



Q-Group

**April 3, 2005 Ocean Reef Club
Key Largo, Florida**

John O'Brien



Q-Group Oral Remarks

**The oral remarks made after dinner
are contained in a separate
document**

“Finance has substantially neglected the protection of our ordinary riches, our careers, our homes, and our ability to be creative professionals.”

- “We need to extend the domain of finance beyond that of physical capital to human capital, and to cover the risks that really matter in our lives.” Robert Shiller

Radical Financial Innovation

- “...not just incremental innovation that has no larger direction or strategy, but innovation that can be transforming to our lives.”
- “The public does not see its biggest risks and tends to focus on [the] inconsequential ...”
- “The time will be ripe for an industry of even bigger proportions that reminds people of their biggest risks and offers ... and the means to deal with those risks.”

Robert Shiller

“Democratizing finance means effectively solving the problem of gratuitous economic inequality ...”

“... that is inequality that cannot be justified by rational grounds in terms of differences in effort or talent.”

Robert Shiller

Household Financial Services (1)

- – “... deep and wide ranging disaggregating [of financial services] has left households with the responsibility for important and technically complex micro financial decisions involving risk ... that they had not had to make in the past, are not trained to make in the present, and are unlikely to execute efficiently even with attempts at education in the future.” Robert Merton

Household Financial Services (2)

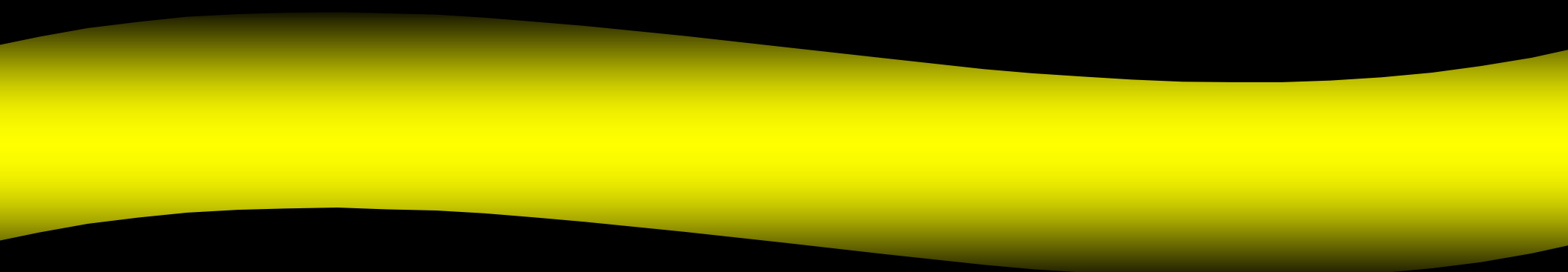
“This is why I believe the trend will shift toward more integrated financial products and services ... will also integrate human-capital considerations, hedging, and income and estate tax planning into the asset-allocation decisions.” Robert Merton

Insuring Livelihoods

- Protect against wage decline in a particular industry; pay from future earnings
- Individual benefits from satisfaction; society from trained specialists and entrepreneurial gains
- Shift some individual “unique” risk to society to diversify away
- Not unlike executive salary plus performance incentives

Insuring Home Values

- Largest financial asset for many families
- Base on index of home values to avoid moral hazard
- Shared appreciation mortgage
- Reverse mortgage



**“...they [livelihood and home value]
would comprise an enormous
institution ..., far more important than
life insurance and other types of
[existing] insurance”**

Inequality Insurance

- “...government should set ... the level of income inequality, ...initially roughly equal to the level of inequality today, ...”
- “... create a tax system that prevents inequality from getting worse.”
- Lorenz Curve; Gini Coefficient
- “... tax system would be framed as enforcing a measure of inequality rather than specifying tax rates.”

Intergenerational Social Security:

Sharing Risk between Young and Old

- “... excessively formulaic ... current formulas are essentially arbitrary.”
- “... dividing up labor income, provided by the young, between young and old.”
- Simple case – “... contributions as a percentage of every working person’s income ... equal to the percentage of people that are retired [about 11%].”
- This scheme contrasts with the present scheme that transfers the income risk of the retired entirely on to the working population.

