Main Proposals to Improve the Chilean Pension System

Olga Fuentes
Superintendence of Pensions, Chile
Paula Benavides
Ministry of Finance, Chile

WPPP/IOPS MEETING
20 June 2017

The Pillars of the Chilean Pension System

Pillars	Pillar 1: Solidarity Pillar Introduced in the pension reform of 2008	Pillar 2: Mandatory Individual Savings Accounts 1981	Pillar 3: Voluntary Savings APV 2002 & APVC 2008
Goal	Poverty alleviation	**Consumption** Smoothing	To complement savings to increase pensions
Financing	General taxes	Individual accounts 10% contribution rate Contribution to D&S insurance	Individual account with tax incentives and matching from the state
Benefits	PBS & APS (mean tested to the 60% of the poorest population)	Depend on total Cumulative savings	Depend on total Cumulative savings

Fuente: Elaboración Propia.

Solidarity Pillar: a successful public policy for poverty relief

Population under poverty situation by income, by age group
(Percentage)

	0 to 3	4 to 17	18 to 29	30 to 44	45 to 59	60 and more
2006	39,6	38,5	24,5	29,2	22,5	22,8
2009	37,2	34,4	23,4	25,0	20,5	16,5
2011	34,4	32,5	19,9	22,3	16,8	13,7
2013	23,2	21,6	13,3	13,7	11,2	8,4
2015	19,5	17,8	11,0	11,3	9,0	6,6

Source: MDS, Casen Survey 1996-2015.

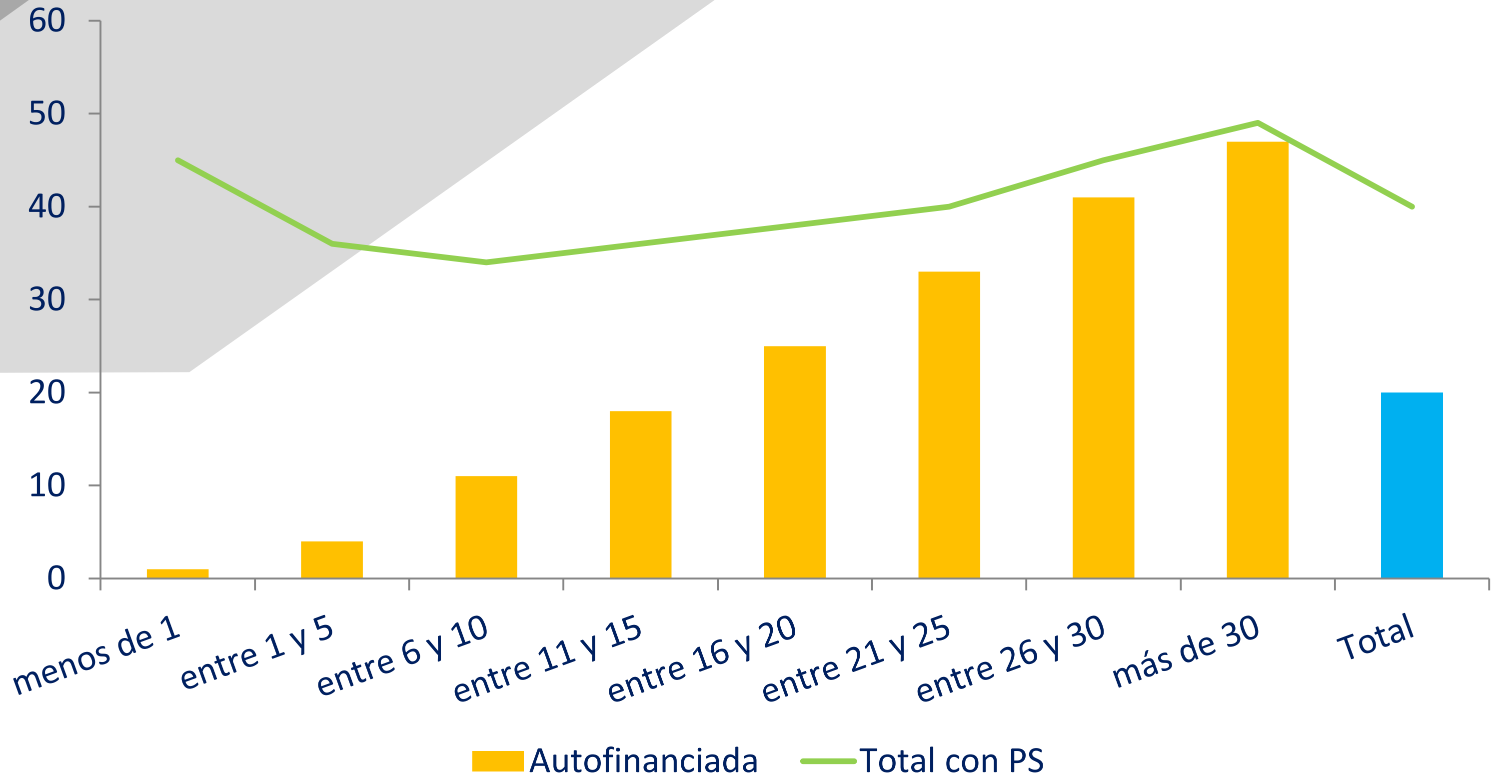
The greatest gap: women and middle class

