“Pension System in Chile: The Effect of the Financial Crisis"

Solange Berstein J.
Head of Pensions Supervisor
Chair of IOPS Technical Committee
OECD/IOPS Global Forum on Private pensions
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Effect of the Financial Crisis on Pension Saving Funds

Pension Funds Monthly Returns

Fund A - Riskiest
Fund B - Risky
Fund C - Intermediate
Fund D - Conservative
Fund E - Most Conservative
Effect of the Financial Crisis on Pension Saving Funds

Pension Funds Nominal Returns, selected OECD and non-OECD countries, 2008

Nominal Return in Chile in 2008 was -16.7%

Source: OCDE, 2009
COMPLEMENTARY PRIVATE PENSIONS ARE STILL NEEDED TO FINANCE RETIREMENT

- The Chilean Pension 2008 Reform strengthens the Mandatory and Voluntary Tiers
  - Pension System will be mandatory for the Self-Employed
  - Subsidy to young workers contributions
  - If contributions are not paid, it is assumed they are owed (automatic DNP) unless there is a notification that the contract terminated
  - Over-contribution for women for the difference in the cost of insurance
  - Improvement of investment regulation
  - Measures to promote competition amongst PFAs
  - Changes in tax regime and subsidy to voluntary savings
Early Retirement needs to meet conditions:
- Since 2004 these conditions have been tightened (gradual implementation)
- Nowadays the conditions are: 67% of labor earnings and 150% of the minimum pension
- From August 2010, the replacement rate must be at least 70% of labor earnings and 150% of the minimum pension
- From July 2012 onwards, the replacement rate must be 80% of the Maximum Pension with Solidarity Complement

2008 Pension Reform introduces incentives for voluntary savings if it is for pensions
- 15% subsidy to savings (with a cap of 6UTM (US$ 410 a year)
Policy Recommendations for the Financial Crisis: What has Chile done?

SUPERVISION MUST BE FLEXIBLE, SENSIBLE AND RISK-BASED

- **2008 reform eases up Investment Rules**
  - Structural limits defined by law only
  - Advise role of the Investment Committee
  - Increase the Foreign Investment limit to 80%

- **The Superintendence is moving towards risk-based supervision**
  - Risk concept was included in the Law
  - Supervision Model and Risk Matrix already defined
  - Nowadays we are designing guidelines for the Supervisor and training staff
  - Pilot before the end of 2009
Policy Recommendations for the Financial Crisis: What has Chile done?

SAFETY NETS SHOULD BE USED TO PROTECT AGAINST INSUFFICIENT PENSION SAVINGS

- **2008 reform introduces a safety net-1st Tier**
  - Basic Solidarity Pension, $75,000 (US$ 140)
  - Solidarity Top Up for pensions below $150,000 (US$280) which gradually increases to $255,000 (US$475) in 2011
  - Eligible: poorest 50% (60% in 2011)

- **Other benefits**
  - Voucher for children (women only)
  - Low income young workers subsidy to contributions
Policy Recommendations for the Financial Crisis: What has Chile done?

IMPROVE THE DESIGN OF THE DEFINED CONTRIBUTION COMPONENT, INCLUDING DEFAULT PORTFOLIO CHOICE

- The Multiple-Funds scheme includes a life-cycle default option
- Portfolio restrictions for those close to retirement
- The Supervisor is evaluating introducing more flexibility to life-cycle investment paths
TO ALLOW MORE FLEXIBILITY TO PENSIONERS TO AVOID LOSSES WHEN THE MARKET IS IN A DOWNTURN

- In spite of the legal pension age, individuals may retire later on.

- Several alternatives to purchasing an annuity upon retirement:
  - Programmed Withdrawal (thus, possibility to purchase an annuity later on)
  - Temporary Income with Deferred Annuity
  - Combine Programmed Withdrawal and Annuity
Policy Recommendations for the Financial Crisis: What has Chile done?

2008 Reform:
- Alternative kinds of pensions are reinforced: Pension Advisor
- Floor for Programmed Withdrawal
ENHANCE COMUNICACION CHANNELS AND INCREASE TRANSPARENCY OF INFORMATION

- The Supervisor has defined several ways for the PFAs to provide information to individuals.
- The Supervisor regularly informs the returns of the Pension Funds.
- The 2008 reform mandates the PFAs must disseminate their Investment Policies, which must be approved by the Board.
- The 2008 reform creates a Users Commission.
- The 2008 reform mandates each PFA to have an Independent Board member.
- List of potential Board members that could be chosen by PFAs in the companies where Pension Funds are invested (119 individuals registered).
ENHANCE FINANCIAL KNOWLEDGE

- Supervisor efforts to educate:
  - Risk concept
  - Relevance of early contributions
  - Relevance of contributions and of postponing retirement (PPP)

- 2008 reform creates a Pension Savings Education Fund

- 2008 reform regulates Pension Savings Advisor, amending conflict of interests and creating advise during the working stage

- The Supervisors Committee (Banking, Insurance and Securities, and Pensions) is working on a financial education project
Early contributions, between 20 and 30 years of age, are very important.
Su futuro está en sus manos, ¡Infórmese hoy de su pensión!

Datos Personales:
Nombre: Estanislao Francisco Ruiz Reyes
RUT: 9.546.779-4
Edad: 43

Información a 30 de Abril de 2005
Monto acumulado $ 7.137.584
Bono de Reconocimiento $ 460.815
Promedio 6 últimas remuneraciones $ 317.419

Importante: En los últimos 12 meses, usted cotizó 6 meses

¿Qué pasaría con su pensión si usted...

…no cotiza nunca más y se pensiona a los 65 años?
Recibiría una Pensión Estimada de $113.018

…sigue cotizando todos los meses por una remuneración de $317.419 hasta pensionarse a los 65 años?
Recibiría una Pensión Estimada de $176.054

Para el cálculo de la Pensión Estimada se considera una ganancia de sus ahorros del 5% al año y como beneficiario una esposa 2 años menor.

Usted puede mejorar su pensión:
- Si es independiente, puede cotizar directamente en su AFP.
- Recuerde que puede pensionarse después de cumplir la edad legal. Si posterga su jubilación, aumenta el monto de su pensión.
- Informese sobre el Ahorro Previsional Voluntario (APV) y la Cuenta de Ahorro Voluntario (Cuenta 2).
- Existe una pensión mínima garantizada por el Estado de $77.077. Si su pensión estimada es inferior a este monto, infórmese sobre los requisitos para obtener este beneficio.

Si desea obtener una proyección de pensión más detallada, contáctese con su AFP en:
AFP xxxxxxx www.afpxxxx.cl F: 800-xxx-xxxx
The 2008 reform moves towards more flexible regulation and, at the same time, more responsibility for the PFAs.

The new focus on Risk-Based-Supervision will allow more flexible conditions.

The challenge is to properly measure the pension risk, which will allow a new view on investment regulation.
Conclusions and Challenges

- The 2008 Chilean Reform closely follows the international recommendations.
- The welfare 1st-tier is key in the provision of adequate pensions not only in Chile but also worldwide.
- Because pension savings are mandatory, the regulation is particularly relevant, as the risk is faced by individuals and the state.
- 2008 reform gives more protection and, at the same time, more flexibility for regulation and more responsibility for PFAs.
- Worldwide trend to a sensible supervision and risk-based regulation.
- Risk-based regulation is key for a suitable development of the Pension System.
- Proper ways to assess the pension risk will help control for it in the future.
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