CHILEAN PENSION SYSTEM: ASSESSMENT OF THE 2008 REFORM AND CURRENT CHALLENGES

TAMARA AGNIC
Superintendent
SUPERINTENDENCE OF PENSIONS, CHILE

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TIMELINE CHILEAN PENSION MAIN REFORMS

1981 - Reform	2002- Multi-funds	2004 – SCOMP	2008 - Pension Reform
A Public PAYG system was replaced by an individual capitalization system managed by private Pension Fund Administrators (AFPs).	The type of funds that people have access increased to 5 in 2002 (more options for individuals to choose)	New system of pension intermediation (more transparency and accessibility of information, to make informed retirement decisions)	Comprehensive reform, strengthening all pillars of the system and designing the new Solidarity Pillar

CHILE HAS A MULTI-PILLAR PENSION SYSTEM

Pillar 1:

Old age poverty prevention, State financed

- Non contributory mean-tested basic pension (PBS)
- Complementary Solidarity Pension (for low levels of accumulation in individual accounts)

Pillar 2:

Consumption smoothing, mandatory

- AFP system (Pension Fund Managers)

Pillar 3:

Consumption smoothing, voluntary savings

- Personal and Occupational Plans managed by:
  - AFPs
  - Life Insurance Companies (LIC)
  - Mutual Funds, brokers, etc..

CHARACTERISTICS OF THE PENSION SYSTEM

- Workers' contributions are saved in individual accounts.
- Savings are invested in financial instruments, by specialized private fund managers (AFPs).
- Workers are free to choose administrator and type of fund.
- Sole purpose (AFP can only provide services stipulated by law).
- Financing through a fee charged to contributors, set freely by each AFP.
- The average fee is 1,16% of monthly wage, being 0,47% the lowest fee.
- There are 6 AFPs currently operating.
- Total number of affiliates: 9.7 millions approx..
- Total pension funds managed: MM US$165,432 (70% GDP).

THE 2008 REFORM: GOALS

Coverage and Adequacy

- **Improve the level of coverage** of the system, by increasing personal contributions while providing a strong safety net for individuals who are not able to contribute

Competition

- **Improve AFP performance**, by increasing the level of competition through higher demand sensitivity, lower barriers to entry and a more flexible investment regulation

THE 2008 REFORM: MAIN RESULTS

New Solidarity Pillar:

- **Mean -Tested :** belong to the least affluent 60% of the population
- **Basic Solidarity Pension (PBS)** for individuals who could not contribute:
  - PBS = $85.964 monthly (US$ 137).
  - PBS pensioners= 583.202 (68% women).
- **Solidarity Complement (APS)** for individuals who financed small pensions below a threshold
    - Threshold: PMAS = $279.427 (US$ 443)
    - APS pensioners= 698.426 (58% women)
    - APS Old age pensioners represent 45% of all pensioners
    - The APS complement represents 76% of the total pension for those whit APS.

THE 2008 REFORM: MAIN RESULTS

Mandate self-employed workers to contribute:

- Voluntary participation + myopia, administrative costs, unstable income and lack of knowledge imply that they tend not to pay contributions
- Introduction of the obligation will has been gradual:
  - 2012-2014 default option will be to contribute
  - Gradual increase in the proportion of income subject to the contribution (40%, 70% and 100%).
  - Mandatory from 2015.
  - The take-up between 2012-2014 has been approx. 30% (70% opt out of contributing). Implies an increase of coverage from 5%.
  - Still the take-up is considered low. The government is planning to extend the gradual phase-in beyond 2015.

THE 2008 REFORM: MAIN RESULTS

Create the legal figure of "voluntary contributor":

- A person can contribute even though he/she is not receiving earnings.
- Encourage contributions between spouses or from parents to children.
- At June 2014: 14,430 voluntary affiliates in the system.
- These are mainly women, but there are also cases of affiliates < 1 year old:
  - 87% are women
  - Average age: Women (53) / Men (11)

THE 2008 REFORM: MAIN RESULTS

Bonus per child (live birth or adopted):

- Equal to 18 months of contributions for the minimum salary.
- $380.000 per child approx. (US$ 600)
- This benefit is universal (not mean tested).
- Since July 2009 to June 2014: 286,418 women beneficiaries.

