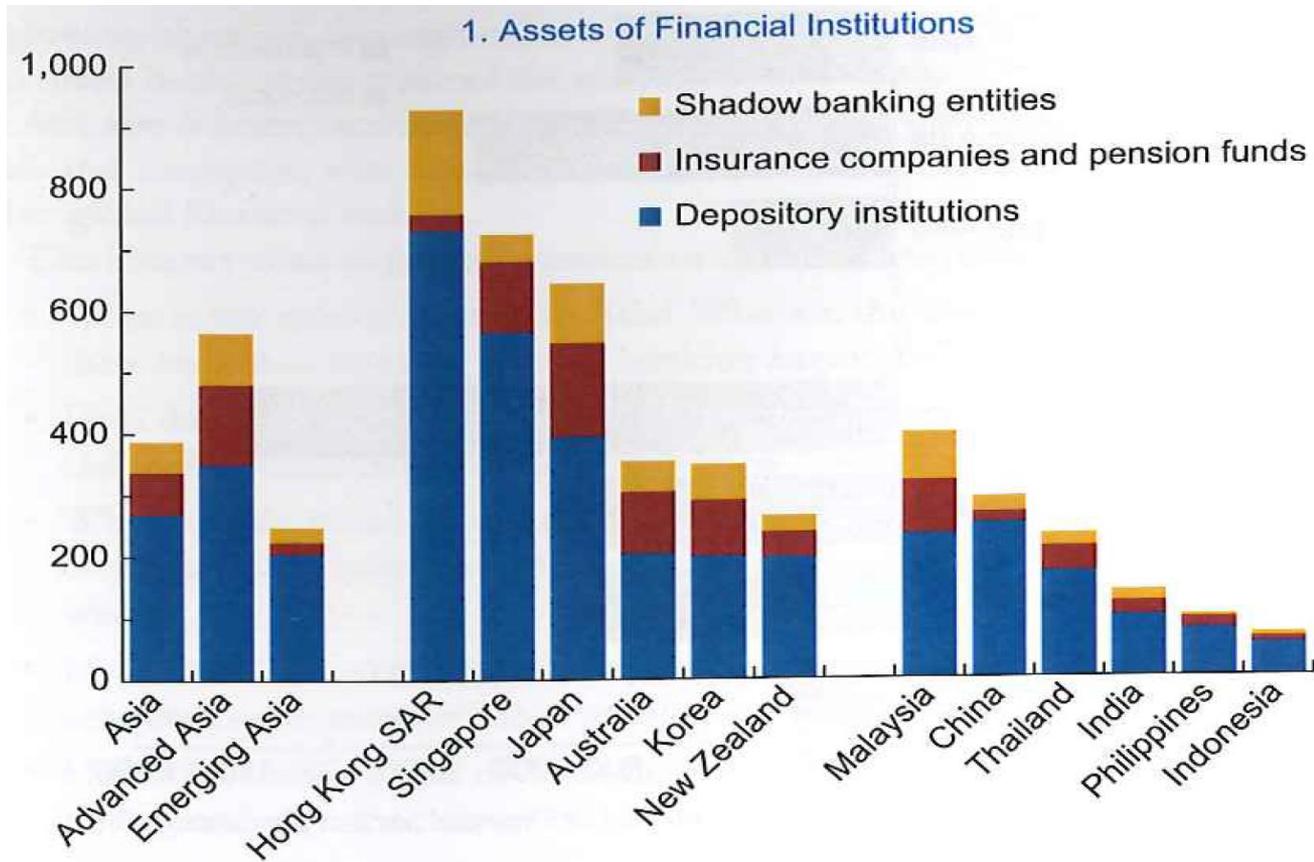
Figure 3.8: Stock Market Index, 2013 and 2014
(annual % change)



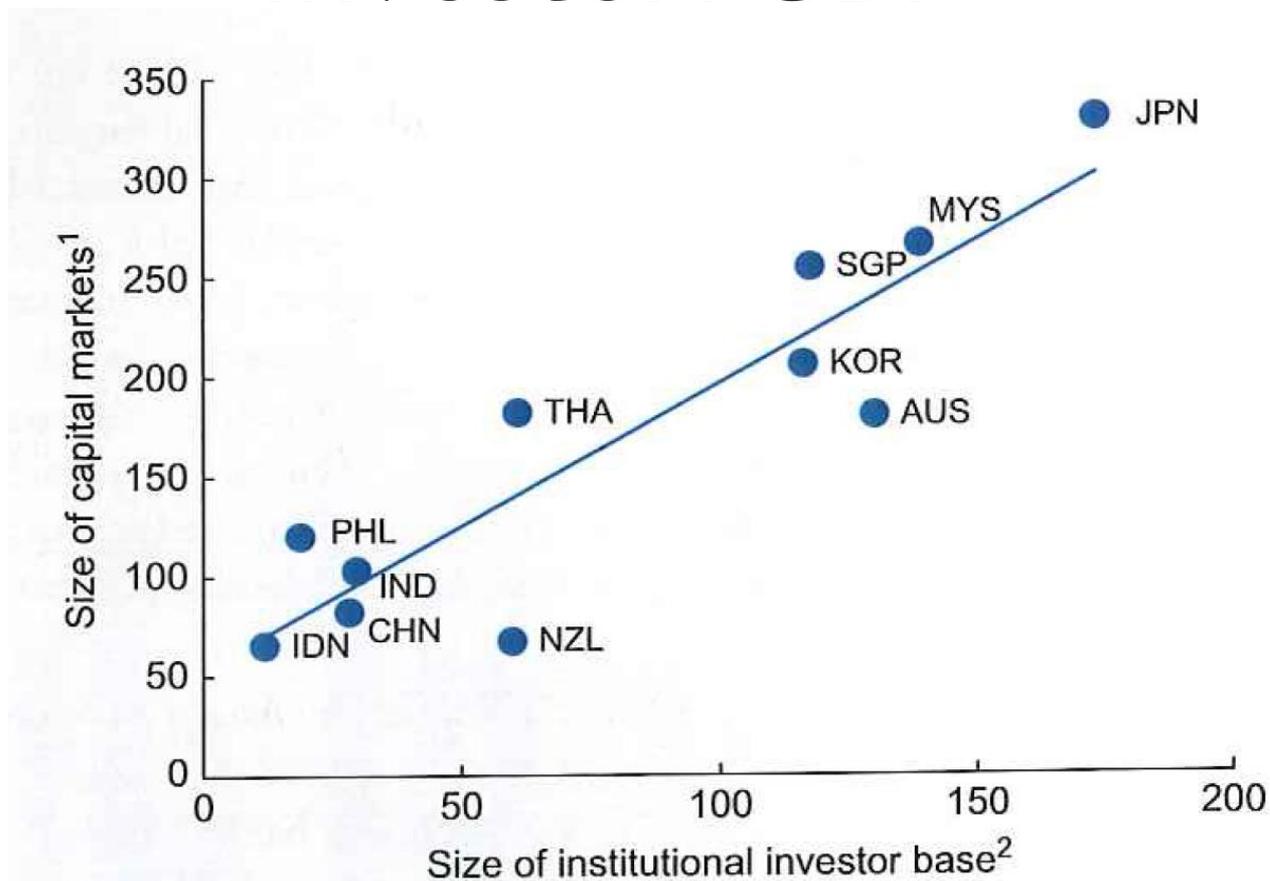
**High
Volatility
of
Stock
Market**

**Large
Share
of
overseas'
Investors**

Assets of Financial Institutions



Size of Institutional Investor / GDP



Asian Financial Markets' Main Features

1. Bank-dominated financial system
2. Small share of bond markets --->
Needs for long term financing
3. **Lack of long-term investors** such as **pension funds and Life insurance**
4. Bench mark bond market (sovereign bond)
Infrastructure bond, corporate bond
5. High percentage of SMEs
6. Large share of Microcredit (finance companies); Lack of venture capital



ADB Working Paper Series

Estimating Dual Deposit Insurance Premium Rates and Forecasting Non-performing Loans: Two New Models

Naoyuki Yoshino,
Farhad Taghizadeh-Hesary,
and Farhad Nili

No. 510
January 2015

Figure 4: Dendrogram Using Average Linkage

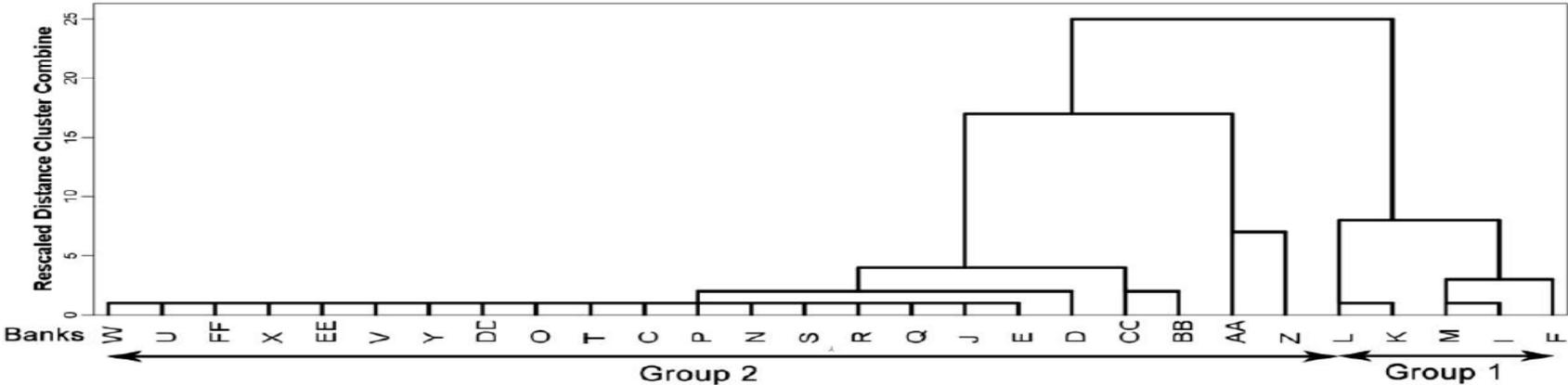
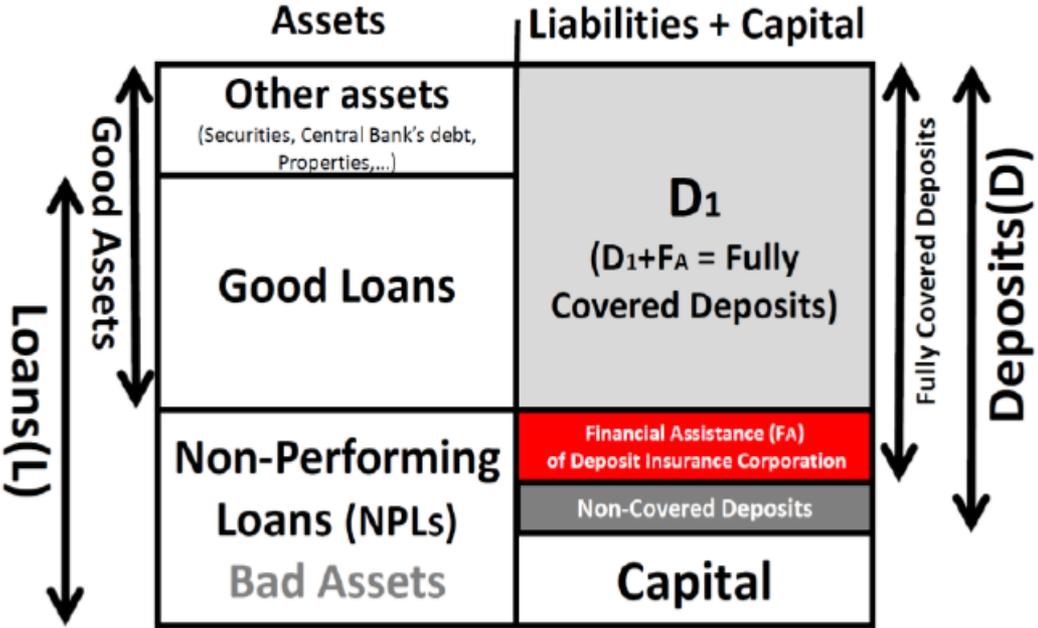


Figure 7: Financial Assistance of the Deposit Insurance Corporation/Agency in a Failed Bank’s Balance Sheet



Fair Deposit Insurance Premium of two groups of banks

Based on these assumptions and our earlier forecast for NPLs, we estimated the present value of FA, and were thus able to obtain fair deposit insurance premium rates for each group of Iranian banks. For Group 1, which is the group with higher soundness and stability, the calculated premium rate is 0.64% and for Group 2, which has lower soundness and stability, the rate is 0.86. To calculate the fair premium income from each group of banks, these two rates need to be multiplied by the amount of eligible deposits. The effective fair premium rate, which is the weighted average of the two estimated premium rates, is 0.83. This rate could be use by the DIC in case it decides to adopt a single premium rate policy.

Figure 2: Income and Expenditure of DIC in the Case of Dual Premium Rates

	Income	Expenditures and Reserves
Income(I)	Premium Income from "A" Banks $I_A = D_A \times \tau_A$	Financial assistance to "A" banks
		Share of "A" banks from DIC operational expenditures
		Reserves of "A" banks at DIC
	Premium Income from "B" Banks $I_B = D_B \times \tau_B$	Financial assistance to "B" banks
		Share of "B" banks from DIC operational expenditures
		Reserves of "B" banks at DIC

DIC = de

$$\left\{ \begin{aligned}
 & \frac{\tau_A D_0^A}{(1+r_0)^0} + \frac{\tau_A D_1^A}{(1+r_1)^1} + \frac{\tau_A D_2^A}{(1+r_2)^2} + \dots + \frac{\tau_A D_n^A}{(1+r_n)^n} = \alpha \left[\frac{E_0}{(1+r_0)^0} + \frac{E_1}{(1+r_1)^1} + \frac{E_2}{(1+r_2)^2} + \dots + \frac{E_n}{(1+r_n)^n} \right] + \\
 & \frac{F_0^A}{(1+r_0)^0} + \frac{F_1^A}{(1+r_1)^1} + \frac{F_2^A}{(1+r_2)^2} + \dots + \frac{F_n^A}{(1+r_n)^n} + \beta \left[\frac{RES_n}{(1+r_n)^n} \right] \\
 & \frac{\tau_B D_0^B}{(1+r_0)^0} + \frac{\tau_B D_1^B}{(1+r_1)^1} + \frac{\tau_B D_2^B}{(1+r_2)^2} + \dots + \frac{\tau_B D_n^B}{(1+r_n)^n} = (1-\alpha) \left[\frac{E_0}{(1+r_0)^0} + \frac{E_1}{(1+r_1)^1} + \frac{E_2}{(1+r_2)^2} + \dots + \frac{E_n}{(1+r_n)^n} \right] + \\
 & \frac{F_0^B}{(1+r_0)^0} + \frac{F_1^B}{(1+r_1)^1} + \frac{F_2^B}{(1+r_2)^2} + \dots + \frac{F_n^B}{(1+r_n)^n} + (1-\beta) \left[\frac{RES_n}{(1+r_n)^n} \right]
 \end{aligned} \right.$$

Financial Education for Individuals

Education Program and School Education

1, Financial Education Council

FSA (Financial Services Agency),

Ministry of Education, Cabinet Ministry

Ministry of Consumer Protection,

Chairperson, YOSHINO

Central Bank of Japan

Various Financial Associations

(Bankers Association, Stock Exchange)

2, Text books, **Educate School teachers**

I. Financial life planning and household expense management

A. Money management and decision making

Goals Goals by category have been set in reference to the four aspects in learning assessment. ^(Note)	Primary School Students		
	1st and 2nd grades	3rd and 4th grades	5th and 6th grades
a. Understanding that resources are limited (i.e., budgets are constrained).	1. Learning the value of goods and money, and making much of them. (Living Environment Studies, Moral Education) 2. Learning that one cannot have all that one wants.	5. Understanding the limitedness of goods and money and the importance of money. (Social Studies)	9. Understanding the limitedness of goods and money, and thinking of better ways to use them. (Home Economics) 10. Being able to exercise moderation in spending, while reviewing one's spending habits. (Moral Education) 11. Being able to buy things according to one's plan, while taking indispensability into account. (Home Economics)
b. Understanding the significance of building a better life under a limited budget, and acquiring the skills and attitude to do so.	3. Learning to be patient when unable to have what one wants. 4. Being able to buy goods within one's budget.	6. Recognizing the difference between needs and wants. 7. Being able to manage money by recording the amount of pocket money or money spent. 8. Becoming aware of the importance of moderateness through learning how to spend money appropriately, and practicing it in one's everyday life. (Moral Education)	12. Learning how to choose goods, and being able to buy goods efficiently. (Home Economics)