		Median replacement rate*	
		Self-financed	Total
Gender	Female	12%	29%
	Male	33%	52%
	Total	**20%**	**40%**
Quintiles	1	14%	110%
	2	10%	55%
	3	18%	41%
	4	26%	35%
	5	26%	27%
	Total	**20%**	**40%**

Source: Superintendence of Pensions.
(*) *Replacement rate as compared to last income.*
Note: *total includes Solidarity Pillar.*

Density helps, but does not seems to be enough

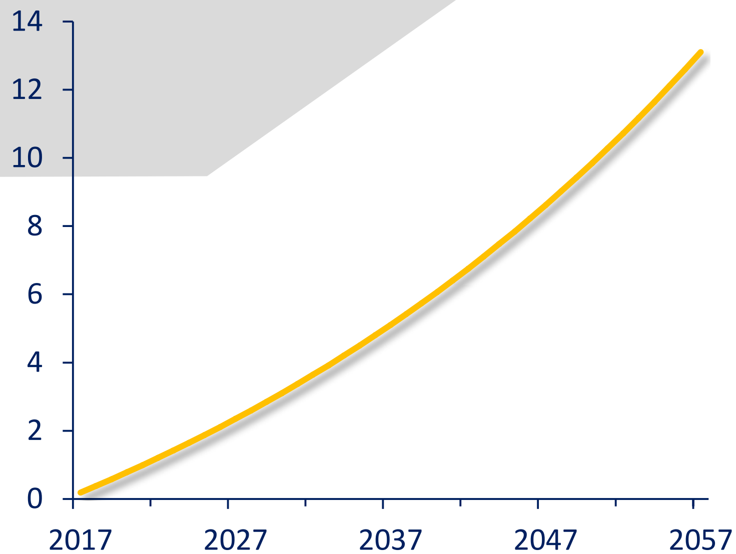
Replacement rate by years of contribution*
(Percentage)



Source: Superintendence of Pensions.
(*) Replacement rate as compared to last income.

The new 5% contribution rate: time constraint vs. population pyramid

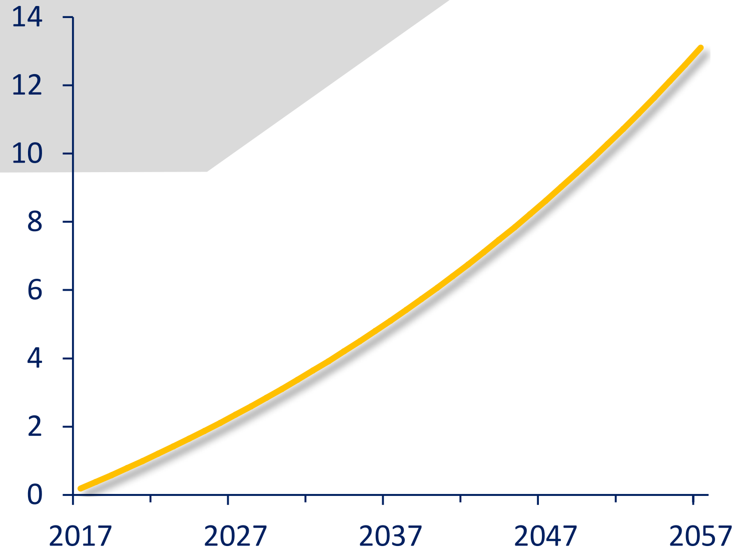
Fully Funded Scheme
(Additional pension/average wage, percentage)



