CHILE

REVIEW OF THE PRIVATE PENSIONS SYSTEM

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FOREWORD

This review of Chile by the Working Party on Private Pensions is part of a series of reviews of national policies undertaken for the OECD Insurance and Private Pensions Committee (IPPC). It was prepared as part of the process of Chile’s accession to OECD membership.

The OECD Council decided to open accession discussions with Chile on 16 May 2007 and an Accession Roadmap, setting out the terms, conditions and process for accession, was adopted on 30 November 2007. In the Roadmap, the Council requested a number of OECD Committees to provide it with a formal opinion. In light of the formal opinions received from OECD Committees and other relevant information, the OECD Council decided to invite Chile to become a Member of the Organisation on 15 December 2009. After completion of its internal procedures, Chile became an OECD Member on 7 May 2010.

The IPPC was requested to examine Chile’s position with respect to core principles related to insurance and private pensions systems. The examinations were carried out by the Working Party of Governmental Experts on Insurance (WPGEI) and Working Party on Private Pensions (WPPP). The present report was finalised on the basis of information available in July 2009. It is released on the responsibility of the Secretary General of the OECD.
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INTRODUCTION

This document has been prepared as part of the OECD’s work in relation to Chile's application for accession to the OECD. The purpose of this document is to assist the Working Party on Private Pensions form an opinion on Chile’s ability and willingness to meet the requirements of membership in the field of private pensions as set out in Appendix A.VIII of the Accession Roadmap for Chile adopted by the Council [C(2007)100/Final]. Accordingly, Chile will be assessed against the two core principles referred to in the Roadmap:

- ensuring sound prudential regulation of private pension systems and protecting the rights of members and beneficiaries; and
- relaxation of restrictions on cross border trade, investment and establishment of pension services as required under the OECD Codes of Liberalisation.

The Working Party reviewed the first core principle of the Roadmap (except supervisory matters) at its meeting in December 2008 on the basis of a first draft of this report. Following that meeting, the Chair sent a letter to the Chilean Delegation (dated 21 January 2009) including a set of questions for clarification. Chile responded in written (letter dated 27 February 2009 included in DAF/AS/PEN/ACS(2008)2/REV1/ADD4), providing detailed answers to all the questions.

A report on private pension supervision was prepared to support the discussion at the July meeting [DAF/AS/PEN/ACS(2008)2/REV1/ADD3], including draft recommendations on supervision. The Chilean Delegation provided comments on supervision during this meeting [DAF/AS/PEN/ACS(2008)2/REV2/ADD5].

In this revised report, particular attention has been paid as to how regulations, supervision and market-practice in Chile measure up in relation to the OECD Recommendation on Core Principles of Occupational Pension Regulation [C(2009)57)], using the Methodology developed for this purpose [DAF/AS/PEN/WD(2008)1/REV2]. The detailed assessment and the main recommendations made by the Working Party are contained in the executive summary.

The report also addresses compliance with the “OECD Recommendation on Good Practices for Financial Education relating to Private Pensions” [C(2008)23]. Market access issues and the Codes of Liberalisation are addressed by the Working Party of Governmental Experts (WPGEI) which assists the Investment Committee in these matters.

The document contains two main sections: the executive summary contains a summary of the assessment of the implementation of the OECD Recommendation on Core Principles of Occupational Pension Regulation in Chile. It highlights the main points of convergence and divergence of the Chilean private pension system with the OECD Recommendation. Any differences with the OECD Recommendation, outstanding questions and areas for further discussion have been categorized and described under the appropriate OECD Core Principle. A reference is also made to the OECD
Recommendation on Good Practices for Financial Education relating to Private Pensions. The second section of this document contains a brief description of the Chilean pension system.

Four additional documents support the analysis and recommendations in this report:


- The original submission by the Chilean authorities in response to the Questionnaire prepared by the Working Party on Private Pensions (DAF/AS/PEN/ACS(2008)2/ADD2);

- The response by the Chilean Delegation to the WPPP’s chair containing various questions for clarification (DAF/AS/PEN/ACS(2008)2/REV1/ADD4).
EXECUTIVE SUMMARY

Overview of the Chilean private pension system

The new private pension system started operating on 1 May 1981. It is a fully funded, defined contribution system in which pensions are based on individuals' savings accumulated during workers’ lives. It is compulsory for all wage and salary workers and involves the mandatory payment of a percentage of gross earnings as contributions into a private pension fund selected by the individual from pension fund administrators (“AFP”) licensed by the supervisory authority (the Superintendency of Pensions, SP).