Promoting Better Lifetime Planning *through* Financial Education

Naoyuki Yoshino
Flore-Anne Messy
Peter J Morgan
Editors



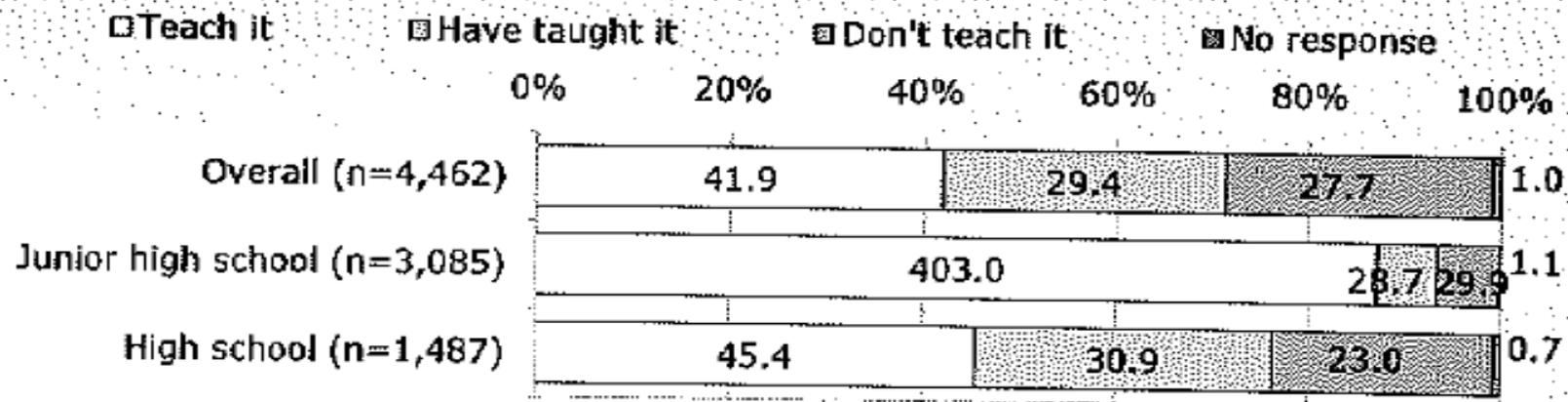
Table 3.2 Financial education after financial liberalization
(around 2000 and after)

Year	Financial Education
2001	Central Council for Savings Promotion was renamed Central Council for Financial Services Information and Local Councils for Savings Promotion were renamed Prefectural Councils for Financial Services Information.
2002	Districts for Promotion of Savings and Life Planning were renamed Financial Study Groups, and Promoters of Savings and Life Planning were renamed Financial Services Information Advisers.
2005	The Central Council regarded this fiscal year as the first year of promoting financial education.
2007	The Central Council published the "Financial Education Program."

Notes: As a result of the Japanese Financial Big Bang, individuals were expected to become independent and to be able to judge financial matters appropriately.

Source: Central Council for Financial Services Information website (<http://www.shiruporuto.jp/about/us/enkaku/>).

Do you actually teach financial and economic education?



Actual Time Spent Teaching Financial and Economic Education

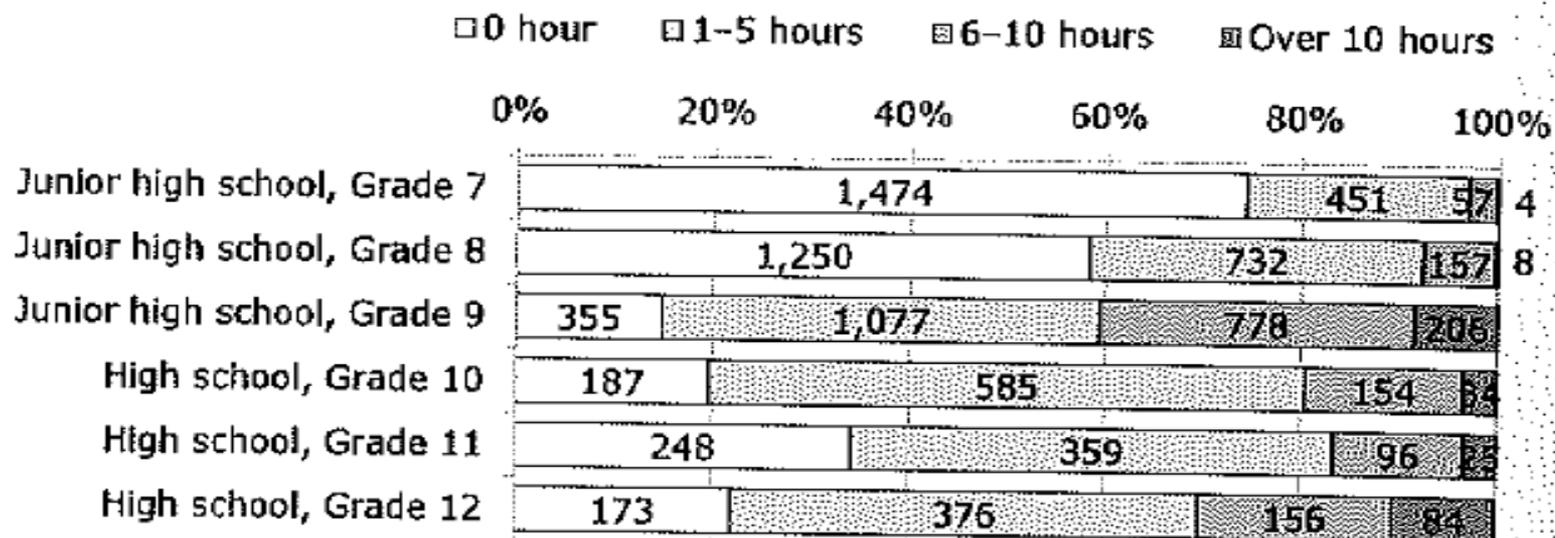


Figure 3.2 Finance is taught, but for few hours

Source: Study Group on the Promotion of Financial and Economic Education (2014).

Why is it difficult to teach?

Difficult for students to understand	Lack of expertise among teachers	Not enough lesson time	Changes in the actual economy are too complex	No appropriate teaching material	Low level of interest among students	Little opportunity for teachers to obtain training	School unused to teaching the subject	Difficult to obtain understanding of parents or guardians
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Figure 29. Difficulties Encountered When Giving Lessons

		Number of questionnaires	Difficult for students to understand	Lack of expertise among teachers	Not enough lesson time	Changes in the actual economy are too complex	No appropriate teaching material	Low level of interest among students	Little opportunity for teachers to obtain training	School unused to teaching the subject	Difficult to obtain understanding of parents or guardians	Others	No response
Overall		4462	48.9	48.4	44.9	37.8	26.6	25.7	14.0	5.2	0.2	1.0	1.6
By school type	Junior high school	3085	49.9	49.4	44.4	38.9	28.3	22.4	13.6	5.4	0.3	0.9	1.6
	High school	1487	46.3	45.9	46.2	35.0	23.2	33.0	14.9	4.5	0.1	1.1	1.8
By subject responsibility	Junior high school social studies	1732	56.2	42.1	45.2	48.0	23.0	19.1	10.7	5.1	0.3	0.9	1.5
	Junior high school technology and home economics	1371	41.8	58.4	43.5	27.5	35.0	26.6	17.2	6.0	0.3	0.9	1.6
	High school civics	612	52.9	36.3	47.9	40.4	22.1	33.0	11.8	5.6	0.3	0.7	2.0
	High school home economics	738	40.1	54.7	48.5	30.4	24.3	31.8	16.4	3.3	-	1.2	1.6
	High school commerce	140	50.0	40.7	27.1	36.4	22.1	38.6	20.7	6.4	-	2.9	2.1

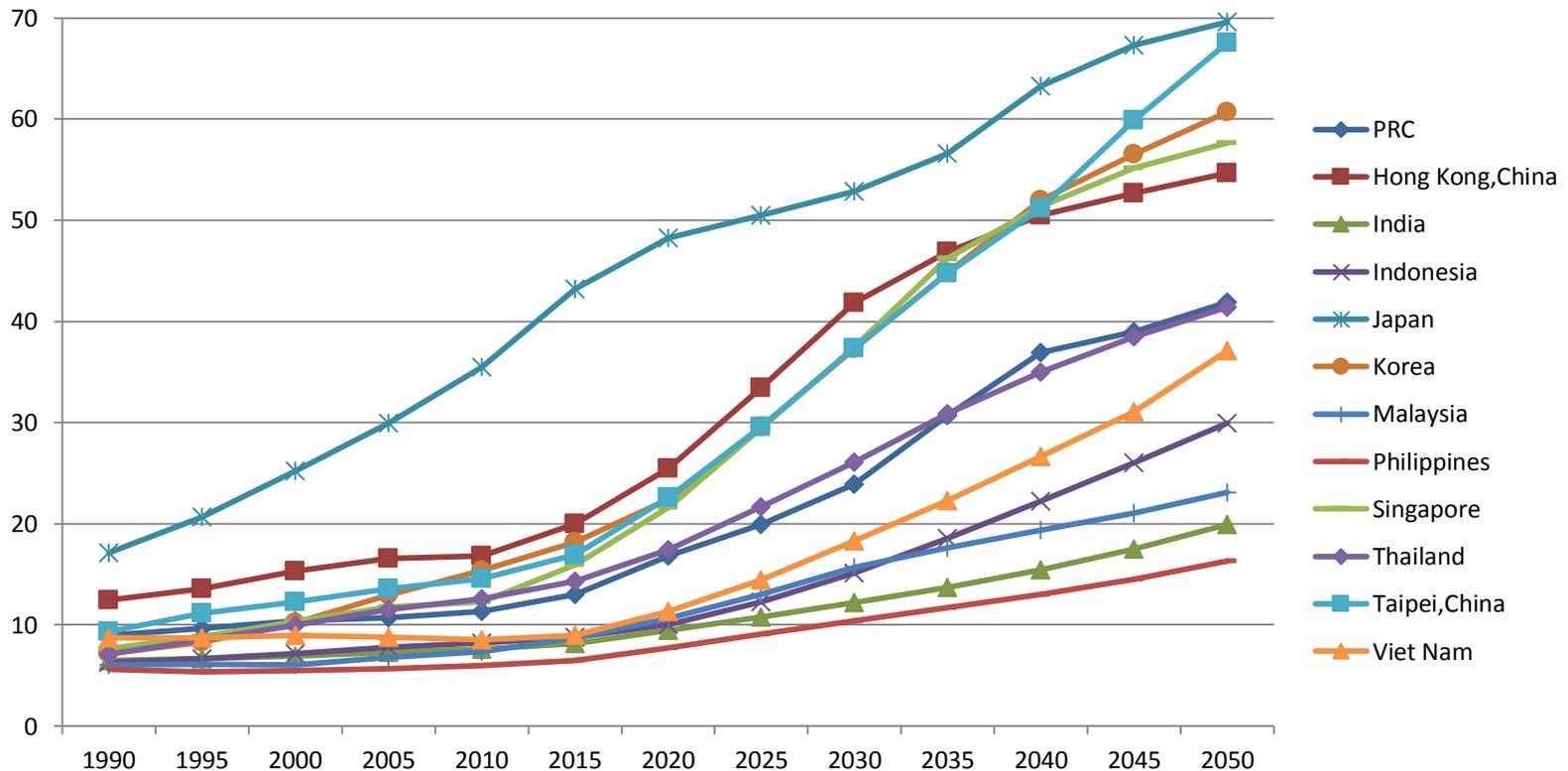
Financial Education in Schools (Japan)

- 1, Secondary School and High School taught in the courses of “**Civics Home economics**”
 - Many teachers are not well trained.
- 2, Financial education in primary schools is taught in “**Home making courses**”.
- 3, Very few hours are allocated to financial education
- 4, It is regarded as a shame to make money by financial investments
- 5, Retirees from financial institutions could teach financial economics to students (Video lectures)

Financial Education to prepare for old age

- 1, Government Support --- Pension System
401K (Self protection for asset allocation)**
- 2, Life Insurance --- long term savings by individuals**
- 3, long term institutional investors
infrastructure investment (long-term funding)**
- 4, Various financial products will be sold in Asia**
- 5, Risks and Returns, individual financial education**

History/projections of dependency ratio (age 65+ / age 15-64) – highest in the Asian NIEs, followed by PRC and Thailand



Sources: World Population Prospects: The 2010 Revision of the United Nations Population Division, available at: <http://data.un.org/Data.aspx?q=dependency+ratio&d=PopDiv&f=variableID%3a44> and Council for economic planning and development (Taipei, China), available at: <http://www.cepd.gov.tw/encontent/m1.aspx?sNo=0001457>, accessed 28.12.2012

Regulation of Money Lenders in Rural Regions

1, Money lenders, **Interest rate = 96% in Japan**

2, License --- Banks

Registration --- Finance companies

3, **New Finance Company Law**

(i) **Highest interest rate = 20%**

(ii) **Amount of borrowing < 1/3 of Income**

(iii) **Minimum Capital requirement**

(iv) **Paper test to run business**

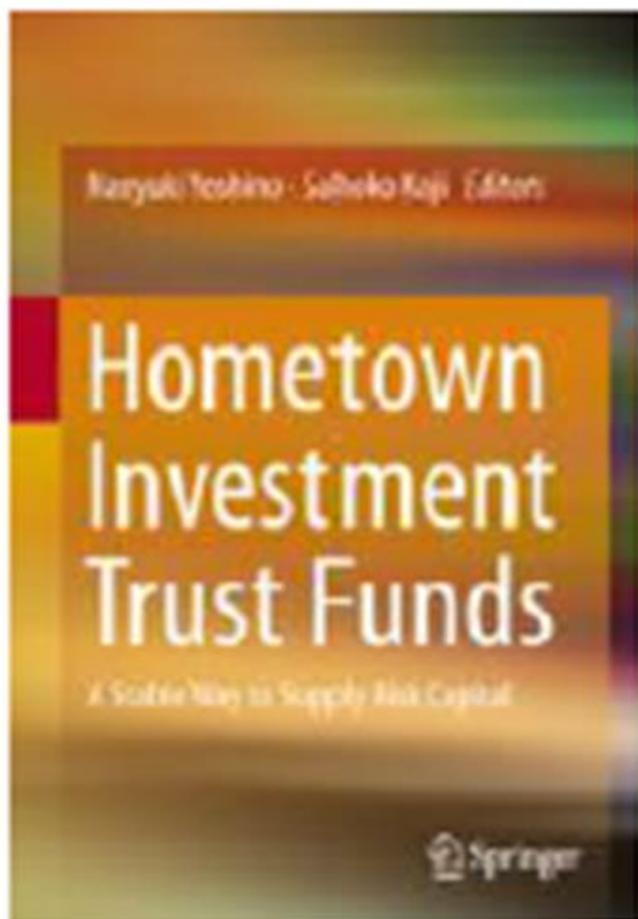
(v) **Self regulatory organization was set up**

two steps of monitoring and supervision

(vi) **Consumers' complaints (hotline)**

Possible Solutions

Start up businesses, farmers



Hometown Investment Trust Funds

-
A Stable Way to Supply Risk Capital

Yoshino, Naoyuki; Kaji Sahoko (Eds.)
2013, IX, 98 p. 41 illus., 20 illus. in color

Available Formats:

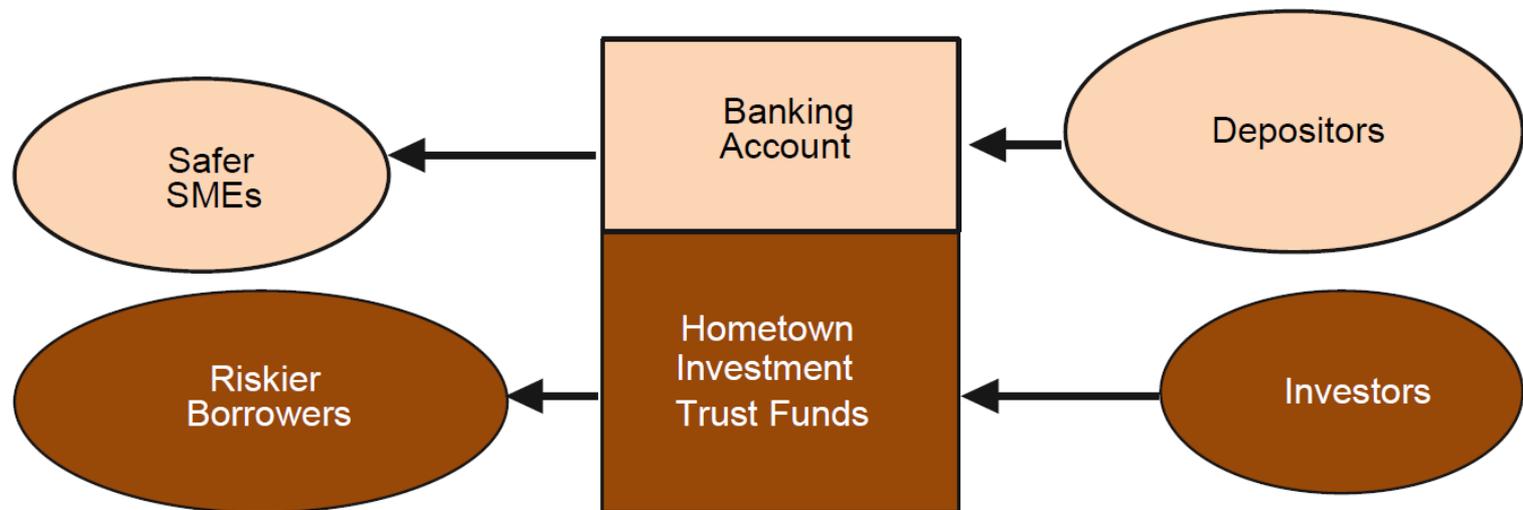
ebook

Hardcover

Springer

**Japan, Cambodia
Vietnam, Peru**

Hometown investment trust funds a new way to finance for Wind power generators, solar power panels etc.