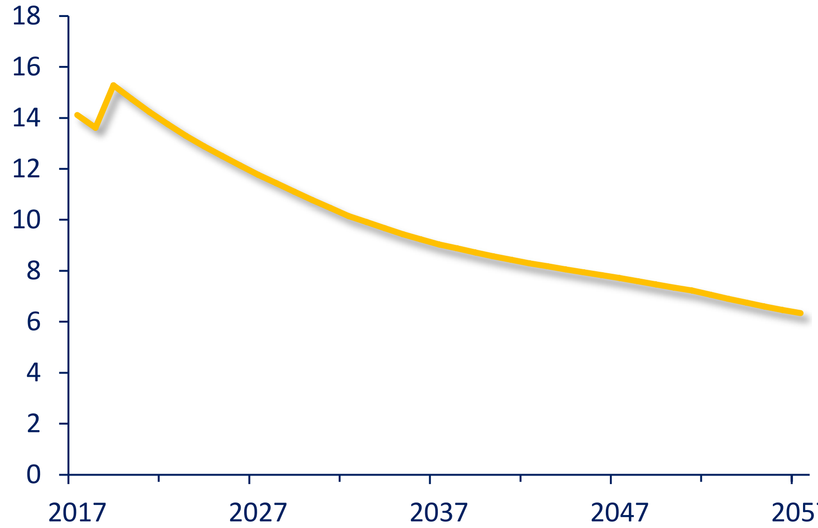
Source: Ministry of Finance.
Note: *Theoretical effects. Simulation of new 5% contribution rate for a man in a fully funded scheme with 4% real return of fund, median density of contribution according to male pensioners retired during 2007-2014 and current average wage of Chilean pension system contributors with 1,5% real rate of growth. PAYG contribution is redistributed equally among the pensioners aged 65 and more.*

The new 5% contribution rate: time constraint vs. population pyramid

Fully Funded Scheme
(Additional pension/average wage, percentage)



PAYG Scheme
(pensioners aged 65 years old and more)
(Additional pension/average wage, percentage)



Source: Ministry of Finance.

Note: *Theoretical effects. Simulation of new 5% contribution rate for a man in a fully funded scheme with 4% real return of fund, median density of contribution according to male pensioners retired during 2007-2014 and current average wage of Chilean pension system contributors with 1,5% real rate of growth. PAYG contribution is redistributed equally among the pensioners aged 65 and more.*

Main contents of the announcement

- The proposed amendment to the system will include the following:

1. New System of Collective Savings for old age pension
2. Changes in parameters and increase of coverage
3. Improvements to regulation and more participation of members.
4. Strengthening of the Solidarity Pillar and of the Voluntary Pillar

Main contents of the announcement: Objectives of the reform

- Improve current and future pensions, with a solidarity component in the contributive pillar.
- To increase savings.
- Improve gender equity
- Keep financing apart between the new system of collective savings and the solidarity pillar.
- Improve the regulation of the private pension system.
- Provide more legitimacy to the pension system.

Changes would be introduced gradually in order to guarantee its sustainability, and to preserve correct economic incentives and macroeconomic stability.

Main contents of the announcement

1. New System of Collective Savings
    - An **increase in the contribution rate by 5 points**, financed by employers, with a phase-in period of 6 years.
    - The creation of a public-run institution for managing the additional 5 points of contribution (unique mandate, autonomous with a robust corporate governance that ensures its efficiency)
    - **3 contribution points** out of the additional 5% will go to members' **individual accounts**, while the other 2 contribution points will finance a **Collective Insurance**