THE 2008 REFORM: MAIN RESULTS

Bidding process to assign new affiliates

- Successful in decreasing average fee in more than 30%
- Market Participation:
  - Total Affiliates: Modelo (15.2%), Planvital (4.4%), Habitat (21.3%)
  - Total Pension Funds: Modelo (1.7%), Planvital (2.8%), Habitat (25.9%)

	Biddings Periods						
	(August 2010-July 2012)		(August 2012-July 2014)		(August 2014-July 2016)		
AFP	Jan 2010	Bid	Jan 2012	Bid	Jan 2014	Bid	August 2014
Capital	1,44%	--	1,44%	--	1,44%	--	1,44%
Curpum	1,48%	1,32%	1,48%	--	1,48%	--	1,48%
Habitat	1,36%	1,21%	1,36%	--	1,27%	--	1,27%
Planvital	2,36%	1,19%	2,36%	0,85%	2,36%	0,47%	0,47%
Provida	1,54%	--	1,54%	--	1,54%	--	1,54%
Modelo	--	1,14%	1,14%	0,77%	0,77%	0,72%	0,77%
Average	1,64%		1,55%		1,48%		1,16%

CURRENT CHALLENGES

- Even though the 2008 Pension Reform introduced several elements improving the Chilean Pension System, there is still space to introduce changes in order to continue improving retirees situation.

- In general, actual pension levels do not live up to the expectations of the population.

- Main Challenge: Continue improving adequacy with a financially sustainable system.

- The Solidarity Pillar have had a meaningful effect increasing the RRs for those who qualify, but in general RRs are low for the general population.

CURRENT CHALLENGES

There is consensus about some elements which can be improved:

Coverage	There are still groups of the population without proper coverage at retirement.
Replacement Rates (RR)	There is currently an important debate about the adequacy of the RR generated by the system. The observed RR heterogeneity opens questions about the risk faced by affiliates.
Competition	The 2008 reform introduced mechanisms to improve competition among pension managers. Although those mechanisms have been successful there is still space to improve competition.
Education	Large educational campaigns can be useful to increase awareness and saving culture

LAST DEVELOPMENTS

- A Pension Commission was set on April 2014.
  - The general Pension Commission's goal is to study the current Chilean Pension System, in order to elaborate a diagnosis and then propose reforms to improve and revise the Pension System.
  - The 2014 Pension Commission is composed by 24 nationals and internationals members.
- General timeline of the Commission:
  - May- August 2014: public hearings
  - First international seminar: August 2014
  - Second international seminar: December 2014
  - Diagnosis and Final report: August 2015
- Proposals are not binding. If a reform is proposed, the president must submit a bill to the Parliament.

LAST DEVELOPMENTS

The specific tasks entrusted to the Commission are:

- Study and analyze the current Pension System's results, and project future pensions and system's outcomes.
- Asses the Pension System's attributes, limitations and challenges.
- Raise proposals to solve the main Pension system's deficiencies.
- Hold public hearings with the civil society and seminars with international experts in order to identify the main trends about pension systems around the world.
- The Commission must ensure that the defined proposals are relevant, effective, efficient and applicable, showing coherence and consistency among them. It will also ensure that the proposals have financial, political and institutional feasibility.

LAST DEVELOPMENTS

The focus of the discussion:

- Parametric reforms (retirement age, contribution rate) to increase adequacy.
- Strength the Solidarity Pillar.
- Increase coverage and competition.
- Encourage instruments for voluntary savings.
- Address longevity risk and new pension products.
- Focus on financial education: local but also large educative campaigns could be useful to increase awareness and saving culture.

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