SME =small and medium-sized enterprise.

Source: Yoshino and Taghizadeh-Hesary (2014).

SME



-Financial Access for All-



Agricultural Funds

Beans and Wine



Societal changes & retail location



Traditional trade



- Papa Mama store where owner live in
- Wet market selling perishables

Modern trade



- Shopping mall as one stop shopping
- Super market with wide assortment

In-station shopping mall



Medical floor



小児科	Pediatrics	兒科
予防接種	Vaccines	疫苗接種
内科	Internal Medicine	內科
皮膚科	Dermatology	皮膚科
旅行医学	Travel Medicine	旅行醫學

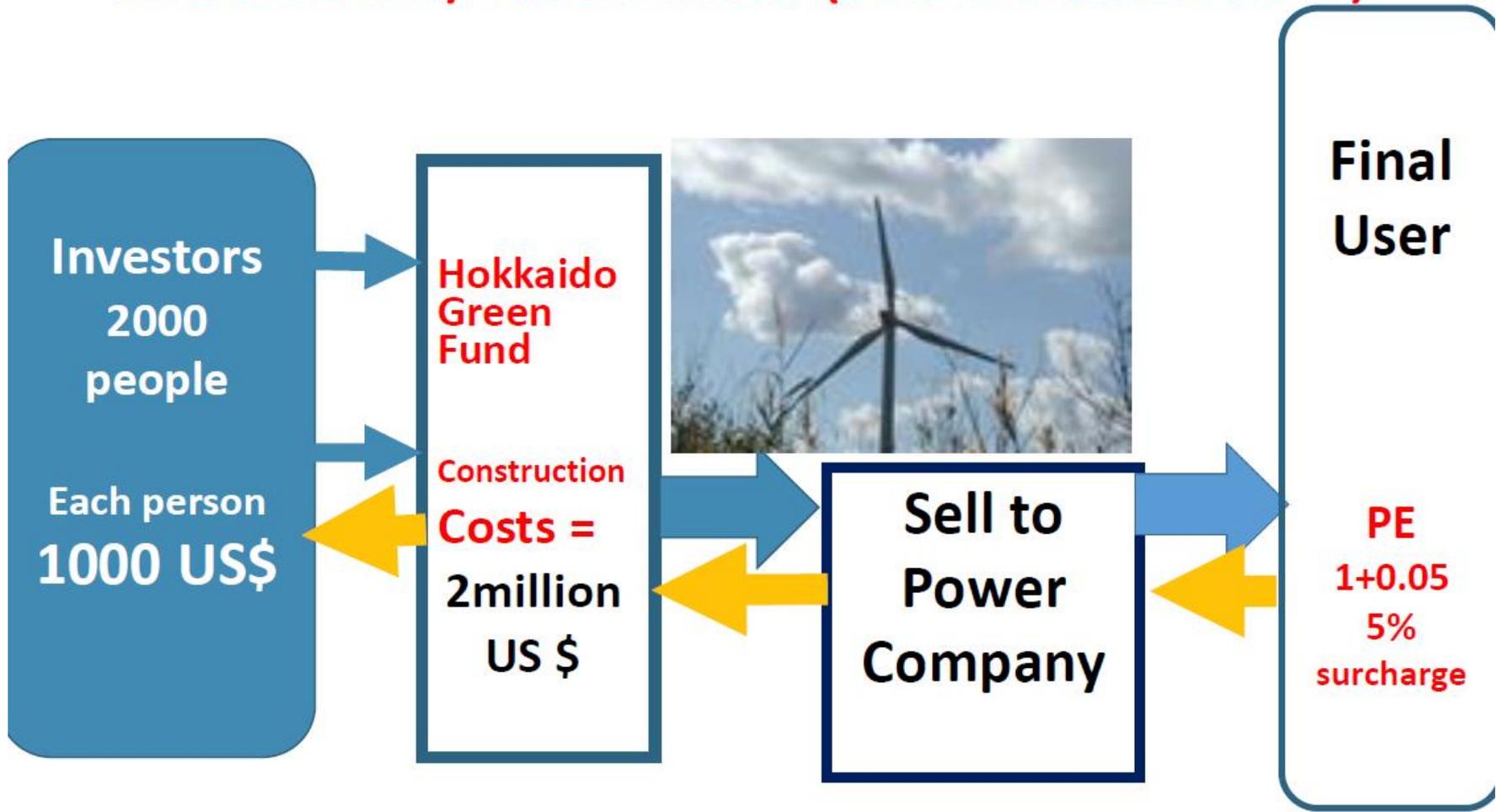
Wind Power Fund

Construction costs = 2 million US \$

**Future Environment
Relies on You**



Private Financial Scheme of Wind Power Collected by Individuals (started in 2001-9)



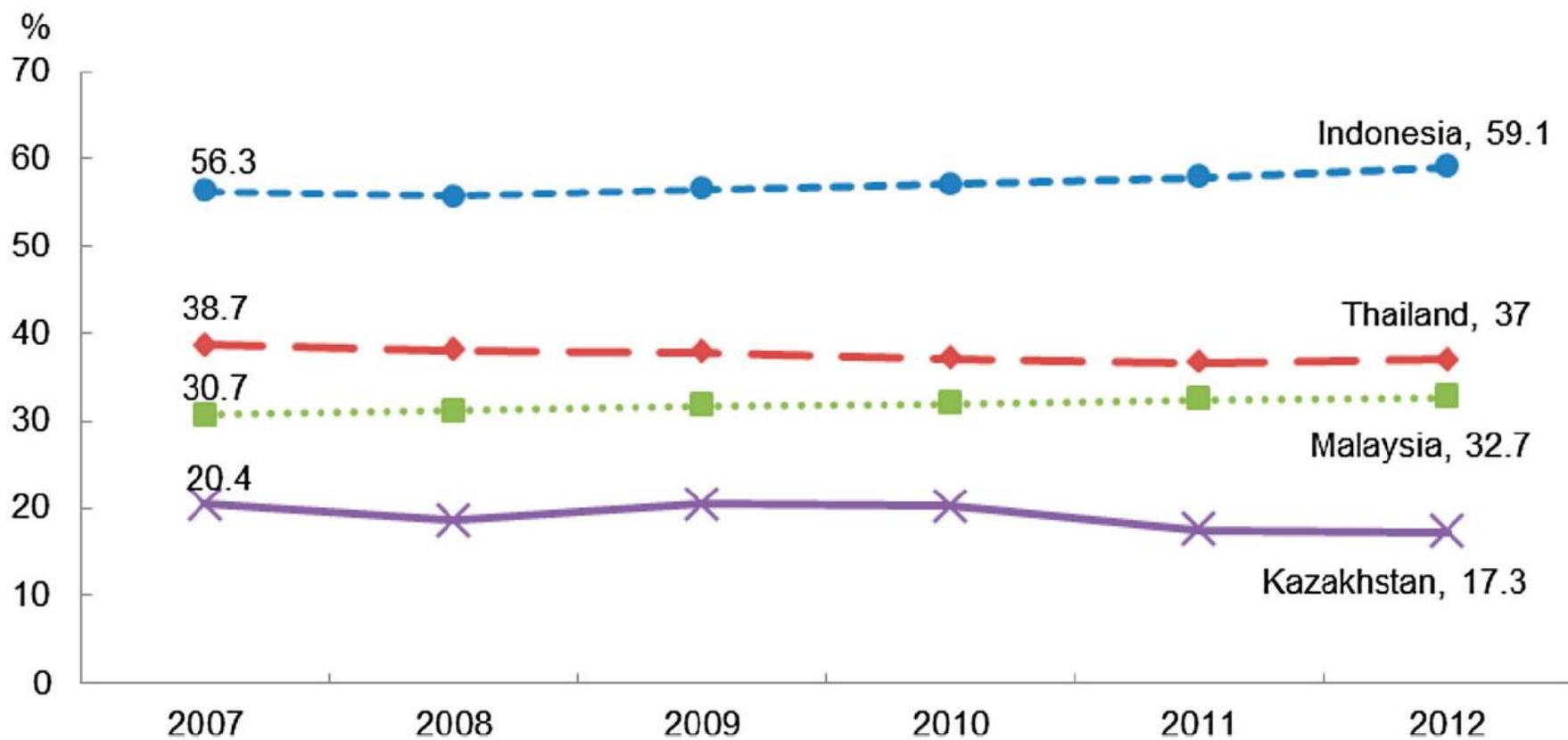
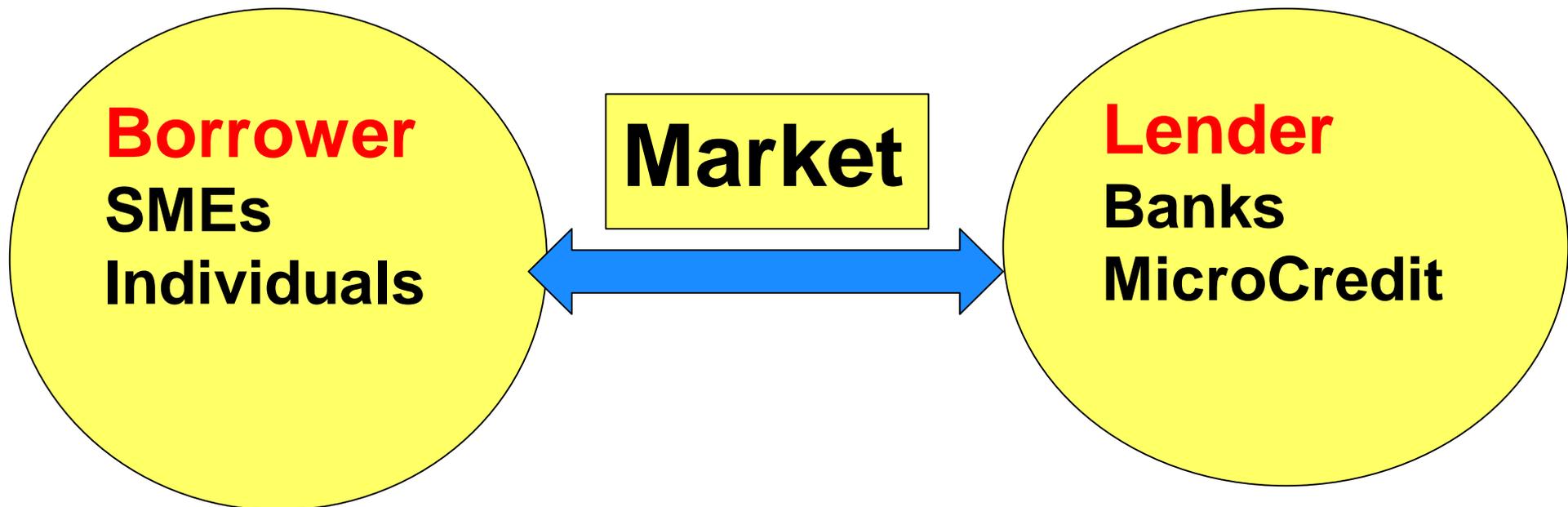


Figure 3. Contribution of Small and Medium-Sized Enterprises. to Gross Domestic Product. Source: ADB (2014).

Borrower, Lender and Market

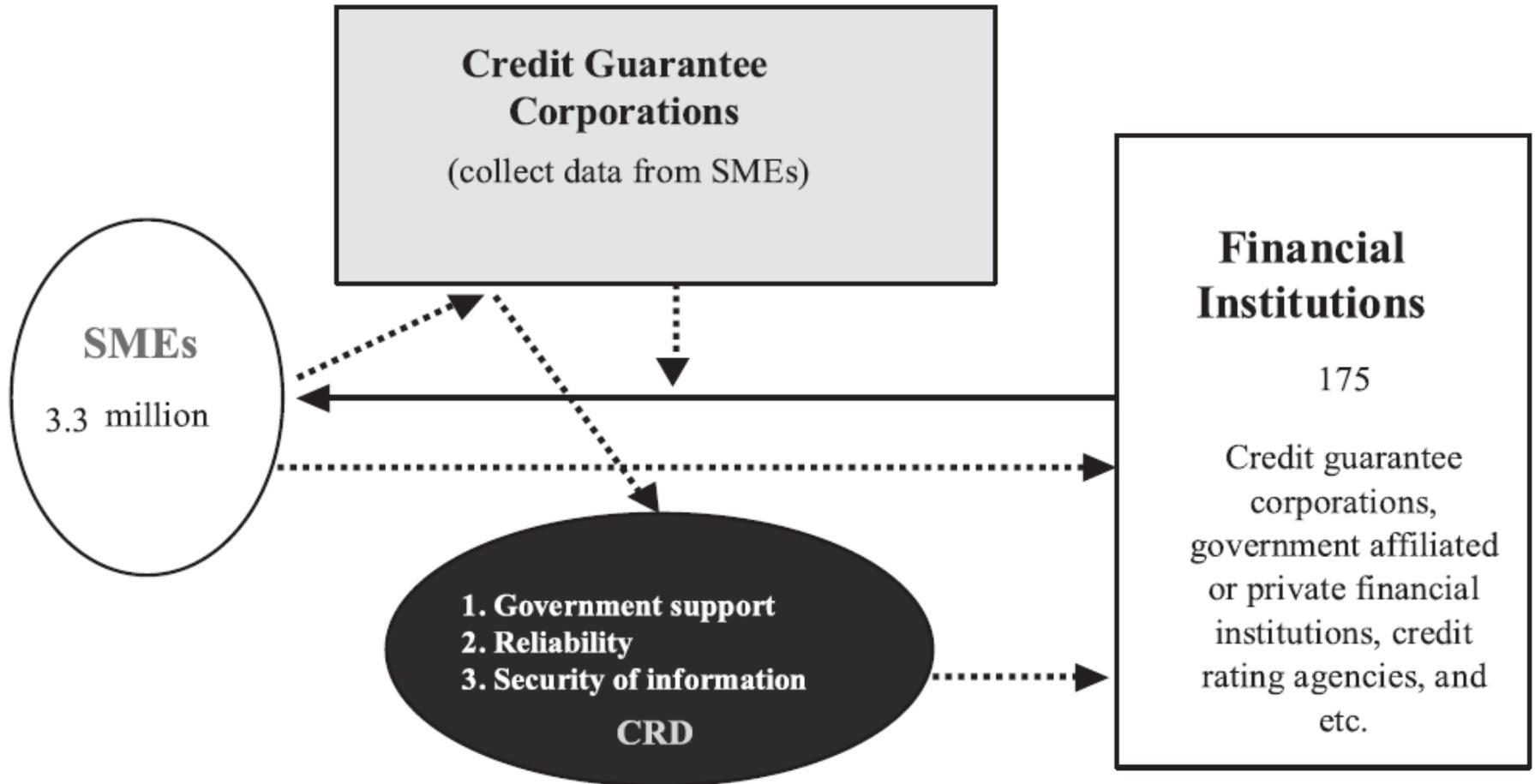


Information Asymmetry
Especially SME market

Four Accounts by SME

- 1, Account to show **Bankers**
- 2, Account to show **tax authority**
- 3, His own account
- 4, Account to show to **his wife**

Figure 5. Credit Risk Database of Small and Medium-Sized Enterprises



Factor Loadings of Financial Variables after Direct Oblimin Rotation

Variables (Financial Ratios)	Component			
	Z1	Z2	Z3	Z4
Equity_TL	0.009	0.068	0.113	0.705
TL_Tassets	-0.032	-0.878	0.069	-0.034
Cash_Tassets	-0.034	-0.061	0.811	0.098
WoC_Tassets	-0.05	0.762	0.044	0.179
Cash_Sales	-0.937	0.021	0.083	0.009
EBIT_Sales	0.962	0.008	0.024	-0.004
Rinc_Tassets	0.014	0.877	0.015	-0.178
Ninc_Sales	0.971	-0.012	0.015	0.014
EBIT_IE	0.035	0.045	0.766	-0.098
AP_Sales	-0.731	-0.017	-0.037	-0.016
AR_TL	0.009	-0.041	-0.104	0.725

Note: The extraction method was principal component analysis, The rotation method was direct oblimin with Kaiser normalization.