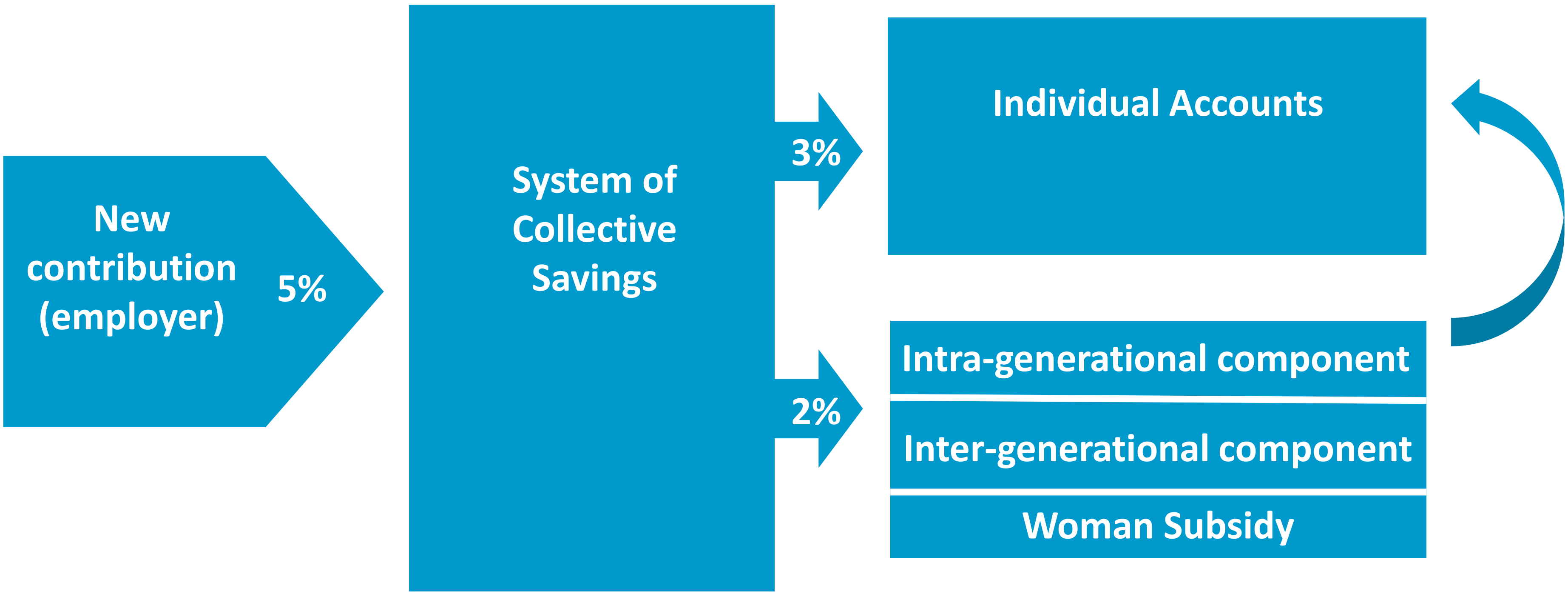
Main contents of the announcement

1. New System of Collective Savings (cont.)
   - The **2 contributions points** to the **Collective Insurance** will be divided into three elements:
     - An **inter-generational component**: to increase old age pensions by 20% of current pensioners older than 65 years old. This benefit is on top of and independent of the current first pillar. The new benefit will have an absolute maximum for higher pensions.
     - A **woman subsidy**: to compensate women for longer life expectancy and to promote the postponement of retirement.
     - An **intra-generational component**: Once the inter-generational component and women subsidy are financed, the rest will be saved in the individual accounts according to a transfer rule that will increase proportionally more the savings of those who have lower relative incomes (solidarity from contributors with higher income to those with lower income)