The administration of the funds is highly regulated to protect the interests of the members. Since August 2002 fund members can choose between five different portfolios differentiated by the proportion of their portfolio invested in variable income securities (such as equities).

Pension funds are subject to a broad range of quantitative portfolio limits, including limits by issuer, risk and asset class. The limit on an AFP’s investments abroad currently stands at 45% of its assets under management but can increase to up to 80% once Law 20.255 comes into force.

The AFPs must comply with a minimum investment return rule with regards to the pension funds that they manage. The minimum required investment return is measured on the basis of the average real yield of all the pension funds of the same type.

Benefits may be paid as annuities, programmed withdrawals or a combination of the two. Annuities are paid by life insurance companies while programmed withdrawals are paid directly by the AFPs.

In addition to the Compulsory Pension System, there are also voluntary pension savings plans provided by the AFP’s and other authorized entities, such as insurance companies, mutual funds, fund managers, etc.

The recent Law N° 20.255, introduced a type of occupational pension plan called the Collective Voluntary Pension Saving or “APVC”. The APVC’s can be set up since October 2008. This type of pension plan is a contract between the employer and authorized institutions to manage voluntary collective pension saving funds.

Position of Chile with regards to the OECD Legal Instruments

In its Initial Memorandum and later communications, Chile formally stated that it accepted all six OECD legal instruments in the field of private pensions. Chile requested a timeframe for the implementation of the Recommendation on Guidelines for Pension Fund Asset Management [C(2006)7] until the end of 2010.

The Working Party finds that Chile is largely compliant with the OECD Core Principles of Occupational Pension Regulation and the related Guidelines. Regulation is comprehensive and
generally well designed. The country also has the main features of a sound supervisory framework as stated in the Core Principles.

At the same time, the Working Party finds that there are some areas where further initiatives by policymakers would be appropriate to improve the operation of the private pension system. These initiatives include:

- Reviewing the preconditions necessary for moving from a compliance-based regulatory framework to a risk-based one, such as establishing comprehensive risk control requirements on the pension fund administrators [Core Principle 1];

- Considering possible alternatives to the minimum rate of return guarantee such as suitable market benchmarks and risk controls that take into account the retirement income objectives of pension funds. In this regard, it will be worth evaluating the experience of the exogenous benchmark established for the mandatory unemployment insurance fund [Core Principles 3 and 4];

- Assessing the impact of recent reforms on the replacement rates that different kinds of individuals are likely to obtain and considering the need for and impact of other policy options such as increasing mandatory contributions and raising the retirement age [Core Principle 5];

- Reviewing the governance arrangements in the AFP’s in order to assess whether the various regulations and internal controls in place are sufficient to provide adequate protection from conflicts of interest situations and promoting practices among the pension fund administrators that are in the best interest of the plan members [Core Principle 6].

- As part of the planned move towards a risk-based supervisory approach, review the legislation under which the SP operates to strengthen its independence and powers and to enhance its transparency [Core Principle 7].

The Chilean delegation has stated its general agreement with these recommendations and briefed the group on their planned implementation at the July meeting [DAF/AS/PEN/ACS(2008)/REV1/ADD5].

The Working Party also finds that Chile is aware of the importance of financial education in the field of pensions and that it has launched useful initiatives in this area, such as the Pension Education Fund which has provides financial support to projects, programmes, activities and educational measures about the pension system. This fund, managed by the Undersecretariat of Social Security at the Ministry of Labour, has had an initial focus on projects whose main focus is to raise awareness among union members and other organizations of employers and employees. The Working Party finds that further initiatives in this area are appropriate and therefore recommends:


- Reviewing the regulation of pension advisors to ensure that possible conflicts of interest are properly addressed.
Implementation of the OECD Core Principles of Occupational Pension Regulation

The following section provides a summary assessment of the Chilean private pension system against the OECD Recommendation on Core Principles for Occupational Pension Regulation, using the methodology developed for this purpose (DAF/AS/PEN/WD(2008)1/REV2). This section highlights the main points of convergence and divergence of the Chilean private pension system with the OECD Recommendation. Any differences with the OECD Recommendation, outstanding questions and areas for further discussion have been categorized and described under the appropriate Core Principle.

Core Principle 1: Conditions for effective regulation and supervision

The operation of pension plans in Chile is governed by a comprehensive regulatory system and the supervision of the Superintendence of Pensions. Given the mandatory nature of the Chilean pension system, pension provision is fairly standard, but many workers (about 40% of the total, mainly self-employed and others employed in the informal sector) do not contribute on a regular basis.