Credit Rating of SMEs using Asian Data



(i) Sales

(ii) Assets

(iii) Liquidity (Cash)

(iv) Total Debt

Small and Medium-Sized Enterprise (SME) Credit Risk Analysis Using Bank Lending Data: An Analysis of Thai SMEs

Naoyuki Yoshino^{a,b}, Farhad Taghizadeh-Hesary ^{b,c},
Phadet Charoensivakorn^d and Baburam Niraula^a

^aAsian Development Bank Institute (ADBI), Tokyo, Japan; ^bFaculty of Economics, Keio University, Tokyo, Japan; ^cGraduate School of Economics, The University of Tokyo, Tokyo, Japan; ^dNational Credit Bureau (NCB), Bangkok, Thailand

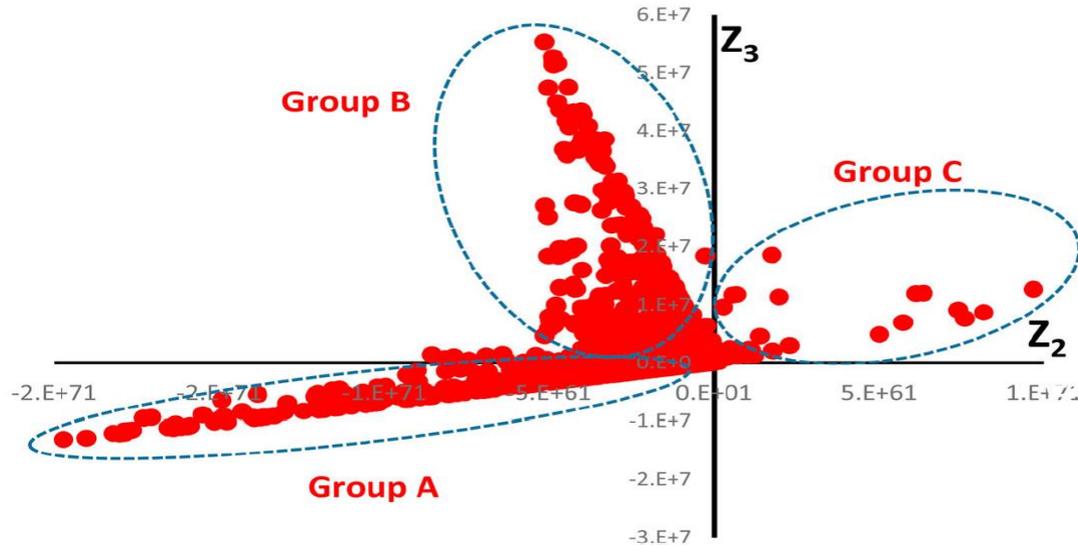
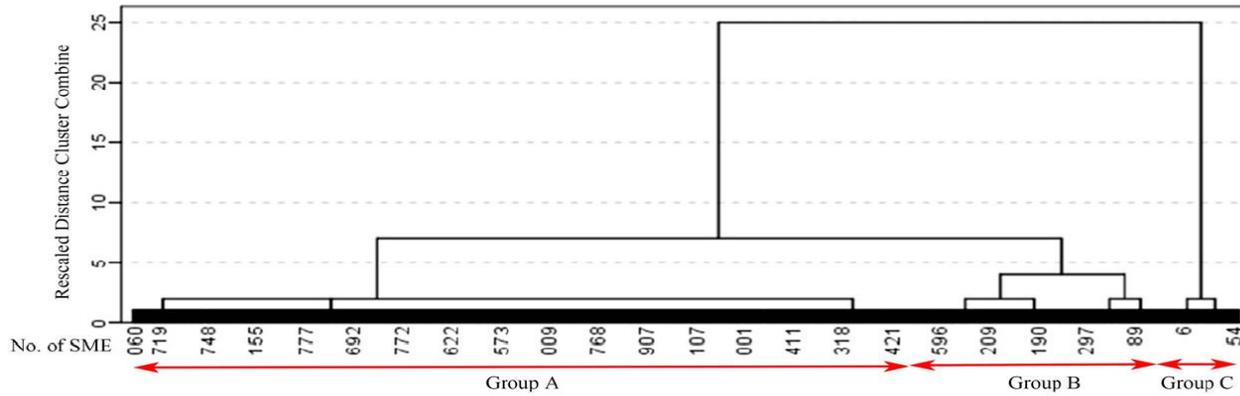


Figure 8. Distribution of Factors. Source: Authors' compilation.

Note: The x-axis is the Z2 component (Expected NPL) and the y-axis is the Z3 component (Stock amount of loans) Each dot shows one SME. Group A is the credit worthiest group of SMEs, Group C has the least credit healthiness and Group B is in between.

Credit Rating for SMEs ***by Use of SME Database***

- 1, Credit Rating is only applicable to large companies**
- 2, Credit Rating for SMEs based on SME Data**
- 3, Three ranking of SMEs (Asian country)**
- 4, SME data can produce default risk ratio**
- 5, Risk based Interest rate**

Japanese Bullet Train



Case Study: Southern Tagalog Arterial Road (STAR), Philippines Micro-d

- The Southern Tagalog Arterial Road (STAR) project in Batangas province, Philippines (south of Metro Manila) is a modified Built-Operate-Transfer (BOT) project.
- The 41.9 km STAR tollway was built to improve road linkage between Metro Manila and Batangas City, provide easy access to the Batangas International Port, and thereby accelerate industrial development in Batangas and nearby provinces.

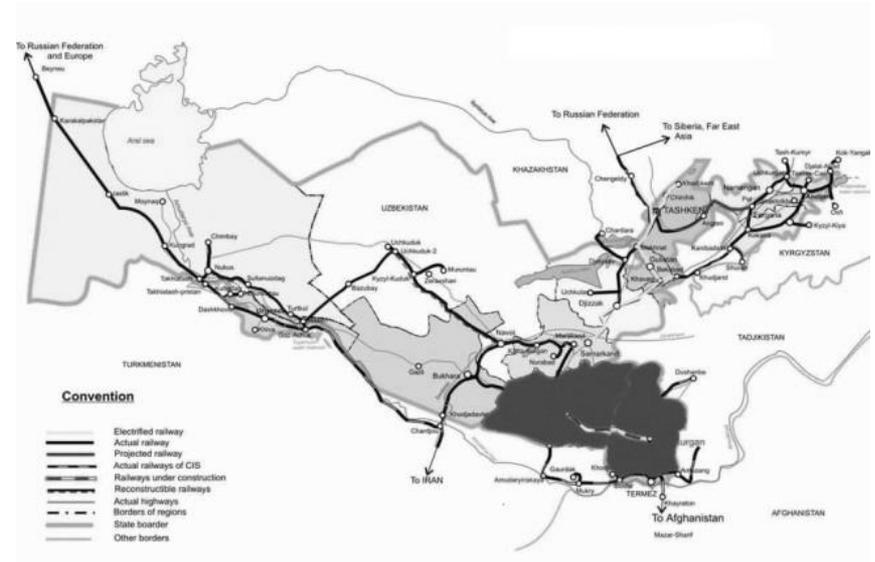


Uzbekistan Railway

GDP growth rate

$Y_{control, before}$

$Y_{treatment, before}$

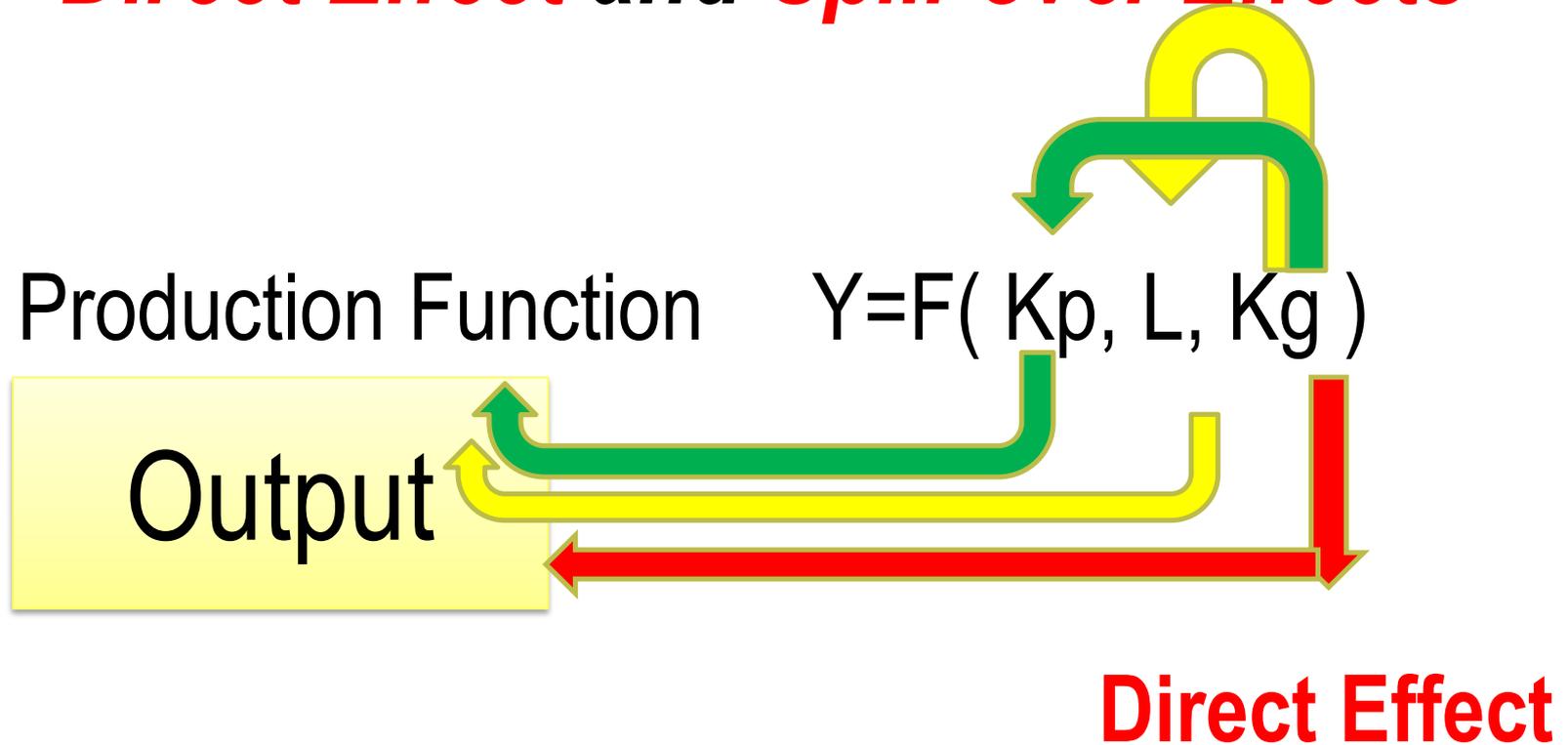


Time

Divide regions affected and not affected by railway connection to “Treated group” and “Control group”

Infrastructure Finance

Direct Effect and Spill-over Effects



Y = Output, K_p = private capital, L = labor

K_g = public capital (infrastructure)

Spillover effects → Return to investors

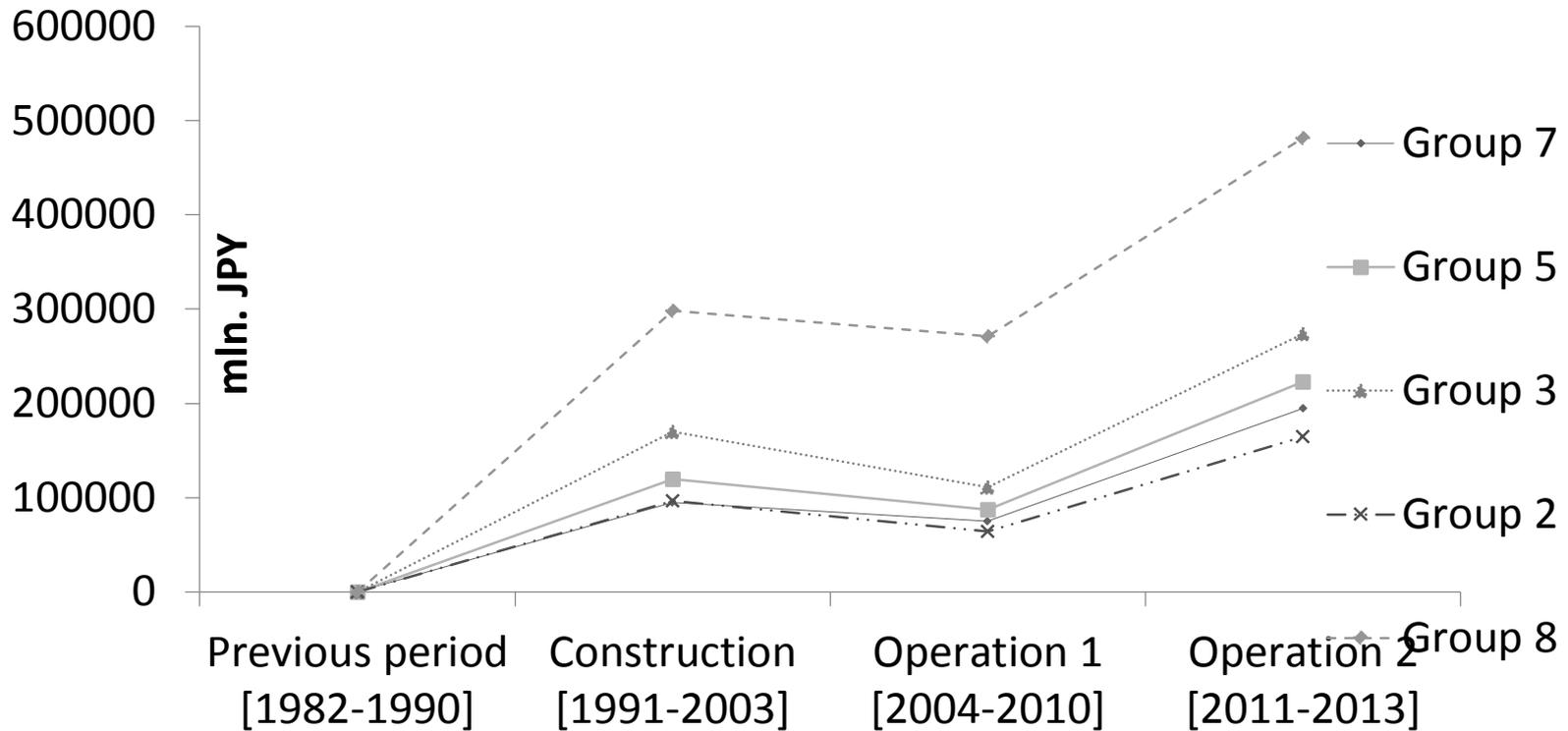
	1956-60	1961-65	1966-70	1971-75	1976-80	1981-85
Direct Effect (Kg)	0.696	0.737	0.638	0.508	0.359	0.275
Indirect Effect (Kp)	0.453	0.553	0.488	0.418	0.304	0.226
Indirect Effect (L)	1.071	0.907	0.740	0.580	0.407	0.317
20% Returned	0.3048	0.292	0.2456	0.1996	0.1422	0.1086
%Increment	1986-90	1991-95	1996-00	2001-05	2006-10	39.5
	0.215	0.181	0.135	0.114	0.108	
	0.195	0.162	0.122	0.1	0.1	
	0.193	0.155	0.105	0.09	0.085	
	0.0776	0.0634	0.0454	0.038	0.037	
	36.1	35.0	33.6	33.3	34.3	

Additional tax revenue, Regional GDP growth and Railway Company Net Income, LCU (bln.)

