

**Individual accounts, DC systems and portability of
pension savings: a comment from the industry's
point of view**

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**OECD/IOPS Global Forum
Istanbul, November 8, 2006**

Individual Accounts in DC

Fiona Stewart's presentation

- provided good coverage of a set of complex issues
- identified the major challenges as: Coverage, Investment decisions and choice, Costs and Governance.

I will say a few things about some of the key points.

Individual Accounts in DC: Administration Costs

The importance of an Accurate Comparison

A key caveat:

Fees cover different things in different countries.

In Chile, for instance, the fee covers costs as well as the Disability and Life Insurance (SIS). These are two separate products and any comparison should be net of the SIS.

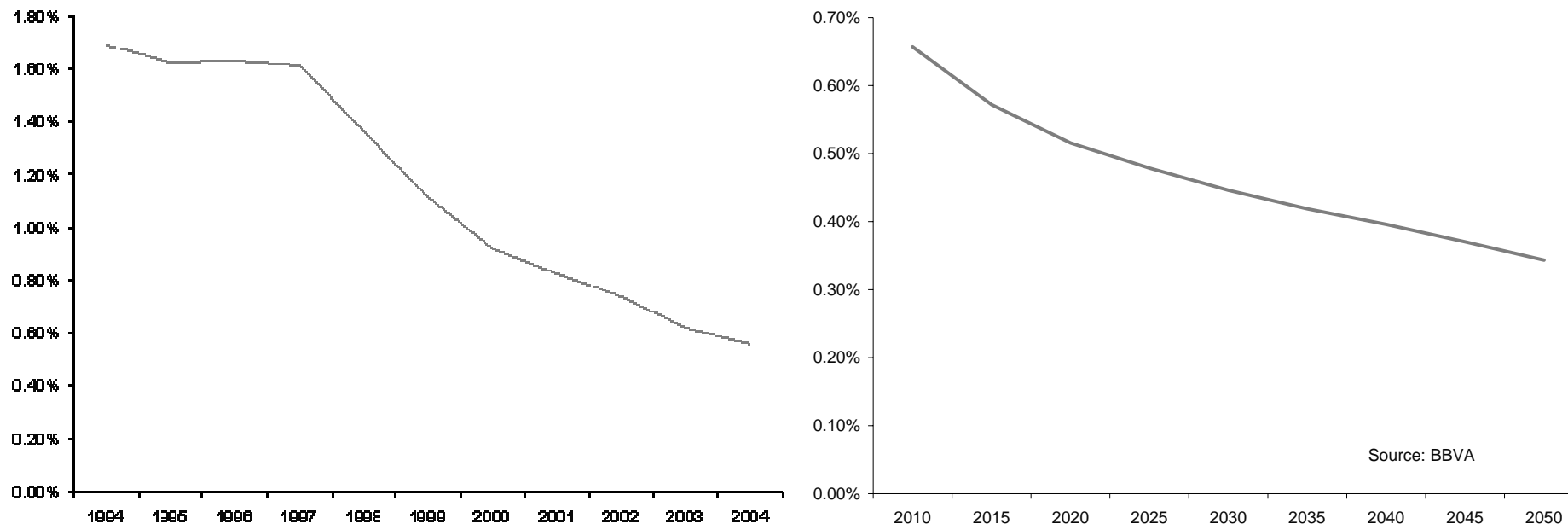
Individual Accounts in DC: Administration Costs

Administration costs have been a contentious issue from the start.

Problem for comparisons: In most countries fees are calculated as a percentage of wages, while in financial markets fees are calculated as a percentage of the fund under administration

For an individual, making a monthly contribution and paying a fee which is a fraction of his salary, fees expressed as a fraction of accumulated savings are high when young and fall as funds accumulate.

Individual Accounts in DC

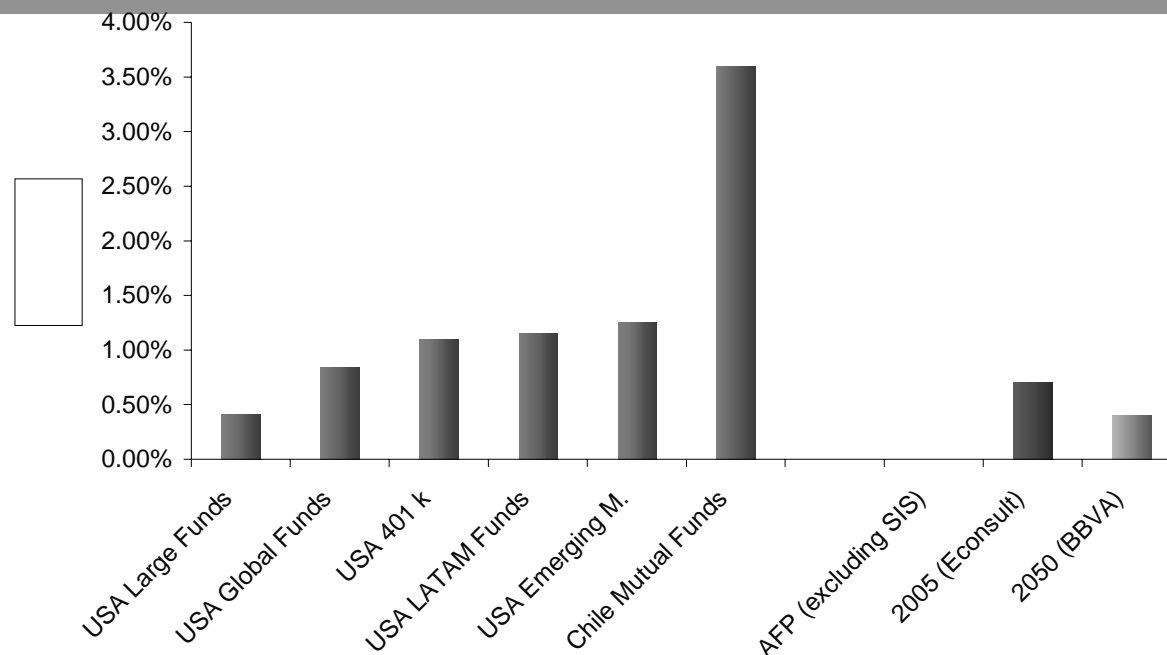


For instance in Chile the average fee expressed as a percentage of the funds under administration has been falling.