The system is based on individual affiliation to a dedicated pension provider chosen by the employee (personal pensions). It also relies heavily on life insurance companies as providers of old-age annuities, disability and survivors’ insurance. Recent legislation also allows employers to provide additional pension benefits to their employees.

Core Principle 2: Establishment of pension plans, funds and fund managing companies

Chile has a fully-fledged licensing framework for pension fund managing entities including at least most of the requirements of the Core Principles. Regulations on risk management systems and controls are expected to be introduced in the near future.

Core Principle 3: Pension plan liabilities, funding rules, winding up, and insurance

Given that Chile’s pension system is almost entirely defined contribution in nature, the core principles relating to pension funding are generally not applicable.

Pension fund administrators are responsible for guaranteeing a minimum rate of return on investments and are required to hold a buffer reserve to meet this requirement. The minimum investment return required of the pension funds is based on the asset-weighted average real yield of all the pension funds of the same type.

As pension fund assets are legally separated from the management companies, the latter’s insolvency can only affect pension funds if the minimum return has not been met. The government provides a back-up guarantee for such cases.
Core Principle 4: Asset Management

Under current law, investment of AFP assets under management is strictly regulated via quantitative ceilings on investments (by asset class, issuer, risk and ownership concentration). The asset class ceilings have been relaxed over the years. Under the recently approved Law 20.255, these limits will be lightened further which should broaden the AFP’s investment options and provide for greater flexibility. The limit on foreign investments is currently 45%, but will be increased to 80% with the new law.

There are currently no requirements for risk management or risk control by the AFP’s. This may be explained by the comprehensiveness of the quantitative regulations, which effectively drive investment decisions such as the extent of diversification in portfolios. However, operational risks require a risk management plan irrespective of the investment regulations in place. New legislation is expected to address this issue in the near future.

Another regulatory concern is that the minimum investment return requirement may encourage funds to invest in similar assets. Furthermore, the asset-weighted average to determine the minimum yield requirement may give the larger funds an advantage.

Core Principle 5: Rights of members and beneficiaries and adequacy of benefits

The rights covered by the Core Principles are generally reflected in the Chilean regulation. In particular, disclosure requirements are very comprehensive. There are however concerns over individuals’ ability to understand the information provided. There is full and immediate vesting and portability in the compulsory scheme and a maximum 2-year vesting period for employer contributions to the new voluntary occupational system.

Despite the mandatory nature of the Chilean pension system, workforce coverage is not universal mainly due to the large informal and self-employed sector. The recent reform to require self-employed individuals who make income tax declarations to contribute should alleviate the problem to an extent. Studies by the SP have estimated that coverage (contributors as a percentage of employed workers) should increase from the current 60% to 69%, equivalent to an increase of about 600,000 workers. The government has also introduced incentives to hiring young workers by providing a subsidy to the contributions made on their behalf. Opportunities for additional voluntary contributions have also been facilitated with the introduction of occupational pension plans.

The adequacy of pension benefits among poorer workers has also been enhanced with the introduction of the solidarity pension and pension bonus for women for each child they have. Projections by the SP estimate an increase of benefits by 15% in real terms by 2015.

The total level of mandatory contributions to the Chilean pension system is nevertheless low by international standards, which may lead to a low level of pension benefits.

The Chilean authorities have indicated that financial education is a key challenge for them and must be better addressed in the future for the system to be successful.
Core Principle 6: Governance

The governance requirements for pension funds in Chile are relatively strong. The regulatory and supervisory system has in the past been quite rules based. However, there is a change underway towards a more risk-based regulatory and supervisory system.

One major concern is that as AFP’s are public, commercial companies, the board of directors has a fiduciary duty to the shareholders. While the AFP’s must comply with pension regulations they have no fiduciary responsibility over the investment policy – beyond minimum return requirements – or the level of management fees charged to plan members. The system relies on information disclosure, competition among providers and individual choice to ensure outcomes that are in the best interest of beneficiaries. However, this assumes high levels of knowledge and interest among individuals which do not seem to be warranted.

There is no requirement for member representation on the governing body of the pension funds (through e.g. oversight committees) or their managing entities. This limits the extent of accountability to plan members, but the recently established Users Committee mitigates these concerns. Plan sponsors do not play a role in governance as the choice of managing entity is made by the member.

Core Principle 7: Supervision

Chile has a fundamentally sound system of pension supervision, which fully or broadly complies with all the International Organisation of Pension Supervisors (IOPS) Principles of Private Pension Supervision.