Period	Coefficients	$T(20)*\Delta Y$ (Tax revenue)	ΔY Affected (Direct + Spillover effects)	Company net income (Revenue - Costs)
Short term (2009-2010)	2.83*** [4.48]	16.0	79.9	315.5
Mid-term (2009-2011)	2.48*** [6.88]	16.3	81.5	411.7
Long-term (2009-2012)	2.06*** [3.04]	14.7	73.5	509.0

Source: Authors' calculations

Total tax revenue, mln. JPY



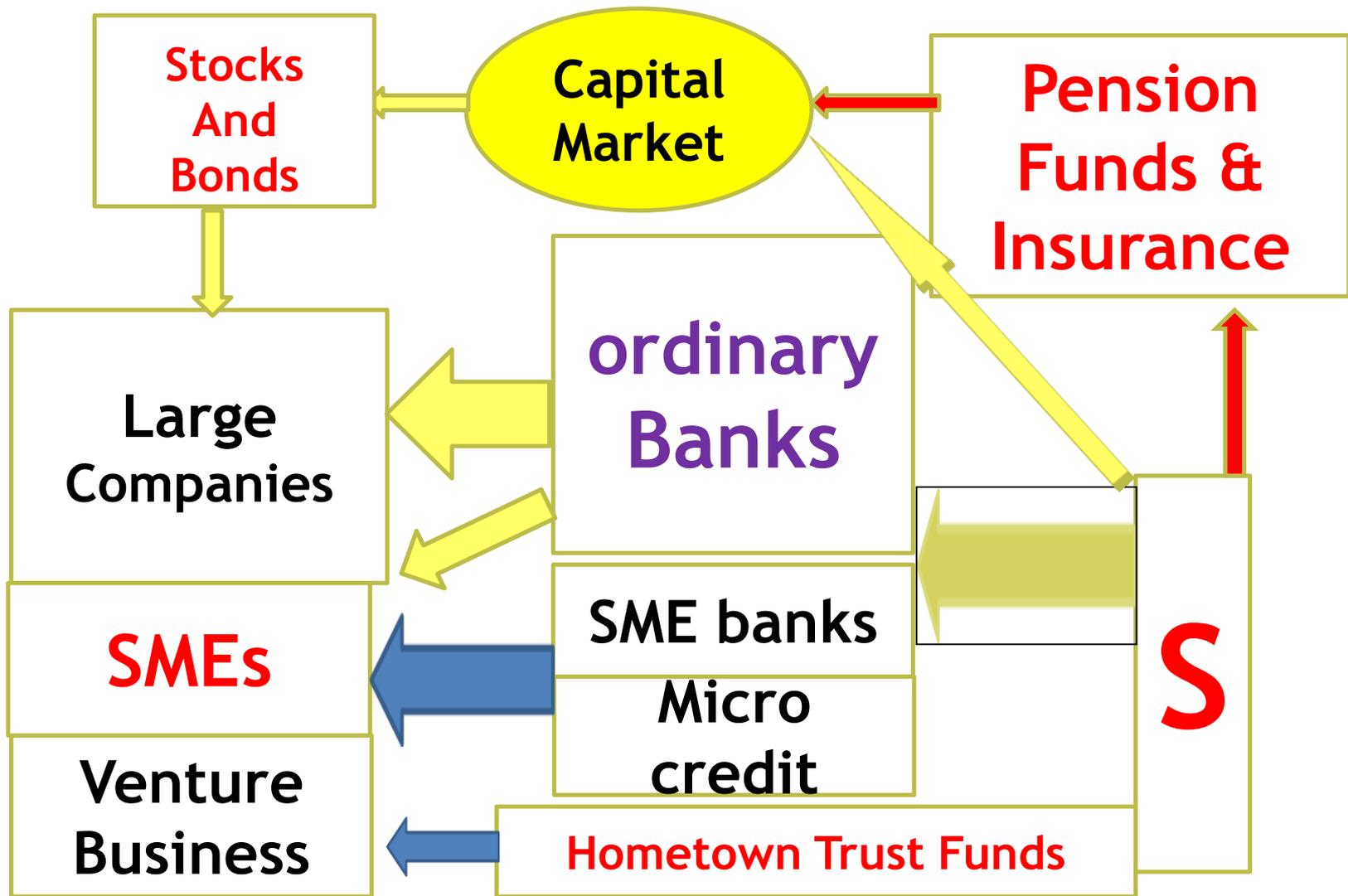
Development of Financial Technology

- 1, Share of banks will decline
- 2, Competition from overseas
- 3, Easy access to Foreign products
- 4, International coordination of regulation
- 5, Security of Financial system
- 6, Financial education and literacy
- 7, various financial products

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Wandering Public Pension Systems in Korea

- Old-age poverty issue and the role of Public Pension System

2016 Global Forum for Financial Consumer Protection in Globalization
(SKK University, Seoul, Korea. November 4-5, 2016)

Jai-seop Lee (Ph.D. in Social Policy)
(Former Chief of Government Employees Pension Research Institute)

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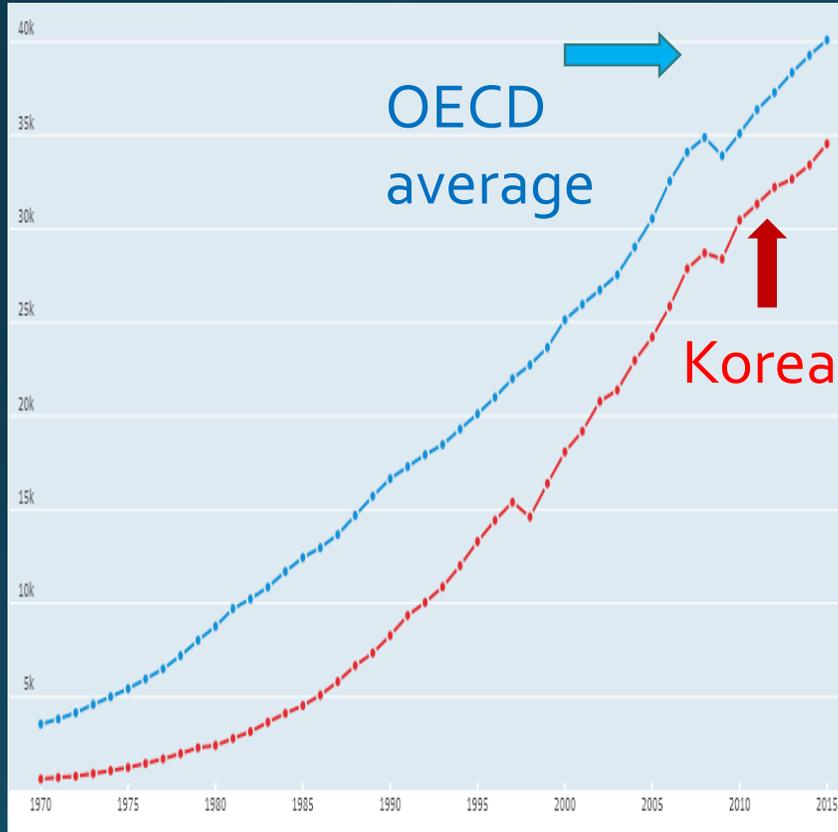
Introduction – raising a question

I. Old-age income security systems in Korea

II. Welfare ideology and its impacts

III. Policy recommendations

Rapid Economic Growth

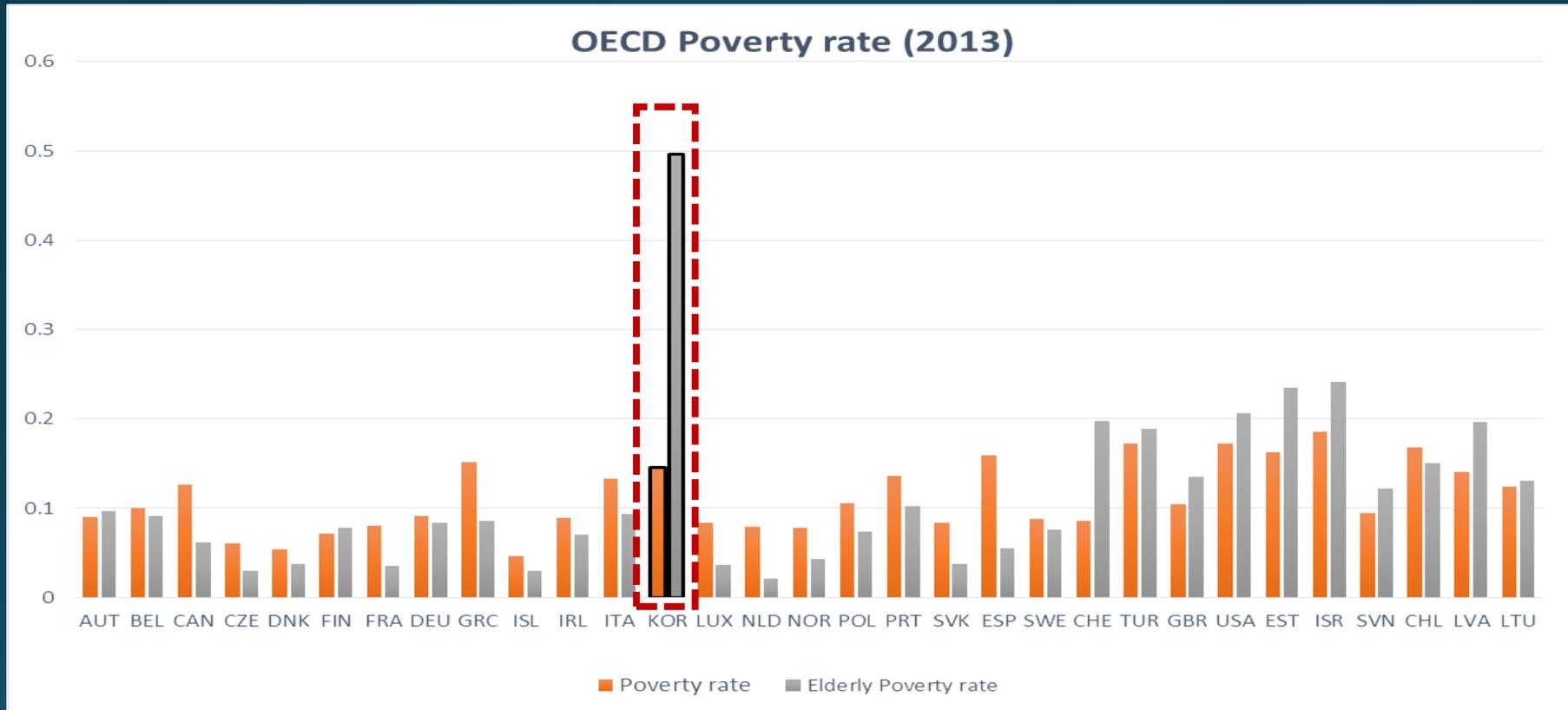


Unit: US \$

	OECD	Korea
1970	3,541	605
2015	40,095	34,549

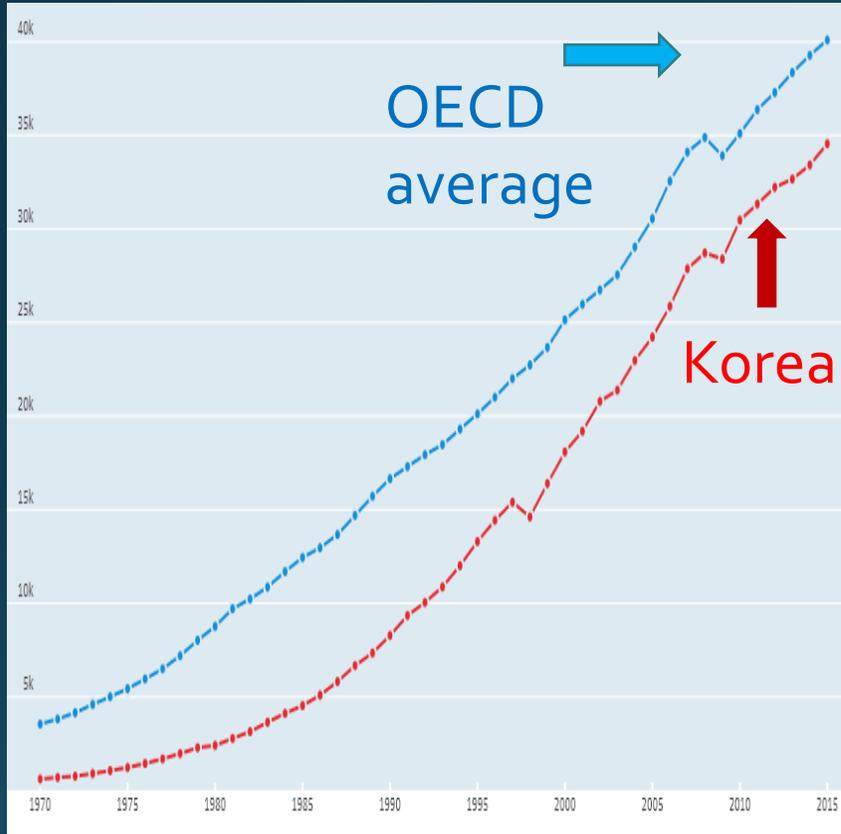
Source: OECD (2016)

Too High Old-age Poverty Rate

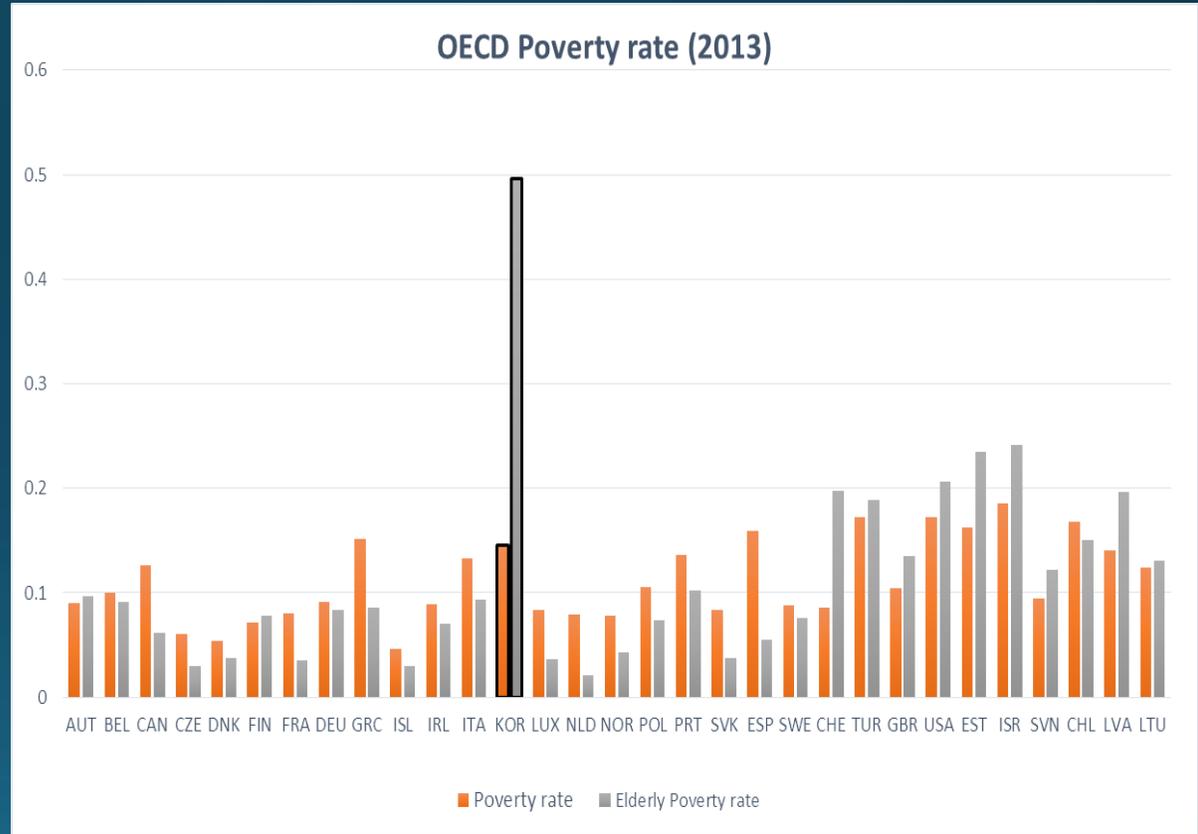


Source: OECD (2016)