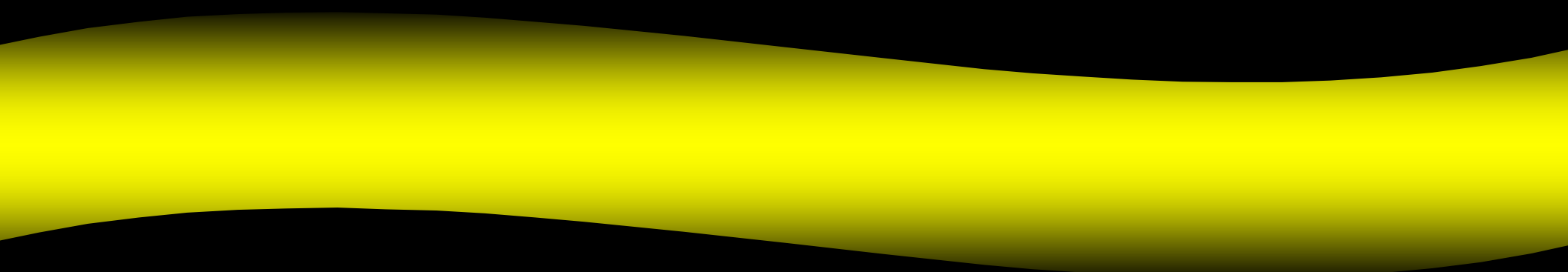
Managing National Economies

- Trade-off between comparative advantage and industrial diversification
- Improving economic efficiency and risk sharing
- Taiwan example is ?
- comparative advantage in electronics, but poor industrial diversification

Radical Financial Innovation (2)

- “We must make a priority experimentation with new financial ideas that will result in fundamental changes that may eventually be copied around the world.”
- “We should be willing to try risk management ideas that seem – at first – unnatural, possibly even unworkable.” Robert Shiller

“It is not the critic who counts; not the man who points out how the strong man stumbles, or where the doer of deeds could have done them better. The credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood; who strives valiantly; who errs, who comes short again and again, because there is no effort without error and shortcoming;



but who does actually strive to do the deeds; who knows great enthusiasm, the great devotions; who spends himself in a worthy cause; who at the best knows in the end the triumph of high achievement, and who at the worst, if he fails, at least fails while daring greatly, so that his place shall never be with those cold and timid souls who neither knew victory nor defeat”

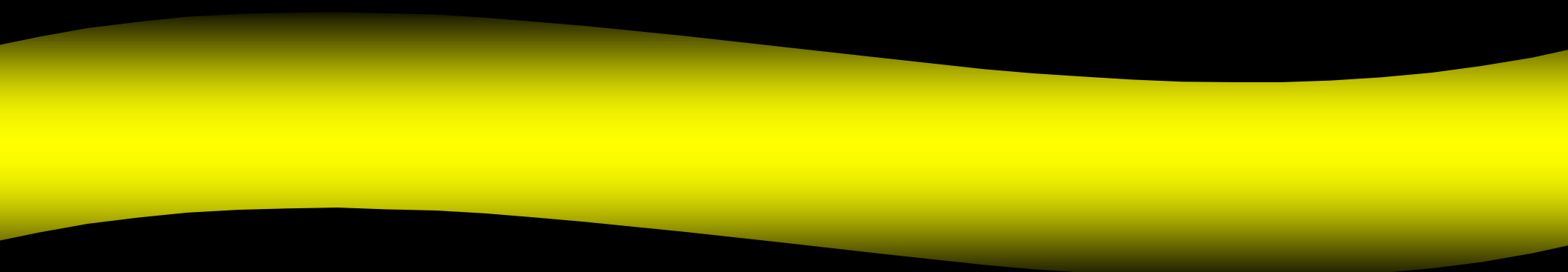
“The Man in the Arena”

Theodore Roosevelt

26th President of the United States

The Sorbonne, Paris, France

April 23, 1910



**“It is certainly an opportune time
to be a finance professional,
financial engineer, or financial
architect.” Robert Merton**