While the SP’s governing legislation specifies functions rather than objectives, the SP has used its power to interpret law to establish objectives that are high level and outcome focused, referring to the timeliness of benefits, the security of savings and the building of confidence.

Legislation provides robustly for the independence of the SP as an institution, with strong separation from Government. In particular, it has complete autonomy in taking decisions, which include interpreting the law and making secondary regulation, can be over-turned by a judicial process. The only constraint on the independence of the SP has been the government’s ability to remove the Superintendent during the Superintendent’s term of office.

The SP has only very limited power to outsource functions, and no interest in outsourcing except for functions that should properly be discharged by pension funds in any case. Were financial or recruitment circumstances to change, this might make this absence significant.

Legislation provides the SP with extensive powers over all aspects of the way pension funds are run and generally provides a robust regulatory regime for the funds themselves. The few significant gaps, relating to fund capital requirements and, especially fund governance, are to be filled by secondary legislation issued by the SP as part of its move to risk-based supervision.

The SP is implementing risk-based supervision during 2009 and 2010. At present, therefore, there is routine compliance focus to its inspection activity, although supervisory understanding of the strengths and weaknesses of the five pension fund administrators does influence the focus of each
inspection. The SP’s approach will also not be truly proportionate until risk-base supervision is implemented.

Apart from feeding back to individual funds on supervisory decisions (which is undertaken in a comprehensive manner) there is as yet little on what the SP would expect from funds when it is supervising them, beyond the legislation. As a compliance-based supervisor, this may well suffice, but the SP recognises the need to publish more guidance when it moves to a risk-basis.

Legislation sets out the basic internal governance rules for the SP, while a Government code of conduct applies to the SP’s staff. There is, however, no document setting out governance and conduct rules specific to the SP.
DESCRIPTION OF THE CHILEAN PENSION SYSTEM

I. The Old Chilean Pension System

The Chilean public pension system was created over time in an ad-hoc manner. By 1979 there were 32 pension institutions in total, with 2,291,183 workers paying into them, and over a hundred different pension schemes. All these public pension programs were defined benefit and financed on a pay-as-you-go basis. Each scheme had significant differences in requirements for retirement, contribution rates and benefits. This diversity of pension schemes led to a discriminatory and unfair system. Furthermore, it did not cover all workers and the resources were insufficient and would demand increasing fiscal expenditures over time.

In 1980, the government introduced a systemic reform that replaced these old pension schemes (except for the armed forces pension systems that were kept unchanged). The new pension system was established on a defined contribution basis with individual savings accounts managed by private firms called the Pension Fund Administrators or “AFP’s”. Workers who had contributed, at the time of the reform, to one of the previous public pension schemes could stay in the old system or switch to the new one (but not switch back). New contributors could only participate in the new system.

As of March 2008, 970,812 pensions were paid from the old public pension schemes (including old age, disability or survivorship benefits), but only 102,452 workers were still contributing to one of these schemes (compared to the 3,895,776 participants in the new system).

II. The New Chilean Pension System

II.1 Types of Pension Plans

The new Chilean pension system consists of four main tiers. All pension savings are managed by external funds and providers.

- The new solidarity pension;
- The compulsory pension system;
- Occupational pension plans: voluntary pension savings; and,
- Occupational pension plans: collective voluntary pension savings.

II.2 New Solidarity Pension

The New Solidarity Pillar was introduced in March 2008. It replaces the previous poverty prevention programs with a unique scheme that guarantees that all individuals in the 60% less affluent fraction of the population will have a guaranteed basic pension, regardless of their contribution history. This new program provides old age and disability subsidies, financed by general revenues of
the State. Individuals with no contributions are entitled to an old-age Basic Solidarity Pension (PBS), once they reach 65 years of age, and fulfil the affluence and residence requirements. Individuals who made contributions but will receive a pension below a certain threshold are entitled to a Pension Solidarity Complement (APS), with the same affluence and residence requirements. The disability program provides benefits under similar conditions, but for individuals between the ages of 18 and 64. Once disabled individuals reach the age of 65, they are eligible for old-age solidarity benefits. The schedule of subsidies is best described in the following Figure, which presents solidarity subsidies and total pensions, as a function of the self-financed pensions from the compulsory pension system.

The new solidarity pension is financed by tax revenues.