Clear Contrast

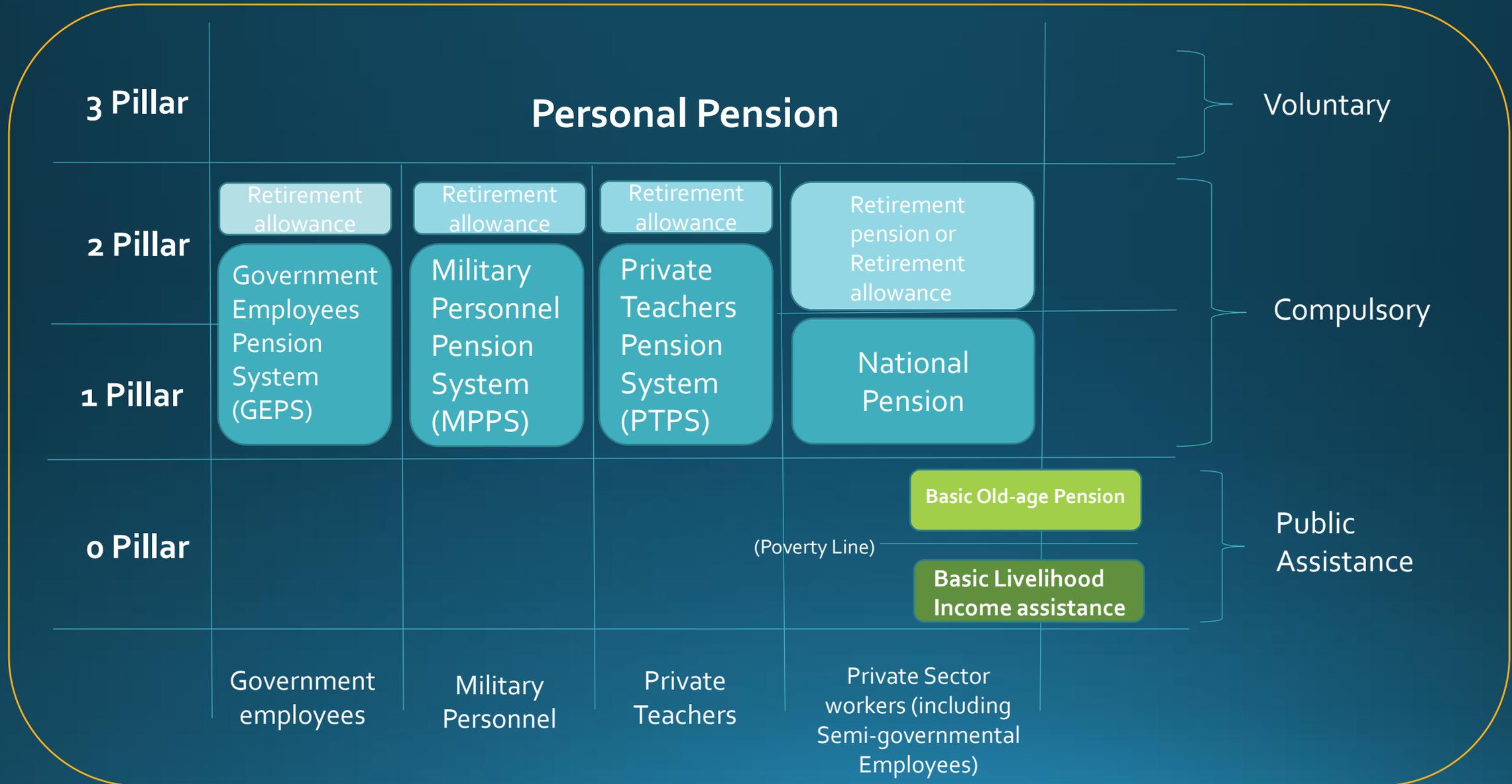


Source: OECD (2016)



I. Old-age Income Security Systems in Korea

Multi-pillar old-age income security system in Korea



II. Welfare Ideology and Its Impacts

1. Welfare Ideology (Fundamental Driving Force)

- Primary Policy Goal

 - : **Economic Growth First**, Income Security Next

- Operational Principle

 - : **Financial Conservatism** (Minimal Govt. Subsidy)

What Should Be the **Primary Goal** of the Public Pension System, Then?

- **Primary Goal** : Old-age Income Security
- **Secondary Goal** : Economic Growth

(N. Barr, Holzmann & Hinz)

Financial Conservatism Represented in the NPS

- The financing principle of the National Pension System(NPS) was clearly declared by the initial designer of the NPS and it was determined that **the NPS should be financially independent from the Government's budget, which needed to be invested for economic purpose** (Kim, Y.H. and Seok, J.E., 1999)
- “The overly ambitious Korean government, which was **enthusiastic about its economic goals, tried to exploit the welfare system as a tool for capital mobilization.** (Lee H.K.,1994)
- **“Promotion in poverty reduction, the primary purpose of the pension system, has been neglected throughout the pension reform process, while great emphasis has been given to financial sustainability.”** (Kim, Y.M., 2013)

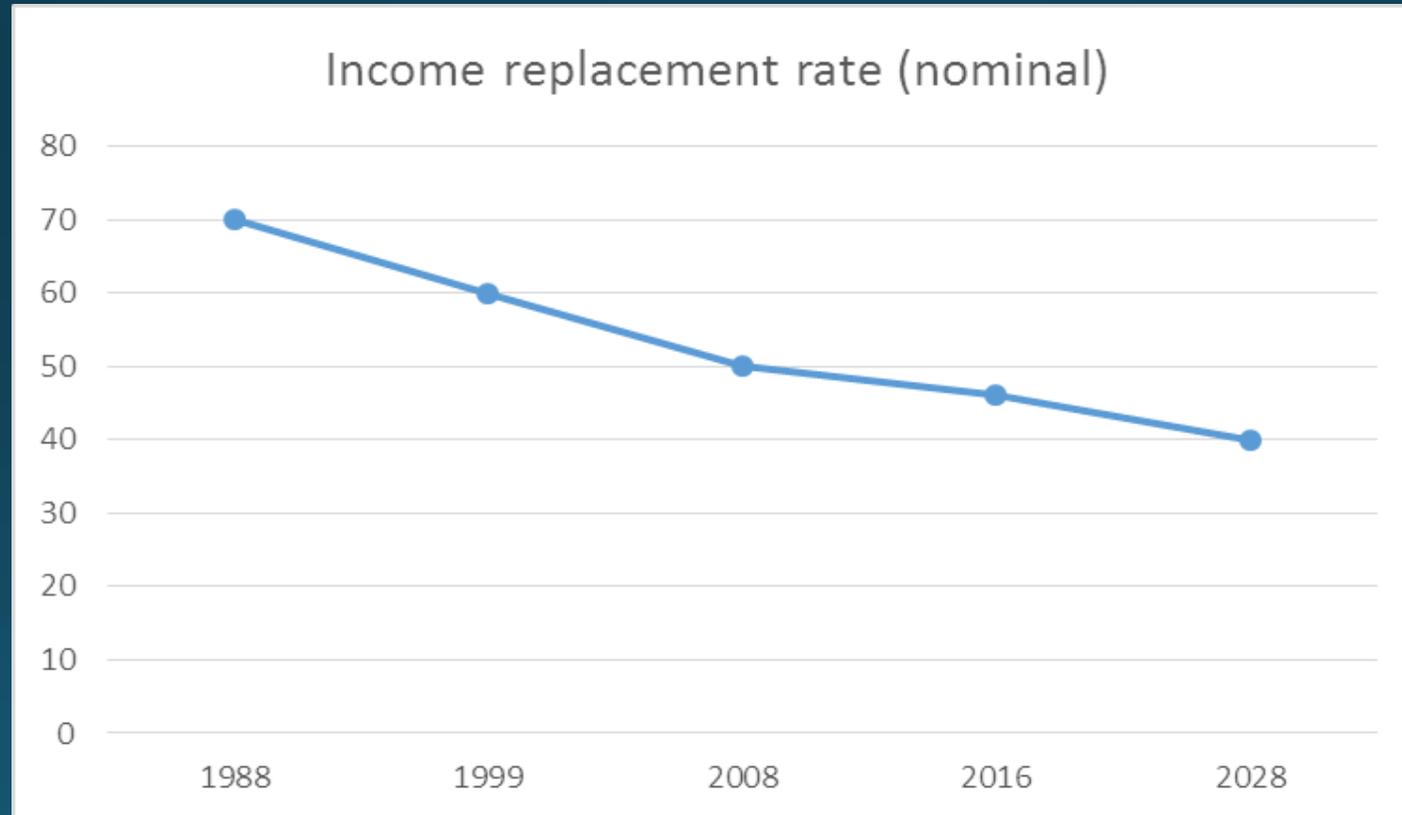
* Financial conservatism: Welfare ideology that minimize government budget allocated to social policy (Lee, J.S., 2014)

Initial Design and Principles in the NPS

- **Semi-funded Scheme**, excluding the elderly population of those days
- **Contributory Scheme** without financial source from tax-revenue
- **No Financial Subsidy** for Poor Incomers

Reforms Dominated by Financial Sustainability

Radical Benefit cut : 70% → 40%



- Welfare Ideology in Korea ,
Financial Conservatism,
Has Become the Fundamental Cause
of the Ineffective Public Pension System
and then
Old-age Poverty in Korea.

2. Policy Problems

1. Narrow coverage of the NPS

● Shortage of the Present Coverage

- Covers only 37.6% of the total present elderly population
 - Initially Excluded Elderly from the NPS
 - Too Many Persons Who Could not Contribute

● Shortage of the Future Coverage

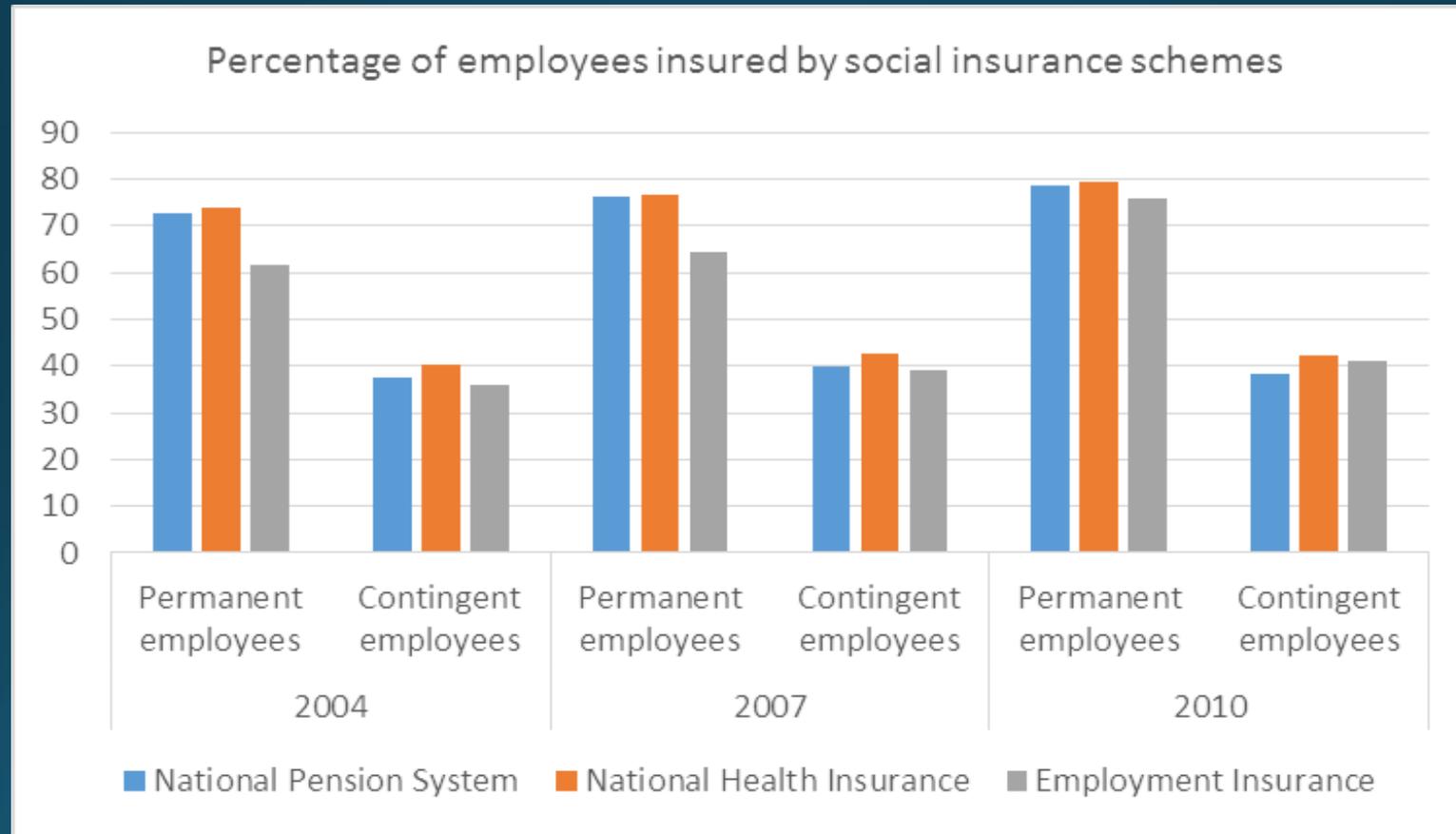
- Non-Contributors Reach 47% of Workable Populations (18-59)
 - Economically Inactive Persons
 - Irregular Workers and Self-employed with low income

Irregular Workers and Self-Employed

	OECD average	Korea
Atypical employment rate (Temporary and part-time)	22.2% (2015)	32.3% (2014)
Self-employment rate	15.8% (2011)	26.8% (2014)

Source: OECD (2016), KOISIS(2016)

Only Half of Irregular Workers Join the Insurance Scheme



Source: Statistics Korea (2012)

2. Short Actual Income Replacement Ratio

- Immature system : introduced in 1988
 - Delayed labor market entry together with early retirement
 - Short contribution period
- * Nominal income replacement ratio : 46 (in 2016)
- * Actual Income Replacement Ratio : 20~30%

	OECD average	Korea
Public Pension history	More than 100 years	28 years
Average retirement age	-	49 (2015)

Source: OECD (2016), KOISIS(2016)

Short Actual Contribution Period

	Male	Female
Sweden	About 40 years	
Austria	43.5	35.1
Germany	40	25
Italy	33.8	27.1
Luxembourg	40	33
UK	86% of the population receives full pension benefits (44 years of contribution)	
France	85% of male participants and 39% of female participants contribute for 40 years	
Finland	31.7	25.9
Belgium	43	31
Greece	27	21
Korea	About 20 years	

Source: EC(2004), OECD(2009), cited in Oh, S.W. and Jung, C.L.(2012)

Benefit Structure Comparison between SOPS and NPS

	SOPS (e.g. GEPS)	NPS
Contribution Rate	18%	9%
Maximum Income Replacement Rate	61.2% (in case of 36 years of contribution)	46% (2016) → 40% (2028) (in case of 40 years of contribution)
Trait of Benefit Structure	High contribution, High return	Low contribution, Low return
Average amount of monthly pension (2015)	2,100 US\$ (GEPS)	270 US\$

Basic pension system

- Introduced in 2014 to complement the NPS benefit cut
- Covers the bottom 70% income group among the elderly population
- Provides about 200 US\$
- Can it make up for a deficiency caused by radical benefit reduction of the NPS?