Women Subsidy

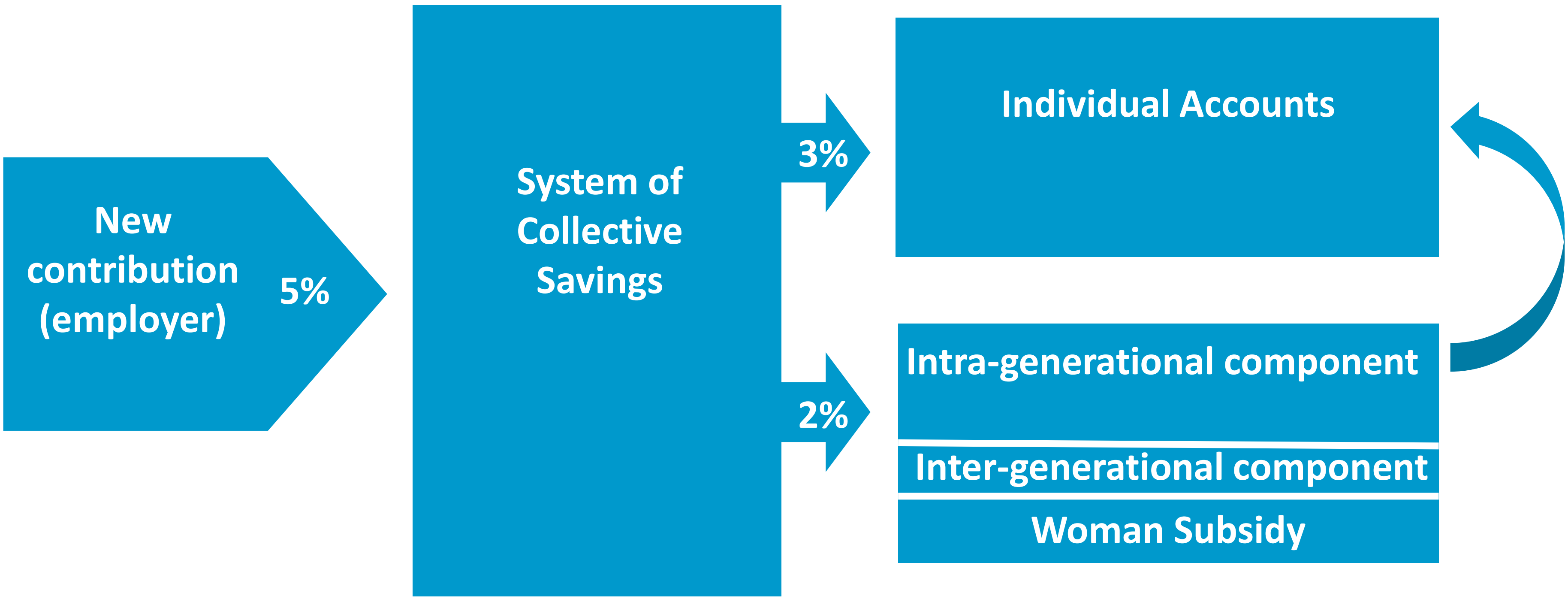
- If a woman retires at age 65 and above, she will receive a full compensation in order to get the same pension of a male retired with the same age and savings. (compensating female’s higher lifespan).
- If a women retires at ages between 60 and 64, she will receive a % of the full compensation. The percentage of the compensation will increase with the age.
- Estimated effect on pension levels: postpone retirement from 60 to 65 implies an increase in pension levels in the range of 35% to 50% depending on the density of contributions.
- The effect of the gender equality component implies and average increase of 14% in pension levels.
- This new improvement in gender equality is in line with the Bonus per Child introduced in the reform of 2008.

New System of Collective Savings



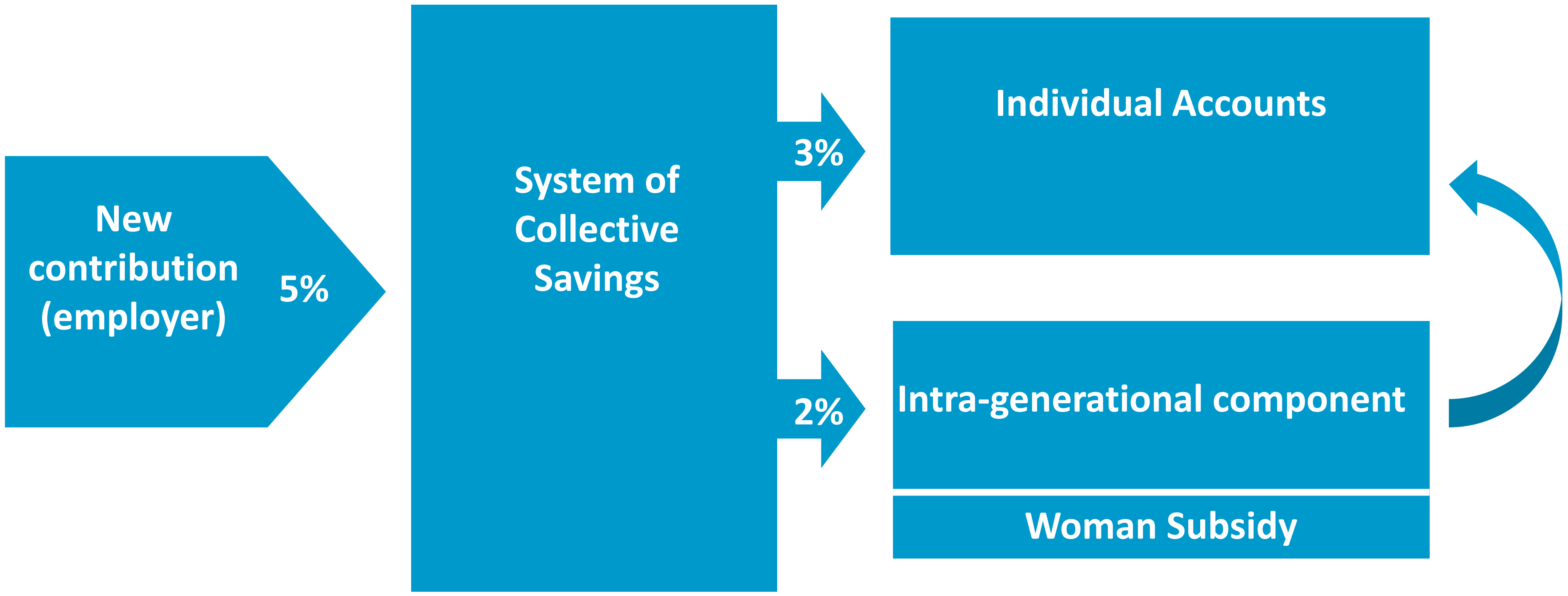
Fuente: Presentación Ministro de Hacienda Seminario "Sistema de Pensiones: Desafíos y Perspectivas" (AIOS-ASSAL-IAIS)