**Figure 1. Subsidies and final pensions under the New Solidarity Pillar**

<table>
<thead>
<tr>
<th>Old age Solidarity Benefits</th>
<th>Disability Solidarity Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Pension</td>
<td>Total Pension</td>
</tr>
<tr>
<td>PBS</td>
<td>PBS</td>
</tr>
<tr>
<td>APS</td>
<td>APS</td>
</tr>
</tbody>
</table>

**II.3 The Compulsory Pension System**

The new pension system commenced on 1 May 1981. It is a fully funded, defined contribution system in which pensions are based on individuals’ savings accumulated during workers’ lives. It is compulsory for all wage and salary workers and involves the mandatory payment of a percentage of gross earnings as contributions into a private pension fund, selected by the individual from pension fund administrators approved by the government (the “AFP’s”). The administration of the funds is highly regulated to protect the interests of the members.

*Compulsion*

The compulsory scheme requires employees to contribute 10% of their total salary, plus administration charges and premiums for disability and survivors’ insurance. However, coverage is

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1 Contributions are deducted from salaries by employers who transfer the monies to AFPs to deposit into the accounts of individual members. The mandatory contribution to the individual accounts is 10% of
not universal. All employees in the private and public sectors are required to participate. Although the scheme covers civil servants and other government employees, members of the armed forces are exempt as they have their own scheme. Participation is not yet mandatory for the self-employed, the unemployed, those in the informal sector or those who were covered by the old public pension system. Employers are required by law to deduct the employee's contribution and forward it to the AFP of the worker's choice. At retirement, benefits are paid as annuities by life insurance companies or as programmed withdrawals by the AFP’s.

Although current workers, covered by the old public pension system, were not obliged to enter the new scheme, they had incentives to switch. Transferring workers were provided with recognition bonds which represented their accrued pension benefits under the old system. In addition, a transfer involved an effective increase in the net wages, because under the new pension scheme the contribution rate is lower than what it was under the old system.

A reform to the system in March 2008 requires all self-employed workers who receive income subject to income tax to make contributions to the compulsory pension system. The introduction of this requirement will be phased in over time.

*AFP’s*

Although contributions are publicly mandated, they are managed by the private, specialized AFP’s. The AFP’s are subject to regulation to protect the assets of the members, reduce risk, promote efficiency and ensure an adequate return. Each AFP can invest in stocks, bonds and government debt. The complete return on the fund is allocated to the individual accounts. The AFP is separate from the funds which it administers, which are owned by the members. If the AFP fails, the assets of the members are not affected, but are transferred to another AFP. In addition to their fund management services, the AFPs collect contributions and make payments, keep records of individual accounts, provide information to the regulatory body and members, and purchase group insurance policies to provide death and disability cover for members.

*Multifunds System*

A new Law implemented in August 2002 requires each AFP to offer mandatory four different types of funds, called simply Funds B, C, D and E, which vary according to the degree of risk. AFPs may also offer voluntarily a Fund A. The funds are differentiated by the proportion of their portfolio invested in variable income securities (such as equities) and fixed income (such as bank deposit, mortgages, or government bond that offer a low level of risk or variability).

The proportion of variable income varies from fund E, with a 0% proportion in variable income up to fund A which may have between 40% and 80% in variable income. In order to avoid that funds overlap, the regulation mandate that fund A must always hold more stocks than fund B, and fund B in turn, more stocks than fund C and so on. An adequate range is given between the minimum and the maximum limits to enable the portfolio manager to optimize the investment in each fund.

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...total salary up to a maximum level of 60 Unidades de Fomento (an inflation-adjusted currency measure).
Figure 2. Maximum and Minimum Limits In Equities

<table>
<thead>
<tr>
<th>Type of Fund</th>
<th>Maximum Limit</th>
<th>Minimum Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund A</td>
<td>80%</td>
<td>40%</td>
</tr>
<tr>
<td>Fund B</td>
<td>60%</td>
<td>25%</td>
</tr>
<tr>
<td>Fund C</td>
<td>40%</td>
<td>15%</td>
</tr>
<tr>
<td>Fund D</td>
<td>20%</td>
<td>5%</td>
</tr>
<tr>
<td>Fund E</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

The new Chilean design lets the members choose freely among the different funds. The only limitation is for pensioners, male members over 55 years old and female members over 50 years old. Pensioners may choose only the Funds C, D and E, which have a lower relative risk, whilst members who are within 10 years or less of the legal retirement age may access to the fund type B, C, D and E. The aim of this regulation is to prevent that pensioners and members close to retiring age may be affected, on the one side, for the volatility of the yield of the funds with a greater proportion of variable income instruments, and, on the other side, for the high risks in the investments made by the portfolio manager with their balances (mandatory contributions). These two menaces may harm irreversibly the futures benefits of the members, which could affect the state guarantees for minimum pension that are involved.