Now the fees are about 0.6% and are expected to fall further to about 0.4% of accumulated savings when the Funds stabilize.

Individual Accounts in DC

Adminisration fees
(% of the Fund)



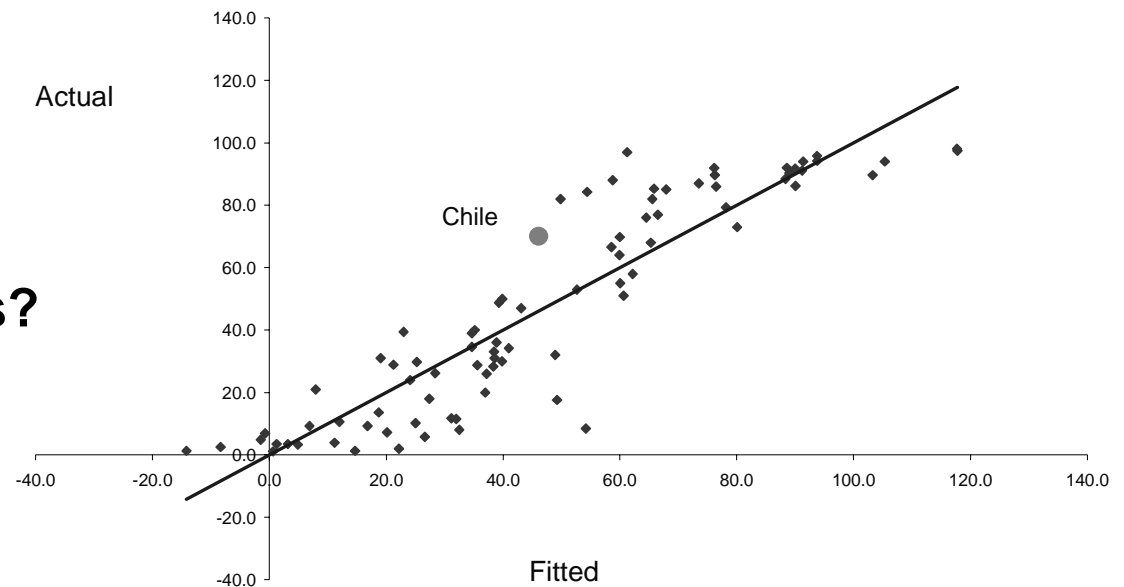
An international comparison with private fund managers shows that the fees charged in Chile are not high; especially when considering the complexity of investment portfolios, and marketing and operational costs, and given that the decision makers are individuals.

Individual Accounts in DC: Coverage

How to induce regular contributions?

- **Informal Labor markets are a major problem for ANY pension system.**

Coverage of the labor force: actual and fitted values controlling for Income per capita



- **Key issue: How far do we want to go in making contributions mandatory for self-employed workers?**

Individual Accounts in DC: Coverage

Next issue: If we make contributions mandatory for everyone, how do we enforce this? Should we recruit the tax system and the Public Health System for this task?

Individual Accounts in DC: Governance

More than meets the eye

Different institutions play different roles. Regulatory authority is essential.

An independent and technically solid Pension Fund (PF)

Superintendency plays a fundamental role. But it requires a good body of laws to do so.

The law must separate the administration of own funds from pension funds. This is why it is so important to maintain PF as separate entities with just that goal.

It is also important to keep the Fund administrator focused: having PF reserves invested in pension funds helps.

Who controls governments? PF hold a lot of public debt, and governments sometimes default. One defense is to invest abroad.

The European Personal Pension Account EPPA

Bernard Delbecque explains many of the advantages of Individual Accounts in DC systems.

One important element he mentions is the portability of second and third pillar pension savings.

Portability could facilitate labor mobility within the EU.

Labor mobility should improve productivity and growth in the region.

Portability results in a win-win situation both for individuals and employers, as well as for the country as a whole.

The European Personal Pension Account

Concerning portability, the Chilean experience has been the following:

In 1981, when the Private system was introduced, portability was not an issue.

A special case was defined: foreign specialists who could either avoid making contributions in the Chilean System, provided their employer was contributing in their country of origin, or withdraw them upon departure.

By the mid-nineties the situation had changed in three important ways:

- Other countries, especially in Latin America, have adopted Private systems,
- Chile has received significant immigration from neighboring countries.
- Chilean companies are investing heavily in neighboring countries, and Chilean nationals are making contributions in individual accounts abroad.

The European Personal Pension Account

Future steps:

Bi-lateral treaties with other countries with Private Pension Systems.

First one has been with Peru. Potential cases are Colombia and Argentina

Conditions to transfer personal accounts from Peru to Chile are:

- Workers need to have 60 months of contributions in the other country.
- Workers must transfer all the contributions, mandatory and voluntary savings.

We have a long way to go, but the fact that accounts are individual is a key factor in promoting the portability of contributions.

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