→ **Less likely to be alternatives or complement**

III. Policy Recommendations

- 1 . Poverty reduction should be set and declared as a primary purpose of public pension reform
- 2 . Increase in the benefit levels of the Basic Pension
- 3 . Extension of pension credits span or subsidies for those who find it difficult to pay their contribution
- 4 . Increase in the contribution rate
- 5 . Introduction of various financing methods such as special purposive tax for income security systems may be introduced

Thank you



2016 Global Forum for Financial Consumers
Seoul, November 2016

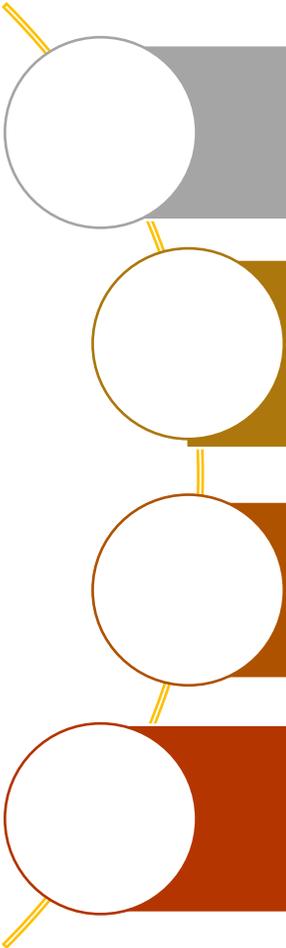


European Consumer Protection in the Financial System

An overview of consumer protection policy

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CONTENTS



1. THE TREATY ON THE FUNCTIONING OF THE EU

2. EU LEGISLATION ON FINANCIAL SERVICES

3. PROTECTION OF THE ECONOMIC INTERESTS OF
CONSUMERS OF FINANCIAL SERVICES

4. ACCESS TO JUSTICE: ADR - ODR

28 European Union Member Countries



THE EU IN BRIEF

- The European Union is a unique economic and political union between [28 European countries](#)
- The EU was created in the aftermath of the Second World War
- The first steps were to foster economic cooperation
- The result was the European Economic Community (EEC), created in 1958 with only 6 countries. Then name changed European Union (EU) in 1993 following the Maastricht Treaty.

The Treaty on the Functioning of the EU

The TFEU and the Charter of Fundamental Rights of the European Union constitute the primary law for consumer protection policy.

Article 169 TFEU defines specific objectives of the policy in order to *promote the interests of consumers, and ensure a high level of consumer protection, the Union shall contribute to protecting the:*



- ***health, safety and***
- ***economic interests of consumers as well as to promoting their right to information, education and to organize themselves in order to safeguard their interests.***

In this way EU law provides a common basic level of protection to all consumers residing in the EU.

Legal Instruments in EU: Consumer Law

1. Directives

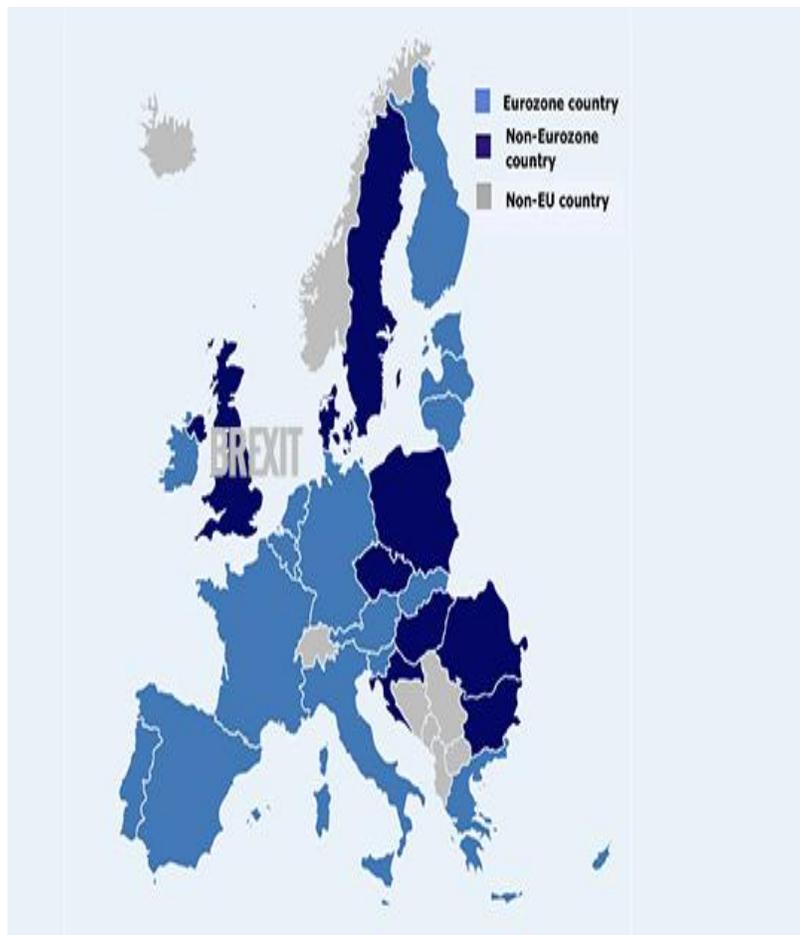
- Traditional instrument in EU Consumer law
- Have to be implemented to the national legislation
- set a minimum or maximum level of protection and Member States (MSs) are free to provide better protection in their own legislation

2. Regulations

- are directly applicable in all MSs
- there is no need to implement them to the national legislation (self-executing)

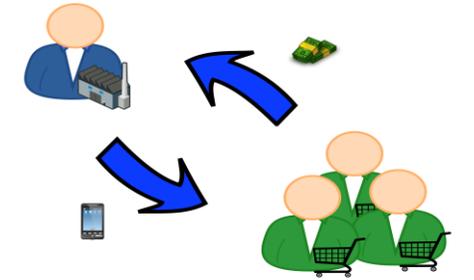


IMPLEMENTATION OF EU LEGISLATION



- According to the Treaty on the Functioning of the European Union (TFEU), consumer protection issues are a shared competence of the EU and Member States.
- Once EU legislation in this domain is adopted through the ordinary legislative procedure, the MSs are responsible for implementing and enforcing the EU rules.
- in [Francovich v. Italy](#), the ECJ found that member states could be liable to pay damages to individuals and companies who had been adversely affected by the non-implementation of a directive.

BASIC DEFINITIONS



Producer - Consumer

Consumer Law

- the class of norms which are *especially designated to protect the consumer* in his or her dealings with a trader (*direct protection*)

Consumer

- A **natural person** who is acquiring goods or services **for an other use than business purposes**
- A new trend: from consumer protection to a more wider user or client protection (eg. Passenger protection in air, railway sea and road transport contracts).

Trader

- *a natural or legal person who is professionally selling goods or providing services to consumers in order to obtain economic benefit.*

THE AVERAGE CONSUMER

The fairness or unfairness of a commercial practice is assessed against the “average consumer” benchmark.

The **average consumer**, as interpreted by the ECJ, is:

- 1. reasonably well informed *and***
- 2. reasonably observant and circumspect**
- 3. taking into account social, cultural and linguistic factors**

If a commercial practice is directed at a particular group of consumers (such as vulnerable categories of consumers, then an average member of that group is the benchmark).

The Concept of Prosumers

- It is the hybrid name combining '**consumer**', '**producer**' and '**professional**'.
- Why does this concept elude clear legal definition?
- A person operating in a field external to one's professional competence, skills and knowledge is treated as a consumer.
- If a prosumer is a producer and a consumer at the same time, the thin line between them may create *legal uncertainty about the responsibility* (of a consumer in the sense of a non-professional party, and a business or, better, an entrepreneur).
- In a situation where the exact legal nature of a prosumer needs to be clarified by the courts, *the turnover, the amount of products, frequency or time involved in an activity of a prosumer helps to define in which quality a person acts* (together with related rights and obligations), bearing in mind that there is a high level of interpretation of facts and consequently of judicial discretion.





The Importance of the Consumer Protection in the Financial Sector

Consumer protection facilitates increased penetration of the financial sector, through improved **awareness of financial products and services, consumers' rights and obligations, and the advantages of life-long financial planning.**

A well-designed consumer protection framework ensures five principles (World Bank, 2008). Namely provides the **financial consumer** with:

- 1) **Transparency** through clear, material and comparable information about the prices, terms and conditions, and risks associated with financial products and services;
- 2) **Free choice** via fair, non-coercive and professional practices in the selling of financial products and services, and collection of payments;
- 3) **Redress** through inexpensive, speedy and effective mechanisms to address complaints and resolve disputes;
- 4) **Privacy** through control over access to personal information; and
- 5) **Access to financial education** to enable consumers to empowers themselves by improving their financial literacy and capability.

FINANCIAL SERVICES AND CONSUMERS

- The EU Commission is committed to ensuring a high degree of consumer protection as an essential feature of a smoothly-functioning EU market for financial services. Its work focuses on [bank accounts](#), [consumer credit](#), [mortgage credit](#) and the [distance marketing of financial services](#) ensuring that consumer interests are considered in other EU financial legislation through specific [market studies](#) in this area.
- [The Financial Services User Group \(FSUG\)](#) is the Expert Group representing the interests of consumers and retail investors. FSUG members provide advice to the Commission on the above policy areas, ensuring that consumer interests are considered in other EU financial legislation.



The G20 High Level Principles on Financial Consumer Protection: An international overview

- The international community has recently increased its focus on *financial consumer protection* with a set of guidelines on market conduct.
- As a matter of fact, the lack of recognized guidelines has of-ten led policymakers to focus on only a few of the many consumer protection issues while failing to close gaps in other areas.
- In October 2011 the Group of G20's Finance Ministers and Central Bank Governors developed **common principles** on consumer protection in financial services releasing its **High-Level Principles on Financial Consumer Protection** (*eg. Equitable and fair treatment, disclosure and transparency*).

The EU Good Practice

- The Good Practice aims to avoid consumer over-indebt-edness and to help consumers in making appropriate decisions on their financial needs.
- **The EU Directive on Unfair Terms in Consumer Contracts 1993/13/EEC and EU Directive on Credit Agreements for Consumers, 2008/48/EC** provide guidance regarding this Good Practice.



EU Directive on Credit Agreements for Consumers

- The Directive ([2008/48/EC](#)) on credit agreements for consumers aims at fostering the integration of the consumer credit market in the EU, ensuring a high level of consumer protection by focusing on **transparency and consumer rights**.
- It stipulates that a comprehensible **set of information should be given to consumers in good time, before the contract is concluded**. In order to allow consumers to compare more easily the various offers and to better understand the information provided, creditors have to provide pre-contractual information in a standardized form (**Standard European Consumer Credit Information**).

The Standard European Consumer Credit Information

The **Standard European Consumer Credit Information form** consists of five distinct sections that cover all major features of the credit agreement:

- **Identity and contact** details of the creditor/credit intermediary;
- Description of the main features of the **credit product** (such as the type of credit, the total amount of credit, the conditions governing the drawdown (how and when the consumer will obtain the money), the duration of the credit agreement, instalments...);
- **Costs of the credit** (such as the borrowing rate or, if applicable, different borrowing rates which apply to the credit agreement, with the index or reference rate applicable to the initial borrowing rate), **periods, Annual Percentage Rate of Charge;**
- Other important **legal aspects**. (*ie* the right of withdrawal without giving any reason within a period of 14 days after the conclusion of the contract, and the right of early

THE IMPLEMENTATION OF THE EU Directive on Credit Agreements for Consumers in ITALY

- The EU Consumer Credit Directive on Credit Agreements for Consumers has been implemented in Italy via the Legislative Decree No. 141/2010.
- The Italian provision imposed certain information/obligations on lenders and intermediaries in order to make potential consumers **aware** of the terms of the proposed loan, or credit agreement, and its consistency with their needs. Such information must be provided in a particular format, including the **Standard European consumer credit information form**.
- Accordingly, the **Italian Consolidated Law on Banking** introduced a set of provisions regulating, *inter alia*, i) **pre-contractual transparency duties**, ii) **verification of the creditworthiness of consumers**, iii) **the rights of consumers in case of withdrawal**, and iv) **right of early termination** without any penalty.

Mortgage Credit Directive 2014/17/EU

- ❖ The [Mortgage Credit Directive 2014/17/EU](#) on credit agreements for consumers relating to residential immovable property **aims to create** a Union-wide mortgage credit market with a high level of consumer protection. It applies to both secured credit and home loans. MSs had to transpose its provisions into their national law **by March 2016**.
- ❖ The main provisions include **consumer information requirements, principle based rules and standards for the performance of services** (e.g. conduct of business obligations, competence and knowledge requirements for staff), **a consumer creditworthiness assessment obligation, provisions on early repayment, provisions on foreign currency loans, provisions on tying practices, some high-level principles** (e.g. those covering financial education, property valuation and arrears and foreclosures) and **a passport for credit intermediaries** who meets the admission requirements in their home MSs.
- ❖ Pursuant to the Directive the creditor shall make a thorough assessment of the consumer's creditworthiness taking appropriate account of factors relevant to verifying the prospect of the consumer to meet his obligations under the credit agreement.

The SUPERVISION of the European Banking Authority



- In order to ensure that the above mentioned provisions of Directive 2014/17/EU on responsible lending are implemented and supervised consistently across the EU Member States, the European Banking Authority (EBA) has issued guidelines on the way in which the creditworthiness assessment should be conducted.
- According to **EBA's guidelines**, the creditor - when verifying a consumer's prospect to meet his obligations under the credit agreement - "***should make reasonable enquiries and take reasonable steps to verify the consumer's underlying income capacity, the consumer's income history and any variability over time***". In the case of consumers that are self-employed or have seasonal or other irregular income, the creditor should make reasonable enquiries and take reasonable steps to verify information that is related to the consumer's ability to meet his/her obligations under the credit agreement, including profit capacity and third-party verification documenting such income.

A black and white photograph showing a hand holding a scale of justice. Below the scale, several other hands are raised, symbolizing collective action or seeking justice.

Access to Justice

Protection of consumers' collective interests

- Injunctions Directive (2009/22/EC)
- Regulation on consumer protection cooperation (2006/2004/EC)

Protection of consumers' individual rights

- Alternative Disputes Resolution (ADR) Directive (2013/11/EU)
- Consumer Online Dispute Resolution (ODR) Regulation (EU n. 525/2013)

Formal Collaboration: Regulation on Consumer Protection Cooperation (No 2006/2004)



- **Every MS** must have a consumer authority, who has jurisdiction to deal with cross-border marketing;
- Consumer authority in the source country (**requested country**) is obliged, on the request of consumer authority in the target country (**applicant authority**), to take all necessary measures to cease illegal cross-border marketing in the source country (art. 8.1);
- The requested authority may, however, determine which measures will be taken (art. 8.2);
- In case legal action in a court is taken, **the applicant authority has to pay the legal expenses which the plaintiff is liable to pay to the defendant if the case is lost** (art. 15.1).

THE SETTLEMENT OF INDIVIDUAL CONSUMER DISPUTES

General different types of consumer disputes:

- 1) **Individual consumer disputes**: one consumer against one trader;
- 2) **Mass consumer disputes**: several individual consumers have disputes in which both the facts and norms are identical (mainly against the same trader);
- 3) **Domestic and cross-border disputes**: the disputing parties have their domicile in the same country (***domestic dispute***) or in different countries (***cross-border dispute***).



Civil Procedure: *The basic problem in the normal civil procedure in courts*



The ordinary civil court procedure is in most cases inapplicable for the settlement of consumer disputes for the following reasons:

- 1) **Expenses**: the high costs of litigation especially when compared to the economic interest of the case
- 2) **The cost rules**: a losing party is often obliged to pay also the legal expenses of the winner
- 3) **The slowness of the procedure** (especially because of the appeals to the higher instances)
- 4) **Psychological barriers**: many people are not willing to participate in a court procedure even if the legal expenses stay in a moderate level
- 5) **Inapplicability to solve mass consumer disputes**: in a traditional system all consumers who want to obtain redress have to take part in the trial part.

Group Action for Compensation

It is a court action in which:

A plaintiff, either a member or a non-member of a specified group,

- 1) brings a legal action in a court for the benefit of a specified group***
- 2) without the express permission of the group members, and***
- 3) this results in a judgement that is binding both for and against all the members of the group all the members of the group.***



How the Group is Formed?

In Group Actions judgements have legal effect for all members of the group, although they are not parties to the case.

There are two opposite ways how the group may be formed:

- **Opt out:** All persons who fill certain requirements become automatically members of the group (*eg. shareholders*). Those, who do not want to be members of the group, have to use their right to opt out.
- **Opt in:** only those persons, who have joined the group by registration, will be members of the group and will be covered by the judgement.

Jurisdiction of Courts in Cross-Border Consumer Disputes

The starting point: court decisions are traditionally not enforceable in other countries. However, the [Regulation No 44/2001 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters](#) contains a provision (art. 15) which gives protection to consumers if:



1) It is question of credit or instalment contract connected to the sale of goods; or **2)** it is question of consumer contract and the contract has been concluded with a trader who **a)** *is carrying on business activities* or **b)** *is directing such activities to the MSs where consumer is domiciled.*

Jurisdiction of Courts in Cross-Border consumer Disputes (*Continue*)

In case one of these conditions is fulfilled:

- 1) A **consumer** is entitled to take legal action against a trader in the courts of the Member State where he is **domiciled** (art. 16.1)
- 2) Proceedings may be brought against a consumer only in the courts of that Member State where he is **domiciled** (art. 16.2)
- 3) Judgment given by the court of the Member State where the consumer is domiciled may be **enforced in an other MS** where the trader has his domicile or property.