Members who do not select a type of Fund when enrolling in the Pension System are assigned according to their age. The rule for carrying out the assigning of members to one of the five Funds consists in separating them into three age-bands, with a Fund that is more intensive in equities corresponding to the younger members and a Fund that is more intensive in fixed income to the older members. This rule is applied to both active members and retired members.

The assignment method is shown in the following table. The default funds by age are highlighted in grey:

Table 1. Assignment By Age-Band For Members Who Do Not Make A Choice

<table>
<thead>
<tr>
<th>Investment Options</th>
<th>Men up to 35 years</th>
<th>Men from 36 to 55 years</th>
<th>Men as from 56 years and Pensioners</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Women up to 35 years</td>
<td>Women from 36 to 50 years</td>
<td>Women as from 51 years</td>
</tr>
<tr>
<td>Fund A</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fund B</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fund C</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fund D</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fund E</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Freedom of Choice

Workers are free to select the AFP of their choice. They are also free to transfer from one AFP to another one. Nowadays, the only limit for permanence and transfers is given by the amount of time that it takes to fulfil a transfer in operative terms, which by regulation should be 30 days at most.

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2 Both groups will be able to choose any of the five Funds for their voluntary contributions and voluntary saving account.
The members can also switch freely their balances 2 times in one calendar year from one fund to another within the same AFP. Administrators are allowed to charge a fee in the case of more than two transfers in order to avoid excessive administration cost and the possibility of negative effects on the capital market. As of today, no administrator has charged this fee.

Investment limits

Pension funds are subject to a broad range of quantitative portfolio limits, including limits by issuer, risk and asset class.

The limit on an AFP’s investments abroad currently stands at 45% of its assets under management but can increase to up to 80% once Law 20.255 comes into force.

Minimum Investment Return

The AFPs must comply with a minimum investment return rule with regards to the pension funds that they manage. The minimum required investment return is measured on the basis of the average real yield of all the pension funds of the same type. The AFP must also have an Obligatory Reserve, funded with its own resources, equivalent to 1% of the pension funds under management. This asset is invested in the pension fund’s accounting units and constitutes a safeguard, in addition to the Yield Fluctuation Reserve, to ensure that the required minimum yield is achieved.

II.4 Voluntary Pension Savings

In addition to the Compulsory Pension System, there are also voluntary pension savings plans provided by the AFP’s and other authorized entities, such as insurance companies, mutual funds, fund managers, etc.

Employers may contribute to their employees’ pension savings above the mandatory requirements in the compulsory pension system through Voluntary Pension Savings. In this case workers can arrange with their employers to deposit amounts assigned to their individual capitalization account, in order to increase the capital to finance an early retirement pension or increase the amount of their pension. These sums are called agreed deposits and are paid into an account called the individual capitalization account for agreed deposits. These assets are independent of the mandatory and voluntary contributions and may be deposited in any of the institutions authorized to offer this type of saving. In the case of Pension Fund Administrators, the savings of this type can be deposited in any type of Fund, without any kind of restriction. As of May 2008, there were 65,656 accounts of this type and only 15,779 deposits were made that month, meaning this is not a widely used savings vehicle. In fact its use is highly concentrated on high income earners and top executives in some companies.

II.5 Occupational Pension Plans: Collective Voluntary Pension Savings

The recent Law No 20.255, introduced a type of occupational pension plan called the Collective Voluntary Pension Saving or “APVC”. The APVC’s can be set up since October 2008. This type of pension plan is a contract between the employer and authorized institutions to manage voluntary collective pension saving funds. This agreement is made by the employer in representation of its employees who want to join the plan. APVC plans will have contributions from both the employer and workers. Such contracts shall be non-discriminatory and may include a vesting period no longer than 24 months for employer’s contributions. Employees’ contributions will be automatically vested. However, plans which only have employer contributions will also be allowed: in this case the
employer can make different contributions in terms of the amount and vesting period with respect to those plans which include workers’ contributions.

The offer of APVC’s is going to be voluntary for employers; however, once the contract is in place, the employer must contribute the agreed amounts.

Workers have the right and not the obligation to join to these offered plans.

III. Regulatory and Supervisory Framework

The pension law laid down in Decree Law 3.500 in 1980 establishes a framework that regulates the main aspects of the Chilean pension system. This includes the operations of AFP’s, asset management and protection of rights. Additional regulations have been passed since then to ensure that the objectives of the pension system are fulfilled more efficiently.