New System of Collective Savings



Fuente: Presentación Ministro de Hacienda Seminario "Sistema de Pensiones: Desafíos y Perspectivas" (AIOS-ASSAL-IAIS)

New System of Collective Savings



Fuente: Presentación Ministro de Hacienda Seminario “Sistema de Pensiones: Desafíos y Perspectivas” (AIOS-ASSAL-IAIS)

Main contents of the announcement

2. Changes in parameters and increase of coverage
   - Self-Employed workers will be enrolled by contributing gradually up to the new contribution rate of 15%.
   - The maximum covered earnings will be increased by 50%.
     - The maximum covered earnings will be gradually increased up to the unemployment insurance ceiling (from UF 75,7 to UF 113,5), with an indexation to the real growth rate of wages onward.

Main contents of the announcement

3. Improvements to regulation and more participation from members
   - Improvements to the multi-funds system and the default investment allocation.
   - Improvements to the auction mechanism for the automatic enrolment of new members.
   - Improvements to the regulation of intermediation fees.
   - Improvement of the electronic quotation system to choose pension products.

   - Participation of members in the AFP’s Investment Committee and Conflict Resolution Committee.
   - Participation of members in process of election of board of directors of companies where pension funds are invested.

Main contents of the announcement

4. Strengthening of the Solidarity Pillar and of the Voluntary Pillar
   - Solidarity Pillar will ensure a defined total pension for all beneficiaries, regardless of the pension product chosen, to ensure the longevity risk protection.

   - Occupational Voluntary Savings Plans will be strengthened both for employers and employees. The objective is to increase middle class voluntary savings.
     - Voluntary for employers to offer the plan
     - Automatic enrolment for employees and tax credit
     - Tax incentives for the employers
     - Matching contributions and vesting period by different income groups

The Pillars of the new Chilean Pension System

Pillars	Pillar 1: Solidarity Pillar Introduced in the pension reform of 2008	Pillar 2: Mandatory		Pillar 3: Voluntary Savings APV 2002 & APVC 2008
		Savings Accounts 1981	Collective Savings System	
Goal	Poverty alleviation	Consumption Smoothing	Consumption Smoothing with Solidarity	To complement savings to increase pensions
Financing	General taxes	Individual accounts 10% contribution rate Contribution to D&S insurance	5% contribution by the employer	Individual account with tax incentives and matching from the state
Benefits	PBS & APS (mean tested to the 60% of the poorest population)	Depend on total Cumulative savings	Depend on total Cumulative savings and Solidarity Rule	Depend on total Cumulative savings

Main Proposals to Improve the Chilean Pension System

Olga Fuentes
Superintendence of Pensions, Chile
Paula Benavides
Ministry of Finance, Chile

WPPP/IOPS MEETING
20 June 2017