ALTERNATIVE DISPUTES RESOLUTION



- There are over [750 ADR schemes](#) in the EU today. They work differently and have different names e.g. **arbitration**, **mediation**, **ombudsmen**, **complaints boards**.
- ADR schemes can be **established** by public authorities, industry or in cooperation between the public sector, industry and consumer organizations.
- Most schemes are free for consumers or below €50, and are settled within 90 days on average. ADR decisions may be taken collegially *e.g.* by boards or by individuals - a mediator or ombudsman. The nature of these decisions ranges from non-binding recommendations, to decisions binding on the trader only (bank ombudsmen) or on both parties (arbitration), and agreement of the parties.

THE CHALLENGE OF THE ALTERNATIVE DISPUTES RESOLUTION MECHANISM



- In 2010, one in five consumers in the EU encountered problems when buying goods or services in the Single Market, leading to financial losses estimated at 0.4% of the EU's GDP. Only a small fraction of consumers sought and secured effective redress.
- It is estimated that if EU consumers can rely on well-functioning and transparent ADR for their disputes they could save around €22.5 billion a year, corresponding to 0.19% of EU GDP.
- Consumers and traders will be able to solve their contractual disputes online or offline, and at local or cross-border levels, through out-of-court dispute resolution.

OUT-OF-COURT SETTLEMENTS:

Legal Basis



- On 18 June 2013, the new [legislation on Alternative Dispute Resolution \(ADR\) and Online Dispute Resolution \(ODR\)](#) has been published.
- [Directive on consumer ADR](#)
- [Regulation on consumer ODR](#)
- The new legislation on ADR and ODR will **allow consumers and traders to solve their disputes without going to court**, in a quick, low-cost and simple way.

What changes will the new legislation bring?

The **ADR Directive** provides for full ADR coverage at EU level. This means that there will be an **ADR procedure available for all contractual disputes in every market sector** (e.g. travel, banking, dry cleaning) and **in every Member State**. The sectors of health and education will not be covered by the ADR Directive.

- Traders are obliged to use ADR and will need to inform consumers about ADR mechanisms on their websites and in their general terms and conditions.

The **ODR Regulation** enables EU consumers and traders to submit disputes arising from online purchases to ADR online, thanks to the EU-wide ODR dispute resolution platform.

- The ODR platform links all the national ADR entities, and it is in all EU official languages, and **free of charge**. Businesses established in the EU that sell goods or services to consumers online need to comply with the ADR/ODR legislation, namely:
 - Online traders must **inform consumers of the dispute resolution bodies by which they are covered**. They should do this on their websites and in the general terms and conditions of service contracts.
 - They are required to **provide a link** (i.e. <http://ec.europa.eu/odr>) **from their website to the ODR platform**.

The ODR platform is accessible to consumers and traders since **15 February 2016**.

FIN-NET” Financial dispute resolution network

"FIN-NET" is a financial dispute resolution network of national out-of-court complaint schemes in the European Economic Area countries that are responsible for handling disputes between:



Consumers and Financial Services Providers

If a consumer in one country has a **dispute** with a financial services provider from another country, FIN-NET members will put the consumer in touch with the relevant out-of-court complaint scheme and provide the necessary information about it.

How to use FIN-NET?



A consumer having a complaint against a financial services provider located in another country may:

- ➔ **Use the FIN-NET website** to identify the relevant out-of court complaint scheme in the country of the financial services provider and contact that body directly.
- ➔ **Contact the out-of-court complaint scheme** in his/her home country, which will help to identify the relevant complaint scheme in the country of the financial services provider and will give all the necessary information about the scheme and its complaints procedure. If a consumer decides to file a complaint, he/she can leave it with the FIN-NET member in his/her country, which will transfer it to the relevant scheme in the service provider's country.
- ➔ Once the competent scheme has received the complaint, it will try to resolve the dispute according to its rules and taking into account the [ADR Directive](#) on principles applicable to bodies responsible for out-of-court settlement of consumer disputes.
- ➔ FIN-NET schemes aim to give consumers the possibility to make their cross-border complaints at least in **the language** of their financial contract or in the language in which they have normally dealt with their financial services provider.

ADR Bodies in Italy (*as example*)



- ➔
- **Arbitro Bancario Finanziario (ABF)** – Banking and Financial Ombudsman
Financial institutions covered: banks, mortgage banks, mortgage intermediaries, credit unions, payment institutions, electronic money institutions, Poste Italiane.
 - **Financial products covered:** payments, deposits, credit & loans, mortgages

- ➔
- **Istituto per la Vigilanza sulle Assicurazioni (IVASS)** ISVAP – *Supervisory body for insurance*
 - **Financial institutions covered:** insurance companies, insurance intermediaries
 - Financial products covered:** Life/non life insurance

- ➔
- **Ombudsman Bancario – Giurì bancario** *Banking Ombudsman*
Financial institutions covered: banks, investment providers, investment intermediaries
 - Financial products covered:** life/non-life insurance, investments, some deposits



תודה
 Dankie Gracias
 Спасибо
 شكرًا
 Merci Takk
 Köszönjük Terima kasih
 Grazie Dziękujemy Děkojame
 Ďakujeme Vielen Dank Paldies
 Kiitos Tänname teid 谢谢
Thank You Tak
 感謝您 Teşekkür Ederiz
 Σας Ευχαριστούμ 감사합니다
 ขอบคุณ
 Bedankt Děkujeme vám
 ありがとうございます
 Tack

2016 GLOBAL FORUM
FOR FINANCIAL CONSUMERS
Financial Service Sectors
in Social Change

Discussion by Martin Dierker
KAIST College of Business,
Graduate School of Finance

Wandering Public Pension Systems in Korea:

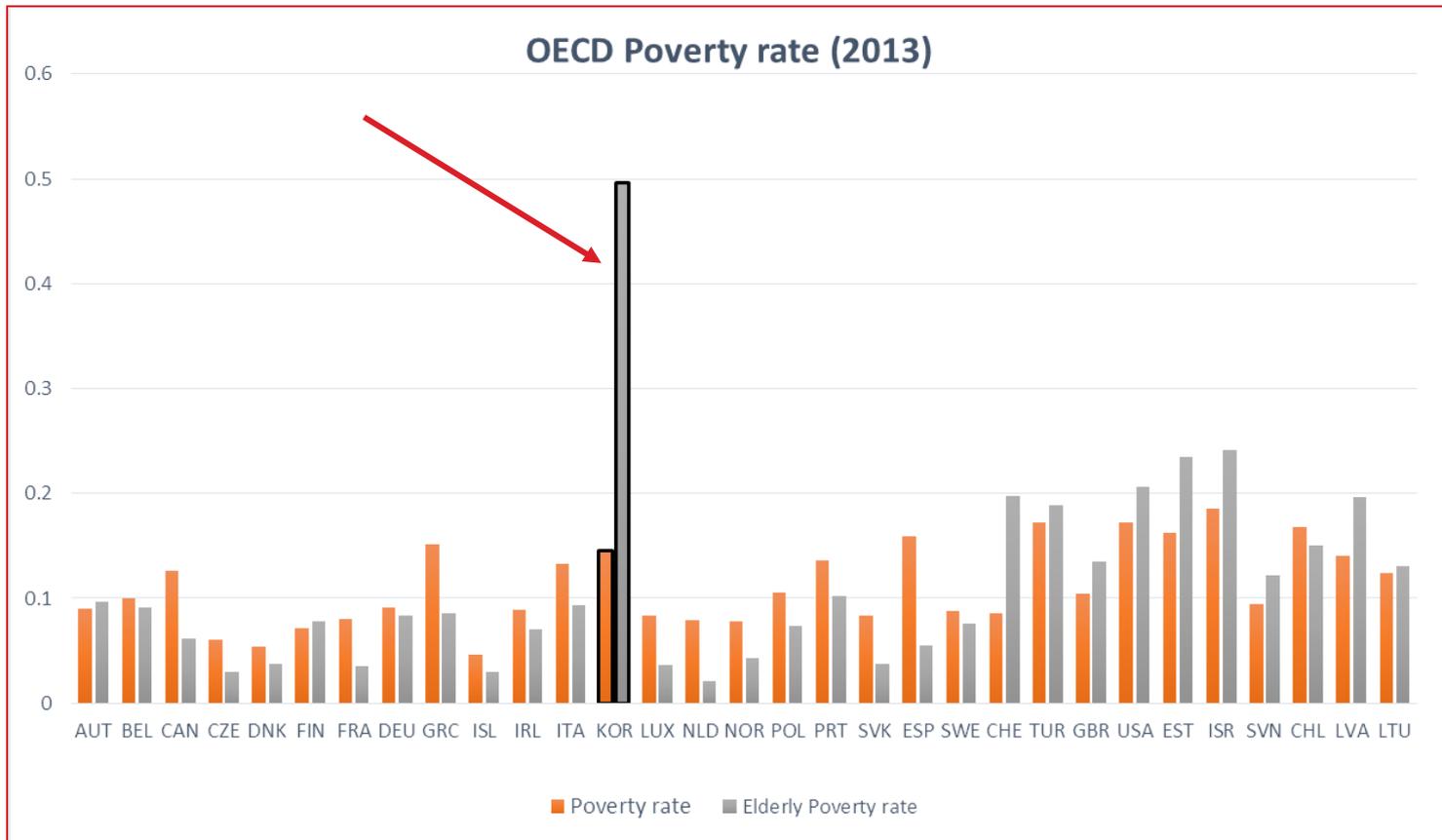
»» Old Age Poverty and the Role of the Public Pension System

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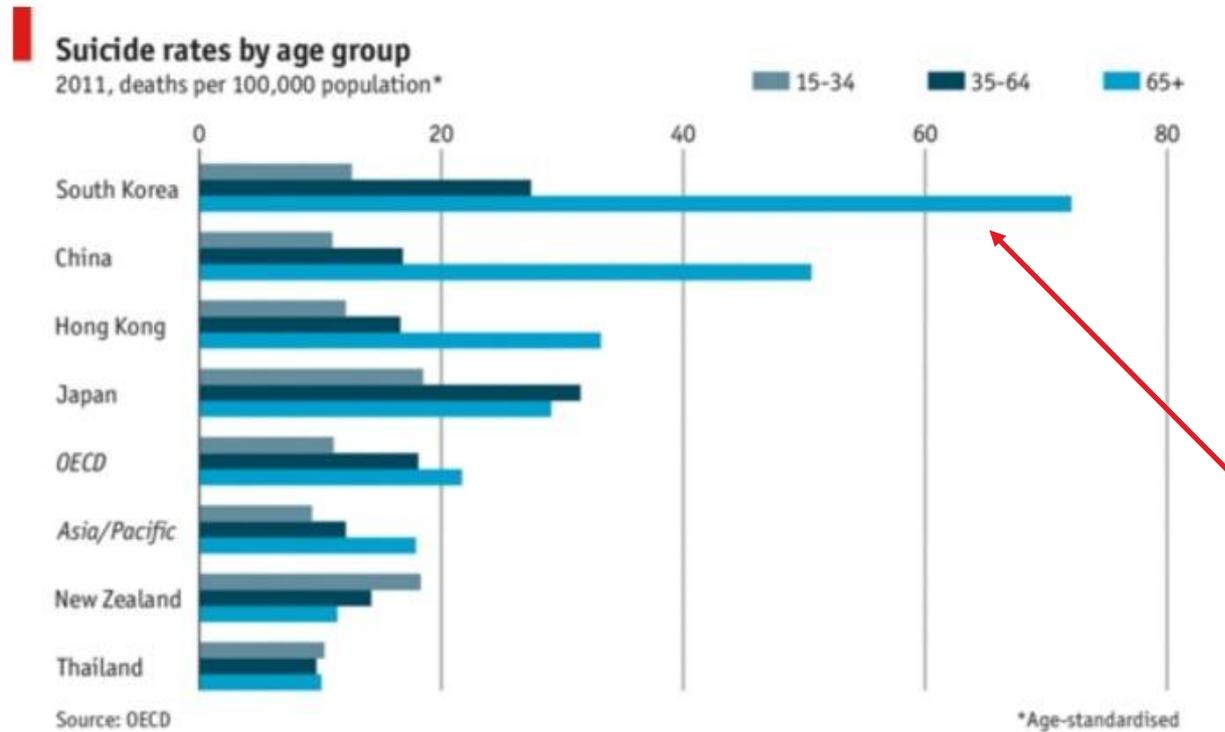
An important and timely topic

- ▶ Changing demographics and low birthrates are well known.
- ▶ New: Effects of financial crisis:
 - Bank interest rates on private savings are low
→ Harder to save for retirement.
 - Large bailouts in 2008 benefitted the rich –
Poor citizens demand their share.
- ▶ Huge international differences:
 - USA, Germany, UK, Chile, Korea
 - **Which approach works best?**

Old people do not benefit from Korean economic success



Combined with high suicide rate for elderly, **this is shocking!**



Economist.com/graphicdetail

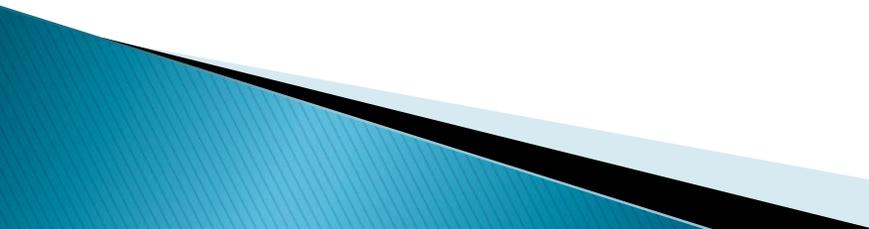
The paper clearly establishes that the Korean pension system is partly to blame for these problems.

Call on more research and debate

- ▶ These charts are among the most disturbing I have ever seen in my career.
- ▶ More data and research is needed:
 - Compare income of elderly with other age groups
 - Can a causal inference on suicide rates be drawn?
- ▶ These facts need to be publicly debated
 - Entirely legitimate to ask what is fair share for elderly people

Question:

Political Power of Old People

- ▶ As society ages, political power of old people has grown
 - Larger share of population
 - Germany, UK, USA: Older people are more likely to vote
 - ▶ In USA (Medicare) and Germany (Pensions), the public is concerned that politicians overly favor the elderly
 - ▶ Interests of elderly are apparently under-represented in Korean politics
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Economic growth or social policy: Which one comes first?

▶ In 1970s:

- There were few financial resources to distribute
- That may explain focus on economic growth
- Feasible in a dictatorship

▶ In 2010s:

- Goals on growth have been (over-)achieved
- Democracy requires a fair division of gains
- Shift in focus necessary ?
- Asset base of NPS is >400 billion US\$ allows relaxation of fiscal conservatism

Comparison to Germany

- ▶ A fiscally conservative system was enacted in 1891 (accumulating capital, low payouts)
 - Reason: Political unrest by workers
- ▶ Capital reserves were wiped out in 1920s and again in 1940s. Even worse:
 - Other private savings were also largely lost in war
 - Many children had died as soldiers and could not support parents in old age
- ▶ In 1950s, pensioners fell behind economy.
 - Average benefit in 1954: US\$ 15 per month
 - Around 30% of wages – e.g. coffee was US\$ 5 per kilo.

Germany in 1957...

- ▶ Had a big public debate about old age poverty. Finally, a pay-as-you-go system was enacted.
 - Pension credits were given to deserving people
 - ▶ Even in war and poverty, people had children
 - Nobody expected that would change
 - ▶ Nowadays, system is stretched by ageing society.
 - Rate of return for young people is small
 - But safety net is valued by young and old
 - Young people have much better lives anyway
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Some observations

- ▶ 63% share of earned income in total income of old people in Korea (OECD: 34%):
 - Too high!
 - ▶ 47% of those 18–59 not participating in NPS
 - Too high!
 - Why? Increase of contingent employment?
 - ▶ Are there survivor benefits for widows who did not work?
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More observations

- ▶ Average retirement age in Korea in 2015:
 - 49 years
- ▶ Average contribution period:
 - Germany: 40 years
 - Korea: ~20 years
- ▶ No wonder the average benefit is only 290 US\$
 - Rather than lower benefits, can these numbers be improved?

To summarize:

- ▶ Korean economic success since WW II is among the most stunning the world has ever seen.
 - Arguably more surprising than Germany or Japan
 - ▶ Yet Korean society is highly divided.
 - By contrast, democratic German governments gave many benefits to the poor to make sure the people support the capitalistic system.
 - ▶ A public debate about the fair division of economic gains is needed.
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