In March 2008, a new comprehensive reform to the pension system was passed. The reform kept the compulsory pension system as the main pillar of Chilean pension savings but introduced a number of changes to increase its coverage (including the extension of compulsory participation to a large group of formal self-employed workers), the level of competition among providers and the flexibility of the investment regime. In addition, the reform replaced the previous old age poverty prevention programs by the new solidarity pillar. Furthermore, the scope for voluntary occupational plans will be widened in 2008.

The main laws regulating the private pension system in Chile are as follows:

- Decree Law 3.500 (1980);
- Law No. 19.934 (2004);
- Law No. 20.022 (2005)
- Law No. 20.023 (2005)
- Law No. 20.255 (2008)

The Chilean government has appointed the Superintendence of Pensions to supervise the private pension system in Chile. The main tasks of the Superintendence of Pensions is to oversee and supervise the AFP’s, to ensure compliance with pension regulation and to aid in the development and interpretation of pension regulation.

IV. Main Indicators of the Private Pension System

IV.1 Coverage

In Chile there exists a substantial movement of people between the formal and informal sectors of the economy. Then, in order to analyze the degree of coverage of the Chilean pension system it is important to distinguish between those workers that are affiliated (members) to an AFP, those who have contributed at least once, and those who are active contributors to the new system.

Among other factors, the difference between active members and contributors reflects job loss, members leaving the work force, delays in the payment of contributions to the Administrators because...
they are being withheld by employers, misplacement of contributions due mainly to mistakes in
information, and the non-payment of contributions by self-employed members who contribute
voluntarily.

To obtain an indicator of the coverage of the Chilean Pension System, one can look at the
percentage of the workforce represented by the total number of workers contributing to the Individual
Capitalization System. By the end of 2007, the contributors of the AFP system represented 61.2% of
the labour force.

**COVERAGE OF THE AFP SYSTEM**

*IN RELATION TO THE WORK FORCE AND THOSE ACTUALLY IN WORK*

(In December of each year)

<table>
<thead>
<tr>
<th>Years</th>
<th>Contributors/ Work Force</th>
<th>Contributors/ People Currently Working</th>
<th>Covered Members(1)/ Work Force</th>
</tr>
</thead>
<tbody>
<tr>
<td>1982</td>
<td>29.0%</td>
<td>36.0%</td>
<td>-</td>
</tr>
<tr>
<td>1983</td>
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<td>1985</td>
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<td>-</td>
</tr>
<tr>
<td>1986</td>
<td>41.1%</td>
<td>45.9%</td>
<td>-</td>
</tr>
<tr>
<td>1987</td>
<td>45.7%</td>
<td>50.6%</td>
<td>-</td>
</tr>
<tr>
<td>1988</td>
<td>46.6%</td>
<td>50.6%</td>
<td>-</td>
</tr>
<tr>
<td>1989</td>
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<td>56.8%</td>
</tr>
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<td>58.4%</td>
<td>58.9%</td>
</tr>
<tr>
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<td>1992</td>
<td>51.8%</td>
<td>55.3%</td>
<td>63.8%</td>
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<tr>
<td>1993</td>
<td>51.1%</td>
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<td>63.8%</td>
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<tr>
<td>1994</td>
<td>51.8%</td>
<td>56.2%</td>
<td>65.1%</td>
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<tr>
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<td>53.5%</td>
<td>57.2%</td>
<td>67.0%</td>
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<td>55.7%</td>
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<td>68.1%</td>
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<tr>
<td>1997</td>
<td>58.0%</td>
<td>61.3%</td>
<td>68.7%</td>
</tr>
<tr>
<td>1998</td>
<td>53.4%</td>
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<td>2001</td>
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<td>57.7%</td>
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<td>63.1%</td>
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<tr>
<td>2006</td>
<td>58.0%</td>
<td>61.7%</td>
<td>66.3%</td>
</tr>
<tr>
<td>2007</td>
<td>61.2%</td>
<td>65.9%</td>
<td>70.3%</td>
</tr>
</tbody>
</table>

(1) Covered Members: corresponds to members with less than twelve months without movement in their
account.

(2) Source: Superintendence of Pensions

The above chart does not include members of the old pension system.
IV.2 Size of the Pension Funds

According to the Superintendence of Pensions, the pension funds administrators have accumulated assets equivalent to 111,037 million dollars. In the last seven years, the growth of the Pension Funds has been 11.5% on average in real terms each year.

GROWTH OF THE PENSION FUNDS

(In millions of dollars of December 2007)

Source: Superintendence of Pensions

In addition, the pension assets represent a growing proportion of GDP. In 1981 pension funds administered by AFPs represented only 0.8% of GDP, but by December 2007 they amounted to 64%.

IV.3 Composition and Diversification of the Pension Fund

The evolution of the funds showed the need for new permanent investment instruments to widen the range of alternatives in order to satisfy the increasing demand for financial assets of different nature. Since the initial reforms took place, three major forces have driven the portfolio composition of the pension funds: the evolution of the investment limits, the increase in the size of pension funds, and the development of the domestic capital market.

When the system was first implemented, the small and unsophisticated capital market and the low volume of the funds were compatible with a strict investment regulation set by the Central Bank. Thus,
at this time investments were restricted to government bonds, mortgage bonds, bonds of financial institutions, and a very limited amount of corporate bonds; investment in foreign securities was not permitted. As the system has matured and become better established, Chile has gradually liberalized investment rules, and restrictions on investments in foreign securities have gradually been eased.

The relative mix of investments in the combined AFP portfolios has changed dramatically since the system began. The share invested in government bonds has decreased steadily, 7.8% of all investments by the end of 2007. Bonds of financial institutions represented the largest share at the inception of the system (about 62%) but by July 2002 had fallen to around 7.2%. Mortgage bonds peaked in 1983 at 51% and since the early 1990s have fallen to 3.6% of portfolio assets. Stocks, which were not permitted until the mid-1980s, have ranged from less than 4% in 1986 to 32% in 1994; by the end of 2007, stocks represented only 15.2% of investments. Corporate bonds have ranged from less than 1% to 8.0%. Foreign investment has gradually increased to about 35.5% in 2007. There were no time deposits at the inception of the system, but now these make up 18.4% of invested assets.

**COMPOSITION OF THE PENSION FUNDS’ PORTFOLIO**

**(December 2007)**

(1) Including investment fund shares, mutual fund shares and FICE.

(2) Source: Superintendence of Pensions
IV.4 Rates of Return

Since the implementation of the Multifunds system (September 2002) the outcome of the new investment scheme has overall been favourable as the five different investment portfolios have, on average, achieved positive returns.

THE REAL RATE OF RETURNS OBTAINED BY THE PENSION FUNDS ON AVERAGE FOR THE WHOLE SYSTEM

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Type A</td>
<td>-4.68</td>
<td>-11.76</td>
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<tr>
<td>Type B</td>
<td>-3.44</td>
<td>-9.23</td>
<td>5.56</td>
<td>8.66</td>
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<tr>
<td>Type C</td>
<td>-2.15</td>
<td>-6.41</td>
<td>4.45</td>
<td>6.64</td>
</tr>
<tr>
<td>Type D</td>
<td>-0.99</td>
<td>-2.74</td>
<td>3.45</td>
<td>5.26</td>
</tr>
<tr>
<td>Type E</td>
<td>0.43</td>
<td>1.91</td>
<td>2.45</td>
<td>3.22</td>
</tr>
</tbody>
</table>

Period since the beginning of the multifunds.
Source: Superintendence of Pensions

IV.5 Fees

Since their creation, the AFPs have funded their operations with fixed and percentage commissions. The fixed commissions were applied for balance maintenance and at present are only authorized on the depositing of contributions. With regard to percentage commissions, these were applied on the member account balances and on taxable income. As of 1987, the possibility of charging commissions on the balance in the individual member account balances was eliminated.

One of the great difficulties produced by the Administrators’ charging structure is that it makes it impossible to measure their efficiency in managing the resources directly, because the commissions that members are charged cannot be compared directly with the yield obtained by the Pension Fund. This is why an estimation is given here of what the annual percentage commission charged by the pension fund on the member’s account balance would be, according to the commissions’ structure.3

For this reason, the following assumptions are made: earnings growing at a rate of 2% per year in real terms and a yield of the Pension Funds of 5% per year in real terms.5

The method consists of looking for that annual percentage commission which, when applied to the balance of the CCI, will give the same final balance at the end of forty years as in the application of the current commissions’ structure for each year of the period 1993 to 2005 (percentage commission on taxable earnings and fixed commission deducted from the fund). In order to make the calculation, the payment of the disability and survivorship insurance is excluded.

The results are presented according to the period in which the member starts his/her active working life.

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The results are presented according to the period in which the member starts his/her active working life.
From the above graph, it is possible to say that a person who entered the System in the year 2007, assuming that the present structure for charging commissions is maintained, will pay commissions equivalent to 0.65% per year on the balance.